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Ratings

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

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Series 2011A & 2011B		
Long Term Rating	BBB-/Stable	Affirmed, Removed from CreditWatch

Rationale

S&P Global Ratings affirmed its 'BBB-' long-term and underlying ratings on the District of Columbia's series 2011A and 2011B revenue bonds issued for Howard University. At the same time, S&P Global Ratings removed the ratings from CreditWatch Negative, where they were placed Oct. 12, 2018. The outlook is stable.

The rating and stable outlook reflect the university's recent approval and receipt of reimbursement funds after its first fall 2018 request from the federal Heightened Cash Monitoring 2 (HCM2) status that it has been subject to since August 2018. Receipt of these money on a timely basis and anticipated further receipt of additional money over the next few months provide reassurance of its ability to successfully submit accurate documentation and realize timely reimbursement. The rating and outlook also reflect our review of the university's fiscal 2018 unrestricted financial results, that while negative on a full-accrual basis, remain adequate to support the rating given the university's sizable endowment.

The 'BBB-' rating reflects our view of Howard's strong enterprise profile and adequate financial profile, including its position as one of the oldest and most prestigious historically black college and universities with a wide array of program offerings and diverse revenues, and steady demand. However, consolidated operations have fluctuated in recent years, from a slight surplus in 2017 when including one-time income related to defeased bonds, to a slight deficit in 2018 (based on unrestricted operations only). Operational stress is somewhat offset by the university's significant endowment and adequate financial resource ratios for the 'BBB' category, with cash and investments of $761.5 million at June 30, 2018, equal to 84% of adjusted expenses and 161% of debt. Combined with the university's HCM2 status and recent events, these credit factors lead to a 'bbb-' indicative stand-alone credit profile and 'BBB-' long-term rating.

The 'BBB-' rating reflects our view of Howard's:

- Revised status of HCM2 and in our opinion, potential reputational risk;
- Howard University Hospital's (HUH) constrained operating environment and weak payer mix that depends largely on Medicaid (26% of patient revenues in fiscal 2018), although the HUH has generated positive margins since fiscal

2016;

- Uneven operating performance; with consolidated unrestricted deficit operations on a full-accrual basis in fiscal 2018;
- Periodic liquidity stress, typically related to the timing of federal appropriation payments during federal budget continuing resolution cycles, resulting in the need for bank lines for liquidity. While Howard ended fiscal year 2018 with no draws on its bank lines of credit (LOC), it currently has $70 million outstanding related to HCM2; and
- Significant deferred maintenance needs.

Some of the university's strengths, in our view, include:

- Niche as one of two federally chartered, nonmilitary higher education institutions and status as one of the most prestigious historically African-American universities in the U.S., as well as its impressive array of professional programs;
- Overall stable enrollment levels and good demand profile with over 9,000 students in fall 2018;
- Adequate financial resource ratios for the 'BBB' category;
- Substantial and historically stable level of federal operating support, which, at $229.8 million in fiscal 2018, was about 25.5% of adjusted operating revenues; and
- Manageable debt burden, with maximum annual debt service (MADS) of about 4.4% of 2018 adjusted operating expenses.

Howard, founded in 1867, is a comprehensive private university in Washington, D.C. The university offers a broad range of undergraduate, graduate, and professional programs, including law, business, medicine, dentistry, pharmacy, engineering, and architecture. Howard also has a school of divinity. In addition, it owns the teaching hospital, which represented about 27% of consolidated operating revenues in 2018. Howard is one of only two nonmilitary schools in the U.S. that are federally chartered and receive an ongoing direct federal appropriation. As the university is a 1928 congressional act mandated institution, we understand that only an act of Congress can terminate its annual appropriation.

During 2018, the U.S. Department of Education (DOE) placed Howard on HCM2 status so that it could closely monitor the institution's federal financial aid management. Approximately 58% of students receive federal financial aid, and the university has taken measures to avoid adverse effects on students in processing aid and the receipt of funds. The HCM2 status has required Howard to submit documentation related to student aid requests for reimbursement before the DOE will release the Title IV funds; to fund federal financial aid upfront from operations, then seek reimbursement from the government. Furthermore, the documentation must be accurate and complete to ensure a swift turnaround on reimbursement. There is no risk of reimbursement denial, because the DOE has already approved the students' federal loans, but there is uncertainty related to timing. Since our last review, Howard's first request for reimbursement was approved in December 2018, and the university received $22.467 million, which constituted 99.3% of its Oct. 24, 2018 request, from the DOE. On Dec. 31, 2018, Howard requested an additional $12.97 million in Federal Student Aid reimbursement from the DOE. If Howard is reimbursed in full, this will bring the fall 2018 Federal Student Aid reimbursement to $64.18 million (including $26.6 million received prior to it being placed on HCM2 status).

Management reports that Howard's first spring 2019 submission will be much larger than the fall 2018 submissions to date. In our opinion, the approval and reimbursement of the first request provide some reassurance and a level of certainty regarding the eventual reimbursement of funds. The university has a $100 million revolving LOC that it intends to use during the next few months to cover any shortfalls related to the HCM2 status; management has indicated it fully expects that any delays in reimbursement will be more than covered by the temporary working capital the university has available to it. In our opinion, this reliance on the LOC to offset potential cash shortfalls, although expected to be temporary in nature, is a credit weakness.

Total debt outstanding at June 30, 2018 was $463.4 million. This included long-term bonds and capital leases. The long-term bonds are general obligations of the university, and there is a debt service reserve. The 2011A and 2011B bonds maintain a bond covenant of a 1.1x debt service coverage pledge. The university complies with its bond covenants. It also has a $100 million LOC with JPMorgan Chase Bank N.A. In recent years, Howard had reduced its dependence on this line and, at fiscal year-end 2018, had no draws on any lines. However, while on HCM2 status, the university has drawn on this line and expects to continue to do so during the current fiscal year. As of this date, approximately $70 million is outstanding on the RLOC, which management expects to pay down by fiscal year-end 2019.

Outlook

The stable outlook reflects our assessment of Howard's and the HUH's consolidated weak operations and lack of consistently stable operations, offset by adequate financial resources for the rating. We expect the university to continue to manage through the HCM2 process and continue to receive reimbursement as projected. At the same time, we expect the university will maintain its enrollment and demand profile.

Downside scenario

We could lower the rating during our two-year outlook period should Howard not maintain its more recent healthy enrollment profile, or if operating performance or financial resources deteriorate, or the university issues additional debt without an improvement in operating margins and liquidity.

Upside scenario

Given the weak operating performance, only adequate balance-sheet metrics, and recent HCM2 status, we do not expect to raise the rating over the outlook period. We would view positively consistent, improved operating results and surpluses and successful navigation through the HCM2 process.

Enterprise Profile

Market position and demand

In our view, Howard has good geographic diversity. Only about 5% of students are from the District of Columbia, and the remaining students come from other states and countries. In recent years, overall enrollment has been declining (although full-time equivalent [FTE] enrollment increased 5.5% in fall 2017, it fell 2% in fall 2018). The university has been focusing on increasing selectivity, raising academic quality, and raising retention. However, according to management, in fall 2016 it increased standards too quickly, resulting in a drop in enrollment. This moderated for fall 2017 and Howard accepted its largest entering undergraduate class, which helped with overall enrollment that year. Fall 2017 enrollment was up 4.8% at 9,392, and in fall 2018 was down 2.7% at 9,139. Slightly more than two-thirds of students are undergraduates (68%), most of them full time. Management reports expectations for modest growth in enrollment in fall 2019.

Historically, university admissions have been moderately selective. At the same time, Howard aims to continue providing students with limited financial means access to higher education. After altering its admissions policies and financial aid policies, the university is rebuilding based on higher academic quality. For fall 2018, applications increased 25% with 29% accepted for a fall freshman class of 1,501, following a larger class of 2,079. For fall 2018, the average freshman SAT score was 1218. We believe that the incoming freshman scores compare favorably with those of peer historically black colleges and universities and are above the national average. Howard typically draws students primarily from Maryland, New York, and New Jersey; the next-largest groups come from Georgia, Virginia, and California. Management reports that it competes primarily with the large public institutions in those states, as well as with other historically black colleges and universities.

For the 2018-2019 academic year, undergraduate tuition, fees, room and board was $40,651, 3.5% higher than in the previous year. Although tuition is well below that of other private institutions in the D.C. metropolitan area, a significant number of students receive merit- or need-based aid, and the university has been shifting more scholarship dollars into need-based aid in recent years. Nearly 57.5% of undergraduates qualify for Federal Pell Grants. The university's overall tuition discount rate has been increasing for the past few years, and for fiscal 2018, it was 44.7%. Combined with declines in enrollment, the increasing discount rate has resulted in declining net tuition revenue in both fiscal years 2017 and 2018.

The university is planning for a capital campaign, although the total fundraising goal has not yet been set.

Howard University Hospital

The HUH is an acute care and teaching and research facility that provides health care services in the D.C. area. There are 482 licensed beds, of which 246 are in service. The hospital is the principal clinical teaching site for Howard's colleges of medicine and dentistry. Most of its facilities are in a six-story structure that opened in 1975 and HUH management reports significant capital needs. Capital expenditures were curtailed while the hospital had significant operating deficits, but with improved operations, the HUH has made capital investments and anticipates increased capital spending. We view the hospital as relatively small for an academic medical center, having 8,166 admissions in 2018. We consider the payer mix weak, with Medicaid representing 26% of total 2018 hospital revenues. In fiscal 2018, inpatient admissions were up and outpatient clinic encounters were also up. In 2014, Howard hired Paladin Healthcare LLC to take day-to-day managerial responsibilities for the HUH's operations. This followed several years of declining financial and clinical performance. Since then, the hospital's emergency department wait-time metrics have improved, as have efficiencies and documentation in case management programs and protocols, resulting in better clinical billing and documentation. With management reviewing the HUH's patient documentation as well as operations, we expect that demand trends will stabilize and net patient revenues will improve.

Management and governance

Howard has a 35-member board, 28 of them general trustees the board elects for three-year terms. There is a three-term limitation, but the chair may waive this. Three alumni trustees that the alumni elect and two elected faculty members also sit on the board, with a maximum of two three-year terms. Two student members can serve for two one-year terms. The president is an ex-officio trustee, without a vote.

During the past few years, management has experienced significant turnover. Dr. Wayne Frederick became president in July 2014 and his contract has been extended through 2026. In April 2015, Michael Masch became the CFO. Over the past two years, many significant key management positions were filled permanently. We expect that with this, there will be more stability at Howard, improved relations with the board, and better ability to focus on improving fiscal operations. In fall 2015, senior management initiated the first stage of a multiyear turnaround plan. The initial focus has been on expenditure reductions to better align expenditures with the revenue base, and the HUH has achieved positive operations for a few consecutive years. However, in the long term, the university is evaluating its strategic options regarding the hospital, including exiting the health care business. Management is also reviewing revenue growth opportunities from operations and asset monetization at both the HUH and university. In addition to financial goals, some of Howard's key strategic priorities include building a culture of academic excellence and rigor; infusing service into the university culture; and increasing philanthropic efforts.

Financial Profile

Financial management policies

Howard has formal policies for investments and debt, but no formal liquidity policy. The university meets the standards for annual disclosure requirements and reports full-accrual interim results. The financial policies assessment reflects our opinion that, although there may be some areas of risk, the organization's overall financial policies are not likely to negatively affect its ability to pay debt service. Our analysis of Howard's financial policies includes a review of financial reporting and disclosure, investment allocation and liquidity, debt profile, and contingent liabilities; and a comparison of these policies with those of comparable institutions.

Revenue diversity and federal appropriation

The university's revenue mix remains a credit strength, in our opinion. Adjusted fiscal 2018 operating revenues included 25.5% federal appropriations, most of which are unrestricted; 33.4% tuition, fees, and student charges; 26.2% hospital and patient income; and 6.0% grants and contracts. Howard has maintained a fairly standard endowment spending draw, in our view, at 5% of the rolling three-year market value average lagged one year; the university held to this level in the fiscal years 2010-2017 operating budgets despite operating pressures, which we view positively. In fiscal 2018, Howard reduced the spending draw to 4% of the rolling three-year market value average. Unlike many state appropriations to public institutions, federal appropriations to Howard have remained fairly flat in recent years and the president's proposed budget for federal fiscal 2019 continues this level.

Financial performance

The university has a history of uneven financial performance with significant unrestricted operating deficits. While fiscal 2018 was budgeted for a surplus, consolidated unrestricted operations resulted in a slight deficit ($19.5 million, or negative 2.2% operating margin) on a full accrual basis. This compares with fiscal 2017, when Howard reported a deficit of $34 million largely due to enrollment declines. However, this deficit excludes income of $33 million from defeased bonds, because it is one-time. When we include it, operations would have resulted in a slight surplus.

Included in Howard's consolidated results is the wholly owned HUH. The hospital has had surplus operations since fiscal 2016 and management sustained these results into fiscal 2017 and fiscal 2018, albeit with a smaller surplus, as it realized the full effects of its cost-containment efforts. It plans to continue these measures, and implement additional revenue enhancement, for fiscal 2019. Paladin has significantly improved clinical documentation and brought labor levels in line with current volume. These efforts have helped increase patient revenues and reduce operating expenses, as well as enhance cash collections.

We believe significant strategic challenges remain for both Howard and its hospital. We expect that the financial performance will stabilize and be positive in 2019. We believe a key challenge for management will be developing a long-term plan for the HUH, given its small size and aging plant, while maintaining the teaching programs of the health sciences departments. The university faces some of the same challenges, including needed renovations and improved productivity from both financial and educational aspects.

Available resources

At the end of fiscal 2018, Howard's total net assets were $667.5 million, of which $233.8 million was unrestricted (UNA), $291.4 million was temporarily restricted, and $142.3 million was permanently restricted. We view the university's financial resource ratios as adequate for the rating. We typically use expendable resources (ER) to measure balance-sheet strength, which we calculate by adjusting UNA for debt outstanding, net plant, and temporarily restricted net assets. For Howard, at June 30, 2018, ER were $487.7 million, equal to only 54% of operating expenses and 103% of debt. In measuring liquidity using cash and investments at fiscal year-end 2018, we view resource ratios as more consistent with those of peer 'BBB' rated institutions. Cash and investments equaled about 84% of expenses and 161% of debt. Howard's endowment had a market value of about $692 million at June 30, 2018, equal to $77,810 per FTE, which is stronger than that of 'BBB' peers.

Debt and contingent liabilities

In fiscal 2016, Howard issued $160 million in variable-rate bonds (not rated), which are backed by an LOC from Barclays Bank PLC. Should the university draw on the LOC, repayment on the draw is over a multiyear period. However, should an event of default occur, repayment could accelerate if the rating on the university falls to below 'BB' (from S&P Global Ratings) or to below Ba3 from Moody's. Moody's currently rates Howard Ba2. While this rating is still two notches away from the trigger level, it is still a risk, in our view. As of fiscal year-end 2018, there have been no draws on the LOC. We believe the risk of a failed remarketing is remote, and that in such a remote circumstance, the university would have sufficient liquidity to repay the LOC draw while seeking alternative long-term financing. However, if this occurs, Howard's financial profile would be further stressed.

There is $108 million in off-balance-sheet housing debt associated with Provident Group-Howard Properties LLC, a not-for-profit corporation organized to construct student housing for Howard. The housing facility opened in August 2014 and consists of 1,360 beds. In addition, in January 2017, Howard transferred title to four on-campus housing facilities to a wholly owned special-purpose entity and entered a 40-year service concession agreement with Corvias

Campus Living-HU LLC. The concessionaire will renovate, operate, and maintain the four facilities. As part of that transaction, there is $144 million in off-balance-sheet debt associated with these units, of which $40 million repaid debt on Howard's balance sheet that was associated with Towers and Cook Hall. We do not expect any operational issues associated with either project.

Substantially all full-time university employees participated in a noncontributory, defined benefit retirement plan. Effective July 1, 2010, the pension plan was closed to new employees and frozen in relation to accruing defined pension benefits. Existing employees began participating in a defined contribution plan. In addition, Howard provides postemployment medical benefits and life insurance benefits to employees; it funds this plan on a pay-as-you-go basis. As of June 30, 2018, the pension liability was $118 million, and the other postemployment benefit liability was $48.4 million.

Howard University, District of Columbia -- Enterprise And Financial Statistics

	--Fiscal year ended June 30--				
	2019	2018	2017	2016	2015
Enrollment and demand					
Headcount	9,139	9,392	8,966	10,002	10,265
Full-time equivalent	8,713	8,893	8,428	9,352	9,530
Freshman acceptance rate (%)	29.4	41.4	30.0	49.0	48.4
Freshman matriculation rate (%)	24.4	29.9	16.5	22.5	22.2
Undergraduates as a % of total enrollment (%)	68.3	67.7	65.8	68.8	68.3
Freshman retention (%)	N.A.	N.A.	96.1	86.0	89.4
Graduation rates (six years) (%)	62.0	63.3	59.2	59.4	59.9
Income statement					
Adjusted operating revenue ($000s)	N.A.	888,363	859,850	882,391	896,008
Adjusted operating expense ($000s)	N.A.	907,890	894,077	872,890	952,387
Net operating income ($000s)	N.A.	(19,527)	(34,227)	9,501	(56,379)
Net operating margin (%)	N.A.	(2.15)	(3.83)	1.09	(5.92)
Change in unrestricted net assets ($000s)	N.A.	11,674	66,652	(44,667)	(108,042)
Tuition discount (%)	N.A.	44.7	40.2	39.5	41.7
Tuition dependence (%)	N.A.	29.2	28.7	29.1	29.5
Student dependence (%)	N.A.	33.4	33.5	35.1	35.5
Health care operations dependence (%)	N.A.	26.2	28.6	29.1	28.9
Research dependence (%)	N.A.	6.0	6.3	6.4	7.2
Endowment and investment income dependence (%)	N.A.	2.5	2.4	1.5	1.6
Debt					
Outstanding debt ($000s)	N.A.	472,701	449,407	481,437	538,787
Current debt service burden (%)	N.A.	3.90	3.48	4.66	3.91
Current MADS burden (%)	N.A.	4.36	4.43	4.53	3.49
Financial resource ratios					
Endowment market value ($000s)	N.A.	691,967	646,557	577,132	590,659

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

	--Fiscal year ended June 30--				
	2019	**2018**	**2017**	**2016**	**2015**
Cash and investments ($000s)	N.A.	761,500	715,307	656,859	649,514
Unrestricted net assets ($000s)	N.A.	233,839	222,165	155,513	200,180
Expendable resources ($000s)	N.A.	487,688	419,552	318,613	396,550
Cash and investments to operations (%)	N.A.	83.9	80.0	75.3	68.2
Cash and investments to debt (%)	N.A.	161.1	159.2	136.4	120.6
Expendable resources to operations (%)	N.A.	53.7	46.9	36.5	41.6
Expendable resources to debt (%)	N.A.	103.2	93.4	66.2	73.6
Average age of plant (years)	N.A.	26.1	20.4	21.8	18.3

N.A.--Not available. 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.