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West Campus Housing LLC, New Jersey New Jersey Economic Development Authority; Auxiliary - Stand Alone

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New Jersey Econ Dev Auth (West Campus Housing, LLC - New Jersey City University Foundation) AUXSTDALN		
Long Term Rating	BB-/Negative	Downgraded, Removed from CreditWatch

Rating Action

S&P Global Ratings lowered its rating to 'BB-' from 'BB+' on the New Jersey Economic Development Authority's series 2015A tax-exempt student housing revenue bonds, issued for West Campus Housing LLC (WCH), and removed the rating from CreditWatch, where it had been placed with negative implications on Aug. 5, 2020. The New Jersey City University Foundation (NJCU Foundation) is the sole member of West Campus Housing LLC. The outlook is negative.

On Aug. 5, we placed our rating on WCH on CreditWatch with negative implications, along with many other U.S. higher education privatized (off balance sheet) student housing projects, in the wake of the COVID-19 pandemic and the uncertainties surrounding the economic fallout (see "Certain U.S. Higher Education Privatized Student Project Rating Placed on CreditWatch Negative," published Aug. 5, 2020, on RatingsDirect).

The downgrade and negative outlook reflect our view of the risk and uncertainty the COVID-19 pandemic places on West Campus Housing and the New Jersey City University. While the university has committed to providing a subsidy of $1.5 million to the project in fiscal 2021 using federal funds it received, which we view as supporting the current rating,-we believe the project will face operating pressure over the near term, depending on actual occupancy levels in fiscal 2021, and if the subsidy is sufficient enough to offset lost rental revenues. The project has a history of weaker occupancy levels, with debt service coverage (DSC) below the 1.2x covenant in recent years (although some improvement is expected for fiscal 2020 based on draft financials). We believe this reflects vulnerabilities in the project's demand profile that could be amplified due to COVID-19. In addition, the project's sponsor institution, New Jersey City University, has faced deteriorating available resources and operating pressure, which we believe will be stressed given pressures from COVID-19 and uncertainties with state funding over the near term. We also believe continued enrollment declines at NJCU could make it difficult to materially improve occupancy and therefore financial performance of the project in fiscal 2021 and beyond.

The project makes debt service payments on July 1 and Jan. 1. It does not plan to draw from any reserves to make its January 2021 debt service payment (approximately $1.6 million) as it anticipates rental revenues and the university's subsidy will be sufficient to cover debt service.

Total project debt outstanding as of June 30, 2020 (unaudited) was $49.28 million. The 2015 bonds are nonrecourse obligations of the LLC, and annual debt service is payable solely from pledged net revenue of the new 425-bed residence hall and net revenue from Vodra and Co-Op halls. We understand there is no debt associated with Vodra and Co-Op halls. A leasehold mortgage and security agreement provide additional security to bondholders, supplementing a pledge of housing complex revenue.

Although we reviewed NJCU's finances and demand to understand the project and the university's role in supporting it, this rating does not directly reflect NJCU's underlying credit characteristics, as the bonds are not a direct debt obligation of NJCU. S&P Global Ratings does not hold a public underlying rating on NJCU.

NJCU transitioned its classes online in spring 2020 due to the COVID-19 pandemic and most students moved out of the residence facilities (about 100 students remained through the end of the semester). Refunds were provided by the university to students residing in the WCH housing project, in the form of credits and cash refunds for seniors. The university covered these refunds (and credits) with the federal Coronavirus Aid, Relief, and Economic Security Act funding it received. Total cash refunds related to housing were $285,865 in fiscal 2020. Occupancy during the summer was minimal with about 50 students remaining on campus. Preliminarily, for fiscal 2020 (June 30 fiscal year end), management anticipates DSC of 1.2x based on draft financials. Although we recognize actual coverage could shift, this better-than-originally-anticipated coverage (preliminary coverage was expected to be between 1.0x-1.2x) is the result of the university covering spring 2020 refunds when students vacated the facilities, as well as lower expenses in spring and summer 2020, with the operations of much of the facilities scaled back.

For fall 2020, consistent with state guidelines, the university will de-densify its residence facilities. The fall 2020 semester started with about 58% occupancy (about 361 students), but there has been some melt, and current occupancy is about 56% (approximately 347 students). The university is planning for instruction to be delivered with hi-flex, hybrid format, with about 25% of instruction being in person. For fiscal 2021, the university anticipates making a $1.5 million subsidy payment to WCH to off the lower rental revenues, since the project is being de-densified. The university anticipates making this subsidy through federal Coronavirus Relief Funds (CRF) that it received through the State of New Jersey. Management indicates that it will re-evaluate the subsidy throughout the fiscal year, and, if needed, increase it to reach the 1.2x DSC requirement. We recognize that these funds are one-time, and while we view the university's commitment to the project and efforts to reach its DSC requirement positively, we believe the fundamental softness in project demand, with historical occupancy and DSC challenges, could remain. Management continues to accept housing applications and has a goal to reach its full de-densified allowed occupancy of 369 students. In addition, the university is working to provide housing scholarship with federal money, to help attract and support students. Other fiscal 2021 budget assumptions include occupancy of 365 beds in the fall, and 310 in spring 2021, a rental rate increase of 3.5%, and expense cuts in its facilities repair and maintenance, security, marketing and leasing, administration, and residence life programs, as the university plans to provide these resources to support the project. Management has communicated to students that it will not be offering refunds with meal plans or housing this year.

The project maintains reserve funds that total $5.498 million as of Aug. 31, 2020, which include: $3.388 million in the debt service reserve, $0.036 million in the bond fund, $1.951 million in the operating surplus fund, and $0.123 million with the repair and replacement funds. Management plans on using approximately $350,000 from the operating bank account fund of the WCH LLC in fall 2020, to repair a building pressurization issue. Debt service for the bonds is at a fixed rate and structured on an escalating basis, which started at less than $1.00 million in 2017 (excluding capitalized interest) and reaching approximately $3.26 million maximum annual debt service (MADS) in 2036.

Prior to COVID-19, the project breached its DSC ratio in fiscal years 2018 and 2019 due to challenged occupancy (particularly in the spring and summer). NJCU has worked with a housing consultant to better align the project and the university. Enrollment and marketing initiatives designed to improve occupancy include providing housing for students through a partnership with The Joffrey Ballet School (with a cohort of 30 students in fall 2020 and 40 planned for fall 2021), diversifying the university's geographic draw by recruiting athletes from out of state and international students, and intentionally increasing the freshman class size. In addition to the enrollment initiatives, management has developed a business plan to market the facilities during the summer through conferences and groups.

Fall 2019 occupancy improved to 96% (compared with 94% in fall 2018), but initial spring 2020 occupancy weakened to 81%. In addition, the project had more than $1 million in summer revenue initially budgeted for summer 2020, with more than $680,000 of that revenue coming from external companies. With the COVID-19 pandemic, this revenue wasn't realized for summer of 2020, but the management team has already begun planning for summer 2021. The university historically hasn't had a residency requirement in place, but beginning in fall 2017, NJCU began requiring international students to live in the residence halls (typically between 60-65 students, but due to challenges with the visas and the pandemic, international students living in the hall in fall 2020 currently total about 12). Also, as a way to boost occupancy, the university is also looking into requiring honors students to live in the facility in the next several years.

We acknowledge that the project is a strategic priority for the university, as all of NJCU's housing is through WCH and the university has a number of initiatives underway to support the project in the near term, and it is planning for beyond the current fiscal year as well. We believe that with so much uncertainty due to COVID-19, it could make it difficult for these initiatives to have their full financial impact.

We understand that so long as the university is working with the consultant and following all reasonable recommendations, DSC under 1.2x does not constitute an event of default. However, if DSC comes in under 1.0x, the project would have one year to bring that above 1.0x. If the project fails to meet that DSC target and timeline, it would constitute an event of default under the loan agreement.

Credit overview

WHC is a not-for-profit single-member LLC formed for the sole purpose of planning, developing, financing, equipping, administering, operating, and maintaining residence, dining, parking, and other related facilities on the NJCU campus, to be used exclusively for the benefit of the university and its students. The NJCU Foundation used proceeds from the $50.6 million series 2015 bonds to design, construct, and equip the new suite-style student residence hall on NJCU's west campus, and renovate two existing on-campus student residence halls, which NJCU owns and operates. The bond proceeds also funded capitalized interest through Feb. 1, 2017 (approximately six months past the project's completion date), and funded a debt service reserve fund (DSRF) fully funded at MADS.

The rating reflects our view of these project-specific and university risks:

- Uncertainty and risk due to the COVID-19 pandemic, although NJCU management intends to provide a subsidy of $1.5 million to the project in fiscal 2021 to offset lower rental revenues;
- Limited financial flexibility of NJCU due to weak available resource metrics, sustained operating deficits, high debt load, and uncertainty with state funding over the near term.
- History of weak DSC, below the 1.2x covenant, at 1.07x in fiscal 2018, and 1.12x in fiscal 2019, but management anticipates coverage reaching 1.2x in fiscal 2020 based on draft results;
- Occupancy rates that have historically fallen short of projections, and will weaken in fall 2020 due to de-densification efforts (currently 56%); and
- Softer enrollment at the university from fall 2017-fall 2019, with a decline of about 5% expected in fall 2020.

The rating further reflects our assessment of these credit factors:

- The good connection between NJCU and its housing facilities, demonstrated by the residence hall's location on the university's west campus, NJCU's active role in marketing and treating the new housing as part of its own housing stock, eventual ownership of the residence hall once the bonds are fully repaid, management of the housing project, and the university providing a subsidy to the project in fiscal 2021;
- The bonds' adequate security features, including a fully funded DSRF, a 1.2x annual DSC covenant, and a 1.2x additional bonds test; and
- Limited competition from off-campus housing in the Jersey City area, with numerous off-campus developments already in operation and several under development and construction; however, none of these projects are actively geared toward the student market and they are appreciably more expensive.

The negative outlook reflects our view of the project's narrow revenue stream and the uncertainties surrounding the economic fallout related to the COVID-19 pandemic. It also reflects our belief that all projects in the sector are facing negative economic or fundamental business conditions that could result in a further rating action. We could lower the rating if the project continues to experience lower-than-targeted occupancy, making it difficult for the project to meet its covenanted 1.2x DSC requirement.

Environmental, social, and governance (ESG) factors

The downgrade and negative outlook reflect our opinion of the operating and financial risk that faces WCH due to COVID-19 through weak occupancy for fall 2020 and potentially spring 2021, due to de-densification efforts and the potential tempering of student demand as many student's financial situations have changed due to the pandemic, which is indirectly factored into the downgrade. NJCU's management team plans to deliver instruction in a hi-flex hybrid model in fall 2020 and de-densify its residence facilities to protect the health and safety of students and limit the social risk associated with the community spread of COVID-19. We view the risks from COVID-19 to public health and safety as a social risk under our ESG factors. Despite the elevated social risk, we believe the project's environmental and governance risk are in line with our view of the sectors as a whole.

Negative Outlook

Downside scenario

Credit factors that we believe could lead to a negative rating action during the outlook period include lower-than-targeted occupancy levels whether due to restrictions or weakened demand, resulting in pressured net pledged revenue and DSC. In addition, we could lower the rating if DSC falls below 1.0x or if the university's credit weakens through further enrollment declines, sustained deficit operating performance, or persistent weakening of balance-sheet ratios.

Return to stable

We could revise the outlook to stable if the housing project improves occupancy levels so that DSC consistently improves to a minimum of 1.2x through operating revenue. In addition, we could revise the outlook to stable, if the university stabilizes its operating performance and improves available reserves.

Credit Opinion

Enterprise Profile

University enrollment and demand

NJCU is one of 12 public institutions in the New Jersey higher education system. It is a co-educational regional university in Jersey City, less than one hour from New York City. It opened in 1929 as the New Jersey Normal School and was renamed New Jersey State Teachers College of Jersey City in 1935, and then Jersey City State College in 1958, and later becoming a liberal arts institution in 1968. In 1998, the New Jersey Commission on Higher Education approved a change of institutional status, and the present name, NJCU, was adopted. The university has been accredited by the Middle States Commission on Higher Education since 1959. NJCU offers 42 undergraduate degree programs, 27 master's and post-master's level programs, and two doctoral programs offered in three colleges.

The university serves undergraduate and graduate students, and maintains, in our view, some diversity in its programmatic offerings. Headcount since fall 2008 has varied, but has weakened in recent years, with a decline in total full-time equivalent (FTE) enrollment of 6.7% in fall 2018 and 0.9% in fall 2019. Preliminary for fall 2020, management anticipates enrollment will decline about 5%, reflecting the uncertainty and pressures from COVID-19. About 77% of fall 2019 headcount comprised undergraduates. While total FTE enrollment has declined, we note that the university's freshman class sizes have increased to historical levels, with 1,008 in fall 2019, 968 in fall 2018, 991 in fall 2017, and 988 in fall 2016. Management anticipates its freshman class in fall 2020, will be up about 2% compared with the previous year. Of the 4,868 freshman applications in fall 2019, approximately 95 % of students were accepted, which is weaker than the university's freshman acceptance rate of 87% in fall 2015. We believe the weakened selectivity demonstrates the competitive and challenging demographic in the U.S. Northeast, and believe enrollment growth could remain pressured over the near term. The university is working on diversifying its geographic draw and has implemented strategies to recruit honors students, and increase out-of-state, international, and other students outside Hudson County, where NJCU is located.

NJCU housing

While the housing project opened on time and on budget in July 2016, attaining full occupancy has been a credit weakness, even before the COVID-19 pandemic. Combined (Vodra, Co-Op, and WCH) fall 2019 occupancy was 96%, and spring occupancy (prior to the pandemic) was 81%. By comparison, fall 2018 occupancy was 92% and spring 2019 occupancy was 83%. Fall 2017 occupancy was 95%, with 82% in spring 2018. The lower spring and summer occupancy levels have weakened financial performance and subsequently resulted in lower-than-covenanted and projected coverage for fiscal years 2018 and 2019.

NJCU has historically provided what we consider limited on-campus housing options. The fall 2014 student housing capacity was only 259 beds (about 4% of total FTE enrollment) consisting of two residence halls (Co-Op Hall and Vodra Hall) and off-campus apartments. After completion of the new residence hall in fall 2016, total student housing increased considerably to 627 beds, or approximately 9% of total FTE enrollment. The university has historically not required any students to reside in on-campus housing; however, beginning in fall 2017 management began requiring international students (which historically was approximately 60-65 students, but is 12 students for the fall 2020 semester) to live on campus. Freshmen currently aren't required to live on campus, which we believe has contributed to the project's less-than-projected occupancy numbers; and we also recognize NJCU as more of a commuter campus.

We understand the Vodra and Co-Op halls are fairly old, being constructed in 1963 and 1989, respectively. Given their age and condition, management partially renovated these residence halls with proceeds from the 2015 bond issuance. It is important to note that the new project beds were not replacement beds, and that the campus added about 142% to its housing stock, which we view as a significant increase. According to management, the availability of off-campus housing in Hudson County is limited and new construction housing projects in the region are geared toward working adults and not actively targeted toward students, while also being appreciably more expensive. Management reports there are no additional housing plans, and the 425-bed residence hall is an important student recruitment and retention tool.

Ground lease provisions

In 2015, NJCU entered into a ground lease wherein WCH LLC leased the land on which the new 425-bed student residence hall (West Campus Village) was built. We understand the ground lease extends beyond the 32-year final maturity of the 2015 bonds. The ground lease contains provisions outlining NJCU's support for the project. The ground lease provides that NJCU will treat the new 425-bed student residence hall as part of its student housing program, on an equal basis with its existing housing facilities, and include the new housing in all information and marketing materials regarding student housing. Another ground lease provision states that NJCU will agree not to construct or otherwise sponsor any additional housing facilities for its students on or off campus beyond the replacement of an equal number of units of existing university housing facilities, unless the following conditions are met:

- The new 425-bed student residence hall is projected to maintain a minimum DSC ratio of at least 1.2x for the then-current fiscal year (to the extent the project has been operational), and management expects to maintain the same level of DSC when taking into account the additional student housing based on projections prepared by an independent consultant.
- The construction of the additional student housing is supported by a demand study from an independent consultant that concluded that sufficient demand exists for the additional number of beds to be constructed so as not to have a

material adverse effect on the project and the rate covenant with respect to the financing.

- No event of default exists under the loan agreement.

The projections and demand study shall be prepared by one or more nationally recognized consulting firms experienced in student housing for comparably sized or larger higher education institutions mutually agreed upon by the university and the LLC.

Ownership of the new 425-bed residence hall will revert to NJCU upon full debt repayment of the series 2015 bonds. While NJCU was expected to use an experienced third-party manager, RISE, (formerly AUDG Management LLC), to manage all three residence halls to reduce its relatively high overhead costs (primarily payroll-related expenses) associated with operating these facilities, as of December 2016 the university terminated that management agreement and has since managed the project. While the change in management was not expected, we recognize that it is not unusual for a university to manage its student housing facilities. We view the university's involvement and commitment to the project's success favorably. Furthermore, we understand NJCU will provide security to the three residence halls at no cost. The project has also insourced cleaning services, at a lower cost to the projects, which we view positively.

Project management and flow of funds

In December 2016, the tri-party management agreement between WCH, RISE, and NJCU was terminated by the university. According to NJCU management, all parties fulfilled their responsibilities, however, the university believes it can manage the project at a lower cost.

The university, on behalf of WCH, collects student housing fees, deposits, charges, and other amounts under the student housing agreements in accordance with the university's policies and deposits these revenue in a restricted receipts fund established under the trust indenture. The university transfers these funds to the trustee for deposit in the receipts fund within three days of receipt.

The waterfall has a traditional monthly flow, with transfers made by the trustee to the operating account to pay for operating expenses of the facilities for the immediately following month, and monthly transfers for debt service payments. Annually, any amounts remaining in the receipts fund shall be transferred to the surplus cash flow fund. Surplus cash flow funds are to be paid to the university as ground rent upon confirmation that release test requirements have been met, including completion of the audit and verification that the project has met at least a 1.2x DSC coverage ratio. We understand there is no management fee paid to the university for managing the project and that subordinated university expenses will be payable out of surplus cash flows but haven't been paid in recent years with DSC below 1.2x.

Financial Profile

DSC

Debt service for the bonds is at a fixed rate and structured on an escalating basis, which started at less than $1 million in 2017 (excluding capitalized interest) and reaching approximately $3.26 million MADS in 2036.

Fiscal 2018 was the first year without capitalized interest and the first year of the DSC requirement. While management initially projected DSC would be around 1.29x, actual coverage fell short of the covenanted 1.2x, at 1.07x due to weaker-than-projected occupancy levels. Coverage in fiscal 2019 also fell short at 1.12x. Since the covenant was breached in fiscal 2018 and fiscal 2019, management has worked with a housing consultant to improve overall occupancy (particularly in the spring and summer period) and to better align the project and the university, including communication between the two when it comes to validating occupancy and financial information mid-year.

Preliminarily, for fiscal 2020, management is anticipating coverage of 1.2x based on draft financials. Although we recognize actual coverage could shift, this better-than-originally anticipated coverage is the result of the university covering spring 2020 refunds when students vacated the facilities due to COVID-19, as well as tight control of expenses in summer 2020.

For the current and next fiscal years, the university anticipates making a $1.5 million subsidy payment to WCH to offset the lower rental revenues, since the project is being de-densified (current occupancy is approximately 56%) due to COVID-19 restrictions placed on universities by the State of New Jersey. The university anticipates making this subsidy through federal CRF that it received through the State of New Jersey. We recognize that these funds are one-time, and while we view the university's commitment to the project and efforts to reach its DSC requirement positively, we believe the fundamental softness in project demand, with historical occupancy and DSC challenges, could remain.

Based on the audited fiscal 2019 coverage, we calculate MADS ($3.256 million in 2036) coverage at approximately 1.06x for the year. We view this as weak but improved from 0.98x in fiscal 2018. We believe it is important for the project to continue to control expenses, raise housing charges, and consistently improve occupancy.

Related Research

Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020

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