CREDIT OPINION
13 July 2018

Worcester State University, MA
Update to credit analysis

Summary
Worcester State University (WSU, A2 stable) will continue to benefit from very good strategic positioning and fiscal discipline demonstrated by consistently positive operations and favorable liquidity. Strong support and oversight from both the Aa1-rated Commonwealth of Massachusetts and Aa2-rated Massachusetts State College Building Authority further support the rating. WSU has capitalized on its presence in the City of Worcester (Aa3 stable) and the growing economy of the central Massachusetts region, which have been integral to stable enrollment in a highly competitive student market. Offsetting challenges include weaker spendable cash and investments to debt and a higher debt burden relative to peers. Reserves recently used for strategic capital investment are expected to be replenished over ten years, though sufficient liquidity remains for near-term financial flexibility. Softening in net tuition revenue growth reflects demand pressures from a narrow regional service area and associated limited pricing power. Inconsistent state funding for state-negotiated labor contracts will require careful management of fees and expenses to maintain strong operations.

Exhibit 1
Consistent double-digit cash flow margins are essential to support high debt burden
Credit strengths
» Strong support from Aa1-rated Massachusetts, with rising state appropriations and intermittent capital funding
» Additional capital program oversight from the Aa2-rated MSCBA for 91% of WSU’s debt
» Disciplined fiscal controls, evidenced by consistent cash flow margins of 13-15% over fiscal 2013-17 period and adequate 1.6x debt service coverage
» Fixed rate debt structure, limited pension exposure, and no new debt plans

Credit challenges
» High debt burden relative to spendable cash and investments, 0.3x in fiscal 2017, and debt service, 8.7% of fiscal 2017 operating expenses
» Softening growth in net tuition revenue reflects competitive pressures of regional service area and limited pricing power
» Limited expense flexibility due to state negotiation of labor contracts

Rating outlook
The stable outlook reflects our expectation that WSU will maintain consistent 12-15% cash flow margins through conscientious budgeting, stable enrollment and continued commonwealth support.

Factors that could lead to an upgrade
» Substantial increase in financial reserves relative to debt and operations
» Strengthened student market evidenced by sustained growth in net tuition per student

Factors that could lead to a downgrade
» Sustained reduction in operating cash flow leading to lower debt service coverage
» Sustained reduction in state financial support or weakening in the state’s credit quality
» Material weakening of liquidity
» Additional large increase in debt without a corresponding increase in revenue or financial resources

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.
Key indicators

Exhibit 2

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<tr>
<td>Total FTE Enrollment</td>
<td>4,891</td>
<td>4,872</td>
<td>4,873</td>
<td>4,863</td>
<td>4,954</td>
<td>10,184</td>
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<tr>
<td>Operating Revenue ($000)</td>
<td>79,045</td>
<td>84,862</td>
<td>90,552</td>
<td>94,367</td>
<td>96,915</td>
<td>212,722</td>
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<td>Annual Change in Operating Revenue (%)</td>
<td>4.9</td>
<td>7.4</td>
<td>6.7</td>
<td>4.2</td>
<td>2.7</td>
<td>1.9</td>
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<tr>
<td>Total Cash &amp; Investments ($000)</td>
<td>61,938</td>
<td>73,408</td>
<td>72,122</td>
<td>70,662</td>
<td>64,637</td>
<td>178,994</td>
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<tr>
<td>Total Debt ($000)</td>
<td>155,462</td>
<td>154,740</td>
<td>153,731</td>
<td>150,719</td>
<td>146,741</td>
<td>139,579</td>
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<tr>
<td>Spendable Cash &amp; Investments to Total Debt (x)</td>
<td>0.3</td>
<td>0.4</td>
<td>0.4</td>
<td>0.4</td>
<td>0.3</td>
<td>0.8</td>
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<tr>
<td>Spendable Cash &amp; Investments to Operating Expenses (x)</td>
<td>0.7</td>
<td>0.8</td>
<td>0.7</td>
<td>0.6</td>
<td>0.5</td>
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<tr>
<td>Monthly Days Cash on Hand (x)</td>
<td>226</td>
<td>251</td>
<td>227</td>
<td>214</td>
<td>170</td>
<td>140</td>
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<tr>
<td>Operating Cash Flow Margin (%)</td>
<td>13.6</td>
<td>15.2</td>
<td>13.9</td>
<td>14.9</td>
<td>13.4</td>
<td>16.3</td>
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<tr>
<td>Total Debt to Cash Flow (x)</td>
<td>14.4</td>
<td>12.1</td>
<td>12.2</td>
<td>10.8</td>
<td>11.4</td>
<td>6.6</td>
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<tr>
<td>Annual Debt Service Coverage (x)</td>
<td>2.0</td>
<td>2.1</td>
<td>1.5</td>
<td>1.6</td>
<td>1.6</td>
<td>1.9</td>
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Source: Moody’s Investors Service

Profile

Worcester State University is a four-year regional public institution located in Worcester, Massachusetts, that provides arts and sciences programming inclusive of business, teacher education, allied health and biotech. As one of nine state institutions issuing debt through MSCBA, the majority of WSU’s debt and capital assets are included on MSCBA’s balance sheet rather than its own. For fiscal year 2017, WSU recorded $97 million in Moody’s adjusted operating revenue and in fall 2017 served 4,954 full-time equivalent (FTE) students.

Detailed credit considerations

Market profile: stable enrollment reflects strategic academic and capital investments

WSU’s will continue to successfully translate its strategic investments in capital and student services into stable enrollment, which is favorable given its regional service area draw and declining high school student demographics. The student body is primarily undergraduate (92%), with a significant portion of commuters. Management has carefully worked to broaden WSU’s recruitment base, expand online offerings, and improve retention. Fall 2017 first year matriculants of 909 were up from the 780 in fall 2013, and aspirations for fall 2018 are similar, though WSU is prudent budgeting for 800.

The university’s location in the economically growing City of Worcester and presence in central Massachusetts is favorable for collaborations that provide students with broad access to industry opportunities and programming. WSU is a member of the Higher Education Consortium of Central Massachusetts (HECCMA), which comprises 11 regionally accessible public and private accredited institutions. WSU has partnered with several of the HECCMA colleges to provide students with combined undergraduate and graduate degree programs.

Operating performance: very good budgeting practices though challenged by state labor contract negotiations

The university’s operations will remain sound in the 12-15% range, which is essential for the A2 rating given a high debt burden (9% of expenses), only adequate debt service coverage (1.6x) and the potential for labor-related expenses that are not fully reimbursed by the state. WSU’s disciplined fiscal practices incorporate budgeting for modest reserve increases. Cash flow margins averaged 13-15% over the fiscal 2013-17 period, above the A2-median of 11%. Preliminary ending fiscal year 2018 results are on budget and are expected to be similar to fiscal 2017.

Historically strong and consistent state operating appropriations, comprising 36% of revenue, in addition to solid capital support underpin the university’s alignment to the state’s credit quality. Capital support totaled $28 million over the last five years. Operating appropriations, of which nearly one-third are for fringe benefits, rose a substantial 33% from fiscal 2013-17, increased an additional 2% for fiscal 2018, and are expected to rise 2% for three years thereafter.
The university’s financial flexibility is constrained by agreements with collective bargaining units that are negotiated at the state level. The state fully funded negotiated increases in fiscal 2018, but did not in fiscal years 2016-17. There is uncertainty around funding for fiscal 2019, though WSU is budgeting for fee increases to address the gap. Over the long-term the university’s goal to maintain tuition affordability may be pressured should the state continue to limit fully funding state negotiated labor and fringe benefit increases.

Wealth and liquidity: good wealth and liquidity cushion expense pressures

Wealth and liquidity will continue to be good relative to peers. Retained surpluses and donor support brought total cash and investments to $71 million in fiscal 2016, up 14% over fiscal 2013, before applying a planned $9.5 million in reserves towards funding a new wellness center. Fiscal 2017 cash and investments totaled $65 million, and spendable cash and investments of $51 million covered expenses 0.5x, on par with the A2-median of 0.5x.

Going forward, surpluses will add to financial resource growth but at a more modest pace than in prior years due to more moderate cash flow margins arising from softer net tuition revenue growth.

The WSU Foundation has been an important partner for strategic fundraising and endowment management. Recent gift activity has supported building renovations and purchases as well as development of an endowment for scholarships. The foundation’s investment assets, which are largely allocated among mutual and multi-asset funds, totaled $23 million as of March 31, 2018. Gift support averaged over $2 million annually over the fiscal 2013-17 period.

Liquidity

WSU has good liquidity. Though the university expended roughly $9.5 million for its wellness center project in fiscal 2017, liquidity remains favorable. WSU had 170 monthly days cash on hand for fiscal 2017, relative to the A2-median of 160 days. The university is planning to rebuild its financial reserves to prior levels, gradually occurring over the next ten years. There are no future plans for material use of reserves.

The university is required to maintain specific reserve levels per its loan agreements with the MSCBA. These funds, totaling $4.8 million for fiscal 2017, are included in WSU’s available reserves.

Leverage: elevated debt profile but no additional debt plans; moderately high pension exposure

The university is highly leveraged due to its strategic capital investment in the campus over the last five years. For fiscal 2017, spendable cash and investments cushioned debt of $147 million by 0.3x, and debt to operating revenue was 1.5x, weaker than the A2-medians of 0.7x and 0.7x, respectively. Debt service is also high, accounting for 9% of operating expenses relative to the A2-median of 6%, which limits future financial flexibility in the absence of ongoing expense controls.

Favorably, 91% of WSU’s outstanding debt is issued through MSCBA and benefits from additional security features provided by the authority’s structure (see Massachusetts State College Building Authority credit opinion dated December 6, 2017).

Exhibit 3

MSCBA oversight for 91% of WSU’s debt is a mitigant to the university’s high debt burden

Outstanding debt as of June 30, 2018

Source: Moody’s Investors Service
Management reports no plans to issue additional debt within the next few years.

The WSU Foundation purchased a building adjacent to the campus (the May Street Property) in fiscal 2015 for $2.2 million. The university and foundation will be evaluating long term options for renovations and costs to incorporate the new space for academic and campus activities.

Debt structure
All of the university's debt is fixed rate and regularly amortizing.

Legal security
The Series 2012 bonds are secured by a broad pledge of general revenues, which include tuition and state appropriations.

Debt-related derivatives
There are no debt-related derivatives.

Pensions and OPEB
WSU has moderate exposure to additional debt-like obligations through its participation in the Massachusetts State Employees Retirement System (MSERS), which is a cost sharing multiple-employer retirement plan sponsored by the state. The Moody's three-year adjusted net pension liability (ANPL) for the university is $40 million. Combined with outstanding debt, this represents 1.9x operating revenues for fiscal year 2017, on par with the A2-rated public university median of 2x. Pension contributions for those in the MSERS plan are determined by the plan and made by the university (roughly one-quarter of the total) and the state (included in state appropriations). WSU's combined defined benefit contribution in fiscal 2017 of $4 million comprised 4% of expenses.

The university does not administer an OPEB plan, but instead participates in the plan provided by the commonwealth.

Governance and management: very good strategic positioning supported by a stable, but proactive leadership team
The university has a track record of strong financial and strategic management, demonstrated by consistent operating performance, prudent investments in its campus and academic programs, and very good strategic positioning. WSU's leadership has carefully capitalized on its favorable location in New England's second largest city, within the economically growing central Massachusetts region, stabilizing enrollment over the last five years.
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