

# Bond Case Briefs

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## Recruiting Scandal for Louisville Cardinals Imperils Bond Rating.

- **Moody's has university on review for a potential downgrade**
- **Criminal charges over paying recruit roil top-grossing team**

When the University of Louisville Cardinals take the court on Oct. 30, the basketball team will have more than just its opening home game hanging in the balance: It's also fighting against a recruiting scandal that's threatening the school's standing on Wall Street.

The team, which pulls in more revenue than any other and won the National College Athletic Association championships in 2013, was ensnared in a federal criminal case last month, when prosecutors alleged that a recruit was paid \$100,000 by Cardinals sponsor Adidas AG to attend the university. Hall of Fame coach Rick Pitino was fired. And Moody's Investors Service warned that it may cut the school's credit rating, citing the financial risks if its ability to attract students and donations suffers.

"The Louisville Cardinals are a stone cold semi-professional money machine," said John Vrooman, a professor of sports economics at Vanderbilt University in Nashville. "The economic connection between Louisville and UL Cardinals basketball is unique."

The Kentucky college, with about 23,000 students, received \$45.6 million in revenue from its basketball team in 2016, according to federal government statistics, the most in the nation and far more than rivals like Duke University. The team has made it to the NCAA March Madness tournament 42 times, raking fifth for all-time appearances, and until his ouster Pitino was the highest paid college coach in the nation.

"This is not going to be positive for the school, because of Louisville's reputation as one of the top basketball programs in the country" said Andrew Zimbalist, a professor of economics at Smith College. "It feeds off that reputation."

Intercollegiate athletics is the university's third largest source of funds behind student tuition and fees and revenue from its affiliated hospital, according to its most recent financial statements.

Such reliance has drawn scrutiny from credit rating companies when other universities have become immersed in sporting scandals.

Pennsylvania State University was downgraded by Moody's in October 2012 following the conviction of assistant football coach Jerry Sandusky for dozens of counts of sexual abuse. The company cited "substantial financial impact on the university" from the scandal and said it raised questions about the adequacy of its management. In April 2013, Moody's placed Rutgers University under review for a downgrade after the release of a video that showed then basketball coach Mike Rice assaulting players. Rutgers was ultimately downgraded a month later by both S&P Global Ratings and Moody's because a merger with a dentistry school threatened to increase its financial strains.

In the weeks since the scandal erupted at Louisville, the university has fired athletic director Tom Jurich, who had headed the program since 1997. The documents released by the U.S. attorney for the Southern District of New York referenced “one or more” unidentified coaches who were involved in the conduct, though no Louisville athletic personnel have been charged. Assistant coach Jordan Fair has been fired and Kenny Johnson placed on paid leave. The recruit at the center of the scandal is said to be freshman Brian Bowen, who has been suspended from all basketball operations.

“We have dealt with several serious issues recently, and we understand there could be some impact on our finances and credit rating,” John Karman, a spokesman for the university, said in a statement. “Any further comment at this time would be pure speculation on our part.”

Adidas said it was unaware of the wrong doing and is cooperating with authorities.

The University of Louisville and its athletic association has \$315.6 million outstanding municipal debt, according to data compiled by Bloomberg. The Louisville Arena Authority has also issued \$356.8 million of debt for the construction of the KFC Yum! Center, where the Cardinals play.

The university is the primary tenant of the Yum! arena. The men’s basketball team drew an averaging 20,846 fans per game, third behind Kentucky and Syracuse for game attendance in 2017, according to data collected by the NCAA. The spending by fans — on tickets, concessions and merchandise — is used to repay the arena authority’s bonds, along with other revenue.

In a worst-case scenario, the Cardinals would be barred from playing indefinitely by the NCAA, an option Moody’s referred to as the “death penalty.” This season, the men’s team is schedule to play 20 home games, excluding post season appearances.

There has so far been little repercussions in the bond market. Debt issued by the university that’s due September 2026 last traded for a yield of about 2.4 percent, or some half a percentage point over top-rated debt. That gap, a measure of the risk perceived by investors, is little changed from where it stood in June.

It may take months for ratings companies to make their decisions regarding downgrades and possibly longer for the NCAA to determine if sanctions are warranted.

In the meantime, fans will likely still pack into the stands, on the day before Halloween, to support the Louisville Cardinals and for two 20 minute halves. The financial worries will wait.

## **Bloomberg Markets**

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