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CREDIT OPINION
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University of Puget Sound, WA

Update following revision of outlook to negative

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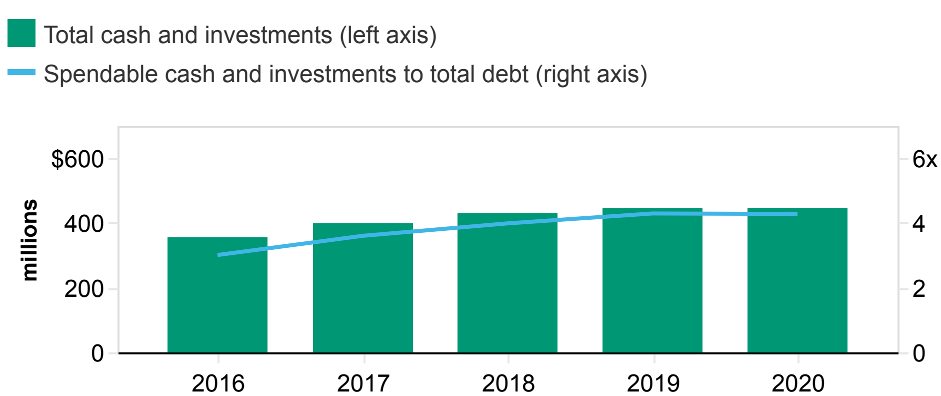
Summary

University of Puget Sound's (A1 negative) credit quality reflects the university's strong wealth and liquidity, providing financial flexibility to partially mitigate impacts linked to the coronavirus. Given a steep enrollment decline of nearly 18% in fall 2020 after several years of modest declines and resulting lower tuition and auxiliary revenue, the university anticipates the use of approximately $10 million reserves to bridge a fiscal 2021 operating loss. Very good strategic positioning is supported by the university's financial management, which has identified further expense reduction initiatives that are expected to improve fiscal 2022 operating performance and to enable a return to balanced operations by fiscal 2023, if enrollment returns closer to prior levels. However, the university remains highly reliant on student charge revenue for nearly three quarters of operating revenue, highlighting its vulnerability to student market pressures. Favorably, Puget Sound's leverage remains manageable, and current liquidity levels mitigate the risks associated with the university's variable rate debt exposure, including potential acceleration risks.

On March 9, 2021, the outlook was revised to negative.

Exhibit 1
The university's strong wealth continues to provide good coverage of outstanding debt



Source: Source: Moody's Investors Service

Credit strengths

» Sizeable wealth with total cash and investments of $446 million as of June 30, 2020, up nearly 26% since fiscal 2016, provides financial flexibility to mitigate coronavirus-related impacts

» Fiscal 2020 monthly days cash on hand of 532 is notably stronger than the A-rated private university median

» Spendable cash and investments of $294 million provide a strong cushion to debt and expenses at 4.3x and 2.6x, respectively

Credit challenges

» Historically strong operating performance will deteriorate in fiscal 2021 due to effects of the pandemic, although management remains committed to improving performance in fiscal 2022

» Enrollment declined by 17.6% in fall 2020 primarily due to coronavirus impacts, although Puget Sound's enrollment had softened in prior years as well, a sign of the highly competitive student market

» Consecutive years of net tuition revenue declines since fiscal 2017 due to both lower enrollment and increased tuition discounting, although discounting remained flat for the smaller entering class in fall 2020

» Small scale of operations compared to peers, with high reliance on strained student charge revenue

Rating outlook

The negative outlook reflects expectations of weakened operating performance in fiscal 2021 due to effects of the coronavirus and prospects for operations to remain thin should enrollment not return closer to prior levels.

Factors that could lead to an upgrade

» Strong and sustained enrollment growth driving increasing net tuition revenue

» Material increase in wealth and liquidity combined with return to strong operating performance

Factors that could lead to a downgrade

» Failure to remain in compliance with debt covenants

» Material decline in liquidity

» Failure to improve operating performance in fiscal 2022, or inability to restore balanced operations by fiscal 2023

» For the short-term rating, an inability to maintain adequate daily liquidity coverage of demand debt

Key indicators

Exhibit 2
UNIVERSITY OF PUGET SOUND, WA

	2016	2017	2018	2019	2020	Median: A Rated Private Universities
Total FTE Enrollment	2,736	2,633	2,619	2,563	2,111	4,695
Operating Revenue ($000)	127,870	130,234	127,151	126,035	121,433	213,591
Annual Change in Operating Revenue (%)	4.2	1.8	-2.4	-0.9	-3.7	3.8
Total Cash & Investments ($000)	355,107	398,607	428,997	445,371	446,276	427,133
Total Debt ($000)	74,856	73,595	72,315	70,551	68,647	150,817
Spendable Cash & Investments to Total Debt (x)	3.0	3.6	4.0	4.3	4.3	1.9
Spendable Cash & Investments to Operating Expenses (x)	1.9	2.2	2.4	2.5	2.5	1.4
Monthly Days Cash on Hand (x)	473	511	451	474	532	350
Operating Cash Flow Margin (%)	18.8	20.1	15.7	16.8	16.5	14.2
Total Debt to Cash Flow (x)	3.1	2.8	3.6	3.3	3.4	5.1
Annual Debt Service Coverage (x)	4.9	5.4	4.2	4.3	4.1	2.9

Source: Moody's Investors Service

Profile

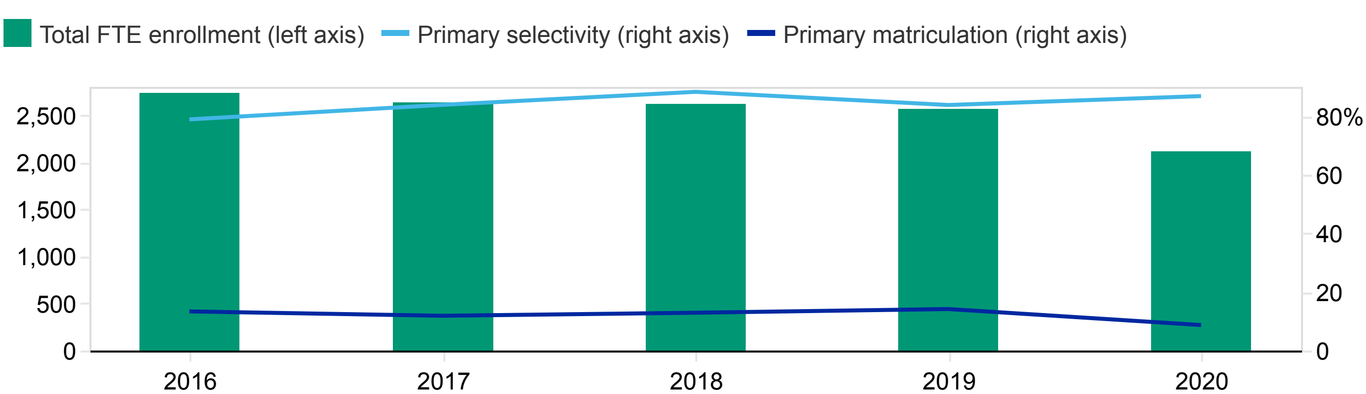
University of Puget Sound is a small private university located in Tacoma, Washington. In fiscal 2020 the university generated operating revenue of $121 million and enrolled 2,111 full-time equivalent (FTE) students as of fall 2020.

Detailed credit considerations

Market profile: strategic positioning remains very good despite material enrollment decline in fall 2020 due to the pandemic

The university's very good strategic positioning will continue to reflect its established role as a liberal arts university in the city of Tacoma and with good donor support, despite a challenged student market. The university saw a heavy decline in fall 2020 enrollment linked to effects of the coronavirus pandemic, with enrollment down nearly 18% as the university conducted an entirely remote fall semester. The incoming first year class ended up at 393 students compared to the university's original goal of 615 students. Roughly 100 students accepted for fall 2020 chose to defer their admission, and 160 continuing students took a leave of absence in the fall. Some of those students already returned in spring 2021 as the university re-opened its campus for some in-person classes.

Exhibit 3
The pandemic exacerbated recent enrollment declines



Source: Source: Moody's Investors Service

Management expects investments in enrollment management processes and strategies to help the university increase fall 2021 enrollment closer to the university's historic levels should effects of the pandemic subside. The university reports acceptances for fall 2021 are slightly ahead of this time in the admissions cycle last year as the university targets an incoming class of 585 students. Should enrollment not rebound to prior levels, credit quality could deteriorate.

Operating performance: effects of the coronavirus will weaken operations in fiscal 2021

The university's historically strong operating performance continued in fiscal 2020 but will weaken notably in fiscal 2021 due to the pandemic. The university currently projects using approximately $10 million in reserves to cover an operating loss in the current fiscal year. The operating loss is driven by lower student-generated revenue due to enrollment declines, reduced housing occupancy and holding tuition rates flat. The university has pursued and implemented expense savings initiatives in the current fiscal year as well including reduced retirement contributions, vacancy savings, and no travel expenses.

Management has a favorable track record of producing strong operating performance and expects to return to balanced operating levels by fiscal 2023 although it acknowledges operating performance could still remain relatively thin in fiscal 2022. The university is reducing some expenses, including faculty positions as it targets moving from a 9:1 student to faculty ratio to 11:1 by fiscal 2023, a move that will provide some recurring expense savings. The ability of the university's management team to successfully adjust expenses to match revenues moving forward and avoid prolonged weakened operating performance is important to maintaining credit quality.

Wealth and liquidity: strong wealth and liquidity support credit quality despite some anticipated use of reserves

Puget Sound's wealth and liquidity remain a key credit strength and provide the university with near-term flexibility to absorb some pandemic-related effects on enrollment and operations. The university's total cash and investments of $446 million as of fiscal 2020 increased by nearly 26% since fiscal 2016 and remain slightly stronger than the A-rated median of $427 million. Gift support is also favorable. The university is currently in the process of planning its next comprehensive fundraising campaign and will be conducting a feasibility study this year. The university's last campaign spanned 2007-2015 and raised nearly $132 million during that time.

The university's $379 million endowment as of June 30, 2020, has been managed by an outsourced chief investment officer (OCIO) platform since 2013. The finance and facilities committee of the board of trustees approves the endowment investment policy including asset allocation with input from its investment subcommittee of the board's finance and facilities committee and the OCIO. The endowment returned 0.7% in fiscal 2020, low compared to peers, although the university's 3-year and 5-year returns remain in line with average endowment returns.

Liquidity

The university maintains strong liquidity relative to expenses and its variable rate debt. The university's 532 monthly days cash on hand as of June 30, 2020 exceeded the A-rated median of 350 days.

The university utilizes self-liquidity for the tender features of the Series 2001 bonds, currently in weekly mode. There are acceptable remarketing procedures as well as a capable treasury function to oversee the self-liquidity program. At December 31, 2020, the university held approximately $28 million of same day liquidity on a discounted basis, providing sound coverage of 3.5x, with coverage rising to nearly 4.2x when including an available $5 million line of credit through Wells Fargo. Same day liquidity is largely comprised of investments in Moody's-rated Wells Fargo Money Market Funds, checking and deposit accounts, and US Treasuries and Agencies. The line of credit expires at the end of March 2021 and may not be renewed; current liquidity coverage is sufficient without including it in coverage ratios.

Leverage: leverage remains manageable, with current liquidity adequately mitigating debt structure risks

Leverage will remain manageable given the university's strong total wealth. In fiscal 2020, spendable cash and investments of $294 million covered debt 4.3x, well above the A-rated median of 1.9x. The university's debt affordability remained strong through fiscal 2020 with total debt to cash flow of 3.4x although this will weaken in the near-term as the university's performance is thinned due to coronavirus impacts. The university has no near-term plans to take on additional debt.

Legal security

All bonds, including the privately placed Series 2019, are issued on parity and are general obligations of the university.

Debt structure

University of Puget Sound's total debt as of June 30, 2020, includes 47% variable rate demand debt. However, 74% of the variable rate debt (the Series 2019 bonds) are in long-term mode with a seven-year term through 2026. The $8.5 million of Series 2001 bonds outstanding are supported by self-liquidity. In the event of a liquidity demand due to an acceleration of either the Series 2001 or Series 2019 bonds, Puget Sound maintains a sizeable $152 million of monthly liquidity. Unrestricted monthly liquidity covers outstanding demand debt by 469% and adequately mitigates any acceleration risk.

The Series 2019 bonds are placed with Bank of America and are governed by a Continuing Covenant Agreement (CCA). There are two financial covenants in the agreement – a debt service coverage ratio of at least 1.1x and an unrestricted liquid assets to debt ratio of at least 0.5x. The university remained in compliance with these covenants through fiscal 2020 with calculated debt service coverage of 2.2x and liquid assets to debt of 2.2x. Failure to comply with the covenants is an event of default and could lead to acceleration of the bonds. Given the deterioration of operating performance in fiscal 2021, the university's debt service coverage calculation will weaken materially compared to the previous year. The university has begun contingency planning should the fiscal 2021 debt service coverage calculation fall below the required 1.1x, including seeking a potential waiver from the bank. The university's liquidity serves as a mitigant to potential acceleration risk. The university expects to remain in compliance with the liquid assets to debt ratio in fiscal 2021.

Debt-related derivatives

The university is counterparty to three interest rate swaps to hedge its variable rate debt. The counterparty for the swap hedging the Series 2001 bonds is Societe Generale and the Bank of New York Mellon serves as the counterparty for the other two swaps. Puget Sound is not required to post collateral for its swaps unless its credit rating drops below Baa2 for the Societe Generale swap and below Baa3 for the Bank of New York Mellon swaps, in which case the amount of collateral posted would be equal to the mark-to-market loss exposure at the time the credit rating drops below the required level. As of June 30, 2020, the swaps represent a liability of $12.4 million. The university's strong liquidity serves as a mitigating factor to the risks associated with these swaps, including termination payments.

Pensions and OPEB

Puget Sound has manageable exposure to post-employment liabilities through both a defined contribution and defined benefit retirement plan. The university also has a post-retirement healthcare plan (OPEB) that is closed to new members. Puget Sounds funds the defined benefit and OPEB plans on a pay-as-you-go basis and had an associated liability of $13.8 million as of June 30, 2020. The university's total retirement expenses represented a manageable 5.4% of fiscal 2020 operating expenses.

ESG considerations

Environmental

Environmental considerations do not have a material credit impact. The university's location in Tacoma, Washington, introduces only medium exposure to extreme rainfall and sea level rise according to Moody's affiliate Four Twenty Seven. University of Puget Sound has a variety of sustainability initiatives including recycling programs and infrastructure improvements designed to focus on reducing the university's carbon footprint.

Social

We regard the coronavirus as a social risk under our ESG framework given the substantial implications for public health and safety. After the transitioning to online course delivery during the spring 2020 semester, the university announced in July 2020 that it would continue to offer courses remotely for the fall 2020 semester. The university did re-open its campus with some in-person course delivery and reduced occupancy housing for the spring 2021 semester. However, enrollment declined significantly following the university's announcement to run an online fall semester. Improvement in enrollment for fall 2021 will be in part dependent on effects of the pandemic subsiding.

The university remains subject to several social considerations. Demographics within the State of Washington (Aaa stable) are generally favorable, with the number of projected high school graduates expected to rise through 2026. Although the university continues to have a favorable out of state draw, with roughly two thirds of students coming from outside the state, the university sees an opportunity to expand its recruitment of resident students. However, the student market remains highly competitive within the state and region, with multiple strong public and private university competitors. As a sign of responsible production, the university reports a cohort default of 2.6%, notably lower than the national rate of 9.7% or private university rate of 6.7% as of fiscal 2017 data.

Governance

The university's financial management team has a demonstrated track record of generating strong financial results and has indicated a commitment to gradually improve operating performance back to historic levels. However, improvement will be largely predicated on whether enrollment rebounds in fall 2021 combined with continued focus on expense containment. Although fiscal 2021 performance will weaken due to the coronavirus and the university will draw upon its strong reserves for operational support in the current fiscal year, management has indicated it targets balanced operations by fiscal 2023.

The university is overseen by board of trustees that contains up to 39 members (currently there are 29 members). Responsibilities of the board include management of the university's mission, appointing the president, and overseeing strategic planning, educational programs, and the university's resources.

Rating methodology and scorecard factors

The Higher Education rating 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 4

University of Puget Sound, WA

Scorecard Factors and Sub-factors		Value	Score
Factor 1:	**Market Profile (30%)**		
	Scope of Operations (Operating Revenue) ($000)	121,433	A2
	Reputation and Pricing Power (Annual Change in Operating Revenue) (%)	(3.7)	B2
	Strategic Positioning	A	A
Factor 2:	**Operating Performance (25%)**		
	Operating Results (Operating Cash Flow Margin) (%)	16.5	Aa3
	Revenue Diversity (Maximum Single Contribution) (%)	75.2	Baa2
Factor 3:	**Wealth & Liquidity (25%)**		
	Total Wealth (Total Cash & Investments) ($000)	446,276	A1
	Operating Reserve (Spendable Cash & Investments to Operating Expenses) (x)	2.5	Aa3
	Liquidity (Monthly Days Cash on Hand)	532	Aa2
Factor 4:	**Leverage (20%)**		
	Financial Leverage (Spendable Cash & Investments to Total Debt) (x)	4.3	Aa2
	Debt Affordability (Total Debt to Cash Flow) (x)	3.4	Aa1
	Scorecard-Indicated Outcome		A2
	Assigned Rating		A1

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.

Source: Moody's Investors Service

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