

Fitch Ratings

Fitch Rates University of Hawaii's Revenue Bonds 'AA'; Outlook Stable

Fitch Ratings-New York-04 September 2015: Fitch Ratings has assigned a 'AA' rating for the following series of bonds issued by the Board of Regents of the University of Hawaii (UH):

- \$8.6 million university revenue bonds taxable series 2015A;
- \$81 million university revenue bonds series 2015B (refunding);
- \$29.8 million university revenue bonds taxable series 2015C (refunding);
- \$18.2 million university revenue bonds taxable series 2015D (medical school, refunding);
- \$51.9 million university revenue bonds series 2015E (medical school) (forward Delivery) (refunding).

Bond proceeds will be used to provide funds to (1) finance or reimburse the Board for a portion of the costs of acquiring, constructing and equipping certain law school (\$3.5 million) and pharmacy school facilities (\$5 million), (2) refunding all or a portion of certain university revenue bonds (series 2006A and 2009A) and university bonds (series 2006A), and (3) pay the costs issuance of the 2015 bonds. The bonds are expected to sell Sept. 9, 2015, via a negotiated sale.

The series 2015E bonds will have a forward delivery, expected in April 2016.

In addition, Fitch has affirmed outstanding revenue bonds and university revenue bonds at 'AA'.

The Rating Outlook is Stable.

SECURITY

University revenue bonds are secured by net revenues of UH's auxiliary network (the network) and a subordinate pledge of legislative appropriations. Additionally, the series 2010A bonds are secured by amounts on deposit in the Hawaii Cancer Research Special Fund.

The series 2015D and series 2015E bonds will be additionally secured by a subordinate pledge of the moneys from the Hawaii Tobacco Settlement Special Fund, which is funded with receipts from the Master Settlement Agreement associated with the industry wide settlement with certain tobacco companies.

The outstanding 2006A university bonds are secured by a senior pledge of moneys from the state of

Hawaii Tobacco Settlement Special Fund; a senior pledge on legislative appropriations; and a subordinate pledge of net revenues of the network.

KEY RATING DRIVERS

STRONG MARKET POSITION: The 'AA' rating reflects UH's monopolistic role as the sole provider of public higher education in the state. UH encompasses the state's community college system as well as traditional university campuses. The flagship Manoa campus drives significant research activity.

STATE SUPPORT; CLOSE TIES: The state of Hawaii (GO bonds rated 'AA' with a Stable Outlook) consistently provides strong operating and capital support to UH. State capital support has kept UH's leverage low and helps mitigate UH's somewhat weak operating performance.

REVENUE DIVERSITY: UH's operating revenues are well-diversified. In addition to state operating support, UH generates significant net tuition and fee revenue from students and receives substantial research funding, mainly from federal sources.

LOW DEBT BURDEN: UH's debt burden is low, reflecting strong state capital support. While operations are somewhat weak on a GAAP basis, debt service coverage from operations remains sound. UH's debt burden should remain low due to a moratorium on new construction and a lack of legislative authorization for additional debt beyond this issuance.

RATING SENSITIVITIES

MARGIN IMPROVEMENT: The Stable Outlook assumes gradual operating improvement. Continued pressure on the University of Hawaii's financial resources due to operational weakness could lead to negative rating action.

ADDITIONAL LEVERAGE: Additional debt without a commensurate increase in financial resources or sustained operating improvement would negatively pressure the rating.

STATE AND FEDERAL FUNDING: Material declines in state appropriations or federal research funding could negatively affect the rating if not offset by increases in other revenue streams.

CREDIT PROFILE

The University of Hawaii was founded in 1907 and is the sole provider of public higher education within the state. The system comprises three university campuses, seven community college campuses, three university centers, and multiple learning, research and service sites across six of Hawaii's islands.

Manoa is UH's flagship campus, located in Honolulu, and has a Carnegie classification of 'Research

University/Very High' - similar to the previous classification of Carnegie Research 1 University. Manoa serves approximately 19,507 of the university's 57,052 total students as of fall 2014.

STRONG MARKET POSITION

UH benefits from its monopolistic role as the only provider of public higher education in the state. The university encompasses the entire spectrum of higher education services, including a community college system, traditional four-year degrees, and a doctoral-granting and research institution. As a sole provider, UH's enrollment depends more on state policy and population trends than on competition to draw students. Fitch views UH's and the state's efforts to increase college-going rates favorably due to its potential long-term impact on student demand.

REVENUE DIVERSITY

Typical of flagship universities, UH benefits from its diverse revenue streams. In 2014, approximately 33% of total operating revenues were derived from grants and contracts (primarily research funding), followed by 26% from state operating appropriations, and 23% from tuition and fees.

SUBSTANTIAL RESEARCH ACTIVITY

Federal grant providers are fairly diverse; primary sponsors include the Department of Health and Human Services, Department of Defense, Department of Education and the National Science Foundation. Overall, the level of research awards has been relatively stable. However, UH faces some operating risk related to its cancer center, which management believes could lose its federal designation without additional state support. Should this occur, Fitch believes the resulting loss of certain grants would be offset by a reduction in associated expenses over time, therefore limiting the impact on UH's financial operations.

SOLID STATE SUPPORT

Hawaii continues to provide significant financial support to UH, and UH management works closely with state officials. In fiscal 2014, operating appropriations totaled \$391 million, up 4.5% from the prior year, evidencing UH's essential service and importance to the state's economy. While there was some decline during the economic downturn, Fitch views recent growth favorably.

In addition, the state has consistently provided a high level of capital support to UH, which has helped the university maintain low leverage and a low debt burden. There are no significant additional debt plans; UH's capital plan focuses on addressing deferred maintenance and is expected to be funded primarily from state sources.

STEADY NET TUITION GROWTH

Net tuition revenue has increased steadily, averaging 4.3% growth over the past five years. Relative enrollment stability at the flagship Manoa campus and moderate countercyclical declines in community college enrollment have been offset by annual tuition increases, which will continue through fiscal 2017.

WEAK BUT IMPROVING OPERATIONS

UH recorded operating deficits in the past three fiscal years but improved slightly in fiscal 2014 to negative 4.2% on a GAAP basis (Fitch-adjusted, excludes annual OPEB costs paid directly by the state). Management expects modest further improvement in fiscal 2015 and more significant improvement thereafter based on recent changes in management and budgeting practices as well as sustained improvement in state funding.

Despite continued accrual-basis deficits, UH's available funds (defined as cash and investments less non-expendable restricted net assets and unspent bond proceeds) increased 3% to \$564.5 million as of June 30, 2014. Available funds equaled 35.7% of operating expenses, comparable to similarly rated peers. However, available funds equaled a stronger 92.9% of pro forma debt, reflective of the state's high level of capital support.

MANAGEABLE DEBT BURDEN

UH's debt burden remains low, with maximum annual debt service (MADS) consuming only 3.1% of fiscal 2014 operating revenues. MADS coverage from operations was sound at 1.6x in fiscal 2014. Fitch expects UH's debt burden to remain low. The regents have self-imposed a 3-year system-wide moratorium on new construction, and the legislature has approved no additional bonding authorization beyond the current issuance.

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In addition to the sources of information identified in the applicable criteria, this action was additionally informed by information from Merrill Lynch, Pierce, Fenner & Smith, Incorporated.

Related Research:

--'Fitch Affirms University of Hawaii's Revs at 'AA'; Outlook Stable' (Feb. 2014);
--'Fitch Rates Hawaii's \$1.1B GOs 'AA'; Outlook Stable' (Oct. 2014).

Applicable Criteria

Revenue-Supported Rating Criteria (pub. 16 Jun 2014)

(https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=750012)

U.S. College and University Rating Criteria (pub. 12 May 2014)

(https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=748013)

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form

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