

CREDIT OPINION

19 December 2019



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Kent State University, OH

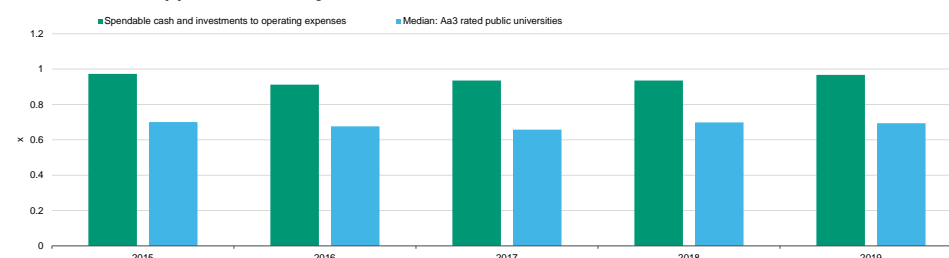
Update to credit analysis

Summary

[Kent State University's](#) (Aa3 stable, "Kent") strong credit quality is supported by its sizeable scope of operations, low financial leverage and strong liquidity, and its importance as a provider of higher education in Northeast Ohio. Enrollment is sizeable, at over 30,000 full-time equivalent students in fall 2019, supporting an operating base of nearly \$638 million in fiscal 2019. Total cash and investments are large, at over \$688 million, with a considerable amount of unrestricted liquidity, providing 273 days of monthly cash on hand. Like other universities in the region, Kent faces significant market challenges, reflected in declining enrollment and net tuition revenue, its largest revenue source, resulting in thinner operating performance than in the past. Future revenue growth from student charges will be challenged due to market pressures, as well as guaranteed tuition and room and board agreements for newly matriculating students. Favorably, operating performance and debt service coverage improved in fiscal 2019 primarily due to expense reductions. Kent also faces a large amount of other debt like obligations, mainly pension related, compared to peers, at over \$1.4 billion in fiscal 2019, as calculated by Moody's. Other factors incorporated include modest state support increases and diverse sources of capital funding.

Exhibit 1

Spendable cash and investments provide solid coverage of operating expenses relative to medians and supports flexibility



Median Aa3 fiscal 2019 spendable cash and investments coverage of expenses is estimated

Source: Moody's Investors Service

Credit strengths

- » Large-scale provider of higher education in Ohio, with fall 2019 full-time equivalent enrollment of 30,631 students across eight campuses and nearly \$638 million of operating revenue in fiscal 2019
- » Sizeable wealth and liquidity, with over \$688 million of total cash and investments and \$438 million of monthly liquidity providing 273 monthly days cash to cover expenses
- » Low financial leverage and excellent operating reserves provide cushion to thinner operating performance

Credit challenges

- » A highly competitive Ohio higher education landscape, highly regional draw, challenging state demographics, and state imposed tuition guarantees will continue pressuring enrollment and revenue growth
- » Improved, but still historically thin operating performance
- » Weak revenue diversity, evidenced by an elevated 63% reliance on student charges
- » Substantial net pension liability adds to expense structure inflexibility

Rating outlook

The stable outlook reflects continued expected operating performance improvement in fiscal 2020, driven by expense adjustments in response to modest revenue growth. The stable outlook also reflects expectations of no additional debt issuance.

Factors that could lead to an upgrade

- » Significantly enhanced revenue diversity
- » Sustained stronger operating performance aided by revenue growth
- » Improved strategic and market position supported by strengthened brand reputation and sustained enrollment growth

Factors that could lead to a downgrade

- » Inability to continue improving operating performance with an operating cash flow margin of at least 10% in fiscal 2020
- » Material decrease in liquid reserves
- » Material increase in debt eroding the university's leverage

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Key indicators

Exhibit 2

KENT STATE UNIVERSITY, OH

	2015	2016	2017	2018	2019	Pro Forma	Median: Aa Rated Public Universities
Total FTE Enrollment	32,482	32,324	31,189	31,523	30,631	30,631	29,353
Operating Revenue (\$000)	673,030	684,079	684,056	634,359	637,685	637,685	1,186,906
Annual Change in Operating Revenue (%)	0.8	1.6	0.0	-7.3	0.5	0.5	3.2
Total Cash & Investments (\$000)	672,383	651,538	696,047	682,371	688,388	688,388	1,363,489
Total Debt (\$000)	505,173	501,087	476,118	454,794	430,788	453,003	643,972
Spendable Cash & Investments to Total Debt (x)	1.2	1.2	1.3	1.4	1.4	1.4	1.4
Spendable Cash & Investments to Operating Expenses (x)	1.0	0.9	0.9	0.9	1.0	1.0	0.7
Monthly Days Cash on Hand (x)	228	247	241	271	273	273	169
Operating Cash Flow Margin (%)	13.9	13.5	10.7	6.9	9.9	9.9	11.2
Total Debt to Cash Flow (x)	5.4	5.4	6.5	10.4	6.8	7.2	4.7
Annual Debt Service Coverage (x)	2.6	2.4	1.5	1.1	1.8	1.8	2.9

Pro forma column assumes incremental parking debt and full refunding of Series 2012A and Series 2014A bonds, which will not be fully called until 2022.

Source: Moody's Investors Service

Profile

Kent State University is a large, comprehensive university with headcount enrollment of more than 37,000 students across its main campus in Kent, the campus of its College of Podiatric Medicine in Independence, and seven regional campuses across northeast Ohio. The university generated \$638 million of revenue in fiscal 2019 and, combined with its foundation, had cash and investment totaling over \$688 million.

Detailed credit considerations

Market profile: large provider of higher education in the State of Ohio facing student market challenges

Kent State's very good strategic positioning will continue, despite market challenges, due to its large size and importance in providing education to students from Northeast Ohio. As a large, multi-campus comprehensive university, Kent's credit profile benefits from multiple campuses and programs on-line and internationally, providing some cushion to demographic challenges in the region. In addition, KSU enjoys relatively sizeable out-of state enrollment at approximately 20%, including graduate students. The university has witnessed significant international enrollment challenges, with international FTE students down approximately 50% since fall 2015. Total enrollment has trended downward in recent years, to 30,631 FTE students in fall 2019 from 32,482 FTE students in fall 2015. This decline occurred primarily at the university's satellite campuses. Kent reports a smaller incoming class in fall 2019, but expects a slight improvement in net tuition revenue due to discounting adjustments and increased tuition rates for incoming students.

Overall operating revenue is large, at nearly \$638 million in fiscal 2019. Fiscal 2019 operating revenue increased by a modest 0.5% with increased auxiliary and grants and contracts revenues offsetting a decline in net tuition revenue. Operating support from the [State of Ohio](#) (Aa1 stable) was relatively flat in fiscal 2019 after a 2.7% increase in fiscal 2018. Kent is budgeting for a 2.5% increase in state operating support in fiscal 2020. Kent also receives capital support from the state, which has totaled nearly \$70 million over the past five years.

Operating performance: improved operating performance in fiscal 2019 driven by expense reductions

Kent's operating performance will continue improving due to cost containment efforts, but remain slightly below peers of similar credit quality. Prior to fiscal 2017, Kent historically produced mid-to-near-mid double digit operating cash flow margins, but net tuition revenue pressures coupled with soft state funding growth has thinned performance. Favorably, fiscal 2019 performance improved from the prior year, with an operating cash flow margin of 9.9% compared to 6.9% in fiscal 2018. Debt service coverage on an entity-wide basis also improved, up to 1.8x from 1.1x.

Revenue is budgeted to improve modestly in fiscal 2020. Net tuition revenue will remain relatively flat due to continued enrollment pressures and a guaranteed tuition program. Management aims to decrease the discount rate in a strategic manner to improve net tuition revenue growth in the future. Auxiliary revenues are also budgeted to increase modestly in fiscal 2020. Those two sources combined are the university's largest revenue sources at approximately 63% in fiscal 2019.

Expenses in fiscal 2019 were down 3% due to a continued focus on salary and benefit expense containment, as well as a recently implemented zero-based budget process. The university implemented a university-wide 5% budget reduction for administrative purposes, a voluntary employee separation plan, and a hiring freeze in September 2019 which will continue producing cost saving efficiencies. Current credit quality relies heavily on management's ability to continue improving operating performance and adjust expenses to low expected revenue growth.

Wealth and liquidity: solid reserves provide cushion in a time of thinner operating performance

The university's healthy reserves will continue to provide solid financial flexibility and also partially mitigate thinner operating performance. Total cash and investments in fiscal 2019 were a sizeable \$688 million, but have increased by a modest 2.4% since fiscal 2015 due to continued capital investments. Spendable cash and investments are large and provide a healthy cushion to expenses at 1.0x, stronger than peers of similar credit quality. Fundraising has been below peers in recent years, with three-year average gift revenue (fiscal 2016 to fiscal 2019) of just over \$10 million.

The university is contemplating a comprehensive fundraising campaign that could bring additional wealth. The prior campaign concluded in fiscal 2012, successfully raising \$265 million against a \$250 million goal. The campaign proceeds would primarily go towards growing the endowment, investment in faculty excellence, and funding future capital projects on campus. The university has an affiliated foundation and recently the university turned to an outside CIO model for investment management. In fiscal 2019 investment returns at the foundation were 3.1%.

Liquidity

Kent's liquidity will remain strong compared to peers, providing additional cushion in a time of thinner operating performance. Available monthly liquidity covered expenses for 273 days in fiscal 2019, well above peers.

Leverage: manageable financial leverage continues despite new debt issuance

Low total debt will remain a key credit strength for the university, despite additional new debt. Spendable cash and investments covers pro forma debt a solid 1.4x. Though still weaker than peers, debt affordability improved due to better operating performance, with pro forma total debt to cash flow of 7.2x. Favorably, the university does regularly amortize its debt and paid down \$22 million in principal in fiscal 2019.

Debt structure

The majority of Kent's debt is fixed rate and amortizing, including the proposed Series 2020A and Series 2020B bonds. The \$60 million of Series 2013A direct bank placement bonds are structured to mature with five equal \$12 million principal payments between fiscal 2028 and fiscal 2032. The terms of that series were recently renegotiated, with some changes to the rate structure and a change in the mandatory tender date to May 1, 2023.

Debt-related derivatives

With one \$60 million matched maturity floating-to-fixed interest rate swap to hedge the interest rate on the Series 2013A bonds, Kent State has minimal swap exposure given its relatively high level of liquid reserves. The university is required to post collateral with a long-term rating below A-/A3 as determined by S&P or Moody's. The bank can terminate the swap if the State of Ohio's rating were to fall below investment grade, as determined by Moody's or S&P. As of June 29, 2019, the swap was an \$1.9 million liability to the university.

Pensions and OPEB

The university has substantial additional debt-like obligations through its participation in two statewide cost-sharing, multiple employer defined benefit retirement plans, adding long-term credit risk. Moody's three-year average adjusted net pension liability (ANPL) was \$1.4 billion for the fiscal year ending 2019. A recent cost-of-living adjustment (COLA) freeze brought some relief, but the liability will remain large. Including the ANPL with university debt, Moody's pro forma total adjusted debt of \$1.9 billion is sizeable. Total adjusted debt to revenue is 2.9x, significantly higher than peers.

The State Teachers' Retirement System of Ohio (STRS) and Ohio Public Employees Retirement System (OPERS) cover substantially all of the university's employees. University contributions for STRS and OPERS are currently capped at 14% of covered payroll, though the Ohio legislature exerts significant control over pensions and has the legal authority to increase the contribution rates.

Environmental, social, and governance risks

Social considerations will continue to be an important element of Kent's credit profile. Within the university's core market, demographics are pressured and population loss is likely to continue. Compared to other similarly rated public universities, Kent has very high exposure to post-retirement benefit obligations, adding to financial constraints. Kent offers a relatively affordable pricing structure, with tuition, fees, room/board fixed for four years of an undergraduate students education. Programs align with labor market needs, especially within the Northeastern section of Ohio, from which it heavily recruits.

Kent's strong management team will continue navigating through a challenging operating environment through careful budgeting, benchmarking, and implementing steps to enhance the university's market strengths. Management implemented a voluntary employee separation plan in 2017 and 2018, a hiring freeze in 2019, and zero based budgeting in 2020 that will produce continued expense reductions in fiscal 2020 and beyond. This fiscal strength proves especially resonant given state pressures on tuition and room and board affordability that will continue limiting revenue growth.

Like most of the higher education sector, environmental considerations are not a material credit driver for Kent at this time.

Rating methodology and scorecard factors

The [Higher Education Methodology](#) includes a scorecard that summarizes the factors that are generally most important to higher education credit profiles. Because the scorecard is a summary and may not include every consideration in the credit analysis for a specific issuer, a scorecard-indicated outcome may or may not match an assigned rating. We assess strategic positioning on a qualitative basis, as described in the methodology.

Exhibit 3

Kent State University

Rating Factors	Value	Score
Factor 1: Market Profile (30%)		
Scope of Operations (Operating Revenue) (\$000)	637,685	Aa3
Reputation and Pricing Power (Annual Change in Operating Revenue) (%)	0.5	Ba3
Strategic Positioning	A	A
Factor 2: Operating Performance (25%)		
Operating Results (Operating Cash Flow Margin) (%)	9.9	A1
Revenue Diversity (Maximum Single Contribution) (%)	62.9	A2
Factor 3: Wealth & Liquidity (25%)		
Total Wealth (Total Cash & Investments) (\$000)	688,388	Aa2
Operating Reserve (Spendable Cash & Investments to Operating Expenses) (x)	1.0	Aa1
Liquidity (Monthly Days Cash on Hand)	273	Aaa
Factor 4: Leverage (20%)		
Financial Leverage (Spendable Cash & Investments to Total Debt) (x)	1.4	Aa2
Debt Affordability (Total Debt to Cash Flow) (x)	7.2	Aa2
Scorecard-Indicated Outcome		Aa3
Assigned Rating		Aa3

Data is based on most recent fiscal year available. Debt may include pro forma data for new debt issued or proposed to be issued after the close of the fiscal year.

For non-US issuers, nominal figures are in US dollars consistent with the Higher Education Methodology.

Numbers provided are on a pro forma basis.

Source: Moody's Investors Service

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