

University of Hawaii

Revenue Bonds New Issue Report

Ratings

New Issue

\$8,850,000 Board of Regents of the University of Hawaii, University Revenue Bonds, Series 2012A (R) AA

Outstanding Debt

\$249,100,000 Board of Regents of the University of Hawaii, University Revenue Bonds AA

\$238,800,000 Board of Regents of the University of Hawaii, University Revenue Bonds (Taxable Build America Bonds) AA

\$135,390,000 Board of Regents of the University of Hawaii, University Bonds AA

Rating Outlook

Stable

New Issue Details

Sale Information: \$8,850,000 Board of Regents of the University of Hawaii University Revenue Bonds, Series 2012A (R), the week of Feb. 6 via negotiation.

Security: Bonds are secured by net revenues of UH's auxiliary network (the network), a subordinate pledge on legislative appropriations, and amounts on deposit in the Hawaii Cancer Research Special Fund (series 2010A-1 and 2010A-2 bonds only). Taxable series 2010A-1 and 2010B-1 Build America Bonds are eligible for federal subsidy payment equal to 35% of interest payable. University bonds are secured by a portion of moneys in the state of Hawaii's Tobacco Settlement Special Fund, a senior pledge on legislative appropriations, and a subordinate pledge of net revenues of the network.

Purpose: To refund series 2001B university revenue bonds.

Final Maturity: Oct. 1, 2018.

Key Rating Drivers

Stable Credit Characteristics: The 'AA' rating reflects UH's deep integration in the state of Hawaii's (GO bonds rated 'AA' with a Stable Rating Outlook by Fitch Ratings) public education system and economy. Substantial state support, prudent financial management, and a dominant market position support stable operations and a sound level of balance sheet resources.

Sole Provider Status: UH's credit benefits from its broad system of campuses, university centers, and other facilities stretching across six of the state's islands. Fall 2011 headcount of 60,330 students was up nearly 20% from four years prior, and UH captured nearly 40% of Hawaii's 2011 high school graduates.

Heavy Reliance on the State: Base state operating appropriations now account for approximately one quarter of annual operating revenues, with other transfers from the state providing another 11%–12%. Recent reductions in state funding challenged UH's performance, but the university implemented revenue and expense measures to maintain stability.

Related Research

[Fitch Rates Hawaii's GOs 'AA'; Outlook Stable, Nov. 4, 2011](#)

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Rating History

Rating	Action	Outlook/ Watch	Date
AA	Affirmed	Stable	2/3/12
AA	Affirmed	Stable	9/14/10
AA	Revised	Stable	4/30/10
AA-	Upgraded	Stable	3/17/09
A+	Affirmed	Positive	9/20/06
A+	Assigned	Stable	5/28/02

Credit Profile

Close Ties to State

The integrated relationship between UH and the state is a primary credit factor. Funding for the university accounted for a significant 12.1% of the state's general fund budget in the first year of the biennium spanning fiscal years 2012 and 2013 (2011–2013 biennium). Base appropriations are up modestly this year after declines during the prior biennium. Capital support, through appropriations and issuances of dedicated state GO bonds, remains strong.

Stable Operating Margin, Adjusted for OPEB

To manage through the operating appropriation declines in the past biennium, the university instituted a series of expenditure cuts. Most significantly, UH and the state negotiated significant union concessions (namely salary reductions), including from faculty. Impressively, UH's actual compensation and benefits expenditures declined 4.9% between fiscal years 2009 and 2011.

Fitch notes this decline excludes the annual cost of other post-employment benefit (OPEB) accrual. UH began reporting OPEB on its financial statements in fiscal 2008 per GAAP reporting standards. Inclusive of this liability, UH's operating margin (including endowment distributions) declined in 2008 to negative 2.6% and continued weakening, reaching negative 6.2% in fiscal 2011. Before 2008, the GAAP margin had generally been closer to break-even or slightly positive.

Importantly all OPEB costs and liabilities are fully borne by the state with no actual expenditures incurred or anticipated by UH. Representatives from the state's Department of Finance confirmed the state's full responsibility for the OPEB obligation in discussions with Fitch. When adjusted by excluding annual OPEB costs, UH's operating margin remained positive since fiscal 2007, reaching 3.8% in fiscal 2010 and 4.2% in fiscal 2011.

Diversifying Revenue Base

In addition to expense management, increases in grants and contracts and student-generated revenues played an important role in offsetting the effects of state operating cuts. Driven by a multiyear tuition increase plan and steady enrollment gains, student-generated revenues grew to 21.7% (\$314.8 million) of fiscal 2011 operating revenues. UH's board of regents recently adopted a new five-year tuition increase plan, providing a stable base of future operating support.

Grants and contracts revenue also increased and grew its share of operating revenues, reaching 34.6% in fiscal 2011 (\$502.4 million). Fitch notes that UH increased funding from multiple federal agencies between fiscal years 2010 and 2011, including the National Science Foundation, the U.S. Department of Health and Human Services, NASA, and the U.S. Department of Commerce.

Improving Financial Cushion

Consistent modest surpluses (adjusted for OPEB) bolstered UH's balance sheet resources. The university's available funds grew 62.6% between fiscal years 2007 and 2011. Coverage of operating expenses and pro forma debt (39.2% and 96.9%, respectively, at the end of fiscal 2011) is in line with other public universities rated similarly by Fitch.

Related Criteria

U.S. College and University Rating
Criteria, July 14, 2011

Revenue-Supported Rating Criteria,
June 20, 2011

Fitch notes that 43.6%, or \$271.9 million, of UH's bonds are expected to be paid from dedicated non-university sources (cigarette tax revenues and tobacco master settlement funding). These streams have historically been sufficient to cover debt service to date, though tobacco master settlement projections provided by the underwriter indicate future declines to slightly below 1.0x coverage. University revenues provide the ultimate backstop in the event of coverage shortfalls, warranting the parity rating with UH's other revenue bonds.

Operating Profile

Enrollment

Demand and Enrollment Data

(Fall Semester)

	2006	2007	2008	2009	2010	2011
Total Systemwide Headcount	49,990	50,454	53,526	57,945	60,090	60,330
Institutions — Full-Time Equivalents						
University of Hawaii at Manoa (UHM) — Undergraduate	12,058	11,865	11,799	11,972	11,934	12,360
University of Hawaii at Manoa — Graduate	4,159	4,170	4,286	4,457	4,397	4,126
University of Hawaii at Hilo — Undergraduate	2,786	2,756	2,829	2,941	2,944	2,944
University of Hawaii at Hilo — Graduate	163	277	416	536	676	686
University of Hawaii at West Oahu — Undergraduate	476	522	640	730	823	910
University of Hawaii at West Oahu — Graduate	0	0	0	0	0	0
Community Colleges	14,580	14,913	16,297	18,492	19,759	19,432
Undergraduates Subtotal	29,900	30,056	31,565	34,135	35,460	35,646
Graduates Subtotal	4,322	4,447	4,702	4,993	5,073	4,812
Total	34,222	34,503	36,267	39,128	40,533	40,458
Admissions (UHM)						
Undergraduate Applications	10,752	10,616	11,456	12,155	11,589	11,513
Undergraduate Admissions	7,806	7,749	8,103	8,615	8,570	9,136
Acceptance Rate (%)	72.6	73.0	70.7	70.9	73.9	79.4
Undergraduate Matriculants	3,913	3,908	3,827	3,985	3,833	4,117
Matriculation Rate (%)	50.1	50.4	47.2	46.3	44.7	45.1
Average SAT Score						
Incoming Freshmen (UHM)	1,094	1,095	1,087	1,087	1,097	1,085
National Average for Incoming Freshmen	1,021	1,017	1,017	1,016	1,017	1,011
Annual Resident Undergraduate Cost of Attendance (UHM)						
Tuition and Mandatory Fees	4,523	5,391	6,259	7,168	8,095	9,100
Room and Board	7,185	7,335	7,564	8,493	9,410	10,279
Total	11,708	12,726	13,823	15,661	17,505	19,379

Note: Numbers may not add due to rounding.

The University of Hawaii's demand profile reflects a mix of strong growth at certain expanding campuses and more stability at its most mature sites. Community colleges and the University of Hawaii at West Oahu (UHWO) both experienced substantial increases in full-time equivalents (FTEs) between fall 2007 and fall 2011 (30.3% and 74.3%, respectively). The weakened economy was the primary driver behind the rapid gains at the community college

campuses. The state's economy began rebounding in 2011, as reflected in employment gains. Accordingly, fall 2011 community college FTEs declined slightly from the fall 2010 level.

UHWO is the newest member of UH's overall system. After several decades as an upper-division campus (serving primarily community college graduates), UHWO became a full four-year institution in fall 2007. Construction on a new campus began in August 2010 and is on track to open for the fall 2012 semester. Over the next 10 years, management expects UHWO to grow from its current 910 FTEs to serve more than 7,600 students at the new campus.

The flagship University of Hawaii at Manoa (UHM) and the University of Hawaii at Hilo (UHH) grew enrollment 2.8% and 19.7%, respectively, between fall 2007 and fall 2011. UHH's growth was partially driven by the establishment of the state's first school of pharmacy, at UHH's Big Island of Hawaii campus. UHH's inaugural class of 90 Doctor of Pharmacy (Pharm. D.) students entered in fall 2007, graduating last spring. The school includes four classes of 90 Pharm. D. students spread across temporary facilities at UHH. The university is pursuing \$38 million in state GO bonds to finance the first phase of a permanent school of pharmacy facility.

UHM serves as the flagship institution for UH and enrolls the vast majority of graduate students and more undergraduates than any other single UH campus. Recent upgrades to UHM's primary undergraduate residential facilities helped drive solid 3.6% growth in undergraduate FTEs in fall 2011 in comparison to the prior year. Management reports that out-of-state enrollment growth has also continued, despite steady tuition and fee increases. In fact, the university's Board of Regents (board) recently increased the cap on out-of-state enrollment at UHM and UHH to 35% because both campuses were on track to exceed the prior 30% cap.

Financial Profile

Revenue Diversity

State appropriations remain a key funding source and did decline annually in fiscal 2010 and 2011 (20.8% and 2.9%, respectively) as the state dealt with tax revenue shortfalls. The change shown in UH's financial statements between fiscal years 2009 and 2010 is much more drastic but largely reflects accounting changes rather than the actual reduction in state moneys provided to the university for day-to-day operations. Beginning with fiscal 2010, the state revised its funding methodology for UH by directly allocating certain funding (for fringe benefits and debt service on state GO bonds) directly to the Department of Budget and Finance, rather than flowing it through UH's appropriations.

Offsetting the actual declines in state operating appropriations during the last biennium, UH experienced consistent growth in its two other primary revenue sources — student-generated revenues and grants and contracts. Both increased by double-digit margins between fiscal years 2009 and 2010 (10.5% and 18.7%, respectively) and more modestly in fiscal 2011. Steady enrollment gains and the multiyear tuition increase plan fueled the growth in student-generated revenues.

UH's growing research profile enhanced its grants and contracts position, and Fitch views continued growth as likely. The completion of the Cancer Care Center in late 2012 should attract more medical research dollars, as it will serve as the new home for the state's only National Cancer Institute. In addition, Department of Defense spending will likely increase, as UH anticipates an additional \$10 million in annual funding attributable to its status as one of five Naval University Affiliated Research Centers.

Financial Summary

(\$000, Audited Fiscal Years Ended June 30)

	2007	2008	2009	2010	2011
Statement of Operating Activities					
Gross Tuition and Fees	173,146	203,243	242,418	291,890	319,772
Less: Student Aid	36,196	52,274	61,340	82,302	95,915
Net Tuition and Fees	136,950	150,969	181,078	209,588	223,857
Sales and Services of Auxiliary Enterprises	74,642	86,633	84,200	83,597	90,939
Federal Grants and Contracts	316,690	313,770	329,646	397,984	438,854
State/Local Grants and Contracts	24,812	30,587	32,038	28,064	18,358
Other Grants and Contracts	31,735	35,007	37,956	48,299	45,202
State Appropriations	623,984	690,625	731,394	369,948	359,077
Gifts and Contributions	40,057	31,543	23,285	24,398	24,703
Dividend and Interest Income ^a	21,378	21,383	15,167	10,470	8,708
Sales of Goods and Services and Other Operating Revenues	37,993	39,284	39,620	46,655	53,919
Transfers to/(from) State of Hawaii	(104,584)	(82,540)	(97,038)	160,971	163,992
Total Operating Revenues	1,203,657	1,317,261	1,377,346	1,379,974	1,427,609
Unrealized/Realized Gains Portion of Endowment Payout ^b	3,722	9,217	14,133	30,430	24,892
Adjusted Total Operating Revenues	1,207,379	1,326,478	1,391,479	1,410,404	1,452,501
Compensation and Benefits ^c	767,285	901,678	995,777	964,094	1,007,237
Supplies, Services, and Cost of Goods Sold	185,582	185,216	201,618	202,521	218,469
Student Aid	31,593	30,162	36,297	46,314	53,411
Operation and Maintenance of Plant (Includes Telephone and Utilities)	67,325	81,449	84,115	79,506	84,741
Depreciation	65,387	71,226	79,228	87,401	85,591
Interest Expense	3,919	10,629	11,175	14,004	22,244
Travel and Other Operating Expenses	66,922	80,728	67,284	64,058	71,094
Total Operating Expenses	1,188,013	1,361,088	1,475,494	1,457,898	1,542,787
OPEB Adjustment ^d	N.A.	88,560	94,770	101,521	150,637
OPEB Adjusted Total Operating Expenses	1,188,013	1,272,528	1,380,724	1,356,377	1,392,150
Change in Net Assets from Operations	15,644	(43,827)	(98,148)	(77,924)	(115,178)
Adjusted Change in Net Assets from Operations	19,366	(34,610)	(84,015)	(47,494)	(90,286)
OPEB Adjusted Changed in Net Assets from Operations	19,366	53,950	10,755	54,027	60,351
Realized and Unrealized Gain/(Loss) on Investments	91,333	179,147	(124,556)	(195,648)	95,339
Capital Grants and Gifts	9,840	8,426	37,653	6,771	15,523
Other Non-Operating Revenues	28,472	49,592	47,882	29,183	38,671
Other Non-Operating Expenses	(47,462)	(77,527)	(54,396)	(28,061)	(41,818)
Total Non-Operating Revenues/(Expenses)	82,183	159,638	(93,417)	(187,755)	107,715
Change in Net Assets	97,827	115,811	(191,565)	(265,679)	(7,463)
Change in Net Assets from Operations:	15,644	(43,827)	(98,148)	(77,924)	(115,178)
Plus Depreciation	65,387	71,226	79,228	87,401	85,591
Plus Interest Expense	3,919	10,629	11,175	14,004	22,244
Net Income Available for Debt Service	84,950	38,028	(7,745)	23,481	(7,343)

^aInterest and dividend portion of annual endowment distributions from UH Foundation and UH endowments. ^bNon-interest and dividend income portion of annual endowment distributions. ^cBeginning in fiscal 2008, includes annual OPEB cost, per GAAP. ^dAnnual OPEB cost per notes in audited financial statements. N.A. – Not applicable. Note: Numbers may not add due to rounding.

Financial Summary (continued)

(\$000, Audited Fiscal Years Ended June 30)

	2007	2008	2009	2010	2011
Adjusted Change in Net Assets from Operations:	19,366	(34,610)	(84,015)	(47,494)	(90,286)
Plus Depreciation	65,387	71,226	79,228	87,401	85,591
Plus Interest Expense	3,919	10,629	11,175	14,004	22,244
Net Income Available for Debt Service	88,672	47,245	6,388	53,911	17,549
OPEB Adjusted Change in Net Assets from Operations:	19,366	53,950	10,755	54,027	60,351
Plus Depreciation	65,387	71,226	79,228	87,401	85,591
Plus Interest Expense	3,919	10,629	11,175	14,004	22,244
Net Income Available for Debt Service	88,672	135,805	101,158	155,432	168,186
Annual Debt Service	17,881	14,114	30,592	23,485	33,596
Maximum Annual Debt Service ^e	46,452	46,452	46,452	46,452	46,452
MADS Fiscal Year ^e	2016	2016	2016	2016	2016
Typical Pro Forma Debt Service ^e	39,134	39,134	39,134	39,134	39,134
Balance Sheet					
Cash and Cash Equivalents	37,815	105,683	53,033	47,031	71,709
Investments	571,698	540,616	681,047	760,675	1,050,493
Total Cash and Investments	609,513	646,299	734,080	807,706	1,122,202
Less: Restricted Non-Expendable and Certain Other Restricted Net Assets ^f	237,926	212,510	299,038	288,372	518,182
Available Funds	371,587	433,789	435,042	519,334	604,020
% Total Investments Classified as Alternative Assets Per Audit ^g	18.6	21.5	13.6	15.1	14.2
Adjusted Available Funds	309,498	363,275	383,046	448,032	528,222
Net Property, Plant, and Equipment	1,074,030	1,188,635	1,275,918	1,356,864	1,513,137
Liabilities					
Fixed-Rate Bonds Payable	264,065	263,045	358,630	351,600	637,045
Total Bonds Payable	264,065	263,045	358,630	351,600	637,045
Other Obligations					
Capital Leases	14,255	13,820	0	0	0
Notes and Installment Contracts Payable	338	364	47	0	0
Bond Premiums, Deferred Bond Refunding and Issuance Costs	(7,538)	(7,342)	(6,890)	(6,567)	(1,469)
Total Other Obligations	7,055	6,842	(6,843)	(6,567)	(1,469)
Total Long-Term Debt	271,120	269,887	351,787	345,033	635,576
Total Pro Forma Debt ^h	N.A.	N.A.	N.A.	N.A.	623,290
Unrestricted Net Assets	154,260	214,699	217,287	272,100	323,649
Invested In Capital Assets, Net of Related Debt	890,877	967,717	1,050,563	1,099,820	1,182,287
Restricted — Nonexpendable and Certain Other Restricted Net Assets ^f	237,926	212,510	299,038	288,372	518,182
Restricted — Expendable	295,207	358,944	281,081	391,926	279,670
Total Net Assets	1,578,270	1,753,870	1,847,969	2,052,218	2,303,788

^eCalculated excluding Build America Bonds subsidy, using pro forma debt service schedule provided by the underwriter. ^fIncludes unspent bond proceeds because Fitch does not view these as available funds. ^gIncludes limited partnerships, real estate, absolute return, and other investments. ^hProvided by the underwriter and as of Feb. 1, 2012. N.A. – Not applicable. Note: Numbers may not add due to rounding.

Financial Ratios

(Audited Fiscal Years Ended June 30)

	2007	2008	2009	2010	2011
Revenue Diversity Ratios (Total Unrestricted Operating Revenues)					
Tuition	11.4	11.5	13.1	15.2	15.7
Student Fees (Tuition and Auxiliary Revenues)	17.6	18.0	19.3	21.2	22.1
Federal Grants and Contracts	26.3	23.8	23.9	28.8	30.7
State/Local Grants and Contracts	2.1	2.3	2.3	2.0	1.3
Other Grants and Contracts	2.6	2.7	2.8	3.5	3.2
Total Grants and Contracts	31.0	28.8	29.0	34.4	35.2
State Appropriations	51.8	52.4	53.1	26.8	25.2
Gifts and Contributions	3.3	2.4	1.7	1.8	1.7
Interest and Dividend Income	1.8	1.6	1.1	0.8	0.6
Transfers to/(from) State of Hawaii	(8.7)	(6.3)	(7.0)	11.7	11.5
Revenue Diversity Ratios (Adjusted Total Unrestricted Operating Revenues)					
Tuition	11.3	11.4	13.0	14.9	15.4
Student Fees (Tuition and Auxiliary Revenues)	17.5	17.9	19.1	20.8	21.7
Federal Grants and Contracts	26.2	23.7	23.7	28.2	30.2
State/Local Grants and Contracts	2.1	2.3	2.3	2.0	1.3
Other Grants and Contracts	2.6	2.6	2.7	3.4	3.1
Total Grants and Contracts	30.9	28.6	28.7	33.6	34.6
State Appropriations	51.7	52.1	52.6	26.2	24.7
Gifts and Contributions	3.3	2.4	1.7	1.7	1.7
Total Endowment Distribution	2.1	2.3	2.1	2.9	2.3
Transfers to/(from) State of Hawaii	(8.7)	(6.2)	(7.0)	11.4	11.3
Financial Aid Ratios					
Tuition Discounting (%)	20.9	25.7	25.3	28.2	30.0
Net Tuition and Fees	136,950	150,969	181,078	209,588	223,857
Δ in Net Tuition and Fees (%)	N.A.	10.2	19.9	15.7	6.8
Operating Performance Ratios (%)					
Operating Margin	1.3	(3.3)	(7.1)	(5.6)	(8.1)
Adjusted Operating Margin	1.6	(2.6)	(6.0)	(3.4)	(6.2)
OPEB Adjusted Operating Margin	1.6	4.1	0.8	3.8	4.2
Liquidity Ratios (%)					
Available Funds/Total Unrestricted Operating Expenses	31.3	31.9	29.5	35.6	39.2
Available Funds/Total Long-Term Debt	137.1	160.7	123.7	150.5	95.0
Available Funds/Total Pro Forma Long-Term Debt	N.A.	N.A.	N.A.	N.A.	96.9
Adjusted Available Funds/Total Unrestricted Operating Expenses	26.1	26.7	26.0	30.7	34.2
Adjusted Available Funds/Total Long Term Debt	114.2	134.6	108.9	129.9	83.1
Adjusted Available Funds/Total Pro-Forma Long Term Debt	N.A.	N.A.	N.A.	N.A.	84.7
Leverage Ratios					
Total Operating Revenues Basis					
Historical Debt Service Coverage (x)	4.8	2.7	(0.3)	1.0	(0.2)
Historical Debt Burden (%)	1.5	1.1	2.2	1.7	2.4
Pro Forma MADS Coverage (x)	1.8	0.8	(0.2)	0.5	(0.2)
Pro Forma MADS Burden (%)	3.9	3.5	3.4	3.4	3.3
Pro Forma AADS Coverage (x)	2.2	1.0	(0.2)	0.6	(0.2)
Pro Forma AADS Burden (%)	3.3	3.0	2.8	2.8	2.7

N.A. – Not applicable. Note: Numbers may not add due to rounding.

Financial Ratios (continued)

(Audited Fiscal Years Ended June 30)

	2007	2008	2009	2010	2011
Adjusted Total Operating Revenues Basis					
Historical Debt Service Coverage (x)	5.0	3.3	0.2	2.3	0.5
Historical Debt Burden (%)	1.5	1.1	2.2	1.7	2.3
Pro Forma MADS Coverage (x)	1.9	1.0	0.1	1.2	0.4
Pro Forma MADS Burden (%)	3.8	3.5	3.3	3.3	3.2
Pro Forma AADS Coverage (x)	2.3	1.2	0.2	1.4	0.4
Pro Forma AADS Burden (%)	3.2	3.0	2.8	2.8	2.7
OPEB Adjusted Total Operating Revenues Basis					
Historical Debt Service Coverage (x)	5.0	9.6	3.3	6.6	5.0
Historical Debt Burden (%)	1.5	1.1	2.2	1.7	2.3
Pro Forma MADS Coverage (x)	1.9	2.9	2.2	3.3	3.6
Pro Forma MADS Burden (%)	3.8	3.5	3.3	3.3	3.2
Pro Forma AADS Coverage (x)	2.3	3.5	2.6	4.0	4.3
Pro Forma AADS Burden (%)	3.2	3.0	2.8	2.8	2.7

N.A. – Not applicable. Note: Numbers may not add due to rounding.

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