New Issue: MOODY'S ASSIGNS Aa2 RATING TO UNIVERSITY OF HAWAII'S $8.9 MILLION OF UNIVERSITY REVENUE BONDS, SERIES 2012A(R); OUTLOOK IS STABLE

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UNIVERSITY WILL HAVE $628 MILLION OF RATED DEBT OUTSTANDING INCLUDING THE CURRENT ISSUANCE

BOARD OF REGENTS OF THE UNIVERSITY OF HAWAII
Public Colleges & Universities
HI

Moody's Rating

ISSUE	RATING
University Revenue Bonds, Series 2012A (R)	Aa2
Sale Amount $8,760,000	
Expected Sale Date 02/09/12	
Rating Description Revenue: Public University Broad Pledge	

Moody's Outlook STA

Opinion

NEW YORK, February 06, 2012 --Moody's Investors Service has assigned Aa2 ratings to the University of Hawaii's ("University" or "UH") $8.9 million of University Revenue Bonds, Series 2012A(R) . The rating outlook is stable. At the same time, we are affirming the University's Aa2 issuer rating and the existing ratings on the University of Hawaii's outstanding long-term debt (see Rated Debt section below.) Also included in rated debt is $1.0 million of reimbursable State-issued general obligation bonds rated Aa2 based on the State's rating, with the University reimbursing the State for debt service.

SUMMARY RATING RATIONALE:

The Aa2 rating for the University of Hawaii reflects its strong market position as the sole provider of public higher education evidenced by large enrollment at its two- and four-year campuses across the state, diversified revenue stream, including strong support from the State of Hawaii (rated Aa2/stable) for operations and capital and good financial resource cushion supporting debt and operations. Offsetting challenges are the high reliance on State of Hawaii for operating and capital support given the economic pressures facing the state and a rising non-cash OPEB liability that is substantially depressing net assets on a GAAP basis and Moody's calculated financial resources.

STRENGTHS

*Sole public higher education provider for the State of Hawaii, with growing enrollment to over 40,000 full time equivalent (FTE) students (over 60,000 headcount students) across its 10 campus system, and strong growth in net tuition revenues to $5,704 in FY 2011, up over 21% over the past two years.

*Diverse revenue sources, including historically strong support and ties with the State of Hawaii and substantial research activity.

*Ample financial resource cushion supporting debt and operations, with expendable financial resources cushioning debt 1.0 times and operations 0.4 times; adjusted to remove the OPEB liability, the expendable financial resources to debt grows to 1.5 times.

*Good liquidity, with $501.4 million of monthly liquidity available at June 30, 2011, translating to a solid 142 monthly days cash on hand.

CHALLENGES

*Diminished state funding due to economic downturn, with a 23% cut to annual operating appropriations from FYs 2009 - FY 2011. However, state operating support increased by 5% in FY 2012 and UH continues to receive substantial capital appropriations, with $205 million of capital appropriations in FY 2011.

*Substantial and rising OPEB liability of $318 million in FY 2011 that although non-cash reduces net assets on a GAAP basis and depressing financial resources as calculated by Moody's, with the liability representing the University's share of the Hawaii Employer-Union Health Benefits Trust Fund, an agent, multi-employer defined benefit plan providing healthcare benefits to governmental employees.

*Imbalanced operating performance with a -5.5% three-average operating margin, although cash flow is better after adjusting for non-cash expenses; 9.4% operating cash flow margin for FY 2011.

DETAILED CREDIT DISCUSSION

USE OF PROCEEDS: Proceeds from the Series 2012A bonds will current refund the Series 2001B bonds and pay issuance costs.

LEGAL SECURITY: The University's University Revenue Bonds have a first lien on revenues of the "Network" that includes System revenues consisting of various housing and auxiliary activities, a subordinate lien on Legislative Appropriations in special and revolving funds appropriated or allocated to the Board of Regents, the University, the System or the Network, to the extent permitted by law, which includes tuition and fees. FY 2011 system gross and net revenues of $87.3 million and $27.2 million, respectively, provided debt service coverage of 4.6 times and 1.4 times, respectively. The special and revolving funds available balance is $603 million for FY 2011.

The lien on special and revolving funds is subordinate to payment on the Series 2002A and 2006A University (Tobacco) Bonds, as well as the reimbursement to the State for debt service on general obligation bonds of the State issued for University purposes.

The Series 2010A-1 and A-2 (Cancer Center) bonds are additionally secured by amounts on deposit in the Hawai'i Cancer Research Special Fund established within the State treasury. As long as any Series 2010A-1 or A-2 bonds remain outstanding, the Legislative Appropriation is to be allocated to the University's Cancer Research Center to be used solely for repayment of debt service on these bonds and current expenses and capital expenditure of the Cancer Research Center. For FY 2011, the University received $16.3 million of funds from the State for the Center.

The Series 2002A and 2006A University (School of Medicine) Bonds are additionally secured by tobacco settlement receipts. Under its Master Settlement Agreement with tobacco companies, the State has pledged to provide 28% of the state annual tobacco settlement receipts for the payment of debt service on these two series of bonds. In FY2011, the University received $12.4 million of funds for debt service, providing 1.25 times debt service coverage.

MARKET POSITION/COMPETITIVE STRATEGY: KEY CREDIT STRENGTH OF SOLE PUBLIC HIGHER EDUCATION PROVIDER IN HAWAII; INCREASED ENROLLMENT ACROSS ALL UH

CAMPUSES

University of Hawaii's role as the sole provider of public higher education for the State of Hawaii is a key component of its credit strength, encompassing continued good enrollment trends, growth in net tuition, strong partnership with the State of Hawaii and maintenance of its research enterprise. UH reported enrollment of 40,458 FTEs for Fall 2011 across its ten campuses located on the islands, with nearly half, or 19,432, at the seven two-year community colleges and 16,486 at the Manoa flagship research campus. Growth has slowed in the past two years following strong growth at the community colleges reflecting students seeking job training or education in the face of the weak economy. Enrollment should be steady or grow slowly as UH and the State continue to push for greater higher education participation of Hawaiian high school students and adults.

The University raised its limitation of non-resident enrollment to 35% at the Manoa, Hilo and West Oahu campuses from 30% in 2011, which will enable it to enroll students at the higher non-resident level and increase tuition revenues. UH's Board completed implementation of the six-year plan to increase tuition rates that moved UH's tuition to be more in line with peer averages on the U.S. mainland, although still well below most. Part of the additional tuition revenues provided increased financial aid to continue to provide access to resident students, coupled with the variance in tuition rates across campuses to provide affordable education. The Board recently approved another five year plan to increase tuition 35% over five years. As a result of the prior six year plan, net tuition per student increased 56% over four years to $5,439 in FY 2011. Net tuition should continue to grow with the next rate increases and provide greater cash flow to meet debt service obligations, although UH may face potential limitation in its rate increases to resident students without having to offer increased financial aid.

The University manages a significant research enterprise, with $502 million of research awards for FY 2011, up from $474 million in the prior year. UH's research funding is heavily from federal agencies at 87% of FY 2011 awards, with large awards from the National Science Foundation, Departments of Defense and Commerce and Department of Education. The reliance on defense spending will increase as UH was recently designated a Naval University Affiliated Research Center, which should provide an additional $10 million of annual funding beginning in the current FY 2012, and the designation provides the potential for additional grants with the Department of the Navy. The substantial amount of federal funding sources exposes UH to potential reductions in future awards or non-renewals of current grants depending upon the federal research focus. Any reductions in defense spending or other areas could have a negative impact on the University's research activities, particularly as funding from state or private sources is currently a small component of awards. However, due to Hawaii's strategic Pacific location for certain federal research activities, UH's level of research awards should be maintained in the face of overall declines in Congressional budgeting or federal research.

OPERATING PERFORMANCE: FAVORABLE OPERATING CASH FLOW PROVIDES GOOD DEBT SERVICE COVERAGE; DIVERSE REVENUE SOURCES REDUCES EXPOSURE TO REDUCTIONS IN STATE FUNDING

University of Hawaii should continue to generate positive operating cash flow providing good debt service coverage. The three-year average operating margin, as calculated by Moody's for FY 2009 - FY 2011, was a negative 5.5%, due in large part to rising OPEB expenses and the inclusion of depreciation. Adjusted for those non-cash expenses, the operating cash flow margin was 9.4% for FY 2011, in line with the previous year and providing annual debt service coverage of 3.9 times. We expect comparable performance to continue given growth in net tuition revenues given both at least steady enrollment and planned tuition increases, at least steady grants revenues and continued expense oversight.

The University remains dependent on State support, which represented 37% of FY 2011 operating revenues, including transfers for benefits and for the tobacco and cancer research funds. Starting FY 2010, the University's share of various overhead costs were transferred out of the University's budget and netted as a deduction against state appropriations, resulting in a reduction in the reported appropriation.

In FY 2010 and 2011, UH experienced funding reductions that resulted in a drop in general fund state appropriations to $359.1million in FY 2011 from $467.0 million in FY 2009. Offsetting the cuts were federal ARRA funding and tuition revenues coupled with expense management initiatives. For FY 2012, the general fund appropriations were increased by nearly 5% to $376.1 million. In addition to the general funding, the State continues to fund employee benefits, as well as tobacco securitization and Cancer Center funds.

The State of Hawaii's general obligation rating was downgraded by Moody's to Aa2 with a stable outlook from Aa1 with a negative outlook on May 17, 2011. The downgrade reflected the State's strained financial operations following the recession-driven revenue fall-off over the last several years; near depletion of reserves planned for the end of fiscal 2011; GAAP negative available balances representing consecutive years of balance sheet deterioration as one-time solutions were used to resolve recent budget shortfalls; pension funded ratios that are low relative to other states and are projected to decline near-term; high debt ratios, in part reflecting debt issues for K-12 school capital projects; and growing expenses for other post employment benefits (OPEB). For more information on the State, please see our last State report dated November 3, 2011.

Moody's affirmation of the Aa2 rating of the University of Hawaii, despite the downgrade of the State of Hawaii to the same rating level, reflects its credit strengths of growing revenues sources outside of state funding driven by its ability to grow tuition revenues from enrollment and tuition increases and from research activities. However, a further downgrade of the State's rating or deep cuts in state appropriations would likely result in pressure on either the rating or outlook.

BALANCE SHEET PROFILE: AMPLE BALANCE SHEET CUSHION SUPPORTING DEBT, ALTHOUGH FINANCIAL RESOURCES UNDERSTATED BY RAPIDLY GROWING OPEB LIABILITY

University of Hawaii showed growing calculated financial resources, although still less than peers due to the substantial State OPEB liability. At FY 2011, total financial resources, including the permanent endowment funds were $803.4 million, up from $746.1 million in FY 2010; expendable financial resources were $619.3 million. However, the University reports a growing State OPEB liability that stood at $318.1 million for FY 2011 that although non-cash reduces net assets on a GAAP basis and depresses financial resources as calculated by Moody's. As a result, removing the liability would result in total and expendable financial resources of $1.12 billion and $937 million, respectively.

The OPEB liability represents UH's share of the liability of the Hawaii Employer-Union Health Benefits Trust Fund, an agent, multi-employer defined benefit plan providing healthcare benefits to governmental employees. However, the liability is subject to change based on actuarial assumptions, as well as the plan's benefits such as co-payments, dependent coverage and other factors. Similar to other state and local governments, the plan is paid on a "pay as you go" basis, which will result in the liability growing substantially. However, the annual cost of health benefits is paid by the State on behalf of the University from the State's general fund appropriations and not the University's. Moody's will monitor the liability and the payout to determine any likelihood of increasing the payout such that it impacts operating cash flow or resources.

Although debt dramatically rose over the past four years, the financial resource cushion supporting the debt remains ample, with expendable financial resources cushioning debt 1.0 times and strengthening to 1.5 times if adjusted to exclude the OPEB liability. The University has additional resources not captured on the balance sheet: $275 million of the University's $628 million of pro forma debt is secured by additional funds. Specifically the Series 2010 A-1, A-2 (Cancer Center) Bonds are secured by amounts on deposit in the Hawai'i Cancer Research Special Fund and the Series 2002A and 2006A University (School of Medicine) Bonds by tobacco settlement receipts. In both cases, these additional revenues stream currently provide sufficient, but declining debt service coverage (see Legal Security section above for more detail).

The University has substantial annual renewal and replacement needs, as well as deferred maintenance, across its campuses and is working with the State to fund these initiatives. The State of Hawaii has provided substantial capital support, including $529 million of State General Obligation Bond Funding over the past five years and an additional $342 million requested, with $170 million earmarked for capital renewal and deferred maintenance projects. In 2010, the State Legislature also approved a 2-year procurement exemption for the University with the goal of developing innovative means of expediting the University's capital improvement plan. We note that any UH revenue bond issuance requires state legislative authorization, the Board of Regents approval and the Governor's approval. The University intends to issue up to $83 million of revenue bonds to finance capital projects on its campuses during FY 2013.

UH has focused on growing its gift revenues, successfully ending in 2009 its Centennial Campaign raising over $282 million compared to the $250 million goal, with much of it already received. The University is currently in the early stage of the next campaign, although the goal and timeline need to yet be determined by the Board. We expect UH will demonstrate continued fundraising success given its high profile in the State and its alumni network, many that have remained in the State and have demonstrated their support through alumni giving and the prior campaign.

For FY 2011, the University reported investment returns consistent with peers, with the Foundation reporting a return of 19.1% on its investments, while the University's return was 16.8%, with the lower return attributable to higher levels of liquid assets earning lower rates of return. At 11/30/2011, the Foundation's portfolio allocation is 43% in domestic and global equities, 13% fixed income, 20% marketable alternatives, 16% private and public real assets, 6% private equity/venture capital and 2% cash. The University maintained good liquidity for operating needs, with $460.6 million of monthly liquidity available as of June 30, 2011, translating into a solid 130 monthly days cash on hand from unrestricted investments liquid within one month.

OUTLOOK

The stable rating outlook reflects expectations of at least stable enrollment, growing tuition revenues and continued growing balance sheet resources from gifts and investment returns. The outlook also incorporates the expectation that pledged revenues will provide adequate debt service and limited borrowing plans for the foreseeable future. A further downgrade of the State's rating or a revision in the outlook to negative could result in a negative pressure on either the outlook or rating.

WHAT COULD MAKE THE RATING GO UP

Substantial growth in expendable financial resources and the cushion for increasing debt levels; enrollment increases with higher non-resident students driving strong increases in net tuition per student.

WHAT COULD MAKE THE RATING GO DOWN

Further downgrade in the State's rating or outlook revision; weakening of strong ties with the State; enrollment declines or stagnant net tuition revenues, especially if leading to weakened operating cash flow generation and weakened debt service coverage; significant additional borrowing absent growth in financial resources or revenue to support debt service.

KEY INDICATORS (Fall 2011 enrollment, FY2011 Financial Results)

Total FTE Enrollment: 40,458 students

Total Pro Forma Debt: $628.1 million

Total Pro Forma Comprehensive Debt: $667.2 million

Total Operating Revenues: $1.40 billion

Total Cash and Investments: $1.12 billion

Expendable Financial Resources: $619.3 million ($937.4 million adjusted for OPEB liability)

Expendable Resources to Pro-forma Debt: 1.0 times (1.5 times adjusted for OPEB liability)

Expendable Resources to Operations: 0.4 times (0.6 adjusted for OPEB liability)

Monthly liquidity: $501.4 million

Monthly days cash: 142 days

Three Year Average Operating Margin: -5.5%

Operating Cash Flow Margin: 9.4%

Reliance on State Funding: 37%

Reliance on Tuition and Auxiliaries: 22%

Reliance on Grants and Contracts: 32%

State of Hawaii General Obligation Rating: Aa2, stable outlook

RATED DEBT

University Bonds, Series 2002A, 2006A: Aa2 (insured by NPFG)

University Revenue Bonds, Series 2006A: Aa2 (insured by NPFG)

University Revenue Bonds, Series 2009A, 2010B-1, 2010B-2, 2012A: Aa2

University Revenue (Cancer Center) Bonds, Series 2010 A-1, Series 2010 A-2: Aa2

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PRINCIPAL 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.

REGULATORY DISCLOSURES

Although this credit rating has been issued in a non-EU country which has not been recognized as endorsable at this date, this credit rating is deemed "EU qualified by extension" and may still be used by financial institutions for regulatory purposes until 30 April 2012. Further information on the EU endorsement status and on the Moody's office that has issued a particular Credit Rating is available on www.moodys.com.

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