



Rating Action: Moody's assigns Aa2 to University of Arizona's (AZ) Series 2021A,B&C SRBs and Aa3 to Series 2021A&B COPs; outlook negative

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New York, April 05, 2021 – Moody's Investors Service has assigned Aa2 ratings to University of Arizona's (AZ) (UArizona) planned University of Arizona System Revenue Bonds (SRBs), which include approximately \$142 million Tax-Exempt Series 2021A and \$43 million Taxable Series 2021C, and \$43 million University of Arizona System Revenue and Revenue Refunding Bonds, Tax-Exempt Series 2021B. All SRB series are fixed rate, with final maturities in 2042, 2043 and 2048, respectively. We have also assigned Aa3 ratings to UA's planned Refunding Certificates of Participation (COPs), which include approximately \$19 million Tax-Exempt Series 2021A (University of Arizona Projects) and \$67 million Taxable Series 2021B (University of Arizona Projects). Both COP series are fixed rate and have a final maturity in 2031. Both the SRBs and COPs will be issued by the Arizona Board of Regents (ABOR). We maintain Aa2 and Aa3 ratings on approximately \$1.4 billion of outstanding SRBs, SPEED (Stimulus Plan for Economic and Educational Development) bonds and COPs. The outlook is negative.

RATINGS RATIONALE

The assignment and maintenance of the Aa2 rating reflects UArizona's role as the flagship and land grant institution, with a \$2.1 billion scope of operations, important position in the provision of medical education for the State of Arizona (Aa1 stable) through its affiliation with Banner Health (not rated), and a very strong research profile. A sizable \$2.1 billion wealth profile is largely driven by strong donor support. However, UArizona's operating performance and liquidity have thinned in recent years, reflecting implementation of a multi-year strategic plan, ongoing infrastructure investment and lagging growth in student charges. UArizona remains challenged by weaker spendable cash and investments to operations and pro forma debt relative to peers, at 0.5x and 6x, respectively, and continued capital needs, though high leverage is somewhat offset by state support for about 32% of debt service. Modest state operating and capital support results in higher reliance on student charges from increasingly price sensitive students. In addition, a recent strategic venture with an online for-profit university carries uncertainties around reputational, execution and financial risks.

The Aa3 rating on the COPs, also one notch below the SRB rating, reflects the structure of the COP leases, which are subject to non-appropriation. The limit to a one notch differential for the COPs evidences the essentiality of the underlying projects to the university.

Federal aid funding from the coronavirus relief packages provides a total of approximately \$171 million, with nearly \$74 million for student aid, and another \$46 million in state directed federal funding. For fiscal 2021, UArizona is using a portion of institutional federal aid, in addition to expense reductions and debt service restructuring, inclusive of the planned 2021 refunding SRBs and COPs, to address auxiliary revenue shortfalls. Overall operating performance for fiscal 2021 is currently forecast by the university to be improved from fiscal 2020 levels.

RATING OUTLOOK

The negative outlook reflects the university's more limited ability to adjust to operating volatility over the next several years due to already modest operating performance and thinning liquidity. While the university continues to invest in multiple strategic objectives, its ability to sustainably return to stronger operating performance is uncertain and will be a key factor driving future credit quality.

FACTORS THAT COULD LEAD TO AN UPGRADE OF THE RATINGS

- Substantial improvement in financial resources relative to debt and operations
- Material sustained improvement in operating performance even as the university continues to invest in growth

FACTORS THAT COULD LEAD TO A DOWNGRADE OF THE RATINGS

- Sustained weakening of financial reserves, liquidity and leverage
- Further weakening of already thin operating performance, resulting in deterioration of debt service coverage
- Material reduction in state support

LEGAL SECURITY

The system revenue bonds (pro forma \$1.1 billion) are payable from and secured by a pledge of a first lien on gross revenues, which include tuition, fees and other revenue-producing facilities including auxiliary enterprises and indirect cost recovery. In fiscal 2020, gross revenues totaled \$1.3 billion, which comprised 62% of the \$2.1 billion of university total operating revenue. The system revenue bonds carry a rate covenant requiring the university to set fees such that gross revenues are at least 2.0x maximum annual debt service (MADS) of the SRBs. Gross revenues cover the estimated pro forma SRB gross MADS of \$88.5 million by 14.7x.

Fifty percent (50%) of the debt service for the Series 2021A and 2021C SRBs, in addition to 50% of the debt service on the outstanding Series 2018B SRBs, will be paid through funding to the university from a state capital infrastructure fund (CIF) legislatively established in fiscal 2017. Under the CIF program, in fiscal 2019, UArizona began receiving at least \$11 million annually of additional appropriations to be used for direct capital investment or for debt service on eligible financings. Appropriations from this program will increase each year at the lower of 2% or an inflation index. The program is funded through fiscal 2043. These appropriations are not pledged as additional security for the planned Series 2021B bonds.

The COPs are secured by lease payments made by the board, as well as a security interest in the leased properties financed by each specific series of COPs. The leases are unconditional obligations of the board during any current fiscal year, payable from UArizona's operating budget but with no security interest in any revenue stream and subject to non-appropriation risk. A portion (58%) of the university's total \$199 million of outstanding COPs are designated as research infrastructure (RI) COPs. The RI COPs receive debt service reimbursement in full from an ongoing appropriation in Arizona law since program inception. The planned Series 2021A and 2021B COPs are not research infrastructure COPs.

USE OF PROCEEDS

Proceeds of the Series 2021A, 2021B and 2021C SRBs will be used for: (1) construction of two new research facilities, renovation of the existing chemistry building, and construction of a new facilities management building; (2) paying the June 1, 2021 principal and interest payments on a majority of the outstanding SRBs; and (3) pay costs of issuance.

Proceeds of the Series 2021A and 2021B COPs bonds will be used to (1) pay the June 1, 2021 principal and interest payments on certain outstanding COPs; (2) refund remaining maturities of certain outstanding COPs; and (3) pay costs of issuance.

PROFILE

The University of Arizona is the flagship and land-grant public higher education institution for the State of Arizona, as well as providing a significant healthcare presence. The main campus is located in Tucson, with an additional medical school and biomedical research campus located in Phoenix. In fiscal 2020, the university recorded Moody's adjusted operating revenue of \$2.1 billion and in fall 2020 enrolled 45,517 full-time equivalent (FTE) students.

METHODOLOGY

The principal methodology used in these ratings was Higher Education published in May 2019 and available at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBM_1175020. Alternatively, please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

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