FITCH AFFIRMS ROOSEVELT UNIVERSITY (IL) REVS AT 'BB'; OUTLOOK NEGATIVE

Fitch Ratings-Chicago-15 February 2018: Fitch Ratings has affirmed the 'BB' rating on approximately $219 million Illinois Finance Authority revenue bonds, series 2007 and 2009, issued on behalf of Roosevelt University (RU).

The Rating Outlook was revised to Negative from Stable.

SECURITY

The bonds are a general obligation of Roosevelt. Additional security provisions include a cash-funded debt service reserve fund, funded at maximum annual debt service (MADS), and a first-lien mortgage on the financed facilities.

KEY RATING DRIVERS

DEFICITS DRIVE NEGATIVE OUTLOOK: Seven consecutive years of negative operating margins, with a significant deficit in fiscal 2017 and another projected for fiscal 2018, drive the Negative Outlook. At this time, the 'BB' rating is supported by adequate but limited liquidity, as management implements financial and strategic changes.

ENROLLMENT PRESSURES OPERATIONS: Roosevelt is highly reliant on student-generated revenue (86% in fiscal 2017). While new student numbers are up slightly in fall 2017, overall full-time equivalent (FTE) enrollment declined 5.1% in fall 2017 and 11% in fall 2016. Unexpectedly smaller classes in prior years are pressuring overall enrollment. Net tuition revenue declined in both fiscal 2016 and 2017; management projects fiscal 2018 net tuition to be stable or up slightly from fiscal 2017.

HIGH DEBT LEVERAGE: RU has very high leverage due to debt related to the Wabash vertical campus which opened in 2012. MADS, which occurs in fiscal 2021, results in a very high 18% debt burden based on fiscal 2017 operating revenues. Balance sheet ratios remain adequate for the rating category.

WEAK DEBT SERVICE COVERAGE: Roosevelt generated less than 1.0x current and MADS coverage in fiscal 2017, and similar coverage is projected for fiscal 2018. This does not violate debt covenants. MADS coverage was at least sufficient between fiscals 2013 through 2016, due to significant depreciation expense for the Wabash building, even with negative GAAP margins. A debt service step-up adds risk, as MADS increases to $19 million in fiscal 2021, up from $16 million. Fitch views the university as having no new debt capacity.

RATING SENSITIVEITIES

OPERATING DEFICITS: Failure of Roosevelt University to improve operating performance in fiscal 2018, steadily grow net tuition revenue, and demonstrate progress in meeting institutional financial goals will result in a negative rating action.

MAINTAIN BALANCE SHEET: Failure of RU to maintain adequate balance sheet strength as it implements its financial plan would pressure the rating.

CREDIT PROFILE
Founded in 1945, Roosevelt's main campus is located in the Chicago "loop" business district, and includes the historic auditorium building and the 32-floor Wabash "vertical campus" building. The university also owns and operates a 27-acre suburban campus in Schaumburg, IL, a northwest Chicago suburb. In 2017, Roosevelt received a $25 million bequest dedicated strictly for scholarships; income from that gift is expected to benefit fall 2018 students.

Roosevelt students are primarily from the Chicago metro area, and are a mix of traditional undergraduates and graduate students. Many students commute to the Chicago or Schaumburg campuses. Admissions in the Chicago metro area are very competitive. In fall 2017, Roosevelt enrolled 3,612 FTE students, a 5.1% decrease from fall 2016. Overall, FTE declined 23% between fall 2017 and fall 2012. Management reports that fall 2016 was particularly difficult due to uncertainty about state of Illinois MAP grants for low-income students. In fall 2017, about 63% of FTE enrollment were undergraduate students, and 37% graduate level.

Management reports that RU is adjusting its enrollment management strategy to focus more on its historical student base: adult, graduate, and transfer populations. The university wants to maintain approximately 400 first-time freshmen matriculants annually (there were 337 in fall 2016 and 360 in fall 2017).

CONTINUING OPERATING DEFICITS

Roosevelt has generated negative GAAP operating margins since at least fiscal 2011, including fiscal 2017. Another sizable GAAP deficit is expected in fiscal 2018. Until fiscal 2017, however, the university's GAAP deficits were partially driven by depreciation expense (about $10 million annually) largely from the Wabash vertical campus, and both current and MADS debt service coverage was positive. That changed in fiscal 2017, with a $16.4 million GAAP deficit (-15.8%), which compared to negative $5.3 million in 2016 (-4.5%), negative $4.7 million in fiscal 2015 (-3.9%), and negative $3.4 million (-2.8%) in fiscal 2014.

Management attributes the 2017 operating results to fall 2016 undergraduate enrollment being well below budget expectations in part due to uncertainty over state of Illinois MAP grants for low-income students. With passage of a state budget for fiscal 2018, MAP grants were not as much of a concern in fall 2017. The university made expense reductions in fiscal 2017, continuing into fiscal 2018, including retirement incentives, staff reductions, and overall cost containment efforts. The university is also reviewing RU's extensive real estate portfolio both in the Chicago loop and in Schaumburg. In fiscal 2017, RU received $20 million cash for its share of the sale of the privatized University Center of Chicago (UCC) housing project.

The university's endowment draw policy was affirmed in 2017 at 5% of a three-year market average; due to operating deficits, Fitch views the actual draw effect as larger. In fiscal 2016, a one-time, Board-approved $3 million additional distribution resulted in an effective 8.7% draw. The 2016 distribution supported operations and scholarships while management began financial plans. Positively, RU benefited from a $30 million increase in restricted endowment in fiscal 2017, most of it being a $25 million bequest for scholarships.

Management expected negative fiscal 2017 results due to enrollment losses in fall 2016 and a second year of net tuition revenue declines. However, the deficit was larger than expected. The fiscal 2018 budget, which RU management reports is on track, shows more stable net tuition revenue, but another operating deficit as expense initiatives take effect over several years. Management projects a balanced budget by fiscal 2020, through a mix of debt service reduction, gradual enrollment growth, new program development, and continued cost containment.
Net tuition revenue declined in both fiscal 2017 (down 5.5%), and 2016 (down 9.3%), following several years of stable revenue. Net tuition revenue for fiscal 2018 is projected to have bottomed out and be stable. RU’s ability to achieve steady progress on its multi-pronged financial plan - a mix of enrollment growth, net student revenue growth, debt service reduction from property sales, and resizing institutional operating expenses - is essential to maintain the current rating.

Operations rely heavily on student-generated revenues, about 86% in fiscal 2017. Tuition increased approximately 3% in fiscal 2018, following 3.6% in fiscal 2017 and 1.5% in fiscal 2016. Management expects tuition will increase about 3% annually, with increases varying by program.

HIGH DEBT LEVERAGE

Available funds (AF), defined by Fitch as cash and investments not permanently restricted, totaled $110 million at Aug. 31, 2017, up slightly from $96.7 million at FYE 2016. This included $20 million from RU’s share of the UCC sale, but excluded $25 million of new restricted endowment. AF equaled 92% of operating expenses (about $120 million) and a narrower 43.5% of outstanding debt (about $253 million). Outstanding debt includes a new $29 million, non-cancelable 10-year operating lease with the owners of the former UCC.

Balance sheet metrics remain adequate for the rating category, and provide Roosevelt some financial cushion as it implements financial and strategic plans. However, continuing operating deficits, failure to achieve current debt service coverage in fiscal 2017, and high debt leverage remain significant ongoing credit concerns.

Annual debt service increases in 2021 from $16 million to about $19 million, which is essentially MADS. The university’s fiscal 2017 MADS burden is very high at 18%. Roosevelt did not achieve MADS coverage in fiscal 2017 (it was 0.4x), but did meet or exceed 1.0x MADS in the prior four fiscal years. Management is focused on debt reduction options to reduce the MADS jump-up and reduce overall debt service. Those actions are still pending. The university has no new debt plans, and Fitch considers the university as having no new debt capacity.

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Applicable Criteria
Rating Criteria for Public Sector Revenue-Supported Debt (pub. 05 Jun 2017)
https://www.fitchratings.com/site/re/898969
U.S. Public Finance College and University Rating Criteria (pub. 26 Apr 2017)
https://www.fitchratings.com/site/re/897285

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