New Issue: Moody's assigns Aa3 to University of Rochester's (NY) $302M Series 2015A, B, and C Rev. Bonds; outlook stable

$1.1B rated debt

UNIVERSITY OF ROCHESTER, NY
Public Colleges & Universities
NY

Moody's Rating

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Moody's Outlook  STA

NEW YORK, June 08, 2015 --Moody's Investors Service assigns a Aa3 rating to University of Rochester's ("UR") proposed $302 million of tax-exempt fixed rate Series 2015A and 2015B Revenue Bonds, and taxable 2015C Revenue Bonds, maturing in 2045. At this time, we also affirm the Aa3 ratings on approximately $934 million of the university's outstanding revenue bonds issued through the Monroe County Industrial Development Corporation and the Dormitory Authority of the State of New York. The outlook is stable.

SUMMARY RATING RATIONALE

The Aa3 reflects UR's presence in the region as a prominent academic medical center, with strong student demand and growing health services.

The rating favorably incorporates UR's large economic impact in the City of Rochester (Aa3 stable) as the largest employer in the city, consistently positive operating performance, large and growing medical center operations that are contributing positively to the university's consolidated financials, improved fundraising and strong fiscal management by a closely aligned management team.

The rating also reflects UR's significant exposure to patient-care related revenue (71%), recent negative pressure on research funding, and a highly competitive student market.

OUTLOOK
The stable outlook reflects expectations of continued positive operating performance at the largest hospitals within the medical center contributing to overall positive performance at the university. Additionally, we expect stable enrollment and successful fundraising that will lead to continued growth in financial resources.

WHAT COULD MAKE THE RATING GO UP

- Substantial increase in unrestricted reserves and monthly liquidity that provides a materially stronger cushion for operations
- Sustained improvement in fundraising

WHAT COULD MAKE THE RATING GO DOWN

- Significant deterioration of overall university operating performance including weakening of healthcare operations
- Material use or loss of unrestricted liquidity
- Large increase in debt without offsetting increase in financial resources

STRENGTHS

- Well-integrated financial, strategic and capital planning between the university and University of Rochester Medical Center (URMC)
- Stable operating surpluses at the health system have contributed to consistently positive operating performance; operating cash flow of 10.2% covered debt service nearly 4.5 -times in FY 2014
- Large and diversified enrollment base; nearly 10,000 FTE students in fall 2014 with average net tuition revenue growth of over 6.0% over the last five years
- Good financial resource coverage of debt; expendable financial resources of $2.2 billion cover pro forma debt 1.8 times
- Significant local and regional economic impact; UR employs twice the number of employees than the next largest employer in the City of Rochester
- Improved fundraising in the context of UR’s $1.2 billion comprehensive campaign; close to $100M of average annual gift revenue

CHALLENGES

- Significant healthcare exposure, including hospital ownership and a large faculty practice plan with patient-care related revenue of nearly $2.25 billion in FY 2014, 71% of -operating revenue
- Pressure on key revenues likely due to healthcare reform and a constrained research funding environment; research expenses are down 15% since FY 2011
- Relatively weak support of operations from liquid financial resources, given the university’s large expense base; 211 monthly days cash is well below the Aa-rated private university FY 13 median of 488 days

RECENT DEVELOPMENTS

Capital and programmatic investment continue to reinforce and enhance UR’s strategic position as a large private university and medical center. The recent completion of the Golisano Children’s Hospital at URMC, the completion of College Town, a mixed-use development adjacent to campus, and the soon to be constructed Wegmans Hall, which will house new data science programs, are all initiatives to raise the local, regional and national profile of the university. Additionally, a proposed integrated Photonics Institute that may incorporate a large amount of federal and state funding that will support facilities and additional research.

DETAILED RATING RATIONALE

MARKET POSITION: LARGE PRIVATE UNIVERSITY WITH EXPANSIVE HEALTHCARE NETWORK SOLIDIFIES REGIONAL PRESENCE

UR continues to strengthen its selective student market and presence in the region with its large medical center
network. FTE student enrollment of 9,977 in fall 2014 represents over 10% growth since fall 2010. UR has been able to grow while meeting its academic and diversity targets. Strong student demand is further highlighted by steady growth in net tuition per student, which averaged nearly 4% per year over the last five years. Large medical and dental schools, and program investments in the areas of data science, humanities and the performing arts continue to strengthen UR’s student market. UR does not plan to grow much past 10,000 students. We expect stability in the university’s student market as it continues to expand its regional and national presence, recruiting more than 70% of its students from outside the state, compared to 60% just 10 years ago.

UR’s large medical center, which includes three owned hospitals, large medical and dental schools and a large faculty practice plan, continues to gain market share in the region. Strong Memorial Hospital (unrated), the largest in URMC’s network and the region at large, generated close to $1.4 billion of operating revenue and had 39,015 inpatient admissions in FY 2014. Management reports that Strong and the university-owned Highland Hospital (Rochester) (A2/stable) have a combined leading market share in the primary service area of Monroe County. Population growth in Monroe County is modest and the recent merger between URMC’s two largest competitors into what is now named Rochester Regional Health System (not rated) could result in new competitive challenges. Through the newly formed Accountable Health Partners, which includes a network of 1,700 physicians in the region, including URMC faculty, URMC hopes to expand its clinical practice and ultimately become the tertiary provider of choice for the upstate New York region. Strong Memorial’s Medicare case mix index is high (2.0 in FY 2014) highlighting the high acuity care provided. Moody’s maintains an A2 rating and stable outlook on Highland Hospital, and standalone financial performance at Highland continues to strengthen.

Sponsored research at the university and the medical center continues to feel funding pressure as federal research dollars remain flat. UR is highly exposed to federal funding with 80% of research dollars coming from the National Institute of Health. Research expenditures of $285 million in FY 2014 represent a departure from recent highs of $334 million in FY 2011. As funding pressure continues, the university is focused on pursuing the most strategically important research over the next several years. The number of awards and funding dollars are up slightly in FY 2015, but we expect to see relatively flat funding over the next couple of years as funding pressures continue. According to management, an area of potential growth in UR’s research portfolio is data science, which will be supported of the construction of Wegmans Hall.

Fundraising continues to play an important role in financial resource growth and operational support at the university. Early achievement of UR’s $1.2 billion comprehensive campaign will help support capital, endowment and current use needs. As of April 6, 2015 nearly $885 million was raised in cash with an additional $326 million in pledges and commitments.

OPERATING PERFORMANCE, BALANCE SHEET, AND CAPITAL PLANS: BALANCE SHEET GROWTH SUPPORTED BY SUCCESSFUL FUNDRAISING AND CASH FLOW

Centralized fiscal management of the university and medical center contributes to positive operating performance. Bolstered by operating surpluses at URMC, the three year average operating margin for the whole university was 3.1% in FY 2014 and cash flow of 10.2% covered debt service obligations a strong 4.5 times. With the exception of research grants and contracts, which make up 11% of operating revenue, net tuition revenue and patient care revenue continue to grow steadily. However, given the high exposure to healthcare, any material disruption in operating performance at URMC would lead to a deterioration in university performance.

As UR capitalizes on its growing reputation, net tuition revenue continues to grow nicely, averaging 6.0% growth over the last five years. Disciplined financial aid budgeting, which has led to consistency in tuition discounting, in addition to incremental growth in certain programs, is likely to contribute to continued growth in tuition revenue. Net tuition per student of $24,690 is high reflecting graduate and professional programs.

The strengthening and expanding of URMC bolsters overall university operations. Strong Memorial Hospital (Strong) makes up nearly half of all URMC revenues at almost $1.4 billion in FY 2014. Strong’s ability to maintain market share, grow revenues and remain profitable are critical to the credit strength of the university. Strong’s standalone operating margin and cash flow margin in FY 2014 were 5.1% and 9.8%, respectively, an improvement over the last several years. Total patient care revenue of the university continues to grow considerably, growing over 8% in FY 2014. We expect performance of URMC to remain strong. However, as URMC works to expand its network, a dilutive acquisition that puts strain on URMC’s operations or balance sheet could negatively impact UR’s credit profile.

UR’s financial reserves are a critical source of credit strength given the large size of university operations. Expendable financial resources of over $2.2 billion, most of which can be liquidated within one month, sufficiently covers pro forma debt 1.8 times. Coverage is below the median of 2.9 times for Aa-rated private universities.
However, there are limited potential calls on liquidity, a successful fundraising campaign that continues to bolster the balance sheet and total cash and investments of over $3 billion.

UR’s endowment is overseen internally through an investment office in conjunction with the investment committee of the board. UR’s endowment performance has been strong, including an 18.7% return in FY 2014, among the highest for similarly sized endowments. We expect FY 2015 endowment performance will be more muted given broader investment market volatility. Asset allocation is comprised mostly of equities (38%) and alternative investments (41%), with fixed income (5%), commodities (5%), real estate (8%) and cash (3%) rounding out the rest of the portfolio. Centralized treasury and investment management is cost efficient and creates a seamless line of communication between the university and URMC and their immediate cash needs.

Liquidity

UR’s monthly liquidity provides moderate support for operations at the Aa3 rating category. Monthly days cash of 211 days is below the median of 488 days for Aa-rated private universities. However, the university has limited potential calls on liquidity with modest exposure to demand debt and manageable unfunded capital commitments. The university’s liquidity profile is in line with its investment strategy and we expect to see little change moving forward.

The university has nearly $1.7 billion in monthly liquidity, providing over 7.5 times coverage of variable rate demand debt ($244 million in FY 2014). The potential of collateral posting exists with the interest rate swaps. However, these potential calls on liquidity are mitigated by the college’s sufficient liquidity profile.

DEBT AND OTHER LIABILITIES: MODERATE LEVERAGE SUPPORTED BY CONSISTENT REVENUE GROWTH AND CASH FLOW

Following the Series 2015 debt issuance, UR’s leverage will be moderate but manageable at the Aa3 rating category. UR typically issues debt every two years. The university has spent nearly $1.2 billion on capital over the last five years, but expects capital spending to be lower over the next five years as it has met many of its most strategic and urgent capital needs.

Debt Structure

With the current issuance, approximately 82% of the university’s direct debt will be fixed rate and 18% will be issued in variable rate mode.

Counterparty risk associated with letters of credit supporting the tender feature of the university’s two series of variable rate bonds (Series 2003A, B and C and 2006A-1 and B-1), and swaps is well diversified. Letters of credit (LOC) are with three banks and expiration dates are also staggered with three and five-year agreements; JPMorgan Chase & Co. (A3 stable), expires March 3, 2017, HSBC Bank USA, N.A. (Aa2 stable), expires September 9, 2018 and Wells Fargo Bank, N.A. (Aa1 stable) expires August 14, 2015. The university indicates it is finalizing the extension of the Wells Fargo LOC.

Debt-Related Derivatives

The university has several swaps outstanding related to its variable rate bonds, with a combined notional amount of $243.9 million. The swap counterparties are diversified among five counterparties, Wells Fargo Bank, N.A. (Aa1 stable, $46.3 million), Citibank N.A. (A1 stable, $46.2 million), Merrill Lynch & Co., Inc. (Baa1, $104.3 million), Key Bank National Association (A1, rating under review for possible upgrade, $10.6 million) and HSBC Bank USA, N.A. (Aa2 stable, $14.3 million). The total fair value for the swap portfolio as of May 16, 2015 was negative $25.6 million to the university, with no collateral posted at that valuation date. The university could be required to post collateral if the fair value of individual swaps exceeds threshold levels, although the university has never had to post collateral to its swap counterparties to-date.

Pensions and OPEB

UR has modest employee benefit obligations, with expenses associated with its defined contribution pension plan and post-employment healthcare benefits totaling 3% of operating expenses in FY 2014. A post-retirement health plan exists for eligible employees. The plan remains open and the FY 2014 accrued liability was $186 million, manageable given the university’s financial resources.

GOVERNANCE AND MANAGEMENT: STRONG MANAGEMENT TEAM AND INTEGRATED PLANNING
An integrated and closely aligned management team supports financial, strategic and capital planning at both the university and the medical center. The organization is run as one entity and all operations and planning are ultimately supported by one centralized management team and Board of Trustees. Operationally, the organization utilizes efficiencies such as centralized capital and debt planning and central services such as IT, purchasing and human resources. A history of strong fiscal stewardship, thoughtful evaluation of the competitive landscape, and the successful execution of strategic plans support the university’s long-term credit profile. Programmatic and capital investment support strategic institutional priorities in terms of strengthening enrollment, expanding URMC’s market share and the university’s overall reputational and economic footprint in the region.

We do not anticipate a departure from the university’s financial strategies after the transition of its long-serving CFO, expected to take place at the beginning of 2016. The university regularly visits its succession planning preparedness and has a history of successfully transitioning academic and administrative leadership.

KEY STATISTICS FOR THE UNIVERSITY (FY 2014 financial data, fall 2014 enrollment data)

- Full-Time Equivalent Enrollment: 9,977 students
- Total Financial Resources: $2.67 billion
- Total Direct Debt: $1.1 billion ($1.22 billion pro forma)
- Total Operating Revenue: $3.18 billion
- Reliance on Patient Care Revenue (% of Operating Revenue): 70.7%
- Monthly Days Cash on Hand: 211.2 days
- Operating Cash Flow Margin: 10.2%

KEY STATISTICS FOR STRONG MEMORIAL HOSPITAL IN FY 2014

- Operating revenue (Moody’s adjusted): $1.41 billion
- Operating margin: 5.1% (Including transfers to University of Rochester Medical Center Divisions as operating expenses)
- Operating cash flow margin: 9.8%
- Cash to debt: 206.8%
- Days cash on hand: 140.1 days

OBLIGOR PROFILE

The University of Rochester, founded in 1850, is a comprehensive private university with a significant research profile and large healthcare operations. The university is highly selective, enrolling nearly 10,000 students in bachelor’s, master’s and doctorate programs. As the largest employer in the City of Rochester with nearly 25,000 employees, the university plays a significant role in the economic vitality of the city and region.

LEGAL SECURITY

All bonds are unsecured general obligations of the university.

USE OF PROCEEDS

The proceeds of the bonds will be used to refund selected maturities of the Series 2004A, 2007A-1, 2007A-2, and 2007B bonds. Additionally, proceeds of the bonds will be used to finance Wegmans Hall (home for the Goergen Institute for Data Science), renovations to dining and student space, offsite leasehold improvements to support community-based medical facilities and major infrastructure projects. The bonds will also pay the cost of issuance.

RATING METHODOLOGY

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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