MOODY'S
INVESTORS SERVICE

Rating Update: Moody's upgrades Liberty University's (VA) bonds to Aa3; outlook stable

Global Credit Research - 09 Sep 2013

$99M of rated debt affected

LIBERTY UNIVERSITY, VA
Private Colleges & Universities
VA

Opinion

NEW YORK, September 09, 2013 --Moody's Investors Service has upgraded to Aa3 from A1 the rating on Liberty University's Series 2012 taxable bonds with $99 million outstanding. The upgrade reflects Liberty's remarkable momentum in revenue growth and cash flow from operations. This momentum, if continued, will produce sufficient cash to fund transformative capital investments as well as to build reserves over time. The growth in revenue and cash and investments makes Liberty a true outlier in Moody's portfolio of not-for-profit universities. Between FY 2008 and FY 2012, operating revenue grew 630%, while total cash and investments increased 148%--more than twice the growth of any other rated university on either measure. The rating outlook is stable.

SUMMARY RATING RATIONALE

The upgrade and Aa3 rating reflects the increasing scope of the University's activity (up 14% to $728 million based on draft information for fiscal 2013), its large pool of financial reserves ($728 million of total financial resources in FY 2012), uncommonly strong operating performance, and discipline around building and maintaining reserves. Cash and investments increased $295 million in fiscal 2013, surpassing the $1 billion mark based on draft reports.

The university's strongly religious character is both a strength and a challenge as it has successfully attracted a growing portion of those students seeking this type of experience but will limit appeal to a broader audience. Additional credit challenges include limited revenue diversity with 89% reliance on student charges based on draft fiscal 2013 data, modest fundraising, and limited pricing power with net tuition per student of $10,346 and brand identity built partially around affordability.

STRENGTHS

*Liberty benefits from a large and growing student market supported by an extensive array of online programs with full-time equivalent (FTE) enrollment of over 50,000 making it one of the largest private universities in the US. Brand strength is built on the university's Christian identity, lower cost, and residential campus experience including intercollegiate athletics.

*Liberty exhibits uncommonly strong operating performance with a three-year average operating margin of 36% through fiscal 2012. The University retains flexibility in its expense base by utilizing full-time and adjunct faculty for online courses for scalability and only offering tenured positions to Law School faculty.

*The university has an ongoing trend of dramatic balance sheet growth from retained surpluses that continued in FY 2013 with a 41% increase in cash and investments. Preliminary results show total cash and investments over $1 billion as of June 30, 2013. Financial reserves are predominantly liquid and free from restrictions with $461 million of funds unrestricted and able to be liquidated within a month at FYE 2012.

*Prospects for sustained strength in online enrollment growth are good given institutional prowess, academic cost structure, and economies of scale.

CHALLENGES

*The university has limited revenue diversity, with student charges comprising 91% of FY 2012 revenues. The University's explosive enrollment growth, diversity of academic programs, and relatively low cost help mitigate the risks of concentrated revenues.

*The university has ongoing capital investment needs for residential program with $329 million of pending projects through 2017 dependant on meeting growth targets. Future investments are likely to be funded from operating cash flow.

*With distinct political interests and religious activities of the campus community, Liberty University has faced challenges in the past to its tax-exempt status.

*Given the limited number of and relatively young age of alumni base, fundraising has remained modest averaging $12 million per year or $220 per student in fiscal 2012.

*Governance and management structure and practices are evolving but decision-making remains relatively concentrated with the Chancellor/President and Liberty has less institutionalization of best practices than more established universities. Governance practices require the board to ascribe to a Liberty University Doctrinal Position, which strengthens the institutional culture but limits diversity of opinion.

RECENT DEVELOPMENTS/RESULTS

Based on preliminary, unaudited results for fiscal year 2013 Liberty achieved another remarkable year of revenue growth (up 13.7% to $728 million) as it continues to attract new online students and slowly build core residential programs. Management guidance for fall 2013 shows ongoing momentum in most market segments.

Despite its low net tuition per student ($10,346 in fiscal 2012), Liberty's low and scalable cost structure has allowed it to respond to market demand and produce very strong operating cash flow margins. Based on draft fiscal 2013 information, the cash flow margin of 35.3% was in line with prior years.

With cash flow from operations averaging $243 million per year in fiscal years 2011 through 2013 combined with limited debt service, the university has been able to both fund an aggressive capital program and build working reserves. The capital spending ratio has been over 5.0 times since fiscal 2008, as compared to a median of 1.4 times for the sector. Cash flow has also supported growth of total cash and investments, crossing the $1 billion mark in fiscal 2013, more than doubling from $475 million as of June 30, 2011.

PROGRAM EXPANSION: Liberty is planning to increase its role in providing health education. With over $20 million of capital support from the Tobacco Indemnification Commission, the university is starting a College of Osteopathic Medicine with an inaugural class in the fall of 2014. The program has received provisional accreditation from the American Osteopathic Association Commission on Osteopathic College Accreditation as well as its regional accrediting agency, the Southern Association of College and Schools. Management's projections show the new program will be self-sustaining after the third year of operation.

INVESTMENT MANAGEMENT: Given the growth of Liberty's cash and investments, the university has increasing focused on managing its reserves. Since 2012 the board has developed and approved an Investment Policy Statement and has established guidance on maintaining a defensive level of reserves to guard against potential revenue declines.

The university has outsourced its chief investment officer function to Permanens Capital, a portfolio management firm in New York that has developed a custom asset allocation for Liberty in keeping with the new policy. The university's investment committee has seven members, four of whom are university employees including the President and Executive Vice President and one is the Chief Investment Officer at Permanens Capital the portfolio, again pointing to somewhat concentrated decision making power. The overall posture of the allocation as of June 30, 2013 was more defensive than most private universities, with just 13% of equity assets, 76% fixed income and similar assets and 11% real assets/natural resources which may limit growth in reserves from investment returns.

OUTLOOK

The stable outlook reflects expectations of continued student market strength, extraordinary cash flow supporting growth of flexible reserves as well as the bulk of funding for capital investments. The outlook also reflects expectations of slow improvement in revenue diversity and absence of plans for additional debt.

WHAT COULD MAKE THE RATING GO UP

An upgrade could be supported by the continuation of recent trends including continued student market strength and resource growth, combined with limited additional debt. While the young university has made significant improvements in its governance and management over the last several years, a future rating upgrade would be dependent on continued evolution and institutionalization of best practices. Recent improvements include long-range operating and capital planning, defining the proper amount of flexible reserves to maintain and implementation of an Investment Policy Statement.

WHAT COULD MAKE THE RATING GO DOWN

Downward pressure could follow a decline in balance sheet strength, marked increased in operating leverage, material deterioration in operating performance, leadership disruption, dislocation of residential or online student market segments, or loss in tax-exempt status.

KEY INDICATORS (FY 2012 financial data, fall 2012 enrollment data)

Full-Time Equivalent Enrollment: 56,325 students

Primary Selectivity: 24.6%

Primary Matriculation: 47.9%

Net Tuition per Student: $10,346

Educational Expenses per Student: $7,338

Average Gifts per Student: $220

Total Cash and Investments: $728 million

Total Direct Debt: $228 million

Comprehensive Debt*: $234 million

Expendable Financial Resources to Direct Debt: 2.45 times

Expendable Financial Resources to Operations: 1.34 times

Monthly Days Cash on Hand: 449 days

Monthly Liquidity to Demand Debt: 16,795%

Operating Revenue: $640 million

Operating Cash Flow Margin: 38.2%

Three-Year Average Debt Service Coverage: 27.8 times

Reliance on Tuition and Auxiliaries Revenue (% of Moody's Adjusted Operating Revenue): 90.6%

* Comprehensive Debt includes direct debt, operating leases, and pension obligation, if applicable.

RATED DEBT:

Taxable Bonds, Series 2012: Aa3

PRINCIPAL RATING METHODOLOGY

The principal methodology used in this rating was U.S. Not-for-Profit Private and Public Higher Education published in August 2011. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

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