American University, DC

New Issue - Moody's assigns A1 to American University, DC's series 2017; outlook stable

Summary Rating Rationale
Moody's Investors Service has assigned an A1 rating to American University, DC's proposed $102 million taxable bonds, series 2017 bonds. The proposed bonds will be issued as fixed rate debt with a final maturity in 2047. We maintain A1 ratings on $347 million of outstanding debt. The outlook is stable.

American University's A1 rating reflects the university's market position as an established research university in an urban location with ongoing robust student demand, consistent revenue growth and exemplary operating performance. Thoughtful strategic and financial planning, in conjunction with strong liquidity, help to offset the impact of the university's large capital program and resulting elevated financial leverage. Other offsetting factors include a high reliance on student charges and a relatively aggressive debt structure.

Credit Strengths
» Continued strengthening of market profile and student demand, evidenced by increased competitiveness in selectivity and matriculation
» Consistently strong operating results and excellent cash flow
» Solid financial flexibility enhanced by high proportion of flexible reserves, with excellent liquidity for the rating category
» Careful planning and monitoring of strategic, operational, and capital initiatives
Credit Challenges

» Elevated financial leverage supporting large capital program
» Relatively aggressive debt structure, with demand debt comprising almost half of pro forma debt as well as bullet maturities
» Limited revenue diversity and lower philanthropic support relative to reputational peers

Rating Outlook

The stable outlook reflects expectations of continued strong student demand, maintenance of flexible reserves and ongoing healthy operating performance.

Factors that Could Lead to an Upgrade

» Exceptional growth in financial resources
» Increased philanthropic support
» Enhanced revenue diversification

Factors that Could Lead to a Downgrade

» Softening of student demand
» Decline in operating performance leading to material reduction in flexible reserves
» Significant additional borrowing beyond current plans

Key Indicators

Exhibit 2

<table>
<thead>
<tr>
<th></th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>Pro forma</th>
<th>Median: A Rated Private Universities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total FTE Enrollment</td>
<td>11,781</td>
<td>12,035</td>
<td>12,112</td>
<td>12,260</td>
<td>12,541</td>
<td>4,526</td>
</tr>
<tr>
<td>Operating Revenue (000$)</td>
<td>520,824</td>
<td>540,598</td>
<td>557,352</td>
<td>576,474</td>
<td>596,956</td>
<td>196,259</td>
</tr>
<tr>
<td>Annual Change in OR (%)</td>
<td>3.4</td>
<td>3.8</td>
<td>3.1</td>
<td>3.4</td>
<td>3.6</td>
<td>3.4</td>
</tr>
<tr>
<td>Total Cash &amp; Investments (000$)</td>
<td>807,231</td>
<td>886,463</td>
<td>952,937</td>
<td>889,493</td>
<td>951,586</td>
<td>359,875</td>
</tr>
<tr>
<td>Total Debt (000$)</td>
<td>383,930</td>
<td>418,676</td>
<td>481,905</td>
<td>481,620</td>
<td>561,375</td>
<td>132,260</td>
</tr>
<tr>
<td>Spendable Cash &amp; Investments to Total Debt (x)</td>
<td>1.9</td>
<td>1.9</td>
<td>1.8</td>
<td>1.6</td>
<td>1.5</td>
<td>1.6</td>
</tr>
<tr>
<td>Spendable Cash &amp; Investments to Operating Expenses (x)</td>
<td>1.5</td>
<td>1.7</td>
<td>1.7</td>
<td>1.6</td>
<td>1.6</td>
<td>1.3</td>
</tr>
<tr>
<td>Monthly Days Cash on Hand (x)</td>
<td>576</td>
<td>627</td>
<td>651</td>
<td>547</td>
<td>552</td>
<td>321</td>
</tr>
<tr>
<td>Operating Cash Flow Margin (%)</td>
<td>18.8</td>
<td>20.4</td>
<td>20.4</td>
<td>21.7</td>
<td>20.5</td>
<td>15.3</td>
</tr>
<tr>
<td>Total Debt to Cash Flow (x)</td>
<td>3.9</td>
<td>3.8</td>
<td>4.2</td>
<td>3.8</td>
<td>4.6</td>
<td>4.6</td>
</tr>
<tr>
<td>Annual Debt Service Coverage (x)</td>
<td>6.6</td>
<td>7.7</td>
<td>7.3</td>
<td>6.2</td>
<td>6.1</td>
<td>3.0</td>
</tr>
</tbody>
</table>

Pro forma column includes preliminary fiscal 2017 results and $80 million in new series 2017 bonds.
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.
Recent Developments
As anticipated, American is issuing $80 million in new debt consistent with its capital plan. The proceeds will be used to fund renovations to several existing buildings. Current funding plans for American's science center include philanthropy and university funds rather than debt, as previously considered.

Detailed Credit Considerations
Market Profile: Robust student demand demonstrated by increased competitiveness
American's market position will continue to strengthen, bolstered by its desirable urban location in a residential area of Washington, DC, capital investment including new residence halls and law school facilities, and brand enhancement. Recent improvements in selectively and matriculation have been particularly strong, with selectivity decreasing to 29% for fall 2017 from 44% in fall 2012 and matriculation growing to 33% from 21% over the same period. Favorably, American achieved these gains without a material increase in its tuition discount rate, which is a low 25% compared to 35% median for A-rated peers.

Growth in undergraduate enrollment will moderate after a 31% increase since 2007 (preliminary 7,981 undergrad FTEs for fall 2017), due in part to the District of Columbia's requirement that American house two-thirds of its undergraduates. While law school enrollment has softened, overall graduate student enrollment remains steady. Management will continue to demonstrate the ability to adjust expenses to enrollment shifts and to grow net tuition revenue while increasing affordability.

Operating Performance: Exemplary operating performance and exceptional cash flow will continue
American will continue to demonstrate sound planning and careful monitoring of strategic, operational and capital initiatives, resulting in ongoing excellent operating performance. Operating cash flow was an exceptional 21% for fiscal 2017 based on preliminary results (April 30 fiscal year end). As in past years, the university's two-year budgeting model for fiscal 2018 through fiscal 2019 includes financial safeguards totaling an estimated 6% of the operating budget. Best practices include budgeting for various contingencies, contributions to the quasi-endowment and investment in staff, facilities and technology.

Limited revenue diversity, with 80% of revenue derived from student charges, underscores the need for continued effective enrollment management. Increased revenue diversity, particularly from fundraising, would be credit positive.

Wealth and Liquidity: Ongoing surpluses contribute to very favorable unrestricted financial resources and liquidity
American will continue to benefit from a high proportion of flexible financial resources built largely through years of consistent operating surpluses and a commitment to limit illiquid investments. Spendable cash and investments comprise a very strong 88% of American's $952 million in total cash and investments for fiscal 2017. However, overall growth in financial resources has been slightly lower than peers due in large part to American's 10-year capital investment program, now nearing completion. Over the past five years, American has invested approximately $375 million in its physical plant.

The $622 million endowment, of which $430 million was unrestricted as of fiscal 2017, showed an annual return over almost 14% through June 2017. Funds have an equity bias, with over one half of funds allocated to global equities. Cambridge Associates serves as investment advisor.

While gift revenue continues to grow, at $46 million for fiscal 2017, gifts per student lag peers. American raised a three-year average of $2,664 per student compared to a median of approximately $7,800 for A1-rated peers. The university will benefit from an upcoming campaign currently in the planning phase and expected to begin fall 2018. In fiscal 2017, the university received an $18.7 million property gift consisting of 367 acres in the foothills of northern Virginia as well as guest rooms, cottages and meeting space.

LIQUIDITY
Liquidity remains extremely strong for the rating category despite a modest reduction due to construction spending in fiscal 2017. Monthly liquidity of $748 million provides an exceptional 552 days cash on hand relative to a 2016 median of 321 days for A-rated peers. Liquidity will remain at least stable.
Leverage: Moderately high financial leverage to support capital plan and relatively complex debt structure
Investment in a large 10-year capital improvement plan, which will culminate with the planned construction of a science center beginning in 2018, has resulted in moderately high financial leverage, which anchors the university at the A1 rating. Spendable cash and investment covers pro forma debt by 1.5 times, lower than a 2.7 times A1 peer median for fiscal 2016. High leverage is mitigated by strong operating cash flow; pro forma debt to cash flow is in line with peers at 4.6 times. With excellent cash flow expected to continue, American is able to absorb this incremental debt at the current rating level.

DEBT STRUCTURE
American's debt structure is relatively aggressive, with demand debt comprising 45% of the $561 million total debt portfolio, which is almost entirely structured as bullet maturities. Tender features on $100 million of variable rate debt are supported by a letter of credit with Royal Bank of Canada, expiring in December 2017. An additional $119 million is in bank purchase mode with two banks; agreements expire in February 2018 and February 2020. The university continues to consider options for refinancing and replacement of expiring agreements. Management continues to demonstrate the ability to manage the portfolio's complexities effectively.

Bank agreements are subject to leverage ratio and debt service coverage ratio covenants. The university has ample headroom under both ratio covenants for fiscal 2017 (leverage ratio of 1.6 times compared to a 0.85 requirement; debt service coverage ratio of 5.7 times compared to a 1.6 times requirement).

DEBT-RELATED DERIVATIVES
American has five swaps with two counterparties for a total notional amount of $195 million. As of September 1, 2017, the swaps were a $81 million liability to the university and required $33 million of collateral to be posted. While the swaps add risk to the university's debt structure, American's significant liquidity mitigates the risk of collateral posting or termination payments.

PENSIONS AND OPEB
The university has a $20 million OPEB liability that is funded on a pay-as-you-go basis. Total OPEB costs and contributions to American's two defined contribution plans were a manageable 3% of expenses for fiscal 2017.

Governance and Management: Strong management exhibits careful planning and management
With a strong management team in place, continued healthy operating performance in a highly competitive higher education environment will continue. The university's board of trustees and senior leadership emphasize transparency and close fiscal oversight, yielding consistently positive results and a heightened market profile. A new president joined the university in June 2017.

Legal Security
The bonds are a general obligation of the university.

Use of Proceeds
Proceeds will be used to finance or refinance the costs of various capital projects of the university and to pay certain costs of issuance.

Obligor Profile
American University is a private non-sectarian research institution situated in a residential area of northwest Washington, DC. The university enrolled over 12,500 students in fall 2017 across a comprehensive array of undergraduate, graduate, and professional programs including law, business, public affairs and international service.

Methodology
The principal methodology used in this rating was Global Higher Education published in November 2015. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.
## Ratings

**Exhibit 3**

### American University, DC

<table>
<thead>
<tr>
<th>Issue</th>
<th>Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td>Taxable Bonds, Series 2017</td>
<td>A1</td>
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<tr>
<td>Rating Type</td>
<td>Underlying LT</td>
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<td>Sale Amount</td>
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<td>Expected Sale Date</td>
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<tr>
<td>Rating Description</td>
<td>Revenue: 501c3 Unsecured General Obligation</td>
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