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

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Credit Profile

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District of Columbia (Gallaudet University) rev rfdg bnds (taxable) (Gallaudet University) ser 2021B due 04/01/2025		
<i>Long Term Rating</i>	A-/Stable	Downgraded
District of Columbia (Gallaudet University) rev & rfdg bnds (Gallaudet University) ser 2021A due 04/01/2051		
<i>Long Term Rating</i>	A-/Stable	Downgraded

Credit Highlights

- S&P Global Ratings lowered its long-term rating on District of Columbia's series 2021A and 2021B revenue bonds, issued for Gallaudet University, to 'A-' from 'A'.
- The outlook is stable.
- The downgrade reflects Gallaudet University's elevated capital spending plans, which we estimate will require \$28.9 million in new-money debt and lease obligations within the outlook period adding significant leverage to the organization's balance sheet. The downgrade also reflects persistent declines in enrollment, equating to more than a 13% drop in headcount since fiscal 2019.

Security

The series 2021 bonds are the university's only bonds, with about \$44.7 million outstanding, and are secured by a general obligation of the university. The university also has a financing lease of about \$8.6 million for IT equipment, which we include in long-term debt. The bonds are fully amortizing with no bullet payments and a maximum annual debt service (MADS) burden of about 2.7%, inclusive of financing lease obligations.

Credit overview

We assessed Gallaudet's enterprise risk profile as strong, with healthy matriculation, good selectivity, and a geographically diverse student body. The recent declines in enrollment and volatility in applications constrain our view of the enterprise profile, although we note that only about 20% of revenues for Gallaudet come from student dependence. We assessed Gallaudet's financial risk profile as strong, with solid financial resource ratios and a manageable debt burden. The significant and consistent support the university receives in federal appropriations, which is expected to help maintain financial performance at the rating level also supports our view of the financial profile. Operating margins have been negative in recent years due largely to one-time costs associated with the repair of a housing facility, which affected financial performance by \$1.7 million and \$17.5 million in fiscal years 2022 and 2021, respectively. We understand these expenses were not capitalized and are included in the repairs and maintenance expenses on the organization's statement of activities, and we note that financial performance would

have been improved absent these one-time costs. Significant capital spending, which will increase long-term debt obligations by more than 50% within the outlook period constrains our view of the financial profile. These credit factors, combined, lead to an anchor of 'a'. As our criteria indicates, the final rating can be adjusted below the indicative level due to a variety of overriding factors. The 'A-' long-term rating better reflects our view of Gallaudet's status as a specialty school with a narrower demand profile compared with other education organizations.

The pro forma debt figures do not incorporate additional capital expenses that will likely be incurred beyond the outlook period for the university's sixth-street project, which will be a combination of retail and mixed-use facilities for students that acts as a gateway to the university. Total costs to the university could be as much as \$23 million beginning in fiscal 2027. Funding sources are still being identified for the project and will likely include a combination of fundraising and debt. We will fully incorporate the capital spending associated with the sixth-street project when information becomes available.

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 to growing support since 1864 from the U.S. government, with federal appropriations constituting close to 70% of operating revenue in most years and an additional \$15 million construction appropriation fund received in fiscal 2023;
- Niche demand profile, reflected by exceptional matriculation rates and good selectivity; and
- Manageable debt load, with a MADS burden of 2.7% of fiscal 2022 operations, although this will likely increase materially within the outlook period.

Partially offsetting credit factors include our opinion of the university's:

- Fluctuations in enrollment over the past five years, with four consecutive years of FTE enrollment declines, and a greater-than-6% decline in fall 2022;
- Expectations for increased leverage within the outlook period as the university enters a phase of elevated capital spending; 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.

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 the 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 due to its mission that ensures the advancement of deaf and hard-of-hearing individuals.

Environmental, social, and governance

We analyzed the university's environmental, social, and governance (ESG) credit factors pertaining to its market position, management and governance, and financial performance. Health and safety risks, which we consider a social risk factor, have largely abated and are neutral in our analysis. We view environmental and governance credit factors as neutral in our analysis.

Outlook

The stable outlook reflects our expectation that enrollment will likely stabilize due to enhanced recruitment strategies implemented by management over the past year. The stable outlook also reflects our expectations that the university's operating performance will be closer to breakeven over the outlook period. We also expect cash and investments will be sustained near current levels.

Downside scenario

We could lower the rating if enrollment continues to decline significantly, or material deficit operating margins persist. Further material declines in cash and investments or additional capital spending beyond what has already been articulated by management could further pressure the rating.

Upside scenario

While not anticipated within the next few years, factors that could lead us to raise the rating include stability in the university's FTE enrollment and sustained improvement in operating performance above breakeven levels. Increases to the university's cash and investments would also be required to raise the rating.

Credit Opinion

Enterprise Risk Profile--Strong

Market position and demand

Gallaudet's headcount has fluctuated in recent years. After increasing by more than 9% from fall 2015 through fall 2018, the university experienced a 13% decline from fiscal 2019 through fall 2022. These declines have been due primarily to smaller incoming freshman classes as well as a drop in transfer matriculants, which management attributes to continued challenges related to the pandemic as well as general market trends and affordability concerns. Management is working on several aspects of its recruiting strategy and programmatic offerings and expects these numbers will stabilize in fall 2023. 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 2021, Gallaudet's total headcount was 1,564, or 1,289 FTE students (FTES), and about 68% of FTES were undergraduates.

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 university's receipt of federal appropriations caps the percentage of hearing students it can admit at the undergraduate level at 8% and the percentage of international students at 15%. We understand the university remains in compliance with these requirements. Gallaudet has a national draw with a

most students coming from outside the state. The majority of undergraduate students have historically lived on campus, prompted by a two-year residency requirement.

Management and governance

The university is governed by a 20-member board of trustees, which includes three members of Congress. Currently, the Honorable Sherrod Brown, Betty McCollum, and Larry Bucshon 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. Although there was some volatility in appropriation in the past with federal funding and midyear cuts, management expects stable appropriations in fiscal 2024.

Gallaudet University appointed new CFO, Brad Hermes, in 2022. Mr. Hermes previously served as CFO for Communications Service for the Deaf. The remainder of the executive management has been stable. The president, Roberta Cordano, joined the university in January 2016 and has focused her attention on long-term planning, building connections with current and prospective students, and increasing research. The university's strategic plan continues to focus on its bilingual mission and research.

Financial Risk Profile--Strong

Financial performance

Prior to fiscal 2020, Gallaudet had a history of achieving consistent operating surpluses, with heavy reliance on federal government appropriations for revenue. Deficits began in fiscal 2020 following unfavorable revenue variances from the plan as a result of the COVID-19 pandemic. These deficits continued through fiscal 2022 due to pandemic-related pressures as well as one-time expenses associated with the repair of a student housing facility, the Laurent Clerc Center, which is a federally funded center catering to elementary and secondary students. We understand repairs were needed due to construction defects and problems with the design and construction of the facility. The operational impact associated with these repairs totaled \$1.7 million in fiscal 2022, \$17.5 million in fiscal 2021, and \$4.6 million in fiscal 2020. These expenses have not been capitalized and were recognized as operating expenses. The university asserted claims against both the construction company and architect to recover these damages and received a \$1.5 million settlement from the architect in fiscal 2022. Management expects improvement in fiscal 2023, with projections indicating breakeven results. We continue to believe the challenging operating environment creates uncertainty for operating performance, and we would view favorably a sustained return to at least breakeven operations over the outlook period without reliance on pandemic-relief funding.

Federal appropriations to Gallaudet are determined annually by 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 and operating appropriations are expected to remain fairly level in fiscal years 2023 and 2024. Federal funding has improved over the past five years and for fiscal 2022 was set at \$157.5 million, an increase of about \$2.8 million from 2021. 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.

Financial resources

Gallaudet's financial resource ratios softened in recent years due to a combination of lower operating cash flow and investment losses. Cash and investments declined to \$205.6 million in fiscal 2022 from approximately \$255 million in fiscal 2021. With the additional leverage, we expect pro forma cash and investments will be about 2.5x total long-term debt, which is significantly lower than historical levels but still healthy for the rating category. Cash and investments to operations, which historically fluctuated over 100%, also declined to about 90% as of fiscal 2022 year-end. As a majority of Gallaudet's upcoming capital expenses are likely to be funded with debt and lease commitments, we do not anticipate a further spenddown in cash and investments at this time.

	--Fiscal year ended Sept. 30--					--Medians reported for 'A' category rated private colleges and universities--	--Medians reported for 'BBB' category rated private colleges and universities--
	2023	2022	2021	2020	2019	2021	2021
Enrollment and demand							
Full-time-equivalent enrollment	1,289	1,379	1,408	1,468	1,521	3,350	2,454
Undergraduates as a % of total enrollment	68.0	69.0	67.5	70.3	72.0	MNR	MNR
First-year acceptance rate (%)	59.2	62.4	62.6	61.2	57.1	70.3	78.2
First-year matriculation rate (%)	71.6	60.6	58.9	62.7	71.0	18.0	16.5
First-year retention rate (%)	73.0	80.0	74.0	75.0	72.0	85.2	78.1
Six-year graduation rate (%)	44.0	58.0	44.0	51.0	47.0	74.9	64.0
Income statement							
Adjusted operating revenue (\$000s)	N.A.	229,189	202,965	193,854	201,610	MNR	MNR
Adjusted operating expense (\$000s)	N.A.	233,037	212,454	197,731	198,562	MNR	MNR
Net operating margin (%)	N.A.	-1.7	-4.5	-2.0	1.5	1.6	1.8
Change in unrestricted net assets (\$000s)	N.A.	-13,664.0	-1,918.0	-3,678.0	7,551.0	MNR	MNR
Tuition discount (%)	N.A.	43.0	29.8	35.0	35.1	41.1	44.0
Student dependence (%)	N.A.	19.5	14.2	20.1	26.6	82.2	85.2
Health care operations dependence (%)	N.A.	N.A.	N.A.	N.A.	N.A.	MNR	MNR
Research dependence (%)	N.A.	4.1	2.6	2.3	1.4	3.7	3.5
Debt							
Outstanding debt (\$000s)	N.A.	53,613	53,343	36,977	35,637	110,132	60,809
Proposed debt (\$000s)	N.A.	28,900	15,000	43,515	43,515	MNR	MNR
Total pro forma debt (\$000s)	N.A.	82,513	N.A.	N.A.	N.A.	MNR	MNR
Current debt service burden (%)	N.A.	2.5	0.1	1.4	1.4	MNR	MNR

Gallaudet University, D.C.--Enterprise And Financial Statistics (cont.)

	--Fiscal year ended Sept. 30--					--Medians reported for 'A' category rated private colleges and universities--	--Medians reported for 'BBB' category rated private colleges and universities--
	2023	2022	2021	2020	2019	2021	2021
Current MADS burden (%)	N.A.	2.7	2.6	1.6	1.6	4.2	4.3
Pro forma MADS burden (%)	N.A.	N.A.	N.A.	N.A.	N.A.	MNR	MNR
Average age of plant (years)	N.A.	14.6	15.0	15.1	14.4	15.3	15.6
Financial resource ratios							
Endowment market value (\$000s)	N.A.	191,649	232,869	194,495	185,975	318,702	107,786
Cash and investments (\$000s)	N.A.	205,652	254,945	223,601	204,413	MNR	MNR
Cash and investments to operations (%)	N.A.	88.2	120.0	113.1	102.9	179.3	114.3
Cash and investments to debt (%)	N.A.	383.6	477.9	604.7	573.6	369.5	204.2
Cash and investments to pro forma debt (%)	N.A.	249.2	N.A.	N.A.	N.A.	MNR	MNR

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 MADS burden = 100*(MADS expense/adjusted operating expenses). Cash and investments = cash + short-term and long-term investments. Average age of plant = accumulated depreciation/depreciation and amortization expense. N.A.--Not available. MNR--Median not reported.

Related Research

Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022

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