Fitch Rates Howard University's (DC) Ser 2020B and 2021A Bonds BBB-; Outlook Stable

Fitch Ratings - Chicago - 05 March 2020:

Fitch Ratings has assigned a 'BBB-' Issuer Default Rating (IDR) and 'BBB-' revenue bond rating to the following Howard University Bonds:

--Approximately $216,000,000 Taxable Bonds, Series 2020B.

Fitch also affirms its 'BBB-' rating on Howard's $145,000,000 taxable bonds, series 2020.

The Rating Outlook is Stable.

Proceeds of the approximately $216 million taxable series 2020B bonds will be used to refund all of the $192.1 million series 2011A tax exempt bonds. The bonds are expected to price the week of March 16, 2020.

SECURITY

A pledge of the available revenues (including tuition and fees) and cash and investments provided via the Trust Estate will secure the 2020B bonds. A mortgage is not provided as security on the series 2011B, 2020, or 2020B bonds. A debt service reserve fund provides additional security on the series 2011B bonds only.

Howard will also pledge to maintain a balance of $100 million in unrestricted cash and investments as a liquidity covenant.

ANALYTICAL CONCLUSION

The 'BBB-' Issuer Default Rating (IDR) and bond rating for Howard University reflect strong demand characteristics (selectivity, student quality, retention) for undergraduate and professional programs as a leading HBCU institution. It is one of only two nonmilitary schools in the U.S. that is federally chartered and receives an ongoing federal appropriation, a significant strength. Another key strength is Howard's balance sheet, with Fitch-calculated available funds of about $656 million at fiscal 2019, in excess of an adjusted debt base of $461 million. The rating is constrained by a somewhat price-sensitive tuition base, an unfavorable net tuition revenue trend, some variability in operating margins, significant lifecycle capital investment needs and related debt plans.
KEY RATING DRIVERS

Revenue Defensibility:: 'a'

Solid Demand with Selective Student Base; Strong Federal Support

Howard's 'a' Revenue Defensibility assessment reflects solid demand for its undergraduate programs and a multi-regional draw for above-average students. The assessment is tempered by flat to declining net tuition revenue and some year-to-year enrollment volatility. Meaningful federal support is a strong consideration in the assessment as an offset to tuition reliance. Howard's healthcare enterprise is unlikely to provide meaningful operating stability and adds some risk given historically variable operations.

Operating Risk:: 'bbb'

Slim Operating Margins and Pending Capital

Howard's 'bbb' Operating Risk assessment reflects positive but slim cash flow margins as adjusted by Fitch for non-cash gift income, as well as significant capital plans. The university's average age of plant is a high 19 years, indicating high lifecycle investment needs and deferred maintenance.

Financial Profile:: 'bbb'

Adequate Financial Resources Consistent with 'bbb' Assessment

The 'bbb' Financial Profile assessment is supported by currently ample liquid reserves, which are necessary against a moderate debt burden that is expected to increase as capital needs are addressed. Leverage ratios remain consistent with the rating category through a stress cycle.

Asymmetric Additional Risk Considerations

No asymmetric additional risk considerations apply to HU's rating.

RATING SENSITIVITIES
Developments That May, Individually or Collectively, Lead to Negative Rating Action:

-- Failure to improve and maintain solid adjusted cash-flow margins of at least 5%-6% to support its capital and operating needs, particularly against some sensitivity to volatility in net tuition revenue as well as healthcare operations.

-- Unexpected failure to maintain an available funds to adjusted debt ratio consistent with the 'BBB' rating category (no less than 30%) as Howard implements its large capital plan would pressure the rating.

Developments That May, Individually or Collectively, Lead to Positive Rating Action:

-- Significant growth in available funds relative to adjusted debt through completion of the capital plan, at levels sustained above 75%.

CREDIT PROFILE

Howard University is a private, non-profit, comprehensive university with its primary campus located in Washington D.C. It was founded in 1867 and is considered one of the leading U.S. universities serving African Americans. In 1928, Congress amended Howard's charter, and since then the university has received an annual operating appropriation from the federal government through the Department of Education (DOE), the great majority of which is available for annual operating expenditure. Only one other non-military college in the U.S. receives such an appropriation. In fall 2019, Howard enrolled 9,398 students, of whom 69% are undergraduate and 31% are graduate/professional students.

Academic offerings are broad. Graduate and professional degrees include law, business, medicine, dentistry, pharmacy, nursing and allied health, engineering, and architecture, and a divinity school. Through its school of communications, Howard operates commercial radio and television stations. The university also owns and operates the Howard University Hospital (HUH), a Level 1 Trauma Center and teaching hospital located on Howard's main campus. The hospital had been managed by a third party for a five-year term, which has improved margins and operations. This contract ended in October 2019. Beginning February 17, 2020 HUH is being operated by Adventist HealthCare under a three-year management services agreement which includes bringing a new senior leadership team to the hospital.

Howard is governed by a board of directors, currently about 25, plus two ex-officio seats for the university president and the secretary of the U.S. DOE. The board appoints the president; Dr. Wayne A. I. Frederick has served as president since 2014, after being in multiple leadership positions at Howard.

Revenue Defensibility

Howard's 'a' Revenue Defensibility assessment reflects solid demand for its undergraduate programs and a multi-regional draw for above-average students. The assessment is tempered by significant price sensitivity as demonstrated by flat to declining net tuition revenue and some year-to-year enrollment volatility. Graduate and professional programs show very strong selectivity.
Howard’s student base has remained largely steady over the past several years, with only marginal volatility in graduate enrollment. Its selectivity is very strong, and retention has been favorable despite some student unrest which made headlines in the past few years related primarily to campus safety issues. Applications have increased materially, resulting in much more selectivity in recent years at the undergraduate level. Class sizes are somewhat restricted for its D.C. campus (due to local zoning requirements) and for its medical programs. Its international student base has been marginal but steady between 5%-7% in recent years.

Over the past few years, Howard’s net tuition revenue has been somewhat variable, indicative of some pricing constraints with this very selective student population. Its net tuition revenue per FTE CAGR is essentially flat, and we expect that enrollment and steadied net tuition should support limited but consistent growth going forward. A three-year decline in net tuition revenue tempers this assessment somewhat, though the fall 2019 class was larger than the prior year’s.

Howard's spending policy allows for an annual 4% distribution of its endowment market value, based on a three-year moving average which excludes the most recent year. Fitch views this as sustainable, particularly in the context of Howard’s 10-year pooled return of 8.5%. The endowment has grown from $417 million in 2009, to nearly $700 million in fiscal 2019, an increase of 126%. An in-house Chief Investment Officer was appointed in 2016 for the first time.

The recent improvement in the HUH healthcare enterprise to better than breakeven operations, as well as the significant revenue provided via federal appropriation, help to buttress a tuition and student base. Over the past five years, Howard’s federal appropriation has increased from $212 million to $237 million, with $240 million approved for 2020. In fiscal 2019, federal grants, contracts and appropriation represented about 28% of operating revenue; the largest component was health care at 33%.

Federal payments are scheduled to be received quarterly, and Howard has a $100 million line of credit available to bridge any payment gaps. Howard was placed on heightened cash monitoring (HCM) status by the DOE from August 2018 through June 2019, due to concerns related to financial aid use and disbursement. Howard improved some processes in Student Financial Aid Services, and demonstrated full compliance with procedures to the DOE, resulting in its removal from HCM status, in less than one year. Howard used the line of credit twice during this nine-month period, but for four years in a row has reported no draw on the line at fiscal year-end.

**Operating Risk**

Howard’s 'bbb' Operating Risk assessment reflects positive but slim cash flow margins as adjusted by Fitch for non-cash gift income, as well as significant capital plans. The university’s fiscal 2019 GAAP margin was a negative $12.3 million, as adjusted by Fitch for a $37 million non-cash gift recorded in operating income. The cash flow margin was stronger at 8.5%, and slightly improved from recent years, including 6.8% in fiscal 2018 and 6.3% in fiscal 2017.
The university's average age of plant in fiscal 2019 was a high 19 years, indicating high lifecycle investment needs and deferred maintenance. Howard's stated capital plans include reconstruction of its steam plant/steam loop in 2020, which will be funded with the $140 million series 2020B bonds and include a long-term performance-based service arrangement for operation and maintenance with a third party. This will not be a concession structure; Howard expects to maintain ownership and help fund repairs/replacement.

Howard has significant capital needs beyond this series 2021A refunding and the pending steam plant project. Fitch's scenario analysis incorporates these needs and the expected strain on leverage. Capital plans call for $1.3 billion over the next 10 years, funded via a combination of debt, equity, land sales and philanthropy. This includes about $220 million in routine renewal and replacement. The total averages to about $135 million per year, which management expects would be sufficient to reduce average age of plant (depreciation was $55 million in fiscal 2019). Despite the competitive landscape for top students in the HBCU niche, Fitch expects Howard has some limited capacity to delay or reduce its capital outlays before student experience is impacted.

**Financial Profile**

Howard University's financial profile reflects ample liquidity and endowment levels against a currently moderate debt burden, inclusive of a defined benefit pension plan and capitalized operating lease burden. As of fiscal year end June 30, 2019, Howard had about $807 million in total cash and investments, of which $656 million Fitch considers available funds (excluded permanently restricted funds). Its long-term debt was about $400 million, including $142 million in weekly variable rate privately placed debt. Available funds to long-term debt equaled about 163% at fiscal year-end 2019.

Howard offers a defined pension plan to eligible employees, funded at a reported 72% (over 90% as Fitch adjusts for an 80% FASB funding threshold) in fiscal 2019. Howard has a material amount of off-balance sheet housing, which is reportedly self-sufficient against $113 million in related non-recourse debt (not included in Fitch's adjusted debt metric). As Fitch calculates, available funds to adjusted debt (including defined benefit and capitalized operating leases) equaled 142% at fiscal 2019.

The 'bbb' financial profile assessment incorporates additional debt expected in support of Howard's capital needs, including an additional new money issuance. With the anticipated new money component, pro forma debt service will extend to 2050 (from 2042) with maximum annual debt service (MADS) of approximately $48 million in 2031. Fitch calculates Howard's coverage of pro forma MADS was 1.5x in fiscal 2019.

**Asymmetric Additional Risk Considerations**

No asymmetric additional risk considerations apply to the university's rating.

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

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Applicable Criteria

U.S. Public Finance College and University Rating Criteria (pub. 03 Jun 2019)
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