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District Of Columbia Gallaudet University; Private Coll/Univ - General Obligation

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Table Of Contents

District Of Columbia
Gallaudet University; Private Coll/Univ - General Obligation

Credit Profile		
District of Columbia, District Of Columbia		
Gallaudet University, District Of Columbia		
ser 2011		
Long Term Rating	A+/Stable	Current

Rationale

S&P Global Ratings affirmed its 'A+' rating on District of Columbia's series 2011 revenue bonds, issued for Gallaudet University. The outlook is stable.

We assessed Gallaudet's enterprise profile as strong, characterized by niche demand metrics, with improving matriculation, essentially stable enrollment, a solid management team, and a geographically diverse student body. We also assessed Gallaudet's financial profile as strong, with a robust operating performance; solid available resource ratios particularly when compared with debt. Combined, these credit factors lead to an indicative stand-alone credit profile of 'a'. The 'A+' long-term rating better reflects Gallaudet's very strong cash and investments relative to debt, status as a specialty school serving the deaf and hard-of-hearing community, and the consistent and robust federal appropriations, which support approximately 60% to 70% of revenue each year.

The rating reflects our assessment of the university's:

- Unique status as a federally chartered private university that provides educational programs and training for individuals who are deaf or hard of hearing;
- Consistent support since 1864 from the U.S. government for operating revenue, with federal appropriations constituting 63% of operating revenue in fiscal 2017;
- History of surplus operating performance, with an expectation of continued surplus operating performance;
- Niche demand profile, indicated by moderate selectivity and exceptional matriculation rates;
- Solid available resource ratios for the rating category relative to operations and debt; and
- Low debt, with a maximum annual debt service (MADS) burden of 1.6% of fiscal 2017 operations.

Partly offsetting credit factors include our opinion of:

- Modest fluctuations in enrollment over the past five years, highlighted by small declines from fall 2013 to fall 2015, although enrollment has stabilized in fall 2016 and fall 2017 and expected to continue improving in the next few years;

- A limited history of fundraising, particularly from alumni; and
- Rescission, sequestration, and annual approval risk related to federally appropriated funds, partially mitigated by the university's demonstrated ability to manage through these challenges in the past.

The bonds are secured by a general obligation of the university.

Gallaudet, founded in 1864 in Washington, D.C., by a federal charter, provides educational programs and training for individuals who are deaf or hard of hearing, and for hearing individuals interested in pursuing careers in areas related to deafness. Gallaudet operates its College of Arts and Sciences; the School of Education, Business, and Human Services; and graduate and professional programs. It also operates the Laurent Clerc National Deaf Education Center, which provides elementary and secondary education to deaf students. Although established as a private institution, Gallaudet receives most of its revenues from annual federal appropriations. As of fall 2017, Gallaudet's enrollment was 1,761, most of them full-time undergraduate students.

Outlook

The stable outlook reflects our expectation that, over a two-year period, federal appropriations will remain stable or increase, and operating performance will remain at least balanced. We expect the university's available resources to grow in relation to the rating category, with debt remaining low during the two-year outlook period.

Upside scenario

Factors that could lead us to take a positive rating action include significant growth in financial resources relative to the rating category and increased revenue diversity, along with maintenance of a stable enrollment and demand profile and positive full accrual operating performance.

Downside scenario

We believe a negative rating action is unlikely given the stable enrollment and solid full accrual operating results, but potential factors would include substantial cuts in federal appropriations resulting in negative operating performance, declines in financial resources relative to the rating category, or steep declines in enrollment or demand.

Enterprise Profile

Industry risk

Industry risk addresses the higher education sector's overall cyclicality and competitive risk and growth by applying various stress scenarios and evaluating barriers to entry, levels and trends of profitability, substitution risk, and growth trends observed in the industry. We believe the higher education sector represents a low credit risk when compared with other industries and sectors.

Economic risk

In our view, the university has good geographic diversity, with very few students from the District of Columbia. As such, our assessment of Gallaudet's economic fundamentals is anchored by the U.S. GDP per capita.

Enrollment and demand

Gallaudet's headcount has fluctuated in recent years. Although the university's enrollment decreased modestly from fall 2013 to fall 2015, enrollment has stabilized in fall 2016 and fall 2017 at roughly 1,700 students, consistent with fall 2013 levels. The demand profile remains moderately selective with a very strong matriculation rate, indicative of the university's niche in educating students who are deaf or hard of hearing. In fall 2017, Gallaudet's total headcount was 1,761, or 1,507 full-time equivalents, 64% of which were undergraduates. Undergraduate enrollment increased 0.7% to 1,129 in fall 2017, though the increase for fall 2017 was more modest than that of fall 2016, which ended a trend of four consecutive years of modest declines. Management attributes the growth to the implementation of a new financial aid plan, the addition of several programs, and targeted recruiting efforts. It is our understanding that management continues to strategize to enhance its academic offerings and target potential students, and it expects headcount increases over the next several years.

The demand profile, with moderate selectivity and strong matriculation, reflects the university's niche and high level of student self-selection in the application process. The acceptance rate was 59% in fall 2017, at its most selective in the past seven years, which we view positively. Matriculation was excellent at 72% for the same period, marking continued strengthening from a recent low of 56.2% in fall 2014. After reaching a peak of 80% in fall 2016, the retention rate decreased to its weakest level of 63%, which we believe offsets the robust matriculation and improving selectivity rate. It is our understanding that the drastic retention rate increase for fall 2016 was largely because of the new President Roberta Cordano, appointed in early 2016. Though management did not expect the retention rate to remain at the 80% high, it is focused on growing retention relative to pre-fall 2016 levels. Management states that diversity programs at elite universities, along with the ability of most universities to accommodate students with special needs, including deaf students, have resulted in increased competition, particularly for the strongest students. We expect both undergraduate and graduate programs to remain relatively stable.

The university's receipt of federal appropriations caps the percentage of hearing students it can admit at the undergraduate level at 5%, and the percentage of international students at 15%. We understand the university remains in compliance with these requirements. Gallaudet has a national draw, with undergraduate students from 49 states. Management indicates the majority of undergraduate students live on campus, prompted by a two-year residency requirement.

The university has limited experience in fundraising. Its first major capital campaign was in 1997, and it has had only two capital campaigns (raising $70 million in the previous campaigns combined) in its nearly 150-year history. Management indicates most of its donors are corporations and foundations, rather than individuals, which is unusual for a university. The university is planning a third major capital campaign to fund capital projects, the endowment, and current funds. The annual fund raised approximately $800,000 in fiscal 2017 and is projected to raise similar levels for fiscal 2018.

Management

The university is governed by a 21-member board of trustees, which includes three positions for members of Congress. Currently, the Honorable Sherrod Brown, Kevin Yoder, and G.K. Butterfield are members of Gallaudet's board. Management maintains a close relationship with the U.S. Department of Education and members of Congress to maintain appropriations each year. Gallaudet states that its appropriation is supported by both parties, and that it does not expect funding to change as a result of leadership changes in the government's executive or congressional branches. Though there was some volatility in appropriation in the past with federal funding and midyear cuts, management expects stable appropriations in the next few years, with flat appropriations received for fiscal 2017. Management indicates that the university received greater appropriations in fiscal 2018.

Executive management has been stable since our last review. The university hired the new president, Roberta Cordano, in January 2016. She had previously worked at the Amherst H. Wilder Foundation in Minnesota, and has focused her attention on long-term planning, building connections with current and prospective students, and increasing research. In our view, the presidential transition was smooth, and we do not expect major changes in the management team during the next year. The university has extended its current strategic plan, focused on enrollment, research, and diversification of non-federal revenue.

Financial Profile

Financial management policies

The board has investment and cash policies and budgets on a full-accrual basis, which we view as a best practice. We view management's conservative budgeting practices and investment and debt policies favorably. We believe management's ability to successfully manage through the federal sequester highlights its conservative budget practices and expense flexibility, which we view as a credit strength.

The university has formal policies for endowment, investments, and debt. It operates according to a strategic plan and has an informal reserve liquidity policy. Gallaudet meets standard annual disclosure requirements. The financial policies assessment reflects our opinion that, while there may be some areas of risk, the organization's overall financial policies are not likely to negatively affect its future ability to pay debt service. Our analysis of financial policies includes a review of the organization's financial reporting and disclosure, investment allocation and liquidity, debt profile, contingent liabilities, and legal structure, as well as a comparison of these policies with those of comparable organizations.

Financial performance

Gallaudet has achieved at least break-even operating performance in the past five years, with heavy reliance on federal government appropriations for revenue that management expects will continue. The university had good financial performance in fiscal 2017, with an operating surplus of $2.6 million (a 1.9% margin), compared with an ample full-accrual surplus of $19 million, or a 10% margin in fiscal 2016. The large operating surplus in fiscal 2016 is attributable to a $17.2 million one-time government appropriation allocated for capital support. While management expected surplus operations in fiscal 2017, results are consistent with historical levels. For fiscal years 2018 and 2019, we expect that operating surpluses will continue. The largest component of revenue is federal appropriations, representing 63% of operating revenues as of fiscal year-end (Sept. 30) 2017. Gross tuition and auxiliary revenues generated a combined 28% of total revenues.

Federal appropriations to Gallaudet are determined annually by the U.S. Congress as authorized under the Education of the Deaf Act, which is part of the Higher Education Act. Appropriations are specifically designated for Gallaudet University. Federal appropriations for operations declined slightly to $111 million in fiscal 2013 from $118 million in

2010, before rising again to $120 million in fiscal 2014 and $121 million in fiscal 2015. Federal funding in fiscal 2016 was around $121 million and remained flat for fiscal 2017. For fiscal 2018, federal funding increased to $128 million. We expected federal funding for fiscal 2019 to be at least consistent with that of fiscal 2018. In recent years, management has had to face midyear cuts and delayed payments. To maintain solid operating performance, management put into place expense reductions in fiscal years 2013-2015. In response to a volatile appropriation environment, management plans to improve its revenue diversity by maximizing tuition revenue, monetizing real estate, and increasing fundraising efforts. We also understand that as federal appropriation stabilizes, management will now shift its focus to academic development and efficiency. We consider the large percentage of federal appropriations in the budget a credit strength due to the U.S. government's strong history of support. However, the high reliance on potentially volatile appropriations limits budgetary flexibility, in our opinion. We consider management's ability to navigate the past three challenging fiscal years, demonstrating its ability to successfully manage volatile revenue, to be a credit strength. In addition to operating support, federal appropriations also include a small portion of capital appropriations, mostly designated for high school-related buildings on campus, along with a limited number of university buildings.

Tuition is quite low compared with that of other private universities, at just $16,032 for fall 2017. Total tuition, room, and board was $33,640. Tuition for international students was much higher. Management indicates that, because the university functions as the national university for deaf individuals, it expects to maintain tuition levels that are equivalent to the upper quartile of U.S. land grant universities. Management also indicates it plans more modest tuition increases than those of the past four years, in which it raised tuition 3% to 8%. The tuition discount rate of 32% in fiscal 2017 and actually decreased slightly from 33% in fiscal 2016, due to the implementation of a new financial aid strategy. We expect financial aid to increase modestly over the next several years, related to broader concerns regarding affordability of higher education.

Available resources

Gallaudet's financial resource ratios are strong for the rating category of private universities, particularly relative to operating expenses. But when compared with those of public universities, many of which receive substantial state appropriations, they are more in line with the rating category. We believe Gallaudet's low debt level relative to net property, plant, and equipment skews the expendable resource calculation (unrestricted net assets plus temporarily restricted net assets less [net property, plant, and equipment minus long-term debt). Therefore, we adjust expendable resources for the strong cash position. Expendable resources were $65 million as of fiscal 2017, equal to a modest 34% of operating expenses and 175% of debt. Cash and investments were much stronger at $195 million at fiscal year-end 2017, equal to 103% of fiscal 2017 operating expenses and 527% of debt. We expect the university's available resource ratios to remain consistent in the future.

The university entered into an agreement with a real estate developer to develop four university-owned commercial properties adjacent to campus. Though the District of Columbia Zoning Commission has approved the planned unit development, the decision has been appealed by a third-party and awaits court proceedings. Gallaudet will receive revenue from the developed properties at the earlier of 2021 or nine months after the project receives final approval. To date, the university has recorded $2.9 million in escrow deposits and the corresponding amount in deferred revenue. For fiscal 2017, Gallaudet recognized approximately 967,000 in revenue, and expects $644,000 in fiscal 2018.

Gallaudet's endowment provides the university with a financial cushion, and management is planning to boost it with a new capital campaign in the next few years. The market value of the endowment was $182 million as of June 30, 2018. The endowment is invested with an asset allocation, as of the same date, of 53% equities, 20% fixed income, 21% hedge funds, and 6% private equity. At the end of fiscal 2017, management changed the asset allocation to shift to equities from fixed income, to position the investment portfolio for further growth over time. In our view, the current asset allocation as consistent with peers, though more aggressive compared with its historically conservative allocation. Management reports that 73% of the portfolio has daily liquidity, while 94% of the portfolio can be made liquid within one year. The university had a 4.8% spending policy, calculated on a three-year average market value of its endowment, which we consider standard. We believe Gallaudet's conservative endowment management with ample liquidity, coupled with a $20 million working capital line of credit, provides an additional cushion. As of June 30, 2018, there is no outstanding balance on the line of credit.

Debt

The university had approximately $36 million in long-term debt and capital leases outstanding as of fiscal year-end 2017. It issued its first bonded debt in 2011, with a par amount of $40 million, to construct a residence hall and an energy conservation project. Management reports that the residence hall and energy conservation projects have been completed on time and on budget. The debt is amortizing with no bullet payments and a MADS burden of $2.7 million, with a MADS burden of $3.4 million in 2017 inclusive of capital lease obligations, or a low 1.6%. Gallaudet does not have additional debt plans.

Gallaudet University, District of Columbia Enterprise And Financial Statistics

	--Fiscal year ended Sept. 30--					Medians for 'A' rated private colleges and universities
	2018	2017	2016	2015	2014	2017
Enrollment and demand						
Headcount	1,761	1,774	1,670	1,691	1,753	MNR
Full-time equivalent	1,507	1,520	1,392	1,415	1,496	3,632
Freshman acceptance rate (%)	59.1	66.1	61.7	65.3	65.5	63.5
Freshman matriculation rate (%)	71.8	72.5	70.9	56.2	58.9	MNR
Undergraduates as a % of total enrollment (%)	64.1	63.2	60.5	61.0	61.4	78.0
Freshman retention (%)	63.0	80.0	67.0	67.0	69.0	85.5
Graduation rates (six years) (%)	53.0	43.0	46.0	46.0	48.0	MNR
Income statement						
Adjusted operating revenue ($000s)	N.A.	192,606	207,472	188,388	182,153	MNR
Adjusted operating expense ($000s)	N.A.	189,994	188,438	179,344	176,651	MNR
Net operating income ($000s)	N.A.	2,612	19,034	9,044	5,502	MNR
Net operating margin (%)	N.A.	1.37	10.10	5.04	3.11	1.37
Change in unrestricted net assets ($000s)	N.A.	4,343	16,938	1,191	8,562	MNR
Tuition discount (%)	N.A.	31.9	32.8	31.6	30.0	36.0
Tuition dependence (%)	N.A.	14.9	13.2	13.5	13.8	MNR

Gallaudet University, District of Columbia Enterprise And Financial Statistics (cont.)

	--Fiscal year ended Sept. 30--					Medians for 'A' rated private colleges and universities
	2018	2017	2016	2015	2014	2017
Student dependence (%)	N.A.	28.1	25.1	24.9	25.2	86.4
Research dependence (%)	N.A.	1.5	1.5	1.8	2.3	MNR
Endowment and investment income dependence (%)	N.A.	4.1	4.0	4.5	4.0	MNR
Debt						
Outstanding debt ($000s)	N.A.	37,083	37,918	38,989	40,154	102,893
Current debt service burden (%)	N.A.	1.78	1.83	1.82	1.94	MNR
Current MADS burden (%)	N.A.	1.62	1.81	1.92	1.95	5.00
Financial resource ratios						
Endowment market value ($000s)	N.A.	179,112	170,539	172,688	193,140	223,898
Cash and investments ($000s)	N.A.	195,444	186,792	193,744	219,925	MNR
Unrestricted net assets ($000s)	N.A.	231,880	227,537	210,599	209,408	MNR
Expendable resources ($000s)	N.A.	64,857	55,905	67,692	94,647	MNR
Cash and investments to operations (%)	N.A.	102.9	99.1	108.0	124.5	146.1
Cash and investments to debt (%)	N.A.	527.0	492.6	496.9	547.7	253.5
Expendable resources to operations (%)	N.A.	34.1	29.7	37.7	53.6	91.5
Expendable resources to debt (%)	N.A.	174.9	147.4	173.6	235.7	171.8
Average age of plant (years)	N.A.	13.3	13.4	14.2	13.7	13.6

N.A.--Not available. MNR--Median not reported. MADS--Maximum annual debt service. Total adjusted operating revenue = unrestricted revenue less realized and unrealized gains/losses and financial aid. Total adjusted operating expense = unrestricted expense plus financial aid expense. Net operating margin = 100*(net adjusted operating income/adjusted operating expense). Student dependence = 100*(gross tuition revenue + auxiliary revenue) / adjusted operating revenue. Current debt service burden = 100*(current debt service expense/adjusted operating expenses). Current MADS burden = 100*(maximum annual debt service expense/adjusted operating expenses). Cash and investments = cash + short-term and long-term investments. Expendable resources = unrestricted net assets + temp. restricted net assets - (net PPE- outstanding debt). Average age of plant = accumulated depreciation/depreciation and amortization expense.

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