Fitch Rates University of Rochester, NY's Revs 'AA-'; Outlook Stable

Fitch Ratings-New York-10 June 2015: Fitch Ratings has assigned an 'AA-' rating to approximately $302 million of Monroe County Industrial Development Corporation, NY (MCIDC) revenue bonds, series 2015A, 2015B, and 2015C, issued on behalf of the University of Rochester (UR).

The bonds are expected to sell via negotiation on the week of June 15. Proceeds will fund various university and medical center capital projects, refund certain outstanding maturities, and pay costs of issuance.

In addition, Fitch affirms the 'AA-' rating on $680 million of outstanding revenue bonds issued by the Dormitory Authority of the State of New York (DASNY) and the MCIDC on behalf of UR.

The Rating Outlook is Stable.

SECURITY
The bonds are a general unsecured obligation of the university.

KEY RATING DRIVERS

SOLID CREDIT CHARACTERISTICS: UR is a comprehensive research university and academic medical center in Rochester, NY. The 'AA-' rating reflects consistently positive margins, derived largely from UR's growing and profitable healthcare enterprise; strong institutional reputation and solid student demand; and manageable debt burden. Offsetting factors include high exposure to the changing healthcare sector and mixed balance sheet metrics. Fitch does not believe that series 2015 new money materially changes UR's leverage or overall credit profile.

STRATEGIC MANAGEMENT: UR's unified management structure ensures coordination of healthcare and higher education operations. As a result of this structure, UR is able to successfully employ joint strategies for the health system's clinical activities, research endeavors, and academic programs.

POSITIVE OPERATIONS: UR generates consistently positive consolidated operating margins due to strong medical center performance and self-supporting traditional university operations. Strong Memorial Hospital (SMH) anchors UR's healthcare operations, which account for 70% of total operating revenue. SMH's strong financial profile, leading market position, and profitability support the medical center's teaching and research missions. Fitch believes UR's strategic planning positions UR well for the changing healthcare environment.

ADEQUATE LIQUIDITY: Liquidity metrics are weaker than those of similarly rated universities due to the large expense base and capital-intensive nature of hospital operations. However, UR's substantial financial resources and endowment have grown significantly in recent years, and metrics compare well to highly rated hospitals and health systems. Management expects stable debt levels over the medium term as principal amortization offsets new issuance.

RATING SENSITIVITIES

BALANCED OPERATIONS: Fitch believes the University of Rochester's strong operating profile makes negative rating action unlikely. However, operating deterioration and a trend of consolidated operating deficits could negatively pressure the rating.

BALANCE SHEET GROWTH: Sustained growth over time in financial resources relative to operating expenses and debt would likely lead to positive rating action.

CREDIT PROFILE
Founded in 1850, UR serves over 11,000 students in its undergraduate, graduate and professional programs. The university is heavily involved in research and is one of the 62 members of the Association of American Universities. UR also encompasses the consolidated University of Rochester Medical Center (URMC) including

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Strong Memorial Hospital (SMH), the largest hospital in the Finger Lakes region. Healthcare operations contribute the majority (70%) of the university's $3.2 billion operating revenue base. Fitch considers UR's management team strong and committed to a unified structure, which allows the university to coordinate strategy effectively across its clinical operations, research endeavors, and academic programs.

**POSITIVE OPERATING RESULTS**

UR has consistently generated positive consolidated operating margins averaging 3.7% over the past five years, including a 3.9% margin in fiscal 2014. Financial results reflect growing and profitable healthcare revenues that accounted for 70% of total operating revenues in fiscal 2014. Healthcare operations are anchored by SMH; while UR operates as a combined entity, SMH generated a very strong standalone fiscal 2014 operating margin of 8.3%. Net tuition revenue continues to grow due to good demand and enrollment trends. UR's annual endowment draw provides additional operating flexibility, as core operations before the endowment draw are generally positive, as well.

Management expects the consolidated operating margin to soften somewhat but remain positive in fiscal 2015; hospital margins will return to a more normal but still strong level after reflecting elevated cost settlements and certain other revenues in fiscal years 2013 and 2014. Fitch expects that clinical profitability will remain sufficient to support capital investment and the university's teaching and research missions.

**SOUND DEMAND AND STRONG MARKET POSITION**

The hospital's strong market position and the university's reputation and sound student demand profile support positive margins. SMH is the largest hospital and the only tertiary/quaternary care center in the Finger Lakes region. With 1,204 licensed beds between SMH, Highland Hospital and F.F. Thompson Hospital, UR makes up 56.2% of the local market. Occupancy remains high. While inpatient volumes were generally flat, outpatient volumes continued to increase largely due to strong growth in oncology and radiation therapy visits. Longer-term, Fitch believes management is responding appropriately to the changing environment and considers UR's regional expansion strategy achievable.

Student demand and enrollment trends are also sound. Enrollment has grown approximately 9.4% over the past five years to a headcount of 11,060 in fall 2014, but UR aims to limit enrollment growth over the next few years. Student quality and success metrics are very high and reflect strong demand for UR's well-regarded programs; applications continue to grow and undergraduate acceptance rates are selective (36.4% for fall 2014). Moderately low but stable matriculation rates (22.6%) reflect UR's solid performance as it competes against other universities with very strong reputations. Graduate programs are also competitive, with selective admissions (22.6% acceptance rate) and high matriculation rates (48.3%).

**ADEQUATE LIQUIDITY**

UR's liquidity is adequate for the rating level. Available funds (defined as cash and investments less permanently restricted net assets) totaled a substantial $2.7 billion as of June 30, 2014. However, available funds equalled 87.8% of operating expenses ($3.08 billion) and 190% of pro forma debt ($1.42 billion, including non-cancellable operating leases), both of which are somewhat below rating category averages. Fitch believes these metrics reflect the larger operating base and capital-intensive nature of healthcare operations. In addition, hospital liquidity metrics are adequate for the rating level, with 145 days cash on hand.

UR also benefits from a strong fundraising culture and endowment. The university recently reached its $1.2 billion campaign goal and continues to raise additional funds. Giving, strong investment returns, and operating surpluses have contributed to endowment growth from approximately $1.4 billion as of June 30, 2010 to $2 billion as of June 30, 2014, part of which is permanently restricted and therefore excluded from Fitch's available funds calculation.

**MANAGEABLE DEBT LOAD**

The university's debt burden remains manageable. Fitch does not believe that the approximately $130 million of additional debt from series 2015 materially changes UR's leverage or credit profile. UR maintains a low MADS burden of 3.2% of operating revenues and solid MADS coverage of 3.5x from operations. The debt structure is fairly conservative, with front-loaded principal amortization and declining annual debt service after 2022. Roughly 22% of UR's debt is variable-rate, and most is swapped to fixed. UR has invested heavily in its campus over the
past decade, and the most recent major addition, the Golisano Children's Hospital, is expected to open this summer. However, management expects fewer large debt-funded projects going forward. Fitch expects debt metrics to remain generally steady over the medium term as management plans to match additional debt issuance roughly to principal amortization over the same period.

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In addition to the sources of information identified in the criteria, this action was additionally informed by information from J.P. Morgan Securities, LLC.

Applicable Criteria
Revenue-Supported Rating Criteria (pub. 16 Jun 2014)
(U.S. College and University Rating Criteria (pub. 12 May 2014)

Related Research
University of Rochester, New York [717368 - 06-SEP-2013]

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