



Rating Action: Moody's assigns Aa3 to University of Arizona's \$128M Series 2014 SPEED bonds; outlook negative

07 Nov 2014

\$1.3B pro forma rated debt

New York, November 07, 2014 --

Moody's Rating

Issue: Revenue Bonds (Stimulus Plan for Economic and Educational Development) Series 2014; Rating: Aa3; Sale Amount: \$127,690,000; Expected Sale Date: 12/2/2014; Rating Description: Revenue: Public University Broad Pledge

Opinion

Moody's Investors Service assigns a Aa3 rating to the University of Arizona's (UA) \$127.7 million of Series 2014 tax-exempt SPEED (Stimulus Plan for Economic and Educational Development) bonds. The outlook is negative. We also affirm the ratings on the university's outstanding system revenue bonds (Aa2 negative), certificates of participation (Aa3 negative), and SPEED bonds (Aa3 negative).

SUMMARY RATING RATIONALE

The Aa2 senior most rating reflects the University of Arizona's role as the flagship and land-grant institution for Arizona, with healthy student demand leading to strong net tuition growth, significant levels of sponsored research funding from diverse sources, solid gift support, and consistent state support for roughly one-third of debt service. The rating also incorporates thin reserves and liquidity relative to debt and operations and increased competition for federal research funding.

The Aa3 rating on the SPEED bonds, one notch below the university's rating, reflects the subordinate lien to the System Revenue Bonds and the mechanics of the program.

The negative outlook reflects UA's exposure to current weakness in the parent of its primary teaching hospital, University Medical Center Corporation (UMCC, Baa2 negative). Medical education and research are important components of UA's market and credit profile and UMCC's weaker performance could impact the university over time through reduced financial transfers or a weakened position when competing for top-tier faculty and researchers.

CHALLENGES

*The university is exposed to fiscal pressure occurring at the University of Arizona Medical Center (UAMC), UA's college of medicine's primary teaching hospital, whose parent, University Medical Center Corporation (UMCC, Baa2 negative), was downgraded in July 2014 due to ongoing operating losses, decline in liquidity and decreased financial flexibility.

*A thin cushion of expendable resources to debt of 0.56 times at fiscal year-end 2014 (pro forma 0.50 times with 2014 SPEED bonds), which is weaker than the 1.2 times median of flagship universities.

*UA's financial reserves are not as sizeable or liquid as comparable flagship and land-grant institutions. The university's fiscal year (FY) 2014 expendable financial resources to operations of 0.40 times and 111 monthly days cash on hand unfavorably compare to the flagship medians of 0.54 times and 151 days, respectively.

*Research activities have declined due to the pressured federal agency funding environment and heightened competition for receipt of federal awards.

*Significant cuts in state appropriations and volatility in state reimbursements, including school of medicine healthcare receipts and the ongoing deferral of \$79 million of state appropriations, have limited UA's operating flexibility.

STRENGTHS

*The University of Arizona is the flagship and land-grant public university in the State of Arizona (Aa3 positive), serving a growing enrollment of over 42,000 full-time equivalent (FTE) students in fall 2014.

*A sizeable research program (\$557 million in FY 2014) adds to UA's strong reputation, with notable activity in the fields of astronomy and the physical sciences, as well as healthcare research.

*Robust growth of net tuition revenue (up 20% for FY 2012-14) and net tuition per student (up 13% for FY 2012-14) helps offset flat state appropriations.

*The university receives state support for roughly one-third of its \$1.2 billion in FY 2014 outstanding debt. The state has historically and is expected to continue to cover debt service on \$156 million of outstanding research infrastructure certificates of participation (COPs) and 80% of the debt service on the pro forma \$385 million of SPEED bonds.

*Good philanthropic support (FY 2012-14 average annual gift revenue of \$115 million) and success with its \$1.5 billion capital campaign favorably enhances UA's financial flexibility.

Outlook

The negative outlook incorporates UA's exposure to current weakness in the parent of its primary teaching hospital, UMCC.

WHAT COULD MAKE THE RATING GO UP

The university's rating could improve with UMCC's return to stronger operating performance, significant growth of financial resources and liquidity, including increased fundraising, to better support debt. A successful conclusion to the Banner-UAHN acquisition given specific details of the support and integration favorable to university operations would add credit stability.

WHAT COULD MAKE THE RATING GO DOWN

Downward rating pressure for UA could occur with sustained deterioration of the operating performance, declines in liquidity, failure of the state to support debt service, or negative impacts due to UMCC's financial pressures.

PRINCIPAL METHODOLOGY USED

The principal methodology used in this rating was U.S. Not-for-Profit Private and Public Higher Education published in August 2011. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

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Mary Cooney
Asst Vice President - Analyst
Public Finance Group
Moody's Investors Service, Inc.
250 Greenwich Street
New York, NY 10007
U.S.A.
JOURNALISTS: 212-553-0376
SUBSCRIBERS: 212-553-1653

Eva Horton Bogaty
Vice President - Senior Analyst
Public Finance Group
JOURNALISTS: 212-553-0376
SUBSCRIBERS: 212-553-1653

Releasing Office:
Moody's Investors Service, Inc.
250 Greenwich Street
New York, NY 10007
U.S.A.
JOURNALISTS: 212-553-0376
SUBSCRIBERS: 212-553-1653

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