



## Fitch Rates Univ of the Sciences in Philadelphia (PA) 2017 Bonds 'BBB+'; Outlook Revised to Stable

Fitch Ratings-New York-17 March 2017: Fitch Ratings has assigned a 'BBB+' rating to approximately \$61.6 million of series 2017 revenue bonds issued by the Philadelphia Authority for Industrial Development on behalf of University of the Sciences in Philadelphia (USciences).

Fitch has also downgraded the ratings on the following outstanding debt issued by the Pennsylvania Higher Educational Facilities Authority, on behalf of USciences to 'BBB+' from 'A-':

- \$31 million revenue bonds, series 2012;
- \$83.7 million revenue bonds, series 2015A;
- \$3.3 million taxable revenue bonds, series 2015B.

The series 2017 bonds are expected to be issued as tax-exempt fixed-rate bonds. The majority of bond proceeds will be used to construct, furnish and equip an approximately 426-bed student housing facility to be located on USciences' campus in Philadelphia; fund approximately 24-months of capitalized interest; and pay the costs of issuance. The bonds are expected to sell via negotiated sale the week of April 3.

The Rating Outlook is revised to Stable from Negative.

### SECURITY

USciences is obligated to make payments that are sufficient to pay debt service when due, a pledge that Fitch considers equivalent to a general obligation.

### KEY RATING DRIVERS

**MATERIAL INCREASE IN DEBT:** The rating downgrade to 'BBB+' reflects the increase in USciences' pro forma debt burden, as a result of the series 2017

bond issuance. Pro forma balance sheet ratios of 12.0% maximum annual debt service (MADS) burden, 1.5x MADS coverage and available funds (AF) to debt of 78.6% are more consistent with a 'BBB' category rating.

**WEAKENING OPERATING PROFILE:** USciences has experienced a weakening trend in its overall operating and financial profiles, over the past five fiscal years. This trend is being driven by persistent declines in both undergraduate and total full-time equivalent (FTE) enrollment, and a modest deterioration in balance sheet resources. In addition, there has been a high degree of management turnover over the past year.

**ENROLLMENT PRESSURES:** Undergraduate FTE enrollment has declined 6.8% over the past five years, though the graduate student population has grown significantly. Total FTE enrollment over the same period is down 2.6%, and experienced only a marginal increase in fall 2016 compared to fall 2015. Favorably, net tuition revenue has grown in each of the last three fiscal years, including 2016.

**SOLID FINANCIAL PROFILE:** USciences' has historically demonstrated financial flexibility through positive operating results and sufficient balance sheet resources that are solid for the 'BBB' rating category. USciences' conservative budget process has allowed management to maintain positive operating margins, despite periodic fluctuations in enrollment.

#### **RATING SENSITIVITIES**

**ENROLLMENT STABILIZATION:** University of the Sciences in Philadelphia's failure to stabilize, diversify, and, over time, grow net tuition revenue could create negative rating pressure, especially if it results in negative GAAP operations.

**CONTINUED POSITIVE OPERATIONS:** Fitch expects USciences to continue to achieve positive operations on a GAAP basis. Endowment draws are also expected to remain at sustainable levels. USciences' failure to meet these expectations could result in rating pressure.

**NEW RESIDENCE HALL:** Fitch expects USciences to complete construction of its planned new residence hall on time and on budget. Significant deviations

that materially impact the university's operations would be viewed negatively.

## CREDIT PROFILE

USciences was founded in 1921 as the Philadelphia College of Pharmacy. After various program expansions, USciences was awarded university status in 1998. Presently, USciences offers academic programming in 22 disciplines across four colleges and awards both graduate and undergraduate degrees. The largest program is PharmD, with students entering as freshman or transfers. Other programs include physical therapy, occupational therapy, public health, healthcare and pharmaceutical business, and chemistry and biological sciences.

## SENIOR MANAGEMENT TURNOVER

USciences has experienced an above-average rate of turnover in its senior management, with the President, Provost, Chief Financial and Operating Officer, and the Vice President of Business Development and Enrollment Management all recent appointments made within the past year. Currently, USciences is actively recruiting for a new Vice President of Institutional Advancement and a new Dean for the Philadelphia College of Pharmacy.

Fitch regards this level of turnover with some concern, but considers financial results, conservative budgeting and ongoing strategic planning to be positive. The 'BBB+' rating reflects Fitch's expectation that the new senior management team will demonstrate effective stewardship in a volatile financial and competitive environment.

## PRESSURED ENROLLMENT PROFILE

USciences' enrollment underpins student-generated revenues, which typically provide approximately 83% of operating revenues. In fall 2016, there were 2,560 FTE students, a marginal increase from 2,523 the prior year. USciences has experienced gains in FTE enrollment at the graduate level, which has increased 43.4% over the past five years. The undergraduate FTE population, on the other hand, has declined by approximately 6.8% over the same time period. Management attributes this decline to the demographic pressure of

fewer high school students, competition with other regional pharmacy programs, and a national decline in the overall demand for pharmacists.

The matriculation rate for first-time freshman was a weak 14.5% for fall 2016, an indication of significant competition. Solid increases in undergraduate transfer students and graduate students largely compensated for the decline in new freshman. Matriculation rates for transfer and graduate students are significantly stronger at 43.7% and 69.7%, respectively, for fall 2016.

Net tuition revenue increased 3.1% in fiscal 2016, compared to essentially no growth in fiscal 2015 and a 1.9% increase in fiscal 2014. Pressure on net tuition revenue in recent years is due to financial aid pressures in the highly competitive New Jersey and Pennsylvania markets. Management projects fall 2017 enrollment to be similar to fall 2016, with growth in graduate and transfer students and flat or slight declines in undergraduate enrollment.

USciences continues to diversify its many health sciences degrees and programs, although the undergraduate and graduate pharmacy program continues to have the largest enrollment, nearly half of USciences' total. Favorably, management reports that year-to-date deposits for the PharmD program are tracking moderately ahead of deposits received as of the same time last year. Fitch recognizes that pharmacy demand, as with other health science programs, is cyclical. Nevertheless, USciences long-term failure to stabilize enrollment and maintain growth in net tuition revenue could pressure the rating, especially if it results in negative GAAP operations.

## SOLID FINANCIAL PROFILE

USciences' history of absorbing enrollment shifts while maintaining positive operating performance is supported by conservative budgeting. Annual budgets include a variety of contingency reserves, as well as conservative revenue and enrollment assumptions. Fitch views the budget process as a credit strength, given USciences' high reliance on student-generated revenues, its high debt burden, and the cyclical nature of pharmacy enrollment.

USciences' operating results are solid for the 'BBB' rating category. Over the

past 10 fiscal years, its operating margin (including endowment distributions) has been positive. Margins were 4.0% in fiscal 2016, 1.8% in fiscal 2015, and 4.5% in fiscal 2014. Net income available for debt service provided adequate 1.5x coverage of pro forma MADS in fiscal 2016.

Positive operations over time have allowed USciences to maintain balance sheet resources that are solid for the 'BBB' rating category; however, these resources have deteriorated over the past three fiscal years. In fiscal 2016, available funds (AF; defined as cash and investments not permanently restricted) totaled \$150.5 million, a decline of \$16.2 million from fiscal 2015 and \$22.0 million from fiscal 2014, due to market fluctuations. Despite this deterioration, fiscal 2016 AF equaled a healthy 164.4% of operating expenses, but a weaker 78.6% of pro forma debt.

USciences has intentionally been moderating its endowment draw rate in recent years. The endowment was \$158.7 million at June 30, 2016. The draw rate based on a rolling 12-quarter market value, improved to 5.8% in fiscal 2016 from 5.9% in fiscal 2015 and 6.0% in fiscal 2014. USciences' budget anticipates the draw rate to be 5.6% in fiscal 2017, as management works towards gradually reducing the rate to what it considers to be best practice of 5%. Fitch considers the current draw rate above average, but still within the 5%-6% range seen in the sector.

## HIGH PRO FORMA DEBT BURDEN

Following the series 2017 issuance, USciences' pro forma debt will total \$191.5 million, representing an increase of more than 47% in its outstanding debt and resulting in pro forma balance sheet ratios that are no longer consistent with an 'A' category rating. Pro forma MADS will increase from \$8.4 million to \$11.4 million, equating to a very high 12.0% of fiscal 2016 operating revenues.

All of USciences' pro forma debt has an amortizing fixed-rate structure, with annual obligations that are approximately equal through 2048, the final maturity of the series 2017.

## NEW RESIDENCE HALL

USciences will use the majority of proceeds from the series 2017 bonds to construct a new, on-campus residence hall focused on first and second year, undergraduate students. The new residence hall will be a 218-unit, 426-bed suite style housing facility, comprising approximately 128,000 square feet of living/learning space and some retail services. Total project cost, estimated at \$60 million, will be entirely debt financed. Current timeline anticipates the completion of construction by December 2018 and the building to be ready for occupancy beginning in January 2019.

Once the new residence hall is open, USciences plans to repurpose its existing housing for study space and some offices, and take another small housing facility offline. The net impact will be to add 86 units to USciences' housing capacity. The design of the new housing units is expected to represent a significant upgrade over that of existing on-campus housing options and make USciences' housing stock more attractive to prospective students. USciences requires all first and second year undergraduates to reside on campus; current housing occupancy is 86.5%.

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**Applicable Criteria**

Revenue-Supported Rating Criteria (pub. 16 Jun 2014)

(<https://www.fitchratings.com/site/re/750012>)

U.S. College and University Rating Criteria (pub. 12 May 2014)

(<https://www.fitchratings.com/site/re/748013>)

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