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University of Hawaii Board of Regents University of Hawaii; Public Coll/Univ - Unlimited Student Fees

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University of Hawaii Board of Regents

University of Hawaii; Public Coll/Univ - Unlimited Student Fees

Credit Profile

University of Hawaii Brd of Regents, Hawaii

University of Hawaii, Hawaii

University of Hawaii Brd of Regents (University of Hawaii) (MBIA of Illinois) ser 2006A

Unenhanced Rating

A+(SPUR)/Stable

Affirmed

Rationale

Standard & Poor's Ratings Services affirmed its 'A+' underlying rating (SPUR) on outstanding revenue bonds issued by the University of Hawaii Board of Regents' for the University of Hawaii (UH), based on our application of government related entities (GRE) criteria. However, we have not revised the outlook on the SPUR to positive despite the state of Hawaii's positive outlook as we view the stand-alone credit profile (SACP) of the university as having a negative outlook. The SACP rating was affirmed at 'a+' but the outlook is negative because of an erosion of the university's operating margins and financial resources, even after adjusting for other postemployment benefit (OPEB) liabilities that are the responsibility of the state. Some long-term ratings may be higher due to bond insurance. The outlook on the SPUR is stable.

More specifically, the ratings reflect our opinion of the university's:

- Comprehensive nature as the state's only public system of higher education;
- Overall stable enrollment; and
- Manageable maximum annual debt service burden of about 3%.

Partly offsetting the preceding credit strengths is our view of the university's:

- Strong reliance on the state for operating and capital funds;
- Negative adjusted operations, after adding back annual OPEB costs for two years, due primarily to a decrease in state funding although this is somewhat mitigated by a stabilization in state funding for the current biennia; and
- Low financial resource ratios for the rating category at June 30, 2013, with negative unrestricted net assets (UNA).

However, we note that the ratios improve when adjusting unrestricted net assets (UNA) for the university's share of OPEB liabilities (for better comparability) to a still low 13.5% of adjusted operations and 36.5% of debt.

The system had about \$608.7 million of revenue debt outstanding as of June 30, 2013; all debt is fixed rate. In addition, the university received a five-year loan for up to \$18 million for construction at the West Oahu campus. As of June 30, 2013, \$16.5 million was drawn on it. There are three slightly different security structures of the revenue debt that we rate the same based on our view of the broad, interconnected mix of pledged revenues available for payment of debt

service. About 43.5% of the university's revenue bond debt is secured by dedicated revenue streams, which we consider a strength. Debt service is level at about \$45 million through 2033, with MADS of \$46.5 million occurring in 2016 (excluding the Build America Bonds, or BABs, interest subsidy, although not including the \$16.5 million note), making for a debt burden we view as low of less than 3%. Management has indicated that it may issue up to \$212 million of new debt in fiscal 2015 primarily for deferred maintenance if authorization by the legislature is approved.

Network revenues secure the 2006A, 2009, 2010B, 2010B-2, and 2012A bonds (about \$343.9 million as of June 30, 2013). Network revenues include receipts from auxiliaries, as well as special and revolving fund appropriations. Network net revenues were about \$54.0 million in fiscal 2012. The pledge of appropriations is subordinate to the 2006A university bonds. Funds available from special and revolving fund appropriations were \$670 million in fiscal 2012.

The \$133.3 million series 2010A-1 (taxable BABs) and 2010A-2 bonds, the proceeds of which were used toward the construction of a cancer research building, are also secured by the above network and special and revolving fund appropriations and are additionally secured by cigarette tax revenues. The Cancer Research Special Fund receives two cents per cigarette sale to be used solely for 2010A debt service or operations of the cancer center. The fund had a balance of \$40.8 million in June 2012, and debt service for these bonds was paid solely through this fund in fiscal 2013.

The university also has about \$131.5 million of bonds outstanding that are separately secured by a lien on special and revolving funds of the university and network revenues, as well as state-allocated and appropriated money from the Hawaii Tobacco Settlement Special Fund. In fiscal 2013, this fund yielded \$12.6 million for debt service on the 2006 bonds.

Outlook

The stable outlook on the bonds is based on the application of the GRE criteria. Currently, we rate Hawaii AA/Positive, and per our GRE criteria, a government related entity with a "moderately high" likelihood of extraordinary support like the UH, would have a positive outlook. However, because we view the SACP's outlook as negative, the outlook remains stable.

A negative rating action on the bonds is unlikely due to our view of "moderately high" likelihood of extraordinary support from the state in the case of fiscal distress. Conversely, we could consider a positive rating action with an improvement in operating margins and financial resources, stable enrollment, and an upgrade of the state's rating. A change in the state's rating alone would not necessarily result in a change to the rating on the bonds in view of the university's weakening financial profile.

Enterprise Profile

Demand

The university serves as Hawaii's flagship research institution, as well as the state's designated land, sea, and space--grant institution. Today it is the state's only public higher-education system and has about 85% of the

higher-education market in Hawaii. UH is a comprehensive institution offering programs in campuses located throughout the state on 10 campuses. Degrees range from certificate programs to doctoral-level study. The oldest campus, the university's flagship, was established in Manoa, in Honolulu, on the island of Oahu, in 1907. The university established a four-year residential campus in Hilo in 1970 and then added an upper-division college in West Oahu in 1976, and opened a new campus in there in 2012. The university system also includes seven community colleges in various locations, which account for slightly more than half of its enrollment. A new community college campus is under construction in Kona.

As a whole, the system enrolled 58,941 (headcount) students in fall 2013, a little lower (by 2.2%) than in previous years. Full-time equivalent enrollment is much lower, at 40,392, reflecting the large percentage of community college students (more than half) in the system. The FTE count is about the same as in previous years. Because so many of the system's students are in the community colleges, the improvement in the economy may account for the slight dip in overall enrollment because community college attendance is often countercyclical to the economy.

Admissions standards vary by campus: Manoa, Hilo, and West Oahu are all fairly competitive, and the university accepts about 75% of applicants at these three campuses (and about the same for transfer applicants). The community colleges accept nearly 100% of their applicants. In fall 2013, there were 16,521 applications to Manoa, the flagship and most competitive campus, which is a good, 8.1% increase from the previous year. The campus has become increasingly less selective, accepting about 75% of first-year applications in fall 2013. During the past two years, the matriculation rate has also declined, to about 35% from closer to 40% in previous years. The first-to second year retention rate has remained consistent at 78%. Transfer applications at Manoa are a large part of the enrollment, and applications were 4,147 in fall 2013, a 3.3% increase from the previous year. About 80% of transfer applications are accepted, with a little more than half enrolling. The articulation agreements between the community colleges and the four-year schools are strong, and students are automatically enrolled in a four-year college when they complete an associate's degree. Management expects overall enrollment to stabilize. About 20% of students at the four-year institutions are from out of state. Student quality at the flagship Manoa campus is consistent with national averages, with the average entering class SAT score of 1093 for fall 2013.

Management

The university is governed by a 15-member board of regents, who are nominated by a council, appointed by the governor, and confirmed by the legislature. The President of the University of Hawaii system recently resigned for personal reasons. The interim president has been with the system since 1977. The executive vice president has also left the system, and an interim is in place. There is a search underway for both positions. In addition, a vice president for administration will be added to focus on risk management, among other areas. The system has current investment and debt policies and has a renewed focus on risk management.

Government-related entities

In accordance with our criteria for government-related entities (GREs), our view of a "moderately high" likelihood of extraordinary government support is based on our assessment of UH's "strong" link with Hawaii, in part due to the state's unique geography. In addition, we note the state's history of regular, ongoing operating support and capital support for academic facilities, as well as the state's ability to appoint the university's governing board and to provide additional funding as needed (subject to legislative approval). In addition, our assessment is based on UH's "important"

role in the state's economy compared with that of other state GREs given its position as the flagship institution of higher education, its provision of health care-related education, its position as a designated land-grant institution, and its role as a general contributor to economic development in the state. The university is a state educational institution created pursuant to the state constitution and statutes. Currently, we rate Hawaii AA/Positive (as of October 2013); per our GRE criteria, generally, the university's SPUR would also have a positive outlook due to its strong link to the state. However, since the SACP's outlook is negative, the SPUR remains stable.

Financial Profile

Operations

Adjusted operating performance for the past six years has been negative. In fiscal 2013, there was an audited negative change in net assets of \$34.4 million; however, when primarily adjusted for capital expenditures (\$128 million), operating results worsened, resulting in negative \$210.6 million on a full-accrual basis. However, adjusting further for OPEB costs that are paid for by the state improves operations to negative \$68 million. And on a cash basis, with depreciation of \$106.6 million in fiscal 2013, operations were positive \$38.6 million, according to our calculation. Management anticipates OPEB liabilities will continue to grow but plans, with the stabilization of state funds, for operations to also stabilize.

In our Oct. 10, 2013, review of the state of Hawaii, we noted that the state spent just 28% of the annual required contribution (ARC), given its pay-as-you-go approach. Further, we noted state lawmakers and the governor enacted legislation establishing an upwardly trending contribution glide path so that, by fiscal 2019, the state's annual funding would match the ARC. In general, we view the state's willingness to begin confronting its OPEB liability as favorable.

Revenue diversity

The university receives a declining, but still substantial amount of state financial support, about 37% of its \$1.4 billion in operating revenues in fiscal 2013. Research funding, after growth to about \$488 million in fiscal 2011, dipped to \$409 million in fiscal 2013, in part due to sequestration. Net tuition accounts for a relatively small, but growing portion of operating revenue, at about 17%. Undergraduate tuition and fees at the Manoa campus for 2013-2014 is \$9,904 for in-state students. In 2006, the regents approved a 15% tuition increase each year for six years, starting in fiscal 2007 -- in effect doubling tuition during that period; the university also increased financial aid during that time. The board of regents approved another multiyear tuition fee increase on Oct. 26, 2011, with modest tuition increases in the near term. Student charges currently remain affordable, in our opinion. Tuition at the community colleges, which represent half of system enrollment, is much lower than that of the four-year campuses.

State appropriations

After two biennia of state appropriation growth, the system lost about 10% of its operating appropriation in fiscal 2010. In fiscal 2012, appropriations appeared to increase to \$375.8 million, but this was due in large part to \$22 million in American Recovery and Reinvestment Act funds. Fiscal 2013 appropriations were down slightly to \$374.3 million. In fiscal 2014, funding is up slightly, by \$9 million. The governor's budget proposal includes an increase for UH. Despite recent declining to flat appropriations, the university receives capital appropriations although this amount declined to \$276 million in the 2011-2013 biennia from \$382 million in the previous biennia. In addition, the state legislature has

approved \$174 million in general obligation bond-funded capital improvements in fiscal 2014.

Financial resources

Total net assets in fiscal 2013 were \$1.94 billion, a slight (1.7%) decrease from the previous year. There were negative unrestricted assets due to the accounting of OPEB liabilities. The university's share of the state's OPEB liability was \$514.4 million in fiscal 2013 and will continue to increase. Expendable assets were \$526.6 million. Management stated that these funds are available to the university. Without adjustments, financial resource ratios are very low (indeed negative) for a public university in this rating category. However, when the \$514.4 million is added back to UNA, the UNA-related ratios improve to a still low 13.5% of adjusted operating expenses and 36.1% of debt.

Endowment and fundraising

The university had about \$285.3 million in its endowment pool as of June 30, 2013, with the majority of the funds (about \$225.1 million) held at the separate university foundation. The effective endowment payout policy in fiscal 2013 was 4.5%, which we view as conservative, and remained so in fiscal 2014. The university and the foundation invest their funds separately. The foundation reported that the investment return for fiscal 2013 was positive 11.4%. Foundation funds are invested in a diversified mix of 14% marketable alternative assets; 20% U.S. equities; 17% global equities; 10% real assets; 13% fixed income; and the balance in private equity, venture capital, and cash. The university-held endowment was up by 8.5% for calendar year 2012 and is invested in 47% domestic equities, 40% fixed income, and the balance in international equities and cash.

The university completed a \$250 million centennial capital campaign in June 2009, raising \$282 million. In fiscal 2013, the university raised \$66.3 million, about the same amount as in fiscal 2011, after dipping in fiscal 2012. More than half of the donors to the campaign were first-time donors to the university. The university has contracted with the university foundation for a seven-year campaign and currently is in the third year of the quiet phase of a potential \$500 million campaign.

University of Hawaii*					
	Fiscal Year Ended				
	2014	2013	2012	2011	2010
Enrollment and demand					
Headcount (HC)	58,941	60,295	60,330	60,090	57,945
Full-time equivalent (FTE)	40,392	40,991	40,460	40,533	39,128
Freshman acceptance rate (%)	79.7	81.2	78.4	70.9	67.2
Freshman matriculation rate (%)	34.2	35.5	39.1	37.2	39.6
Undergraduates as a % of total enrollment		89.5	74.8	73.9	73.0
Freshman retention (%)		79.0			
Graduation rates (5 years) (%)		44.3			
Income statement					
Adj. operating revenue (\$000s)		1,461,038	1,427,718	1,471,199	1,397,709
Adj. operating expense (\$000s)		1,671,711	1,627,888	1,548,778	1,457,898
Change in net income before capital (\$000s)		(214,491)	(209,214)	(102,712)	(84,106)
Annual OPEB		142,602	136,078	150,637	

University of Hawaii* (cont.)				
Estimated operating gain/loss before depreciation (\$000s)	(104,042)	(108,237)	8,012	27,212
Change in unrestricted net assets (\$000s)	(158,666)	(135,636)	(60,323)	(23,547)
State operating appropriations (\$000s)	374,280	375,754	359,077	369,948
State appropriations to revenue (%)	25.6	26.3	24.4	26.5
Tuition dependence (%)	16.6	16.6	15.2	15.0
Debt				
Outstanding debt (\$000s)	625,170	622,910	637,045	351,600
Current debt service burden (%)	2.71	2.77	2.17	1.61
Current MADS burden (%)	2.78	2.86	2.87	1.72
Financial resource ratios				
Endowment market value (\$000s)	468,100	526,700	449,300	502,400
Related foundation MV (\$000s)	359,168	324,691	316,656	279,012
Cash and investments (\$000s)	845,665	975,009	1,122,202	807,706
Unrestricted net assets (UNA) (\$000s)	(288,796)	(130,130)	5,506	65,829
Adjusted UNA (\$000s)	225,568	283,332	323,606	272,129
Cash and investments to operations (%)	50.6	59.9	72.5	55.4
Cash and investments to debt (%)	135.3	156.5	176.2	229.7
Unrestricted net assets to operations (%)	(17.3)	(8.0)	0.4	4.5
Adjusted UNA to ops	13.5	17.4	20.9	18.7
Adjusted UNA plus debt service reserve to debt (%)	36.1	45.5	50.8	77.4
Average age of plant (years)	10.8	11.6	11.6	10.7
OPEB liability to total liabilities (%)	35.0	29.7	25.2	24.5

Net operating margin = $100 \times (\text{net adj. operating income} / \text{adj. operating expense})$. Tuition dependence = $100 \times (\text{gross tuition revenue} / \text{adj. operating revenue})$. Current debt service burden = $100 \times (\text{current debt service expense} / \text{adjusted operating expenses})$. Current MADS burden = $100 \times (\text{maximum annual debt service expense} / \text{adjusted operating expenses})$. Cash and investments = cash + short-term & long-term investments. Adjusted UNA = Unrestricted net assets + unrestricted net assets of the foundation. Average age of plant = accumulated depreciation / depreciation & amortization expense.

Related Criteria And Research

Related Criteria

- USPF Criteria: Higher Education, June 19, 2007
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, Dec. 9, 2010

Ratings Detail (As Of January 2, 2014)

University of Hawaii Brd of Regents, Hawaii

University of Hawaii, Hawaii

University of Hawaii Brd of Regents (University of Hawaii) univ rev bnds

Long Term Rating A+/Stable Affirmed

University of Hawaii Brd of Regents (University of Hawaii) univ rev bnds ser 2006A (Berkshire)

Unenhanced Rating A+(SPUR)/Stable Affirmed

University of Hawaii Brd of Regents (University of Hawaii) univ rev bnds (University of Hawaii) ser 2006A

Ratings Detail (As Of January 2, 2014) (cont.)

<i>Unenhanced Rating</i>	A+(SPUR)/Stable	Affirmed
University of Hawaii Brd of Regents (University of Hawaii) univ rfdg bnds (University of Hawaii) ser 2006A		
<i>Unenhanced Rating</i>	A+(SPUR)/Stable	Affirmed
Univ of Hawaii Brd of Regents (Univ of Hawaii) univ rev bnds ser 2009A		
<i>Long Term Rating</i>	A+/Stable	Affirmed
Many issues are enhanced by bond insurance.		

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