Indiana University, IN

New Issue - Moody's Assigns Aaa to Indiana University's Lease Purchase Obligations Series 2017A; Outlook Stable

**Summary Rating Rationale**
Moody's Investors Service has assigned an Aaa to Indiana University's proposed $74 million of Lease Purchase Obligations, Series 2017A (maturing 2035). The rating outlook is stable. Moody's maintains Aaa ratings on $937 million of rated debt (Consolidated Revenue Bonds, Student Fee Bonds and outstanding Lease Purchase Obligations/Certificates of Participation).

Indiana University's (IU) Aaa rating reflects its strong student demand and research activities, superior balance sheet reserves and liquidity combined with funding from the Aaa-rated State of Indiana for operations and debt service related to the fee-replaced student fee bonds (reflected in Exhibit 1). The credit strength is tempered by prospects for constrained revenue growth and ongoing capital needs.

**Exhibit 1**
State Debt Service Funding For Fee-Replaced Debt Results in Low Leverage

*Source: Moody's Investors Service, Indiana University Financial Statements*
Credit Strengths

» Strong market position with global demand and excellent national research standing

» Funding from State of Indiana for debt service of $46.5 million in fiscal year (FY) 2016 or nearly 43% of that year’s actual debt service

» Modest leverage, with debt-to-revenues of just 0.3 times including the state-supported fee-replaced debt, and conservative fixed rate debt structure

» Healthy balance sheet resources and monthly unrestricted liquidity at $1.7 billion or 236 monthly days cash on hand

» Favorable management and governance, including active operating oversight, strategic focus on academic and research missions and balance sheet reserve growth

» Adequate cash flow with a 11% operating cash flow margin

Credit Challenges

» Constrained revenue growth prospects with moderate cash flow likely from modest net tuition growth and slowly growing state funding

» High competition for sponsored research funding

» Ongoing capital needs for the multi-campus university

Rating Outlook

The stable outlook reflects expectations of strong student demand and research activity, favorable operating cash flow, healthy liquidity and moderate additional debt. The outlook also incorporates the ongoing state fee-replacement appropriations supporting a significant proportion of IU’s debt.

Factors that Could Lead to an Upgrade

» Not applicable

Factors that Could Lead to a Downgrade

» Protracted reduction in cash flow generation

» Weakening of student market position

» Significant reduction in either the state’s reimbursement of debt service or share of total debt paid by the state, or decline in the state’s credit quality

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
Indiana University, IN

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<tbody>
<tr>
<td>Total FTE Enrollment</td>
<td>80,376</td>
<td>80,932</td>
<td>81,578</td>
<td>81,102</td>
<td>82,093</td>
<td>82,093</td>
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<tr>
<td>Operating Revenue ($)</td>
<td>2,711,354</td>
<td>2,794,909</td>
<td>2,888,904</td>
<td>2,923,819</td>
<td>2,968,866</td>
<td>2,968,866</td>
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<tr>
<td>Annual Change in Operating Revenue (%)</td>
<td>1.2</td>
<td>3.1</td>
<td>3.4</td>
<td>1.2</td>
<td>1.5</td>
<td>1.5</td>
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<tr>
<td>Total Cash &amp; Investments ($)</td>
<td>3,595,152</td>
<td>3,843,450</td>
<td>4,248,516</td>
<td>4,028,897</td>
<td>3,919,918</td>
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<tr>
<td>Total Debt ($)</td>
<td>962,332</td>
<td>943,387</td>
<td>893,573</td>
<td>979,966</td>
<td>940,095</td>
<td>1,009,766</td>
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<td>Spendable Cash &amp; Investments to Total Debt (%)</td>
<td>2.8</td>
<td>3.0</td>
<td>3.3</td>
<td>2.8</td>
<td>2.9</td>
<td>2.7</td>
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<td>Spendable Cash &amp; Investments to Operating Expenses (%)</td>
<td>1.1</td>
<td>1.1</td>
<td>1.1</td>
<td>1.0</td>
<td>1.0</td>
<td>1.0</td>
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<tr>
<td>Monthly Days Cash on Hand ($)</td>
<td>251</td>
<td>249</td>
<td>240</td>
<td>240</td>
<td>236</td>
<td>236</td>
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<tr>
<td>Operating Cash Flow Margin (%)</td>
<td>13.7</td>
<td>13.5</td>
<td>11.6</td>
<td>11.5</td>
<td>11.0</td>
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<tr>
<td>Total Debt to Cash Flow (%)</td>
<td>2.6</td>
<td>2.5</td>
<td>2.7</td>
<td>2.9</td>
<td>2.9</td>
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<tr>
<td>Annual Debt Service Coverage (%)</td>
<td>4.7</td>
<td>4.6</td>
<td>3.6</td>
<td>3.5</td>
<td>3.2</td>
<td>3.2</td>
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2016 Sensitivity Total Debt includes the Series 2017A Lease Purchase Obligations and principal repayment since June 30, 2016
Total FTE Enrollment is fall enrollment for the indicated year
Source: Moody’s Investors Service

Detailed Rating Considerations

Market Profile: Favorable Student Demand as One of Two State Flagships, with Stable Enrollment and Growing Research Position

Indiana University will continue to benefit from favorable student demand and growing student-generated revenues. The pace of revenue growth will slow as IU manages student costs with no tuition fee increases for Bloomington resident undergraduates in FY 2016 and 2017. However, the substantial share of non-resident students (30% of total enrollment and 49% at the Bloomington main campus) provides it the ability to grow student charges as seen in the 2.1% increase for FY 2016.

As a key strategic emphasis for the board and president, IU’s academic reputation will be bolstered by its prominent research profile. It reported $614 million in awards in FY 2016, up 13% from FY 2015 and a notable 36% since FY 2013. The research growth is driven in part by the university’s Grand Challenges program, a part of IU’s Bicentennial Strategic Plan, that will invest up to $300 million in programs addressing large scale problems facing society. Under the investment IU has made 39 new hires with additional faculty and graduate students that should lead to further grant growth. Funding sources are diverse, with nearly half of the awards from non-federal sources. IU and other Indiana institutions enjoy funding from Lilly foundations, which provided about $273 million over the ten-year period ending June 30, 2016.

IU has a medical school in Indianapolis but neither owns nor operates a hospital, affiliating with Indiana University Health (IU Health, Aa3 positive) for clinical training sites. IU Health also controls IU Health Physicians, an organization for IU Health’s employed and affiliated physicians with Indiana University faculty practice plan. IU Health announced it would consolidate two downtown Indianapolis hospitals and will build a replacement facility that will also house a medical education building for faculty of IU School of Medicine. IU Health will also construct a new hospital on IU’s Bloomington campus, with IU constructing a research facility at the site. The IU Board of Trustees has given project approval for research facilities at the new hospital costing $45 million. Timing, final determination of funding sources, and financing structure is still under consideration.
Operating Performance: Positive Operating Results and Moderate Cash Flow
With its active fiscal oversight, IU will continue to generate positive operating performance supported by diverse revenue streams. In FY 2016, IU generated an 11% cash flow margin providing over 3 times debt service coverage, generally in line with the past three years. IU is conducting expense control efforts, including restructuring employee benefits, to slow expense growth in the face of modest revenue growth (1.2% and 1.5% for FY 2015 and 2016, respectively). State funding for the FY 2016-2017 biennium was up from the prior biennium, with IU receiving $508 million and $511 million appropriations for FY 2016 and FY 2017, respectively. A portion of the increase reflects IU’s success under the state’s performance funding metrics.

Wealth and Liquidity: Ample Financial Reserves and Strong Liquidity
Financial reserves will remain ample relative to other Aaa-rated public universities. IU reported total cash and investments of $3.9 billion as of June 30, 2016, including $1.9 billion at its foundation (excluding university funds). IU has good financial flexibility, with spendable cash and investments of $2.7 billion.

Fundraising will continue to support strategic priorities, with gift revenue averaging $128 million per year for FY 2013-2015. The university is in the public phase of its university-wide Bicentennial Campaign, following those successfully completed by the Bloomington and IUPUI campuses. As of June 30, 2016, IU has raised $1.59 billion against its $2.5 billion goal. The campaign is targeted to end December 31, 2019.

The investment portfolio is well diversified across managers and strategies, with allocations comparable to other large endowments. The FY 2016 foundation investment return of -5.7% was lower than peers for the period, reflecting portfolio allocations. IUF has seven member investment office staff and uses external investment consultants.

LIQUIDITY
Liquidity is excellent and provides a good cushion for operations. For FY 2016 IU reported $1.73 billion of unrestricted monthly liquidity, or 236 monthly days cash on hand.

Leverage: Modest Leverage with Manageable Debt Plans
IU should continue to have low financial leverage, with spendable cash and investments to total debt (including fee-replaced debt) of 2.7 times, while total debt-to-cash flow is only 3.1 times. The effective ratio is even lower when factoring that 35% of the total debt is fee-replaced (see Exhibit 1), with the state providing the full annual debt service through appropriations. This support has never been reduced even during years when direct operating support was cut.

IU has manageable debt plans. IU has on its capital plan about $120 million in FY 2018 - $79 million of fee-replaced student fee bonds, subject to receiving all requisite approvals, and $40 million of revenue bonds.

DEBT STRUCTURE
All of Indiana University’s debt is fixed rate and amortizing. There is significant principal payments during the next five years of $316 million, or 31% of total pro-forma debt.

DEBT-RELATED DERIVATIVES
None

PENSIONS AND OPEB
IU’s other debt-like obligations are manageable with total pension and retiree health care costs about 2.4% of operating expenses.

IU offers defined contribution retirement plans, with certain staff hired prior to July 1, 2013 participating in the state’s Public Employees Retirement Fund, a defined benefit plan (DBP). For FY 2016 IU had a $303 million Moody’s Adjusted Net Pension Liability (ANPL) for the DBP. Spendable Cash and Investments to Adjusted Debt (including the ANPL) are a favorable 2.0 times, with Adjusted Debt to Operating Revenue of 0.4 times. IU’s funding requirement is limited to the required annual contribution to the plan. IU reports a $98 million unfunded liability under GASB 68, down from FY 2015 and reflecting IU’s payment under amended state law to reduce its share of the unfunded liability.

IU offers OPEB benefits through its single-employer defined benefit plan. For FY 2015, IU contributed a manageable $49 million to the plan, with a $37 million reported OPEB liability at FYE 2016.
Governance and Management: Strong Central Oversight and Governance Practices Anchor Excellent Strategic Position

Indiana University demonstrates good management and governance that, with its market position, anchors its excellent strategic position. IU has substantial formal disclosure practices, including a special Investor Disclosure site. Leadership has very active system governance using an integrated strategic and capital planning process including debt management. It is a national leader in its use of responsibility center management, a decentralized budget model moving financial responsibility of revenues and expenses to the schools. IU continues to conduct extensive university-wide expense management initiatives to manage expense growth to support its goals of containing the cost of attendance particularly for in-state students.

Legal Security

The Series 2017A Lease Purchase Obligations, previously issued as Certificates of Participation and all on parity, (rated Aaa) are secured by IU’s lease with Indiana University Building Corporation (IUBC). The leases cannot be terminated except for IU’s lack of available funds. The leases are not subject to abatement or reduction. IU has the option to purchase the facilities in an amount sufficient to refund the facilities’ related outstanding indebtedness. There is no debt service reserve fund.

For other pledges, please see Moody’s February 24, 2016 report on Indiana University.

Use of Proceeds

Proceeds from the Lease Purchase Obligations, Series 2017A will be used to fund project costs for the Eskenazi Museum of Art renovation and the Memorial Stadium-Excellence Academy addition and partial renovation of the Memorial Stadium, and pay issuance costs.

Obligor Profile

Indiana University, founded in 1820, is one of the state’s flagship universities and a member of the prestigious Big 10 athletic conference. IU has students on seven campuses, including its main Bloomington campus. It is one of the nation’s largest universities, with over 82,000 full time equivalent students, not including about 7,400 IU students at the Fort Wayne campus, which is currently administered by Purdue University.

Methodology

The principal methodology used in this rating was Global Higher Education published in November 2015. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

Ratings

Exhibit 3

<table>
<thead>
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<th>Issue</th>
<th>Rating</th>
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<tr>
<td>Lease Purchase Obligations, Series 2017A</td>
<td>Aaa</td>
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<td>Rating Type</td>
<td>Underlying LT</td>
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<td>Sale Amount</td>
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<td>Expected Sale Date</td>
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<td>Rating Description</td>
<td>Revenue: Public University Broad Pledge</td>
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Source: Moody’s Investors Service
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