

Rating Action: Moody's downgrades University of Hawaii (HI) to Aa3 and assigns Aa3 to proposed bonds; outlook stable

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New York, October 01, 2020 -- Moody's Investors Service has downgraded University of Hawaii's (UH) issuer and revenue bond ratings to Aa3 from Aa2. We have assigned the Aa3 to the proposed University Revenue Bonds: \$10 million Series 2020A (Taxable), \$42 million Series 2020B (Refunding), \$54 million Series 2020C (Taxable Refunding), \$49 million Series 2020D (Refunding) and \$62 million Series 2020E (Taxable Refunding). The bonds will have maturities through fiscal 2040. The rating action affects approximately \$500 million of revenue bonds outstanding. The outlook is stable.

RATINGS RATIONALE

The downgrade to Aa3 is driven by the university's exposure to likely material reductions in state support over the next several years which will be difficult to accommodate given already thin operating performance and limited autonomy to reduce expenses. The university has strong financial and governance links with the State of Hawaii (Aa2 stable), including a very high reliance on the state for operating and capital support, as well as payment of significant postretirement benefit liabilities. The state is facing mounting fiscal pressure driven by the impacts of the coronavirus pandemic, and the university is preparing for an up to 10% reduction in state funding. Depending on the pace of economic recovery, the university's primary funding source could face pressures beyond fiscal 2021. The downgrade is explicitly driven by social and governance considerations, including the financial impact of the pandemic, the rigidity of the university's labor structure, and an institutional framework that makes independent budget reductions difficult.

The assignment of the Aa3 is supported by the university's essential role in the State of Hawaii as the sole provider of public higher education and an economic driver within the state. UH's rating also incorporates the university's large scale and scope of operations, with three universities and seven community colleges across the system. Reserve levels have grown steadily with liquidity providing an adequate cushion for operations. UH maintains a manageable debt burden with its leverage profile becoming stronger when excluding debt that is paid from non-university revenue.

The rating is tempered by significant expense pressures across the 10-campus system, declining enrollment and extensive capital needs with a large backlog of deferred maintenance. Leading up the pandemic, operating performance, while showing signs of improvement, still operated at a deficit with thin cash flow compared to Aa-rated peers.

Moody's considers the coronavirus pandemic to be a social risk under our ESG framework due to the implications for health and safety. The university managed the impacts of the pandemic well in fiscal 2020 with only a modest decline in revenue that was mostly offset with expense reductions and CARES ACT funding. However, the university is preparing for an aggregate \$100 million negative budget impact in fiscal 2021 including reduced student generated revenues and cuts to general operating support from the state. The university is limited in its ability to implement expense reductions independently and expediently in the current fiscal year. The university has already publicized its approach to identify areas for reduction, but will also have to rely on the state for additional expense mitigations related to personnel if needed. Additional complications come from the many bargaining units that represent the university's employees.

RATING OUTLOOK

The stable outlook reflects expectations of weaker, but manageable operating performance through fiscal 2021. It incorporates expectations of state funding reductions in line with the university's current forecasts and that the state will take action to aid the university's ability to balance its budget.

FACTORS THAT COULD LEAD TO AN UPGRADE OF THE RATINGS

- Sustained and material improvement to operating cash flow
- Substantial growth of reserves relative to debt and operations

- Strengthening of the state's credit profile

FACTORS THAT COULD LEAD TO A DOWNGRADE OF THE RATINGS

- Sustained reduction of state support, capital or funding of fringe benefit payments without offsetting revenue growth
- Further weakening of operating cash flow beyond fiscal 2021
- Material decline of monthly liquidity

LEGAL SECURITY

All university revenue bonds are secured by a first lien on the Network revenue, including 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.

USE OF PROCEEDS

Proceeds of the Series 2020A bonds (\$10 million) will be used for parking structure improvements. The proceeds of the Series 2020B, C, D and E bonds will be used to refund the Series 2010A-1 and Series 2010B-1 bonds and to pay the costs of issuance.

PROFILE

The University of Hawaii is a large multi-campus system with three university campuses, seven community college campuses and nine educational centers distributed across six islands throughout the State. The scope and scale of the university is reflected in its \$1.7 billion operating revenue and over 34,000 FTE students. The university has a strong and unique research profile, particularly in earth and marine sciences.

METHODOLOGY

The principal methodology used in these ratings was Higher Education published in May 2019 and available at https://www.moody.com/researchdocumentcontentpage.aspx?docid=PBM_1175020. Alternatively, please see the Rating Methodologies page on www.moody.com for a copy of this methodology.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found at: https://www.moody.com/researchdocumentcontentpage.aspx?docid=PBC_79004.

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Moody's general principles for assessing environmental, social and governance (ESG) risks in our credit analysis can be found at https://www.moody's.com/researchdocumentcontentpage.aspx?docid=PBC_1133569.

At least one ESG consideration was material to the credit rating action(s) announced and described above.

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