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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 the 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. The stand-alone credit profile rating was affirmed at 'a+'. 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 (MADS) burden of about 2.8%.

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 on a full-accrual basis, but positive on a cash basis after adding back annual other postemployment benefit (OPEB) costs and depreciation expenses; and
- Low financial resource ratios for the rating category at June 30, 2014, with negative unrestricted net assets (UNA).

However, we note that the ratios improve when adjusting UNA for the university's share of OPEB liabilities (for better comparability) but is still low at 12% of adjusted operations and 34% of debt.

The system had about \$593.9 million of revenue debt outstanding as of June 30, 2014; 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, 2014, \$17 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 \$46.4 million occurring in 2016 (excluding the Build America Bonds (BABs) interest subsidy although not including the \$17 million note), making for a debt burden we view as low of less than 3% of expenditures. Management has indicated that it is contemplating

issuing around \$35 million of new debt in fiscal 2016 for various campus capital projections.

Network revenues secure the 2006A, 2009, 2010B-1 (taxable BABs), 2010B-2, and 2012A bonds (about \$336 million as of June 30, 2014). Network revenues include receipts from auxiliaries, as well as special and revolving fund appropriations. Network net revenues were about \$40.2 million in fiscal 2014. The pledge of appropriations is subordinate to the 2006A university bonds. Funds available from special and revolving fund appropriations were \$729.4 million in fiscal 2014.

The \$130.5 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 \$19.4 million in June 2014, and debt service for these bonds was paid solely through this fund in fiscal 2014.

The university also has about \$127.4 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 2014, this fund yielded \$12.6 million for debt service on the 2006 bonds.

## Outlook

The stable outlook on the bonds reflects the application of our GRE criteria, in which the university has a "moderately high" likelihood of receiving extraordinary support from Hawaii (AA/Stable). The outlook also reflects a slight improvement in the university's operations; a low MADS burden; and a large, diverse enrollment base as the only system in the state, despite low and declining financial resources.

A negative rating action on the bonds could occur if there is a significant decline in enrollment, operations decline substantially, or the university issues additional debt without a commensurate increase in financial resources. We could also lower the rating if financial resources continue to decline, to below their current levels. Although unlikely, we could consider a positive rating action with a significant improvement in operating margins and financial resources, stable enrollment, and an upgrade of the state's rating.

## 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 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.

The entire system had 57,052 total students enrolled in fall 2014. Headcount declined for the third year in a row, by 3.2%, from 58,941 in fall 2013. Because 54% 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. However, a decline was also observed at UH Manoa and UH Hilo. UH West Oahu was a bright spot, increasing its enrollment by 13% in fall 2014 to 2,661 students. Management expect to see enrollment trends similar to 2014-2015 in the upcoming year as the economy continues to remain strong, and jobs are an often chosen alternative in lieu of attending community college. Full-time equivalent (FTE) enrollment is much lower, at 39,237, reflecting the large percentage of community college students in the system. Like total headcount, FTE enrollment also declined in fall 2014. Although these trends will continue, management expects the enrollment declines to moderate somewhat over the outlook period.

Admissions standards vary by campus: Manoa, Hilo, and West Oahu are all fairly competitive, and the university accepts about 83% of applicants at these three campuses and about 90% of transfer applicants. The community colleges accept nearly 100% of their applicants. In fall 2014, there were 7,604 applications to Manoa, the flagship and most competitive campus, which is a good, 3.3% increase from the previous year. The campus' selectivity rate improved slightly to 78% of first-year applications in fall 2014, compared with 80% the prior year. However, during the past year, the matriculation rate has also declined, to about 31% from closer to 39% in previous years. The first-to-second year retention rate improved to 79% from 78% the prior year. Transfer applications at Manoa are a large part of that campus' enrollment, and applications were 3,761 in fall 2014, a 9% decrease from the previous year. About 82% 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 18% 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 1080 for fall 2014.

## **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. Over the past year, four regents resigned due to newly adopted public financial disclosures laws. Since then, four new regents have been appointed subject to legislative confirmation, and the search for two regents for seats with terms ending June 30, 2015 is underway. The system has also had significant management transition since the resignation of the prior UH system president in 2013. Of key importance is the appointment of David Lassner as the system's new president as of July 1, 2014 after serving as interim president since September 2013. Some of the other changes in senior management over the past year include the appointment of a new CFO, a new vice president for administration, and a new chief information officer. While we view the significant changes in management as presenting some transition risk, we note that it is not uncommon for such changes to occur upon the appointment of a new leader.

Over the past year, senior management has been focused on risk and financial management. As a result, the board

adopted a financial reserve policy in November 2013 to establish systemwide operating reserves from nongeneral fund revenue in amounts sufficient to provide continued operations for two months with a minimum of 5% unencumbered cash from all tuition and fee funds, special funds, and revolving funds. In addition, the policy established the requirement for quarterly financial management reports to be reviewed to determine if revenue and expenses are on target and to ensure the reserve meet the minimum target. We view the establishment of these policies as a positive key factor that is in keeping with best practices.

### **Government-related entities**

In accordance with our criteria for 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). Our assessment is additionally 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.

## **Financial Profile**

### **Operations**

Adjusted operating performance for the past six years has been negative with a change in net income before capital of negative \$144.6 million. After adjusting for \$64 million in annual OPEB costs that are paid by the state and depreciation of \$109.5 million, operations were positive on a cash basis by \$33.8 million. Management anticipates OPEB liabilities will continue to grow but plans, with the stabilization of state funds, for operations to also stabilize.

In the 2013 legislative session, Act 268, SLH 2013 was enacted requiring phased state contributions towards OPEB liabilities starting in fiscal 2015 based on each jurisdiction's actuarially determined annual required contribution (ARC). The act requires each public employer's contribution, including the university's, to be equal to the full ARC commencing in fiscal 2019 with annual increases of contributions by 20% up to that time. Although the legislature appropriates general funds to the State Department of Budget and Finance to pay for all state agencies' general funded personnel, including UH, UH is required under Government Accounting Standards Board 45 to reflect its share of the state's actuarial cost and obligation in its financial statement. As a result, we expect to see an increase in annual OPEB expenses and liabilities that are paid by the state and will adjust the expenses and liabilities where appropriate. In general, we view the state's willingness to begin confronting its OPEB liability as favorable.

### **Revenue diversity**

The state has historically provided a substantial amount of financial support to UH with state appropriations accounting for approximately 26% of total revenues. Research funding, after growth to about \$488 million in fiscal 2011, declined in fiscal 2014 to \$427 million, in part due to sequestration. The university expects continued downward trends from the 2011 peak. Net tuition accounts for a relatively small, but growing portion of operating revenue, at

about 16%. Undergraduate tuition at the Manoa campus for 2014-2015 increased by 7% to \$10,624 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 and has fluctuated somewhat since that time. 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. However, in fiscal 2014 and fiscal 2015, funding grew to \$391.3 million and \$407.5 million, respectively. UH also benefited from capital improvement appropriations of \$341 million for the fiscal biennium 2013-2015, which was an increase from the prior biennium. For the upcoming biennium, the university has made general fund appropriation requests of \$456 million and \$460 million, respectively. In addition, the board and governor have made requests for capital improvement funds of \$200 million and \$197 million for fiscal 2016 and fiscal 2017, respectively. These budget requests will be determined in the 2015 legislative session, but we understand that the outlook for an increase is positive.

### **Financial resources**

Total net assets in fiscal 2014 were \$1.96 billion, a slight (1.2%) increase from the previous year. UNA was negative due to the accounting inclusion of OPEB liabilities. The university's share of the state's OPEB liability grew by 13%, to \$579 million in fiscal 2014, and will continue to increase. Expendable assets were \$598 million and increased by 14%. Although these are marked as restricted, management has indicated that some of these funds are available to the university as they include fund balances from contracts and grants, loans, renewals and replacements, and retirement plant assets, and restricted endowment funds. Without adjustments, financial resource ratios are extremely weak (negative) for a public university in this rating category. However, when the \$579 million is added back to UNA, the UNA-related ratios improve but are still weak at 12.4% of adjusted operating expenses and 34% of debt, marking the fourth consecutive year of declining UNA relative to operations and debt.

### **Endowment and fundraising**

The university had about \$335.6 million in its endowment pool as of June 30, 2014, with the majority of the funds (about \$261.5 million) held at the separate university foundation. The UH endowment payout policy in fiscal 2014 was 5.0% while the foundation has a payout rate of 5.5% based on a blended three-year rate. The university and the foundation invest their funds separately. The foundation reported that the investment return for fiscal 2014 was positive 14.9%. Foundation funds are invested in a diversified mix of 14% marketable alternative assets, 19% U.S. equities, 17% global equities, 19% fixed income, 12% real assets, 8% emerging market equity, 6% global tactical asset allocation, and the balance in private equity and venture capital investments. The university-held endowment was up by 3.9% for calendar year 2014 and is invested in 60% equity and 40% fixed income.

The university completed a \$250 million centennial capital campaign in June 2009, raising \$282 million. 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 fourth year of the quiet phase of a potential \$500 million campaign. As of June 30, 2014, the university raised \$231.8 million towards its campaign goal. In fiscal 2014, the university raised \$98.6 million towards this goal, exceeding its goal of \$61 million for the year.

University of Hawaii					
	--Fiscal year ended June 30,--				
	2014	2013	2012	2011	2010
<b>Enrollment and demand</b>					
Headcount	58,941	60,295	60,330	60,090	57,945
Full-time equivalent	40,392	40,991	40,460	40,533	39,128
Freshman acceptance rate (%)	79.7	80.0	78.5	70.9	67.2
Freshman matriculation rate (%)	34.2	35.3	38.8	37.2	39.6
Undergraduates as a % of total enrollment	89.7	89.5	74.8	73.9	73.0
Freshman retention (%)	77.9	79.0	N.A.	N.A.	N.A.
Graduation rates (five years; %)	45.3	44.3	N.A.	N.A.	N.A.
<b>Income statement</b>					
Adjusted operating revenue (\$000s)	1,546,065	1,531,640	1,432,292	1,471,199	1,397,709
Adjusted operating expense (\$000s)	1,686,546	1,671,711	1,627,888	1,548,778	1,457,898
Net adjusted operating income (\$000s)	(140,481)	(140,071)	(195,596)	(77,579)	(60,189)
Estimated operating gain/loss before depreciation (\$000s)	33,809	67,462	-8,344	119,884	105,572
Change in UNA (\$000s)	(85,550)	(158,666)	(135,636)	(60,323)	(23,547)
State operating appropriations (\$000s)	391,266	374,280	375,754	359,077	369,948
State appropriations to revenue (%)	25.3	24.4	26.2	24.4	26.5
Student dependence (%)	22.4	21.4	22.7	21.4	21.0
Health care operations dependence (%)	N.A.	N.A.	N.A.	N.A.	N.A.
Research dependence (%)	N.A.	N.A.	N.A.	N.A.	N.A.
Endowment and investment income dependence (%)	3.3	2.1	0.1	3.2	2.0
<b>Debt</b>					
Outstanding debt (\$000s)	610,930	625,170	622,910	637,045	351,600
Proposed debt (\$000s)	35,000	N.A.	N.A.	N.A.	N.A.
Total pro forma debt (\$000s)	645,930	N.A.	N.A.	N.A.	N.A.
Pro forma MADS	48,683	N.A.	N.A.	N.A.	N.A.
Current debt service burden (%)	2.69	2.71	2.77	2.17	1.61
Current MADS burden (%)	2.75	2.78	2.86	2.87	1.72
Pro forma MADS burden (%)	2.89	N.A.	N.A.	N.A.	N.A.
<b>Financial resource ratios</b>					
Endowment market value (\$000s)	335,553	292,856	265,216	449,300	502,400
Related foundation market value (\$000s)	436,115	359,168	324,691	316,656	279,012
Cash and investments (\$000s)	841,813	845,665	975,009	1,122,202	807,706
UNA (\$000s)	(374,346)	(288,796)	(130,130)	5,506	65,829
Adjusted UNA (\$000s)	208,621	225,568	283,332	323,649	272,100

<b>University of Hawaii (cont.)</b>					
Cash and investments to operations (%)	49.9	50.6	59.9	72.5	55.4
Cash and investments to debt (%)	137.8	135.3	156.5	176.2	229.7
Cash and investments to pro forma debt (%)	130.3	N.A.	N.A.	N.A.	N.A.
Adjusted UNA to operations (%)	12.4	13.5	17.4	20.9	18.7
Adjusted UNA plus debt service reserve to debt (%)	34.1	36.1	45.5	50.8	77.4
Adjusted UNA plus debt service reserve to pro forma debt (%)	32.3	N.A.	N.A.	N.A.	N.A.
Average age of plant (years)	11.2	10.8	11.6	11.6	10.7
OPEB liability to total liabilities (%)	38.2	35.0	29.7	25.2	24.5

Total adjusted operating revenue = unrestricted revenue less realized and unrealized gains/losses and financial aid. Total adjusted operating expense = unrestricted expense plus financial aid expense. Net operating margin = 100\*(net adjusted operating income/adjusted operating expense). Current debt service burden = 100\*(current debt service expense/adjusted operating expenses). Current MADS burden = 100\*(maximum annual debt service expense/adjusted operating expenses). Cash and investments = cash + short- and long-term investments. Expendable resources = unrestricted net assets + temporary restricted net assets - (net PPE - outstanding debt). Average age of plant = accumulated depreciation/depreciation and amortization expense. MADS—Maximum annual debt service. N.A.—Not available. UNA--Unrestricted net assets.

## 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 February 10, 2015)

#### 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

*Unenhanced Rating* A+(SPUR)/Stable Affirmed

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

*Unenhanced Rating* A+(SPUR)/Stable Affirmed

#### Univ of Hawaii Brd of Regents (Univ of Hawaii) univ rev bnds ser 2009A

*Long Term Rating* A+/Stable Affirmed

Many issues are enhanced by bond insurance.

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