Moody's Investors Service

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New Issue: University of Rochester, NY

MOODY'S ASSIGNS Aa3 RATING TO UNIVERSITY OF ROCHESTER'S $134 MILLION REVENUE BONDS SERIES 2009 TO BE ISSUED THROUGH THE DORMITORY AUTHORITY OF THE STATE OF NEW YORK; OUTLOOK IS STABLE

RATINGS AFFIRMED ON $694 MILLION OF DEBT BACKED BY THE UNIVERSITY

Dormitory Authority of the State of New York
Higher Education
NY

Moody's Rating

ISSUE		RATING
Revenue Bonds, Series 2009A		Aa3
Sale Amount	$89,240,000	
Expected Sale Date	07/08/09	
Rating Description	Private University Revenue Bonds	
Revenue Bonds, Series 2009B		Aa3
Sale Amount	$36,185,000	
Expected Sale Date	07/08/09	
Rating Description	Private University Revenue Bonds	
Revenue Bonds, Series 2009C		Aa3
Sale Amount	$10,895,000	
Expected Sale Date	07/08/09	
Rating Description	Private University Revenue Bonds	
Revenue Bonds, Series 2009D		Aa3
Sale Amount	$3,680,000	
Expected Sale Date	07/08/09	
Rating Description	Private University Revenue Bonds	

Moody's Outlook Stable

Opinion

NEW YORK, Jun 23, 2009 -- Moody's Investors Service has assigned a Aa3 rating to the University of Rochester's $134 million Revenue Bonds Series 2009 to be issued through the Dormitory Authority of the State of New York. The rating on the University's previously issued debt backed by the University's general obligation has also been affirmed. The outlook is stable.

Moody's also maintains an A2 rating on Highland Hospital's bonds. Highland Hospital is a wholly owned subsidiary of the University.

LEGAL SECURITY: The bonds are a general, unsecured obligation of the University. The University and Authority will be seeking, in conjunction with the issuance of the Series 2009 bonds to amend the loan agreement to remove and amend certain covenants, including an Available Assets to General Liabilities test.

INTEREST RATE DERIVATIVES: The University has several swaps outstanding related to its variable rate bonds. The swap counterparties are diversified amongst three counterparties reflecting 25%, 27% and 44% of the notional amount with Wells Fargo, Citibank, and Merrill Lynch respectively. The total fair value for the swap portfolio was negative $17 million as of June 1, 2009, with no collateral posted at that valuation date.

The University is required to post collateral if the fair value of individual swaps exceed threshold levels. Based on a stress test of low interest rates, including rates near 0%, however, the University is unlikely to be required to post a material amount of collateral.

STRENGTHS

- Large and diversified enrollment base (8,750 full-time equivalent students) with highly reputable graduate programs and continued healthy growth in net tuition per student ($19,326 in FY2008); continued strengthening of student demand most directly demonstrated by a ramp up in yield on admitted students to 25% in fall 2008 from 20% in fall 2005;

- Healthy and highly consistent cash flow generation by the University as a whole (average operating margin of 2.9%) stemming from consistently positive performance of health system, growing research activities and improved philanthropic support;

- Large financial resource base despite recent investment losses ($2.0 billion of total financial resources at FYE 2008; projected to be approximately $1.4 billion assuming 30% decline) which has been enhanced over the last few years as fundraising and investment returns fueled growth;

- Potential for significant expansion in fundraising success over multiple years, despite challenging environment as senior leadership team focuses on investing in development infrastructure (gift revenue of $99 million in FY2008 compared to average below $50 million in FY2004-2006)

CHALLENGES

- Relatively heavy reliance on healthcare operations (64% of total revenue) which has historically been more volatile than other University operating units, although recent performance has been healthy and the University's hospitals are leaders in service area;

- Highly competitive environment for students (demonstrated by low matriculation rate of 25%) may place pressure on future tuition flexibility, although recent enrollment trends have been sustained as the University has lowered its tuition discount rate;

- Capital spending requirements are likely to remain substantial, but several projects have been delayed or cancelled and we expect future borrowing to be moderate.

MARKET POSITION/COMPETITIVE STRATEGY: RECENT STRENGTHENING OF STUDENT MARKET POSITION HELPS POSITION UNIVERSITY FOR MORE CHALLENGING ECONOMIC ENVIRONMENT; HEALTHCARE SYSTEM MAINTAINS MARKET LEADERSHIP

Moody's believes the University of Rochester will continue to build strength in its undergraduate and graduate student markets over time, despite strong competition, leading to relatively stable enrollments and student related revenues. The University experienced greater than 3% growth in total FTE enrollment for each of the last three years, with total enrollment rising to 8,750 students. The University's graduate enrollment is relatively large, comprising approximately 40% of total enrollment including schools of Medicine, Business and Education.

Although the University faces strong competition from other educational institutions, management has continued to improve the University's standing, with continual improvements in selectivity (41% in fall 2008 compared to 53% in fall 2002). The University achieved an increase in yield on admitted students for the last four years after reaching a low of 19.7% in fall 2004 (compared to 25% fall 2008). Moody's believes the improvement in yield rate, coupled with ongoing growth in net tuition per student, has positioned the University more favorably for a more challenging student recruitment and financial aid environment. While we expect most institutions, including the University, will experience some weakening in student demand metrics for fall 2009, the University is expected to comfortably maintain relatively stable enrollment and net tuition revenue.

Strong Memorial Hospital (SMH) continues to maintain its role as a regional referral center providing high end exclusive services, ensuring its status as an essential provider in the area, maintaining together with Highland Hospital (HH) a growing 53.1% market share in the greater Rochester metropolitan area (based on 2006 data), well ahead of Rochester General Hospital's 30.5% and Park Ridge Hospital's 16.4% market share. After the opening of eighteen new beds, inpatient admissions grew 2.1% in FY 2008 due to patient throughput and length of stay initiatives, although occupancy remains elevated at 93.5%. Through the first ten months of FY 2009, SMH has continued to experience an overall increase in inpatient volume and a slight decline in surgical volume. The recent completion of the Cancer Center has resulted in growth in radiation therapy and infusion services.

OPERATING PERFORMANCE: OPERATING PERFORMANCE HAS REMAINED HEALTHY, CONTINUING LONG TREND OF BALANCED OPERATIONS FOR THE UNIVERSITY AS A WHOLE

Moody's expects the University of Rochester to maintain a long record of balanced operating performance, although heavy reliance on healthcare operations indicates some potential for volatility in performance over the long term. On a consolidated basis, the University has generated an average annual operating margin of 2.9% over the last three years. Operating cash flow margins have historically ranged from 8% to 10% annually with average debt service coverage of 3.6 times in FY2008.

The University's revenue sources are varied, but concentrated in healthcare activities (64%). In addition, grant and contract revenue, primarily reflecting the research activity of the University represents 15% of operating revenues, with student derived tuition and auxiliary service revenue representing just 10% of the total. As such, the University's ability to sustain balanced or positive operating performance is highly reliant on the continued strong performance of the healthcare enterprises, primarily Strong Memorial Hospital and Highland Hospital.

Following nine consecutive years of improved operating cash flow, the health care entities generated $110.4 million (9.1% margin) of operating cash flow in FY 2008, flat compared to $110.4 million of operating cash flow (9.6% margin) in FY 2007. Through April 30, 2009, the health care entities generated $77.8 million of operating cash flow (8.1% margin). Expense growth outpaced revenue growth in part due to the ramp up and recent opening of the Wilmot Cancer Center and work force recruitment expenditures. Potential revenue pressures stem from lower than expected Medicare reimbursement, reductions in graduate medical education reimbursement, the implementation of a state provider tax program, and a $12 million unfavorable impact due to reduced Medicaid reimbursement in FY 2009. As a result, management has formulated several operational improvement initiatives, including a reduction of 109 FTEs, the implementation of a hiring freeze, and elimination of agency nurse utilization. SMH continues to address capacity constraints and decompress the main campus and ramp up services at HH.

Grant and contract revenue has grown rapidly in past years and somewhat flattened recently. Grant and contract revenue reached $366 million in FY2008 compared to $205 million in FY2000. The University has experienced approximately 5% growth in research expenditures year-to-date in FY2009 and is likely to see some boost in research grant revenue due to the federal stimulus funding and a substantial increase in the number of grant applications associated with the stimulus programs.

The University's ability to continue to attract stable enrollment should ensure that tuition revenues continue to grow. In addition, as the University has invested in development and fundraising efforts, gift revenue has grown, with total gift revenue reaching a record $99 million in FY2008, compared to $43 million in FY2006. Expanded fundraising staff and investment should fuel additional annual fund and endowment growth to support operations over the longer term, despite a challenging fundraising environment. Year-to-date cash receipts from gifts are lower than the prior year, after record receipts of over $100 million in FY2008.

BALANCE SHEET POSITION: FINANCIAL RESOURCES EXPECTED TO REFLECT SUBSTANTIAL DECLINE DUE TO INVESTMENT LOSSES, BUT REMAIN HEALTHY WITH ADEQUATE LIQUIDITY

Despite substantial investment losses, on par with other universities, Moody's believes that the University's balance sheet profile will continue to provide a healthy cushion for debt and operations of the University. At the end of FY2008, the majority of the University's financial resources were unrestricted with $1.4 billion of unrestricted financial resources compared to a total of $2.0 billion. At the end of FY2008, expendable financial resources cushioned debt and operations by 2.4 times and 0.7 times respectively.

Through March 31, 2009, the University's endowment had returned a negative 26% for the fiscal year, largely on par with other institutions. Assuming a 30% decline in total resources due to investment losses and spending fully recognized in expendable financial resources, Moody's projects expendable resources of $993 million at the end of FY2009, which would cushion pro-forma debt and operations by 1.3 and 0.4 times.

The University's liquidity remains healthy with over $376 million of working capital funds invested in highly liquid securities and a combined $125 million available under two operating lines of credit. In addition, the University estimates that another $800 million of endowment funds are liquid within a 12 month period, or approximately 60% of the endowment portfolio. The University has run multiple scenarios to project its liquidity over the next several years, and is closely managing its liquidity profile.

The University's investments are well diversified across traditional equities (31%), traditional fixed income (9%), hedge funds and other alternatives (60%). The University's largest manager allocation is to a single, traditional, long-only domestic equity and fixed income manager and amounts to 6.7%. The only other firm with greater than 5% of the portfolio is a large, domestic fixed income institutional mutual fund.

The University's debt structure is somewhat unique in that a large portion of principal is retired annually and future debt service declines substantially over time. On average the University has paid down approximately $30 million in debt annually. Debt service peaks at approximately $61 million in 2016 but falls rapidly thereafter and reaches just $24 million in 2029. The University is likely to continue significant capital investment and renewal spending over time. However, management has demonstrated a willingness to scale back capital or postpone projects with the current borrowing representing more than $100 million less in borrowing than previously expected. The medical center's clinical and translational sciences building (CTSB) was on hold but is now proceeding with the confirmation of New York State grant funds and with a portion of the Series 2009 bond proceeds. The pediatric replacement and imaging sciences modernization (PRISM) project is on hold due to the financial environment. While the project is likely to proceed in some form over time, the University does not have any near-term plans for additional borrowing beyond the Series 2009 bonds.

The University has two series of variable rate bonds backed by letters of credit (Series 2003A, B and C and 2006A-1 and B-1). The letters of credit are backed by several banks (see rated debt section) with expirations in 2011 and 2013.

Outlook

The stable outlook is based on Moody's expectation of maintenance of positive operating performance with stabilization and eventual growth in financial resources with limited additional borrowing in the near-term.

WHAT COULD CHANGE THE RATING - UP

Ability to expand fundraising success leading to growth in financial resources relative to debt and operations, without deterioration in performance of healthcare enterprises

WHAT COULD CHANGE THE RATING - DOWN

Operating deficits; rapid expansion of debt without offsetting financial resource growth

KEY DATA AND RATIOS (Fiscal year 2008 financial data; fall 2008 enrollment data):

*The first figure represents FY2008 financial data and fall 2008 enrollment with current debt outstanding

*The second figure represents FY2008 financial data and fall 2008 enrollment, with a 30% estimated decline in investments and financial resources (calculated by taking 30% of total resources out of expendable resources), and pro-forma debt levels since the end of the fiscal year.

Total Enrollment: 8,750 full-time equivalent students

Total Direct Debt: $710 million; $789 million (pro-forma)

Expendable Resources to Pro-forma Debt: 2.4x; 1.3x

Expendable Resources to Operations: 0.7x; 0.4x

Three-Year Average Operating Margin: 2.9%

Reliance on Patient Care Revenue: 64%

RATED DEBT:

University Backed Bonds:

Series 1999A and B, 2004A, 2007A and B: Aa3 rating

Series 1997A, 1998A, 2000A, and 2003 Direct Note Obligation: Aa3 Rating; Insured by National Public Finance Guarantee Corp whose current financial strength rating is Baa1 on review for possible upgrade

Series 2001A: Aa3 rating; Insured by Ambac whose current financial strength rating is Ba3 with a developing outlook

Series 2003A, B and C: Aa3 underlying rating; Aaa/VMIG1 enhanced rating based on letters of credit from JPMorgan Chase (rated Aa1/P-1), HSBC Bank USA (rated Aa3/P-1), and JPMorgan Chase respectively and based on Moody's two-party pay methodology

Series 2006A-1 and B-1: Aa3 underlying rating; Aaa/VMIG1 enhanced rating based on letters of credit from Bank of America (rated Aa3/P-1), using two party pay methodology

Highland Hospital Backed Bonds: Fixed Rate Series 2005C, Direct Note Obligation (Taxable) Series 2005: A2 rating

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METHODOLOGY

The principal methodology used in rating University of Rochester was "Moody's Rating Approach for Private Colleges and Universities," which can be found at www.moodys.com in the Credit Policy & Methodologies directory, in the Ratings Methodologies subdirectory. Other methodologies and factors that may have been considered in the process of rating this issuer can also be found in the Credit Policy & Methodologies directory.

The last rating action was on August 26, 2008 when the ratings of the University of Rochester were upgraded to Aa3 from A1.

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