Rutgers, the State Univ. of New Jersey

Update to credit analysis

Summary

Our credit opinion of Rutgers, the State University of New Jersey, (Aa3 stable) positively incorporates the university’s large scale of operations and critical role in the State of New Jersey’s (A3 stable) educational framework as the flagship and land grant university and member of the Big Ten Conference. Favorably, university leadership continues to demonstrate the ability to plan and execute complex strategic change and to increase the university’s already sizeable financial resources through fundraising, providing a growing cushion to adjust to moderate revenue volatility. Offsetting characteristics include high leverage and the increasingly pressured state environment, including long-term pension pressure. In addition, Rutgers’ ambitious capital plan and aging facilities require significant capital investment.

Credit strengths

» Substantial scale with close to $4 billion of operating revenue and over $2 billion of total cash and investments

» Effective management that has successfully demonstrated the ability to plan and execute major strategic and operational changes

» Solid growth in enrollment and net tuition per student and brand strengthening through medical and athletic enterprises as well as introduction of honors college

» Diversified revenue, including student charges, state appropriations, research grants, and patient service revenue
Credit challenges

» Thin operating reserve with spendable cash and investments to operating expenses of 0.4x and limited liquidity with 106 monthly days cash on hand

» Pressure across multiple revenue streams including state and federal funding

» Poor funding of state-sponsored pension funds could result in higher fringe benefit costs for the university

» Aspirational, multi-campus capital plan to improve competitive position may be too costly to fulfill within 15-year time frame

Rating outlook

The stable outlook is based on expectations of continued generally breakeven operations. The outlook also incorporates our belief that the university will be able to absorb some reductions in state and federal funding, that it will limit any additional debt to current levels and that liquidity will not deteriorate.

Factors that could lead to an upgrade

» Sustained, material improvement in operating performance resulting in strengthened cash flow and debt service coverage

» Significant growth of available reserves and liquidity to cushion operations and reduce financial leverage

» Reduction of dependence on the state for financial support

Factors that could lead to a downgrade

» Prolonged contraction of already slim operating margins

» Decline in cash and investments or weakening of liquidity

» Further pressure on the State of New Jersey’s credit quality or material reduction of financial support

» Material additional debt without compensating growth in cash and investments

Key indicators

Exhibit 2

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<tr>
<td>Total FTE Enrollment</td>
<td>56,921</td>
<td>57,531</td>
<td>59,066</td>
<td>60,345</td>
<td>60,608</td>
<td>28,405</td>
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<tr>
<td>Operating Revenue ($000)</td>
<td>2,021,934</td>
<td>3,429,611</td>
<td>3,574,970</td>
<td>3,675,775</td>
<td>3,868,259</td>
<td>1,104,854</td>
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<tr>
<td>Annual Change in Operating Revenue (%)</td>
<td>-2.0</td>
<td>69.6</td>
<td>4.2</td>
<td>2.8</td>
<td>5.2</td>
<td>4.4</td>
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<tr>
<td>Total Cash &amp; Investments ($000)</td>
<td>1,572,444</td>
<td>2,050,455</td>
<td>2,063,038</td>
<td>2,095,952</td>
<td>2,056,120</td>
<td>1,201,140</td>
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<tr>
<td>Total Debt ($000)</td>
<td>1,104,796</td>
<td>2,094,596</td>
<td>1,985,833</td>
<td>1,953,525</td>
<td>1,926,370</td>
<td>597,459</td>
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<tr>
<td>Spendable Cash &amp; Investments to Total Debt (x)</td>
<td>1.0</td>
<td>0.7</td>
<td>0.8</td>
<td>0.8</td>
<td>0.7</td>
<td>1.3</td>
</tr>
<tr>
<td>Spendable Cash &amp; Investments to Operating Expenses (x)</td>
<td>0.6</td>
<td>0.4</td>
<td>0.4</td>
<td>0.4</td>
<td>0.4</td>
<td>0.7</td>
</tr>
<tr>
<td>Monthly Days Cash on Hand (x)</td>
<td>156</td>
<td>82</td>
<td>98</td>
<td>91</td>
<td>106</td>
<td>162</td>
</tr>
<tr>
<td>Operating Cash Flow Margin (%)</td>
<td>8.7</td>
<td>6.1</td>
<td>9.1</td>
<td>9.5</td>
<td>8.6</td>
<td>12.0</td>
</tr>
<tr>
<td>Total Debt to Cash Flow (x)</td>
<td>6.3</td>
<td>10.1</td>
<td>6.1</td>
<td>5.6</td>
<td>5.8</td>
<td>4.4</td>
</tr>
<tr>
<td>Annual Debt Service Coverage (x)</td>
<td>1.8</td>
<td>1.5</td>
<td>2.4</td>
<td>2.4</td>
<td>2.3</td>
<td>3.0</td>
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Source: Moody’s Investors Service

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moodys.com for the most updated credit rating action information and rating history.
Profile
Rutgers, the State University of New Jersey is the State of New Jersey’s flagship and land grant university. A comprehensive research university, it is also a member of the Big Ten Athletic Conference. With campuses strategically located throughout the state in New Brunswick, Newark, and Camden, the university’s full-time equivalent enrollment is over 60,000. Annual revenue is almost $3.9 billion.

Detailed credit considerations
Market profile: strategic initiatives attract students, resulting in healthy demand
Student demand will remain healthy given a number of strategic initiatives to attract and retain students including joining the Big Ten Athletic Conference, adoption of a comprehensive physical master plan and recruiting in select markets outside of New Jersey. The university’s academic reputation continues to improve with the new School of Graduate Studies, which consolidated existing programs, research growth and the 2017 launch of Rutgers Health (the clinical arm of the university and the state’s academic health center), including ongoing development of a partnership with RWJ Barnabas Health (A1 stable).

Rutgers benefits from its position as the state’s flagship and land grant university, with multiple campuses enhancing demand and political support. The university's large scale and diversity as a public comprehensive research university with over $600 million in research awards, the state’s only nationally designated comprehensive cancer center and 60,000 full-time equivalent students are credit positives.

Despite strong demand, net tuition per student will experience some pressure resulting from the university's emphasis on affordability, with below inflationary increases in sticker price and growing financial aid support. With the New Brunswick campus near capacity, the ability to attract students and faculty to the Newark and Camden campuses will impact how large the university can grow. Favorably, both Newark and Camden campuses increased enrollment in fall 2017.

Operating performance: break-even operations to continue, diverse but pressured revenue streams
Improved operations will continue, but operating margins are expected to be in the 1% to 1.5% range given the university’s continued focus on affordability. Moody’s-adjusted operating performance for fiscal 2017 was slightly weaker than fiscal 2016, impacted by increased pension and other post-retirement benefit expenses and expenses relating to a new financial reporting system and close out of legacy UMDNJ grants.

Rutgers benefits from diverse revenue streams, though some are vulnerable to declines, particularly government sources. Student charges revenue growth will remain solid, representing the largest component of operating revenue, at 35% for fiscal 2017. While low tuition increases will continue in the near term, Rutgers could leverage its pricing power and tuition-setting authority to grow net tuition revenue in order to counter declines in other revenue streams if needed.

While state support is expected to remain flat in the near term, a slightly larger portion continues to be devoted to fringe benefits rather than operations each year. With the creation of Rutgers Health, the university projects that patient care revenue will rise. Additionally, the university will also realize improved revenues from its Big Ten contract in the near future, with repayment of internal advances built into athletics operating plans.

Wealth and liquidity: strong overall wealth with very good liquidity
Rutgers’ strong financial reserves will continue to provide a good financial cushion for operations. Fiscal 2017 spendable cash and investments of $1.4 billion covered 35% of annual operating expenses. Total cash and investments have increased a strong 30% since fiscal 2013, bolstered by completion of $1 billion campaign. Fundraising exceeded $200 million in fiscal 2017 and is above target for fiscal 2018, at over $120 million as of December 31, 2017.

The $1.2 billion endowment (December 31, 2017) is managed internally and reported a 12.7% return for fiscal 2017, consistent with sector-wide returns.

LIQUIDITY
Rutgers’ monthly liquidity is thin relative to Aa3 peers but is adequate given the limited near term potential calls on liquidity. Approximately $1 billion of monthly liquidity translates into 106 days cash on hand, a more modest cushion post-absorption of the legacy UMDNJ units. The university does not own a hospital, does not provide its own liquidity for demand debt, and has less than
$1 million collateral posting on swaps currently. Favorably, the university’s overall $1.4 billion of spendable cash and investments and positive fundraising momentum provide alternate liquidity sources that could be accessed if needed.

The university has liquidity agreements with a diversified set of banks for its variable rate debt and commercial paper (CP) program. To support the CP program, Rutgers has a $100 million facility with Bank of America (expiration July 2020) and intends to renew its existing $200 million facility with Wells Fargo Bank, N.A for a three-year period. The current US Bank, N.A., facility supporting Series 2009 variable rate debt, which expires in May, is expected to be replaced with a five-year facility from TD Bank, N.A. Series 2002 variable rate debt, currently supported by a facility from TD Bank, N.A., will mature in May.

**Leverage: high leverage with stable overall position despite ambitious capital plan**

Careful capital planning and debt management will contribute to a relatively stable leverage position. The university has a large pipeline of aspirational capital projects as part of its Rutgers 2030 plan but is taking a disciplined approach to moving forward with specific projects. While no total price tag has been associated with this 15-year plan, a complex multi-campus system and rising age of plant to 18 years highlight a capital intensive organization with significant capital needs. Capital spending has been well in excess of depreciation over the past five years. Spending of approximately $570 million is expected for fiscal 2018 through fiscal 2021, funded through a combination of new and existing debt, gifts, cash flow and reserves.

Unlike most New Jersey public universities, which are highly leveraged within their respective rating categories, Rutgers has some debt capacity at the current rating level. Its bonded debt burden is in line with other Aa-rated public universities; debt to cash flow was 5.8x for fiscal 2017. Financial leverage is a little weaker when measured against spendable cash and investments, at 0.7x compared to a 1.2x median for peers. We expect limited total debt growth, with additional debt in 2018 largely offset by principal payments on outstanding bonds.

**Debt structure**

Approximately 92% of the university’s fiscal 2017 outstanding debt, before swaps, consists of long-term, fixed rate bonds, providing stability for planning purposes. Variable rate debt includes $81 million (as of January 21, 2018) of the current maximum allowable $300 million of CP supported by two SBPAs and $78 million of variable rate demand bonds supported by two existing SBPAs. Debt service is in the $125-$150 million range through fiscal 2033 after which it gradually declines through the final maturity in fiscal 2046.

**Debt-related derivatives**

Four synthetic fixed rate interest rate swaps with a total notational amount of $123 million are used as a hedge against the variable rate bonds. Regular swap payments to the three counterparties are on parity with the university’s debt service obligations, and any required payments due to termination of a swap are considered subordinate to debt service payments. For three of the swaps, the university is required to post collateral if the rating falls to A1 (or A+ by S&P) or lower, subject to a $20 million collateral threshold; the fourth has a zero threshold. The aggregate liability to the university was $28 million as of June 30, 2017. As of February 2018, the university posted less than $1 million in collateral.

**Pensions and OPEB**

Rutgers’ pension liability is manageable given its scope of operations and financial resources. Total adjusted debt, including almost $2 billion of total debt and $1.9 billion Moody’s Adjusted Net Pension Liability and operating leases is equivalent to operating revenue and in line with other Aa-rated public universities. However, spendable cash and investments only cover total adjusted debt by 0.4x compared to the fiscal 2016 median of 0.6x for Aa3-rated public universities.

Rutgers participates in three pension plans administered by the State of New Jersey, two of which are defined benefit plans. For all plans, the state pays 100% of employer contributions, but the university is responsible for reimbursing the state for the pension contributions based on salaries and number of employees that exceed the state-determined levels. The university also participates in two defined benefit and two defined contribution federal retirement plans.

**Legal security**

Rutgers’ general obligation bonds, lease revenue bonds, and commercial paper are payable from all legally available revenue and fund balances. In addition, Rutgers guarantees debt service on certain bonds of the LEAP Academy University Charter School, Inc. The university has covenanted that it will charge and collect tuition, fees, rents, charges and other revenues which, together with other legally available funds, will be sufficient to make all debt service payments on time and to meet all other obligations of the university.
Governance and management: Strong leadership with demonstrated ability to plan and execute strategic change
Rutgers’ strategic positioning is very good, supported by senior leadership’s ability to plan and execute significant strategic changes. Leadership has completed a 5-year comprehensive strategic plan and a 15-year comprehensive physical master plan that is guided by strategic plan priorities and has successfully established the Rutgers Biomedical and Health Sciences as a major division of the university, consolidated two nursing schools and two law schools, as well as the creation of Rutgers Health and partnership with RWJ Barnabas.

The university has successfully merged two payroll systems and consolidated other financial and information systems that will facilitate multi-year financial and capital planning. In addition, it has built out senior staff to include a chief enterprise risk, ethics, and compliance officer and director of endowment investments in recognition of its growing enterprise.
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