MOODY'S INVESTORS SERVICE

CREDIT OPINION
18 April 2016

New Issue

Rate this Research

Analyst Contacts

Mary Kay Cooney 212-553-7815
AVP-Analyst
marykay.cooney@moodys.com

Karen Kedem 212-553-3614
VP-Sr Credit Officer/ Manager
karen.kedem@moodys.com

Joshua M Levine 212-553-4826
Associate Analyst
joshua.levine@moodys.com

Northern Kentucky University

New Issue - Moody's Assigns A1 Underlying and Aa3 Enhanced to Northern Kentucky Univ's $45M 2016 Ser A&B; Outlook Stable

Summary Rating Rationale

Moody's Investors Service has assigned an A1 underlying and Aa3 enhanced rating to Northern Kentucky University's (NKU) proposed $44.6 million of fixed rate General Receipt Refunding Bonds, 2016 Series A (maturing 2027) and 2016 Series B (maturing 2028). At the same time, Moody's affirmed the A1 underlying and Aa3 enhanced ratings on $119 million of general receipt bonds outstanding. The outlook on the underlying and enhanced ratings is stable.

The university's underlying A1 rating reflects its moderate scale and proximity to the greater Cincinnati metropolitan area, lending itself to internship and employment opportunities for its primarily commuter student population. Solid liquidity, manageable leverage, and consistently positive operations also support the A1. Challenges facing NKU include softening growth in net tuition revenue and funding or cost pressure that could result from the Commonwealth of Kentucky's (Aa2 stable) budgetary and pension challenges.

The Aa3 enhanced rating is derived from the structure and mechanics of the Kentucky Public University Intercept Program, which is based on the commonwealth's current rating and outlook, combined with the sufficiency of interceptable funds.

Credit Strengths

» Moderate scale and proximity to the greater Cincinnati metropolitan area provides internship and employment opportunities for its nearly 12,600 full-time equivalent (FTE) students

» Consistently sound positive operating cash flow margins (11% over fiscal 2013-15 period) providing over 2 times debt service coverage

» Good liquidity, with 192 monthly days cash on hand

» Manageable leverage (debt to cash flow of 5.2 times), with no new debt plans

» Bondholders of the general receipt bonds benefit from Kentucky's public university intercept enhancement program

Credit Challenges

» Slowed net tuition revenue growth due to weak regional demographics and stiff competition for students (student charges are 60% of operating revenues)

» Funding or cost pressure likely to result as Kentucky grapples with economic and pension funding challenges

Rating Outlook

The stable outlook reflects our expectation that operating cash flow will remain in the 10%-12% range, providing good coverage of debt service obligations, and liquidity will remain sound.

The stable outlook for the enhanced rating is based on the commonwealth's outlook.

Factors that Could Lead to an Upgrade

» Underlying rating: Strengthened growth in net tuition revenue leading to sustained improvements in cash flow and financial reserves

» Enhanced rating: Upgrade in the Commonwealth of Kentucky's rating

Factors that Could Lead to a Downgrade

» Underlying rating: Erosion of liquidity or substantial increase in leverage

» Enhanced rating: Deterioration in credit quality of the Commonwealth of Kentucky or insufficient debt service coverage by interceptable funds

Key Indicators

Exhibit 1

NORTHERN KENTUCKY UNIVERSITY, KY

	2011	2012	2013	2014	2015
Total FTE Enrollment	13,633	13,545	13,283	12,861	12,592
Operating Revenue ($000)	203,890	207,292	210,765	212,033	213,994
Annual Change in Operating Revenue (%)	5.1	1.7	1.7	0.6	0.9
Total Cash & Investments ($000)	173,034	209,614	214,950	229,515	229,286
Total Debt ($000)	98,457	103,825	94,860	137,130	128,218
Spendable Cash & Investments to Total Debt (x)	1.3	1.6	1.8	1.3	1.4
Spendable Cash & Investments to Operating Expenses (x)	0.7	0.8	0.8	0.9	0.8
Monthly Days Cash on Hand (x)	132	177	180	191	192
Operating Cash Flow Margin (%)	16.6	13.4	11.4	11.8	11.5
Total Debt to Cash Flow (x)	2.9	3.7	4.0	5.5	5.2

Source: Moody's Investors Service

Recent Developments

On March 31, 2016, Kentucky's governor imposed a 4.5% cut on the fiscal year (FY) 2016 state appropriations on seven of the commonwealth's eight public universities. For NKU, the cut totaled $2.2 million of its $48.5 million total FY 2016 operating appropriations. The Kentucky Attorney General filed a lawsuit alleging the governor's cut was not aligned with current legislation requiring a declared budgetary shortfall. As of April 18, 2016, the cut had been implemented but no decision had been made on its legality.

On April 15, 2016, the Executive Branch Biennial Budget (HB 303) was passed by the Kentucky General Assembly and delivered to the Governor. The bill, in its current form, will result in ongoing annual cuts of 4.5% to the seven of eight universities for fiscal years 2017 and 2018. However, NKU's share will be offset by a recurring $5.3 million funding equity adjustment, commencing in FY 2018, which will begin aligning the university's per student funding with regional peers within the state.

Detailed Rating Considerations

Market Profile: Focus on Employment-Oriented Curriculum To Mitigate Enrollment Challenges

Northern Kentucky University's primarily commuter enrollment will remain sensitive to changing economic conditions, with declines expected to continue in a favorable employment market. This moderate sized regional public university operates in an increasingly competitive market for a declining population of high school graduates in the region. NKU's enrollment declined in each of the last five years, falling nearly 8% from its peak during the recession. Leveraging its proximity to the greater Cincinnati metropolitan area, NKU partners with local corporations to develop an employment-oriented curriculum, yielding a roughly steady incoming class of 2,200 students.

The university's mission for strategic investment in employment-oriented curriculum, with affordable pricing, is favorable for strengthening its student demand profile. NKU's College of Informatics, opened in 2011, has been a fast growing academic segment. The College of Health Professions will be housed in the state-funded Health Innovations Center, furthering NKU's mission. Tuition pricing remains an important attribute to NKU's price sensitive students. The FY 2015 net tuition per student of $8,800 was among the lowest of the Kentucky public universities, which does provide NKU with some pricing flexibility. Biennium FYs 2017-18 tuition increases have not yet been determined, but are expected to remain modest.

Operating Performance: Sound but Moderating Operating Performance

NKU's operating performance remains sound despite some moderation as revenue stagnates. In FY 2015, annual operating cash flow was sound at 11%, but down from a recent peak of 17% in FY 2011. Continued expected pressure on net tuition revenue and state funding highlight the importance of continued strong budgetary controls and expense flexibility. Top line net tuition revenue grew 12% from FY 2011-13, but since then declined 2.4% due to limited tuition increases and rising student aid. Student charges comprised 60% of Moody's adjusted revenues over the FY 2011-15 period. For FY 2016, management expects a slight decline in operating performance, due primarily to the recent 4.5% state appropriation reduction.

The university will continue to weather state appropriation cuts through careful oversight and expense control. Kentucky has made cuts to its biennial appropriations since 2009, including the very recent 4.5% cut of FY 2016 appropriations instituted this past March. NKU's state operating appropriations (inclusive of the FY 2016 cut) are down 14.6% since FY 2011, to $46.4 million in FY 2016. State aid comprises a very meaningful 23% of operating revenues. Though, the current state budget for NKU's appropriations for the FYs 2017-18 biennium include the 4.5% cut going forward, the university will be receiving a recurring $5.3 million in equity funds beginning in FY 2018 to begin realigning NKU's appropriation per student and the other Kentucky comprehensive institutions.

Wealth and Liquidity: Solid Cash and Investments, Strong Liquidity, Mitigate Softer Revenue Growth

NKU's spendable cash and investments covered nearly ten months of expenses, or 0.8 times, in FY 2015. The size and pace of growth of NKU's financial reserves are slightly stronger than similar A1-rated peers, which is favorable given the recent slowing in revenue growth. The university's limited fundraising history has primarily gone to support capital investment, reducing the potential to bolster reserves.

The Northern Kentucky University foundation manages the university's long-term endowment, with assistance from an external advisory firm. For June 30, 2015, the endowment of $94.9 million recorded a low fiscal year return of 0.9%. As of December 31, 2015, the endowment was $88.2 million.

LIQUIDITY

NKU's sound liquidity is an important mitigant to state funding uncertainties. The university's monthly liquidity totaled $101 million at year end FY 2015, which translates to a strong 192 monthly days cash on hand and exceeding the A1-median of 139 days. NKU has limited additional calls on liquidity and all bonds are issued as fixed rate and amortizing.

Leverage: Manageable Leverage; Exploring Partnerships for Capital Investment

NKU's leverage is very manageable at the current time. FY 2015 debt of $128 million to operating revenues of 0.6 times is slightly stronger than the A1 median of 0.7 times. Spendable cash and investments to debt of 1.4 times exceeded the A1-median of 0.9 times.

State funding for capital, though not frequent, has served as an important component to meeting new academic priorities. The state is directly funding $97 million toward the cost of NKU's new Health Innovations Center that will house the College of Health Professions. An $8 million gift from St. Elizabeth Healthcare (Kentucky, not rated) will fund a state-of-the-art healthcare simulation center. The new building is expected to open in summer 2018.

NKU capital structure will become more complicated as it explores a public-private partnership (P3) for development of a student housing/mixed use development on campus land. A request for proposal has been released, with a deadline of June 3, 2016. The university anticipates having FY 2016-18 biennium authorization for up to $125 million in a development venture that will initially include a 500-bed residence hall. External partnerships for housing will assist NKU in reaching its goal of 3,000 total beds (current capacity is 2,004 beds) within 10 years.

DEBT STRUCTURE

All of the university's bond debt is fixed and amortizing over a 20-year period, providing predictability for budgetary planning.

DEBT-RELATED DERIVATIVES

None.

PENSIONS AND OPEB

Northern Kentucky University has a large and growing exposure to a state multiple-employer cost sharing defined benefit (DB) plan. Significant underfunding of the commonwealth's pension fund presents the potential for escalating costs for NKU and other state agencies. The state does not make any on-behalf payments. The university participates in the Kentucky Employees' Retirement System DB plan (KERS) and one defined contribution (DC) plan. The Moody's adjusted net pension liability (ANPL) for the university is $324 million, and, combined with outstanding debt, represents 2.1 times operating revenue for fiscal year 2015, which was weaker than the preliminary Moody's public university median of 1.3 times.

The university does not have a direct OPEB liability.

Governance and Management: Milestones in Implementation of Strategic Plan

NKU's leadership is making strides on its 2013-18 Strategic Plan, evidenced in the growth in two of its newer colleges (Informatics and Health Professions). The demonstrated ability to maintain healthy liquidity, manageable leverage, and consistently favorable operating performance in the midst of stagnant state aid and softer enrollment reflects NKU's conservative budgeting priorities. NKU is entering a new stage of capital development as it evaluates third party housing and mixed use development opportunities.

Smooth transitions in senior leadership positions will be essential for NKU's financial stability A new Senior Vice President for Administration and Finance was appointed in July 2015 and a new position for chief financial officer was established and filled in August 2015.

Legal Security

The General Receipts Bonds are secured by a pledge of substantially all unrestricted revenue, including student tuition and fees, state appropriations, local and private grants and contracts, sales and services of educational activities, and investment income.

The general receipts pledge is subordinate to the university's Housing System Revenue Bonds (the housing bonds) outstanding in the amount of $1.1 million as of June 30, 2015.

Aggregate pledged revenues totaled $183 million in FY 2015, with the net pledged revenues (subordinate to the housing bonds) at $181 million, providing pro forma maximum annual debt service ($12.5 million) coverage of 14.5 times.

The university's general receipts bonds benefit from the presence of a state intercept program. If the university fails to make debt service payments 10 days in advance of the debt service payment date, the Secretary of the Finance and Administration Cabinet of the Commonwealth is obligated to use any funds that have been appropriated to the university but not yet expended to make debt service payments.

Given that NKU's General Receipts debt service payments are due in September and March, we are reasonably assured that sufficient non-distributed, legislatively adopted state appropriations will be available for intercept. Debt service coverage is calculated by dividing interceptable state aid available to pay the remaining periodic debt service payments. For NKU, this calculation results in a pro forma peak debt service coverage of 3.00 times (accounting for the 4.5% FY 2016 appropriation cut) which is strong sufficiency.

Use of Proceeds

Proceeds of the planned Series 2016A and 2016B bonds will be used to refund all or portions of the Series 2007A and 2008A bonds, and to pay costs of issuance.

Obligor Profile

Northern Kentucky University is a four-year public university with six colleges serving undergraduate and graduate programs, located within the greater Cincinnati metropolitan area. In FY 2015, NKU recorded operating revenues of $214 million and for fall 2015 served an FTE enrollment of 12,592 students.

Methodology

The principal methodology used in the underlying rating was Global Higher Education published in November 2015. The principal methodology used in the enhanced rating was State Aid Intercept Programs and Financings: Pre and Post Default published in July 2013. Please see the Ratings Methodologies page on www.moodys.com for a copy of these methodologies.

Ratings

Exhibit 2

Northern Kentucky University, KY

Issue	Rating
General Receipts Refunding Bonds, 2016 Series A	A1
Rating Type	Underlying LT
Sale Amount	$27,840,000
Expected Sale Date	04/26/2016
Rating Description	Revenue: Public University Broad Pledge
General Receipts Refunding Bonds, 2016 Series A	Aa3
Rating Type	Enhanced LT
Sale Amount	$27,840,000
Expected Sale Date	04/26/2016
Rating Description	Revenue: Public University Broad Pledge
General Receipts Refunding Bonds, 2016 Series B	A1
Rating Type	Underlying LT
Sale Amount	$16,740,000
Expected Sale Date	04/26/2016
Rating Description	Revenue: Public University Broad Pledge
General Receipts Refunding Bonds, 2016 Series B	Aa3
Rating Type	Enhanced LT
Sale Amount	$16,740,000
Expected Sale Date	04/26/2016
Rating Description	Revenue: Public University Broad Pledge

Source: Moody's Investors Service

REPORT NUMBER 1023544

Contacts

Mary Kay Cooney 212-553-7815
AVP-Analyst
marykay.cooney@moodys.com

Joshua M Levine 212-553-4826
Associate Analyst
joshua.levine@moodys.com

Karen Kedem 212-553-3614
VP-Sr Credit Officer/ Manager
karen.kedem@moodys.com

CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454

Moody's INVESTORS SERVICE