S&P Global Ratings

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American University, District of Columbia; CP; Private Coll/Univ - General Obligation

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Long Term Rating	A+/Stable	Affirmed

Rating Action

S&P Global Ratings' affirmed its 'A+' long-term rating on American University's (AU) series 2019 taxable bonds and which reflects AU's proposed "tap" issuance for $100 million. This is in addition to the $410 million issued in 2019. At the same time, S&P Global Ratings' affirmed its 'A+' ratings on AU's existing debt, 'A+' issuer credit rating (ICR) on the university, and 'A-1' short-term rating on the series 2011 commercial paper (CP) program. The outlook, where applicable, is stable.

As of fiscal 2020 year-end, total debt was $640.5 million, all of which was fixed rate with bullet maturities. AU plans to issue an additional $100 million in debt, bringing total pro forma debt to $740.5 million. The new debt will be used to provide additional liquidity and funding for capital projects. The 2019 "tap" bonds will be fixed rate, with a 28-year bullet maturity. All of the university's debt, including the new issuance, is secured by a general obligation of AU.

In response to the COVID-19 pandemic, AU transitioned to remote instruction in March 2020. Management estimates the closure of campus resulted in a negative financial impact of $25 million, which includes refunds to students for housing and dining services. Despite the operating challenges presented by the pandemic, AU ended fiscal 2020 with an operating surplus of 3.1%, a result we consider solid in a challenging environment. In fiscal 2020 and fiscal 2021, the university has taken a number of expense cutting measures including delayed capital spending, temporarily suspending retirement contributions, a one-week furlough of all faculty and staff, delaying salary increases, implementing a hiring freeze, cutting operating costs, and reducing the salary of certain school administrators. AU also received $6.3 million from the Coronavirus Aid, Recovery, and Economic Security (CARES) Act. Half of these funds are designated as relief funds for students and the other half is for institutional use. About 55% of the CARES Act funds were recognized as revenue in fiscal 2020 and the remainder will be recognized in fiscal 2021.

In fall 2020, AU taught classes online with no students living on-campus. Thus, auxiliary revenues were negatively affected and those operations typically comprise 12% of operating revenue, which we view as average. Also affecting revenue is fiscal 2021 was a 10% discount on tuition for the 2020-2021 school year. Full time equivalent (FTE) enrollment was down approximately 4% in fall 2020 compared with the prior year. We view this as a moderate decline when compared with the enrollment decreases seen at AU's peer instructions. AU had exposure to declines in international enrollment; however the school managed to retain many of these students. In fall 2020, approximately 16% of undergraduate FTE was international, compared with 18% the prior year.

For spring 2021, the university will have 200 student athletes and students on campus, some of whom are studying sciences, art, or media. Additionally, the university hopes to bring approximately 1,000 freshmen on-campus for an eight-week "mini-semester". Using their most conservative assumptions, management projects an operating deficit of approximately $26 million for fiscal 2021. While we view the scale of the budget shortfall negatively, AU has a history of outperforming its budget with healthy operating surpluses and we believe management can return to positive operations following the pandemic.

Credit overview

We assess AU's enterprise profile as very strong, characterized by relatively stable demand characteristics and broad draw for students despite the pandemic. We assess the financial profile as strong with a history of robust operating margins and sufficient available resources offset by projected operating deficits in fiscal 2021 and all outstanding bonds that have bullet maturities. Combined, we believe these credit factors lead to an indicative standalone credit profile of 'a+' and a final rating of 'A+.' While we expect the university to produce an operating deficit in fiscal 2021, we believe that the university's solid demand profile and track record of sound management and healthy historical operating surpluses will allow the financial resources to remain sufficient for the rating.

The 'A-1' rating reflects our view of AU's self-liquidity program. The university has committed several sources of funds, including its working capital and endowment, to support its outstanding unenhanced CP program ($125 million is authorized with currently nothing outstanding and no planned draws). As of Oct. 31, 2020, AU identified about $304 million in (undiscounted) assets available same or next day. S&P Global Ratings continues to monitor both the sufficiency and liquidity available on a monthly basis to ensure the university can cover a failed remarketing for the outstanding CP. In our opinion, there is ample liquidity provided through the money held in domestic equities, cash and high-quality, short-term, fixed-income securities.

The rating reflects our assessment of AU's following strengths:

- Relatively stable demand metrics even in fall 2020 with no residential component;
- Consistent history of positive full accrual operations, though a deficit is projected in fiscal 2021; and
- An endowment market value that was increasing prior to fiscal 2020 and flat in fiscal 2020 and sufficient expendable resources to pro forma debt for the rating level.

The rating reflects our assessment of AU's following weaknesses:

- A debt profile with all of the debt structured with bullet maturities; and
- Increased debt load to provide additional liquidity and fund capital projects.

American University is on two campuses on 84 acres in northwest Washington, D.C. and is an independent, private, coeducational institution. The university's academic programs are offered through eight major divisions: The College of Arts and Sciences, The School of Public Affairs, Kogod School of Business, Washington College of Law, The School of Communication, The School of Education, The School of International Service, and The School of Professional and External Studies. Within these divisions, the university offers 70 bachelor's degrees, 91 master's degrees, 10 doctoral degrees, six Law programs, and a J.D. program, S.J.D program, as well as more than 70 certificate programs, at both the graduate and undergraduate level.

The stable outlook reflects our view of the university's track record of positive operating performance and solid demand which should allow for a return to historical operating performance over time. While management expects a deficit in fiscal 2021 which may weaken balance sheet ratios, we believe AU has taken steps to lower expenses without affecting the school's culture. The avoidance of widespread layoffs as well as tuition discounts for students during a difficult period may help maintain demand and relationships with faculty and staff. Offsetting credit factors include a relatively high pro forma MADS burden and expendable resources relative to pro forma debt below the median for the rating category.

Environmental, social, and governance (ESG) factors

In our opinion, similarly to other higher education institutions, AU faces elevated social risk due to uncertainty surrounding the duration of the COVID-19 pandemic. The school has adopted strategies to protect the health and safety of students, faculty, and staff. We view the risks posed by COVID-19 to public health and safety as a social risk under our ESG factors. Despite the elevated social risk, we believe the university's environmental and governance risks are in line with our view of the sector as a whole.

Stable Outlook

Downside scenario

We could consider a negative rating action if larger operating deficits persist beyond fiscal 2021 or if there is further material weakening of available resources. Although we think the university has taken proactive steps to address COVID-19, we understand the virus is a global risk, and we could consider further negative rating action should pressures related to the pandemic continue to materially affect enrollment, demand, or finances.

Upside scenario

A higher rating or positive outlook is unlikely during the outlook period due to the operating pressure from the pandemic, the university's additional debt, and available resources that remain below average for the rating category. We could consider a positive rating action over time if the university can show substantial growth in available resources while maintaining demand metrics at current levels or better.

Enterprise Profile

Economic fundamentals

In our view, the university has good geographic diversity, with increasing draw outside the primary region (D.C., Virginia, Maryland) and international draw in more than 122 countries. Thus our assessment of American University's economic fundamentals is anchored by the U.S. GDP per capita.

Market position and demand

After several years of steady, moderate growth, total headcount fell by 2.2% in fall 2020 to 14,001. On an FTE basis, enrollment was down 3.8% in fall 2020 compared with the prior fall. We consider the scale of the enrollment decline manageable compared with AU's peers as schools manage the impacts of the COVID-19 pandemic and AU remains larger than it was prior to fall 2017. The majority of students at AU are undergraduates--7,475 or 53% of headcount. Freshman applicants increased in fall 2020 by 8% to over 20,000 following a 2% decline in fall 2019. Management expects application numbers for fall 2021 will remain healthy but are unlikely to exceed 20,000. Selectivity and matriculation have weakened over the last three years and these trends continued for a fourth year. In fall 2020, 39% of applicants were offered admission. Matriculation fell to 21%, compared with 26% in fall 2019.

Overall, AU's demand metrics remain solid for the rating. Management attributes this to the university's unique location and market position as well as the programs and internship opportunities that the school provides to its students. We view student quality as good based on incoming students' average SAT scores and the freshman-to-sophomore retention rate. We expect market position and demand may see another year of weakening due to the challenges of the pandemic, but expect these metrics to stabilize in the long run given AU's market position and track record.

Management

AU's president, Sylvia Burwell, has been in her role since 2017 following the retirement of the previous president. Mrs. Burwell was the former secretary of U.S. Department of Health and Human Services--experience which has served AU well during the pandemic. In early spring 2020, AU added a chief online officer to its management team. In May 2020, the school's provost returned to a teaching role and a dean has stepped in as acting provost. We are not aware of any other management changes. We believe that, overall, the senior team remains stable and the detailed financial management and tenure of the financial management team provides stability at the current rating. Management provides two-year detailed operating budgets that reflect contingencies, deferred maintenance, and routine plant renewal, which is less than annual depreciation expense, but do not reflect generally accepted accounting principles. We view the detailed budgets and capital forecasts, as well as management's ongoing focus on revenue growth and cost control positively, as they all provide stability to the university. We understand that more than 600 employees from academic affairs and 80 from the school's radio station voted to unionize and collective bargaining will begin in fiscal 2021. While this may present some limitation to expense management efforts, the school does have some union representation on campus already.

AU is in the third year of a five-year strategic plan focused on improving retention and graduation rates, enhancing the university's reputation, revenue growth, affordability, and operational excellence. While management is prioritizing operational challenges from the pandemic, they also continue to focus on the most impactful initiatives in the strategic plan. We understand that a capital campaign is likely to be publicly launched in the near term.

The board of trustees, which is self-perpetuating, has 30 members, with a limit of50. Trustees serve for a minimum of a three-year term. Board members are approved by both the General Board of Higher Education and the Ministry of the United Methodist Church.

Financial Profile

Financial policies

The university has formal policies for investment management, liquidity, and debt management. It operates according to a five-year strategic plan and 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 weaken 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, and a comparison of these policies to comparable providers.

Financial performance

AU has demonstrated consistently positive operating performance, which lends strength to the overall credit profile. While margins have softened from the 7%-8% seen prior to fiscal 2018, AU accomplished a solid 3.1% margin in fiscal 2020 despite the challenges of operating through the pandemic. Management estimates the closure of campus in spring 2020 resulted in a negative financial impact of $25 million. The university has taken a number of expense cutting measures including delayed capital spending, temporarily suspending retirement contributions, a one-week furlough of all faculty and staff, delaying salary increases, implementing a hiring freeze, cutting operating costs, and reducing the salary of certain school administrators. Additionally, AU received $3.16 million in institutional funding from the CARES Act; 55% of these funds were recognized as revenue in fiscal 2020 and the remainder will be recognized in fiscal 2021.

Despite AU's cost cutting efforts, management projects a deficit in fiscal 2021 as the school has virtually no students on-campus in the fall and winter with limited occupancy projected for the spring and offered a 10% discount on tuition for the 2020-2021 school year. Using their most conservative estimates, management estimates a shortfall of $26 million. While we view the size of the projected deficit negatively, we recognize AU's track record of strong operating performance and do not expect deficits to persist in the long run. As with most private universities, AU relies heavily on tuition and other student-generated fees to support operations. For fiscal 2020, student-dependence was 85%. Auxiliary operations typically comprise 12% of operating revenue, which we view as average. Tuition for the 2020-2021 school year was $45,488. The tuition discount rate was stable in fiscal 2020 and remains relatively low 28%, partly due to the university's graduate programs.

Available resources

Available resources, as measured by expendable resources, fell by 4% in fiscal 2020 to $890.2 million but remain consistent with the rating when compared with operating expenses at 112%. However, when expendable resources are compared to pro forma debt, the ratio is below the category median at 120%. We expect financial resources may continue to stagnate in the short term as AU manages the negative impacts of the pandemic.

AU's endowment was valued at $760.3 million as of Sept. 30, 2020. The endowment return was essentially flat in fiscal 2020 compared to fiscal 2019. In spring 2020 AU divested its endowment from fossil fuels, as part of the school's overall sustainability goals. Otherwise there were no material changes to the endowment's asset allocation. According to management, the university is able to access about 55% of the endowment on a monthly basis. The university's endowment spending policy is 5% of a rolling three-year average though the effective rate is generally below or equal to 3%. Management does not plan any changes to the endowment draw for fiscal 2021.

During the next few years, management is considering construction of an athletic facility as well as other major building renovations. In August 2020, AU completed the construction of a new Hall of Science and the project came in under budget. Several of the school's capital projects are being delayed due to COVID-19. Items in the current campus plan are fully funded from the series 2019 additional tap issuance and 2017 debt issuances, reserves, and gift funds.

Debt and contingent liabilities

As of fiscal 2020 year-end, total debt was $640.5 million all of which was fixed rate and secured by a general obligation of the university. All the debt has bullet maturities, an offsetting credit factor. The proceeds from the original series 2019 bonds were used to refinance direct purchase debt and pay swap termination costs. The transaction reduced risk related to the direct purchase covenant requirements and liquidity and put risks from the previous variable rate demand bonds.

The series 2019 "tap" purchase will add an additional $100 million in debt, bringing total pro forma debt to $740.5 million. The new debt will be used to provide additional liquidity and funding for capital projects. The series 2019 additional bonds will be fixed rate, with a 28-year bullet maturity, and will be secured by a general obligation of AU. With the new debt, AU's pro forma MADS burden will be 6.2%, which we consider above average. The university has no confirmed additional plans for debt at this time.

American University, District of Columbia	Enterprise And Financial Statistics					
	--Fiscal year ended June 30--					Medians for 'A' rated private colleges & universities
	2021	2020	2019	2018	2017	2019
Enrollment and demand						
Headcount	14,001	14,318	14,311	13,858	13,347	MNR
Full-time equivalent	12,538	13,031	13,091	12,615	12,226	3,383
Freshman acceptance rate (%)	38.7	36.1	31.5	29.4	25.9	67.5
Freshman matriculation rate (%)	20.8	26.2	29.3	32.5	33.5	MNR
Undergraduates as a % of total enrollment (%)	53.4	53.3	52.0	53.3	59.2	81.0
Freshman retention (%)	84.8	86.8	87.8	89.8	89.8	85.1
Graduation rates (six years) (%)	79.1	78.8	79.8	79.2	81.0	MNR
Income statement						
Adjusted operating revenue ($000s)	N.A.	823,257	835,859	755,795	718,537	MNR
Adjusted operating expense ($000s)	N.A.	798,297	789,327	741,593	665,519	MNR
Net operating income ($000s)	N.A.	24,960	46,532	14,202	53,018	MNR
Net operating margin (%)	N.A.	3.13	5.90	1.92	7.97	1.60
Change in unrestricted net assets ($000s)	N.A.	8,078	41,116	70,171	119,817	MNR
Tuition discount (%)	N.A.	27.8	27.6	28.0	24.9	38.3
Tuition dependence (%)	N.A.	74.3	70.8	73.8	73.1	MNR

American University, District of Columbia	Enterprise And Financial Statistics (cont.)					
	--Fiscal year ended June 30--					Medians for 'A' rated private colleges & universities
	2021	2020	2019	2018	2017	2019
Student dependence (%)	N.A.	85.2	83.7	85.7	84.5	85.6
Health care operations dependence (%)	N.A.	N.A.	N.A.	N.A.	N.A.	MNR
Research dependence (%)	N.A.	4.5	3.5	6.2	5.2	MNR
Endowment and investment income dependence (%)	N.A.	3.6	3.6	3.6	3.5	MNR
Debt						
Outstanding debt ($000s)	N.A.	640,500	640,500	561,375	481,311	106,232
Proposed debt ($000s)	N.A.	100,000	N.A.	N.A.	N.A.	MNR
Total pro forma debt ($000s)	N.A.	740,500	N.A.	N.A.	N.A.	MNR
Pro forma MADS	N.A.	49,065	N.A.	N.A.	N.A.	MNR
Current debt service burden (%)	N.A.	2.65	2.92	3.02	2.98	MNR
Current MADS burden (%)	N.A.	5.36	5.70	4.42	3.94	4.20
Pro forma MADS burden (%)	N.A.	6.15	N.A.	N.A.	N.A.	MNR
Financial resource ratios						
Endowment market value ($000s)	N.A.	701,308	705,027	694,462	641,758	240,596
Cash and investments ($000s)	N.A.	1,044,116	1,087,207	1,107,386	951,586	MNR
Unrestricted net assets ($000s)	N.A.	1,039,634	1,031,556	1,043,748	973,577	MNR
Expendable resources ($000s)	N.A.	890,233	926,881	927,166	773,736	MNR
Cash and investments to operations (%)	N.A.	130.8	137.7	149.3	143.0	142.2
Cash and investments to debt (%)	N.A.	163.0	169.7	197.3	197.7	287.1
Cash and investments to pro forma debt (%)	N.A.	141.0	N.A.	N.A.	N.A.	MNR
Expendable resources to operations (%)	N.A.	111.5	117.4	125.0	116.3	89.0
Expendable resources to debt (%)	N.A.	139.0	144.7	165.2	160.8	178.3
Expendable resources to pro forma debt (%)	N.A.	120.2	N.A.	N.A.	N.A.	MNR
Average age of plant (years)	N.A.	14.5	13.8	13.0	12.9	14.1

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.

Related Research

Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020