MOODY'S
INVESTORS SERVICE

# Rating Update: Moody's affirms Rutgers (NJ) Aa3; outlook negative

Global Credit Research - 26 Nov 2014

**$1.9B debt affected**

RUTGERS, THE STATE UNIVERSITY OF NEW JERSEY, NJ
Public Colleges & Universities
NJ

**Opinion**

NEW YORK, November 26, 2014 --Moody's Investors Service affirms the Aa3, Aa3/VMIG 1, and P-1 ratings on $1.85 billion of Rutgers, the State University of New Jersey rated debt. We have also maintained the negative outlook.

SUMMARY RATING RATIONALE

The Aa3 rating reflects Rutgers' large, diverse operations at over $3 billion in operating revenue, a strong market position as a new member of the Big Ten Athletic Conference and over 57,000 full-time equivalent students; sizeable cash and investments approaching $2 billion; and importance to the state economy. Also driving the rating is the substantial progress made to date in the integration of the legacy University of Medicine and Dentistry of New Jersey (UMDNJ) units into Rutgers. These strengths are offset by the university's high leverage compared to spendable cash and investments and operations; adequate liquidity; and weak operating performance resulting in modest debt service coverage.

The short-term ratings incorporate the strength of the underlying rating as well as the bank liquidity facilities supporting them.

The negative outlook reflects the vast amount of work still required to fully integrate the UMDNJ units, the costs associated with that integration, and potential pressure on government appropriations due to the state's fiscal imbalance.

STRENGTHS

*Rutgers is strengthening its market position both academically and through its athletic program. The newly expanded Rutgers has more emphasis on research ($690 million of grant revenue in FY 2014) and biomedical sciences ($488 million patient service revenue in FY 2014).

*Implementation of the restructuring is going well, with successful execution of many of the integration initiatives required to successfully merge programs and processes from two disparate entities. The university has a new strategic plan and plans for each campus and RBHS are either done or in the works. Next, management plans to tackle a master facilities plan to help rationalize capital investment for the future.

*Rutgers has augmented its programs and diversified its revenue by absorbing eight schools and three institutes into the newly formed Rutgers Biomedical Health Sciences (RBHS) Division, helping to protect against unpopular curricula and a downturn in any single revenue. Student charges represented the largest portion of revenue in FY 2014 at 34% while government appropriations, grants and contracts, and patient service revenue represented 23%, 21%, and 15%, respectively.

*Rutgers has demonstrated its strong fundraising capability with the conclusion of its $1 billion "Our Rutgers, Our Future" campaign this year.

CHALLENGES

*There are still many remaining integration issues to address, including rationalizing disparate, and in some cases, duplicative, systems and practices that it inherited and human resource issues.

*The university's balance sheet reserves are modest relative to high debt and operations, with expendable financial resources to direct debt of 0.54x and expendable financial resources to operations of only 0.34x. The high leverage is expected to continue given the need to invest in new high tech facilities to support expanded research and renovation of existing facilities.

*Rutgers is operating with thin margins with a 6.2% operating cash flow margin providing a slim 1.42x debt service coverage in FY 2014. Operations are expected to be relatively flat in FY 2015 resulting in the same moderate debt service coverage.

*The university's unrestricted liquidity is only moderate compared to peers with only 146 monthly days cash on hand as of June 30, 2014.

*Historical underfunding of the state's retirement system could require increased contributions, which could constrain state operating support or add expense pressure. The state currently pays a majority of pension contributions on behalf of the university.

DETAILED CREDIT DISCUSSION

RECENT DEVELOPMENTS/UPDATE

Rutgers is reaping the benefits of being a junior member of the Big Ten. Out-of-state applications were up 36% in fall 2014 compared to fall 2013, helping it leverage its position as a research university and enrolling students paying non-resident charges. For fall 2014, 13% of the freshman class is from outside of New Jersey compared to 9% of overall enrollment.

The current 2014-2015 school year is Rutgers' first as a member of the Big Ten Athletic Conference. Membership in the Big Ten brings with it the promise of a self-supporting athletic program. It raises the university's profile outside of New Jersey helping to attract students from out-of-state and permits the university to participate in the Committee on Institutional Cooperation (CIC), a consortium of research universities that share expertise and provide joint opportunities for students and faculty.

Tuition for FY 2014 increased by an average of 3.4%, but is only up 2.3% in FY 2015 making it more difficult to address expenditure pressures. Base state appropriations for FY 2015 are flat and while research revenue increased 20% in FY 2014 to $691 million, success in obtaining new grant awards was muted at $446 million. Management is optimistic that they can incentivize faculty to leverage Rutgers' research strengths in cancer, neurology, environmental and public health, and drug development to generate more research grants in the near future. This may prove challenging given the high competition for research funding and constrained federal budgets.

As expected, FY 2014, the first year of consolidated operations of the newly expanded Rutgers University, was a year of high costs with little opportunity to reduce expenses. The year was slightly negative closing with a Moody's adjusted negative $25 million operating loss, largely attributed to $20 million of nonrecurring integration costs. Management reports that substantial structural deficits at the Robert Wood Johnson Medical School and less than break-even performance at New Jersey Medical School contributed to the deficit. Breakeven operations are budgeted for FY 2015. As a result of thin operations and almost a doubling of debt to $2.1 billion as June 30, 2014, debt service coverage slipped to a relatively weak 1.42 times.

The Working Capital and Liquidity Portfolio stood at $1.285 billion at FYE 2014 providing the university with 146 monthly days cash on hand. While average for Aa3-rated flagship and land grant universities, liquidity relative to operations has steadily declined from a recent high of 217 monthly days cash on hand in FY 2010. This liquidity does not provide much cushion if Rutgers were downgraded and required to post swap collateral. There is no current plan to increase liquidity.

Rutgers appears to be functioning well with its new, fairly complex governance and expanded management structure. Since September 30, 2013, six senior management appointments were made, including chancellors for each of the three campuses and for RBHS; president of the foundation, and Senior Vice President for Finance & Treasurer. The university strategic plan was adopted and strategic plans for each of the university divisions are either completed or underway. The two nursing schools have merged. The $1 billion "Our Rutgers, Out Future" campaign is nearly complete and a new effort to raise money for the Rutgers Biomedical and Health Sciences (RBHS) is being undertaken by a reorganized Rutgers University Foundation. Given the growth of the endowment, the university is considering employing an outsourced chief investment officer.

There remains substantial work to integrate the legacy UMDNJ units into Rutgers. The culture and business practices of the two organizations need to be harmonized. At the same time, the university is considering where to consolidate operations for efficiencies. The changes will take time but provide the opportunity to trim costs while raising its profile.

One possible consolidation involves the two law schools. The university is also considering offering one set of basic science classes to students to both medical and non-medical students.

Negotiations are underway to redefine the affiliation between RBHS and Robert Wood Johnson University Hospital, NJ (A2 stable). In FY 2015, the university will begin to implement an Enterprise Resource Planning (ERP) system to house student applications, financial and operational data.

LEGAL SECURITY

Rutgers' general obligation bonds, lease revenue bonds, and commercial paper are payable from all legally available revenue and fund balances. The certificates of participation are secured by the unconditional obligation of the university to make rental payments under a master lease agreement. In addition, Rutgers guarantees debt service on the bonds of the LEAP Academy University Charter School, Inc.

DEBT STRUCTURE AND DERVIATIVES

Roughly 80% of the university's debt, before swaps, consists of long-term, fixed rate bonds. Variable rate debt includes $200 million CP (the maximum that can be issued under the liquidity facility supporting the CP) and $115.4 million of variable rate demand bonds as of June 30, 2014. The swaps hedge all of the variable rate bonds. Liquidity for all variable rate instruments is provided by bank stand-by purchase agreements (SBPAs).

The CP program is authorized by the Board of Governors for $500 million; however, the aggregate principal amount of commercial paper outstanding cannot exceed the $200 million provided under the liquidity facility supporting the outstanding notes. As of June 30, 2014, $48.5 million of commercial paper was outstanding.

Rutgers University is party to four synthetic fixed rate interest rate swaps which total $173.3 million notional with three counterparties. Regular swap payments 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. 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.

OUTLOOK

The negative outlook reflects the substantial work remaining to fully integrate the legacy University of Medicine and Dentistry of New Jersey units into Rutgers, the costs associated with that integration, and potential pressure on government appropriations due to the state's fiscal imbalance.

WHAT COULD MAKE THE RATING MOVE UP

A return to a positive operating margin while continuing to conquer the integration issues and building a stronger financial cushion for operations and debt could lead to a stable outlook.

WHAT COULD MAKE THE RATING MOVE DOWN

The rating could be lowered if Rutgers cannot return to positive operations and stronger cash flow, debt increases substantially, or the state reduces support or mandates that the university pay for expenses historically borne by the state. A material erosion of liquidity or downgrade of the state's rating could also lead to a downgrade.

KEY INDICATORS (FY 2014 financial data, fall 2014 enrollment data)

Total FTE Enrollment: 57,531

Total Financial Resources: $1.68 billion

Total Cash and Investments: $1.96 billion

Total Direct Debt: $2.1 billion

Total Operating Revenue: $3.3 billion

Largest Contributor to Revenue (Tuition and Auxiliaries): 34%

Reliance on State of NJ Funding: 23%

Monthly Days Cash on Hand: 146 days

Operating Cash Flow Margin: 6.2%

Debt Service Coverage: 1.42 times

State of New Jersey GO rating: A1 negative

METHODOLOGY

The principal methodology used in this rating was U.S. Not-for-Profit Private and Public Higher Education published in August 2011. The additional methodology used in the short term rating was Variable Rate Instruments Supported by Conditional Liquidity Facilities published in May 2013. Please see the Credit Policy page on www.moodys.com for a copy of these methodologies.

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