

Rating Action: Moody's downgrades Virginia Commonwealth University's (VA) to Aa3, assigns Aa3 to Series 2020A&B; outlook stable

06 May 2020

New York, May 06, 2020 -- Moody's Investors Service has downgraded the ratings on Virginia Commonwealth University's (VA) (VCU) approximately \$155 million of outstanding general revenue pledge bonds to Aa3 from Aa2. We have also assigned Aa3 ratings to Virginia Commonwealth University's (VA) planned approximately \$25 million General Revenue Pledge Refunding Bonds, Series 2020A (Tax-Exempt) and \$77 million General Revenue Pledge Refunding Bonds, Series 2020B (Taxable). Both issues will be fixed rate, maturing in 2033 and 2050, respectively. Depending on market conditions, VCU may upsize the new issue amount to incorporate additional refunding opportunities. Concurrently, we have affirmed the P-1 short-term ratings on VCU's taxable and tax-exempt commercial paper programs with combined \$75 million authorization. The rating outlook is revised to stable from negative.

RATINGS RATIONALE

The downgrade to Aa3 from Aa2 is driven by VCU's recent years of weaker operating performance and declining liquidity, with limited prospects for strengthening as the university confronts difficult business conditions due to the coronavirus pandemic. The university, excluding its health system, generated a second year of modest deficits in fiscal 2019, with a narrow 1.1x debt service coverage. Consolidated operating performance including Virginia Commonwealth University Health System (VCUHS, Aa3 negative) also recorded narrowing margins to 3.8% for fiscal 2019. Liquidity across both the university alone and the consolidated entity weakened to 133 days and 104 days, respectively.

The assignment of the Aa3 rating reflects VCU's excellent strategic position as an urban comprehensive university located in the state capital of Richmond, Virginia, and strong academic medical center affiliation with Virginia Commonwealth University Health System. The combined VCU and VCUHS entity benefits from its sizeable \$5.1 billion scope of operations, generally stable and ongoing operating and capital support from the Commonwealth of Virginia (Aaa stable), still adequate liquidity, moderately-large research enterprise, and manageable debt burden.

Operational challenges at both VCU and VCUHS will persist through fiscal 2020 and may be more pronounced in fiscal 2021 depending on coronavirus pandemic impacts to healthcare revenue, student enrollment, auxiliary facilities and state support. Recent investment losses, if sustained, will cause near term softening in wealth and liquidity. The magnitude of weakening will be tempered by management's actions to pare spending along with receipt of revenue from recently passed federal aid packages. Additional challenges include a sizeable net pension liability, heightened competition for federal research funding, and relatively flat historical state operating support.

The affirmation of the P-1 short term rating reflects VCU's long term credit quality combined with ample liquidity assets and sound treasury management supporting the commercial paper program.

We regard the coronavirus (COVID-19) outbreak as a social risk under our ESG framework given substantial implications for public health and safety. The coronavirus situation has created dislocation across industries and geographies and triggered urgent challenges for many businesses and organizations to address. Social distancing measures and other restrictions designed to curb the spread of the virus are exacting tremendous economic costs. The prospects and path of economic recovery for the second half of the year and beyond will depend on factors including when and at what pace lockdown measures will ease and to what extent fiscal and monetary policy measures are available to assist businesses and organizations. The combined credit effects of these developments are unprecedented.

RATING OUTLOOK

The stable outlook reflects our expectation that management will continue to take actions to adjust expenses relative to revenue volatility, with only modest deterioration of liquidity. The university's favorable academic and health care brands will continue to support the core strength of the university's credit profile.

FACTORS THAT COULD LEAD TO AN UPGRADE OF THE RATINGS

- Marked increase in liquidity and other flexible reserves, including heightened donor support
- Sustained improvement in operating performance at both the university and the health system
- Strengthening of the student market profile, in part reflected in increased geographic diversification of the student population and associated improvement in tuition revenue flexibility

FACTORS THAT COULD LEAD TO A DOWNGRADE OF THE RATINGS

- Escalation of downside risks associated with the coronavirus pandemic and associated global macroeconomic instability
- Sustained operating cash flow margins of under 8%
- Material erosion of unrestricted liquidity
- A decline in VCUHS' credit quality given significant consolidated exposure to the health system
- Consistently weak coverage of CP from self-liquidity (short-term rating)

LEGAL SECURITY

VCU's general revenue pledge bonds and commercial paper notes are on parity, and are secured by the irrevocable pledge of general revenues of the university, including student fees and tuition, auxiliary revenues, and unrestricted gifts, but excluding state appropriations. The university does have certain Qualifying Senior Obligations (Section 9(c) bonds issued by the Commonwealth of Virginia on behalf of VCU, \$52.4 million outstanding at June 30, 2019) that have a senior pledge on a portion of the university's revenues.

VCU Health System debt, totaling \$676 million for fiscal 2019, is separately secured from university debt by a revenue pledge within its obligated group.

USE OF PROCEEDS

Proceeds of the Series 2020A and 2020B bonds will be used to: refund all or portions of the Series 2013A, 2013C and 2014A bonds; permanently finance a portion of VCU's tax-exempt and taxable CP; refund and restructure certain VCU bonds issued through the Virginia College Building Authority (VCBA) pooled financing program; and pay costs of issuance.

PROFILE

Virginia Commonwealth University is a comprehensive public university and academic medical center, established from the merger of two organizations in 1968. The university is a component of a larger system that includes a Health System Authority (VCUHS) and multiple foundations. VCU is located in Virginia's state capital of Richmond. For fiscal 2019, the consolidated organization's combined operating revenue was \$5.1 billion and university-only revenue totaled \$1.1 billion. In fall 2019, the university enrolled 26,742 full-time equivalent (FTE) students.

METHODOLOGY

The principal methodology used in the long-term ratings was Higher Education published in May 2019 and available at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBM_1175020 . The principal methodology used in the short-term ratings was Municipal Bonds and Commercial Paper Supported by a Borrower's Self-Liquidity Methodology published in October 2019 and available at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBM_1146778 . Alternatively, please see the Rating Methodologies page on www.moodys.com for a copy of these methodologies.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found at: https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_79004.

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The ratings have been disclosed to the rated entity or its designated agent(s) and issued with no amendment resulting from that disclosure.

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Moody's general principles for assessing environmental, social and governance (ESG) risks in our credit analysis can be found at https://www.moody.com/researchdocumentcontentpage.aspx?docid=PBC_1133569.

At least one ESG consideration was material to the credit rating action(s) announced and described above.

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