FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms the University of Hawaii Revs at 'AA'; Outlook Stable

Mon 26 Sep, 2022 - 11:18 AM ET

Fitch Ratings - New York - 26 Sep 2022: Fitch Ratings has affirmed the 'AA' rating on approximately $437 million outstanding Board of Regents of the University of Hawaii (UH) university revenue bonds, consisting of the following:

--$7.5 million (taxable) series 2015A;

--$47.0 million series 2015B;

--$1.0 million (taxable) series 2015C;

--$66.0 million 2015E;

--$3.2 million series 2017A;

--$12.0 million series 2017B;

--$4.1 million (taxable) series 2017C;

--$13.2 million series 2017D;

--$4.5 million (taxable) series 2017E;

--$47.8 million series 2017F;

--$18.4 million (taxable) series 2017G;

--$9.6 million (taxable) series 2020A;

--$42.2 million series 2020B;

--$54.3 million (taxable) series 2020C;

--$71.5 million series 2020D;

--$31.1 million (taxable) series 2020E.

In addition, Fitch has affirmed the University of Hawaii's 'AA' Issuer Default Rating (IDR).

The Rating Outlook is Stable.

SECURITY

University revenue bonds are secured by a lien on the net revenues of UH's auxiliary network (the network, including the net revenues of various housing and auxiliary activities) and legislative appropriations in special and revolving funds appropriated or allocated to the Board of Regents, UH, or the network, including tuition and fees. Certain bonds are additionally secured by a pledge of collections of a portion of the excise tax on cigarettes (including the series 2020B and 2020C bonds) and a lien on a portion of the moneys in the Hawaii Tobacco Settlement Special Fund.

ANALYTICAL CONCLUSION

The 'AA' IDR and revenue bond rating reflect UH's role as the sole public provider of post-secondary education in Hawaii and the strong operating and capital support provided by the state (IDR, AA/Stable). The ratings further reflect an expectation that the university's financial profile will continue to weather near-term economic pressures as enrollment challenges persist at both the four-year institutions and the community colleges and as it manages extensive renewal and maintenance needs under its capital improvement program over the next several years. Preliminary fall 2022 headcount enrollment across the system softened, after a modest increase at the four-year institutions fully offset a modest decrease across the community colleges in fall 2021.

The Stable Outlook is supported by Fitch's expectation that the state will continue its steady support to the university, after a modest decline in fiscal 2022 (unaudited), in the face of ongoing economic pressures and that the university will manage shifting enrollment and a growing expense base with effective cost management and a potential tuition rate increase in future years, if needed, to preserve balanced operations and resources.

KEY RATING DRIVERS

Revenue Defensibility: 'aa'

Statewide System with Strong State Support

The 'aa' assessment for revenue defensibility is anchored by UH's role as the state's only public provider of higher education, with a largely in-state draw across the system. A significant 40% non-resident student population continues to be a credit strength. UH's overall headcount enrollment has softened in recent years but is generally steady over time. Further, UH has revenue diversity with strong levels of state operating support (32.1% of 2021 operating revenues) and research grants (29.6%), and some fundraising, which have all sufficiently offset revenue contraction in a pressured student-generated revenue environment.

Operating Risk: 'a'

Strong Capital Support for Related Needs; Variable Cash Flow

The university's operating risk profile is consistent with an 'a' assessment, reflecting somewhat thin and inconsistent cash flow margins driven by fluctuations in fringe benefit transfers from the state and variations in expenses, countered with meaningful flexibility and strong external support for capital needs and debt service on certain obligations. Fitch expects that UH will manage its variable costs and capital expenditures effectively against expected revenue pressure.

Non-recurring institutional HEERF funding supported improved cash-flow in fiscal 2021 and 2022 at 14.3% and is likely to improve further in fiscal 2022 (unaudited). After the university expends the remaining institutional portion of HEERF funds ($22.8 million) in FY23, margins should be lower but remain consistent with an 'a' assessment.

Financial Profile: 'aa'

Elevated leverage; Strong Support for Debt Service and Debt-Equivalents

With a comparatively thin 28% available funds to adjusted debt (almost $3 billion, including a substantial $2.5 billion of net pension liabilities) ratio in fiscal 2021, UH maintains a financial profile through Fitch's stress case scenario that is more consistent with an 'a' assessment under the parameters of the rating positioning table. However, consideration of this metric is strengthened by the state's consistent operating support, including for fringe benefits, which effectively lessens the burden of adjusted debt relative to the calculated level and supports a financial profile assessment in the 'aa' category.

Asymmetric Additional Risk Considerations

No asymmetric factors affected the rating.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--Material declines in enrollment that constrain net tuition revenue or research funding could pressure the rating, particularly if cash flow margin levels fall below 5%-6% over a prolonged period.

--Diminished state support (whether declining or failing to keep pace with expenditure growth) for long-term liability contributions, operating or capital support would very likely pressure the rating.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--Improvement in demand, particularly at the pressured community colleges, that supports net tuition revenue growth and lessens long-term reliance on state support.

--Improvement in operating performance with adjusted cash flow margins that are sustained over 15%, excluding non-recurring revenues.

--Sustained growth in resources that supports financial leverage ratios above 40% for a prolonged period, including long-term pension liability and fringe benefit contributions in Fitch's calculation of adjusted debt.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

CREDIT PROFILE

UH, founded in 1907, is the sole provider of public higher education within the state. The system comprises three comprehensive universities, seven community colleges, three university centers, and multiple learning, research and academic service sites across six of Hawaii's islands.

UH's flagship campus Manoa is located in Honolulu. Manoa represented over 70% of the four-year campus enrollment in fall 2022 and houses the majority of UH's research activity. The UH system supports about 49,773 enrolled students in fall 2021, about half of whom are studying in four-year colleges, and the other half in community colleges. UH reported about $1.68 billion in total revenue (Fitch-adjusted total revenue includes state appropriations and certain other items classified as non-operating) in fiscal 2021.

UH's fiscal 2022 audit is due out in December 2022, and final enrollment census data for fall 2022 will be reported in mid-October. Management reports that a small drop off in enrollment in fall 2022 is expected, largely at the community colleges, along with an expected bump up in total adjusted revenues near $1.75 billion for fiscal 2022 (unaudited), which includes one-time federal stimulus funding.

Student housing capacity has been limited over the past several years due to the pandemic. Auxiliary revenue was down significantly in FY21, largely due to vacated housing in fall 2020 and spring 2021. In fiscal 2022 (unaudited) UH's FY22 auxiliary revenue recovered (based on an estimated 50% occupancy in fall 2021 and spring 2022). Management reports that housing capacity is back to full occupancy for fall 2022, and there is a robust waiting list which they expect will restore auxiliary revenues back to historical levels in FY23.

REVENUE DEFENSIBILITY

The 'aa' assessment for revenue defensibility is anchored by UH's role as the state's sole provider of public higher education, which has supported generally steady enrollment at its four-year institutions and strong levels of state operating support, as well as a robust land, space, and ocean research platform and a solid fundraising history.

UH's demand assessment reflects a mix of demand indicators, as expected across a system with both four-year and community college institutions. For the four-year institutions, demand characteristics reflect a very strong in-state role countered with a somewhat more competitive graduate environment against mainland universities. Student quality indicators are relatively consistent with state and national averages, though they are slightly stronger at the four-year institutions.

Total system enrollment has been on a mild downward trajectory since the end of the 2008 recession, driven primarily by declines at the community colleges against more stable enrollment at the four-year schools. Fall 2022 preliminary headcount enrollment of 24,964 at the four-year institutions reflects a mild dip of 1.5% over fall 2021. UH's position as sole provider of higher education in the state means that its demand is driven more by state policy and demographic trends than by competition. UH retains the great majority of public-school graduates in Hawaii and is generally not constrained by price sensitivity.

Preliminary fall 2022 data suggests that the percentage of in-state students dropped slightly to below 60% from near 69% in fall 2017 due to an increase in the international percentage with stability in students from the mainland. UH is focused on attracting a greater proportion of in-state private high school graduates, who have a greater rate of seeking post-secondary education in the mainland U.S. than those students graduating from public K-12 schools.

The state of Hawaii (AA/Stable) has a diverse employment base and economy, with key sources of external support provided by tourism and a substantial federal presence. The state benefits from a history of steady to strong population growth and an increasingly diversified economic base away from the globally important tourism industry. The high school graduate trajectory is solid, and Fitch projects that Hawaii will see material growth in graduating high school students between now and the 2026 school year, in contrast to national trends of flat or declining numbers of high school graduates.

Approximately 85% of total UH system students are from Hawaii, with 11% from the U.S. mainland and 4% international. At Manoa, just nearly 60% of students are from Hawaii, reflecting its heavy research role and somewhat wider geographic reach.

UH's revenue sources are diverse, with strong trends in research and fundraising, along with steady state support. With 32% and 30% of fiscal 2021 total operating revenues derived from state appropriations and grants/contracts, respectively, UH's reliance on student fee revenue (18%) is lower than other 'AA' category peers (35% median student fee revenue).

Unlike many other public universities, UH has benefited from strong and consistent state support over time. Fiscal 2022 preliminary results reflect an increase in grant support to 37% of revenue and a decrease in state support to 28.5% of revenues, which is partially related to the increase in one-time federal stimulus funding and decreased state support.

Total state direct and indirect funding is expected to decreased in fiscal 2022 (unaudited) following a budgeted appropriation reduction, after a modest increase in fiscal 2021. However, the general fund appropriation should improve in fiscal 2023 as the state budget is expected to increase as per management. Fitch expect the state's direct support of university debt service and retirement benefit and health premium payments to remain steady.

The university has a Federal Land, Sea and Space Grant designation and its Manoa campus carries an R1 Carnegie research classification. Extramural research awards have been very steady over the past decade, and total awards well over $400 million in fiscal 2021 and fiscal 2020.

UH has no legal limitation on setting tuition rates; the Board of Regents has final approval. Regents are appointed by a Regents Candidate Advisory Council, whose members, in turn, are appointed by the governor and confirmed by the legislature. Under the currently approved schedule, tuition rates will remain flat through the fall 2023 incoming class or FY24.

According to management, there is a strong likelihood in FY25 that tuition rate increases will be proposed to partly offset student driven revenue pressures and rising costs associated with inflation, increases in salaries and benefits arising from collective bargaining agreements, some of which could be made whole by the state.

The tuition differential is material; at Manoa, average non-resident tuition is 3x that of resident tuition. Historically, UH's net tuition revenue per FTE compound annual growth rate has historically been above 4%; however, this has tempered somewhat to about 2.4% reflecting UH's strategic efforts to increase access.

In general, price sensitivity is not a challenge across the system for its four-year or community colleges. UH captures approximately 70% of public high school graduates at its four-year institutions but only 25% of private high school graduates. UH Manoa's tuition is less expensive than private high school, but it needs to be able to compete for students that want a 'mainland' experience.

OPERATING RISK

The university's operating risk profile is consistent with an 'a' assessment. Following use of the remaining federal stimulus HEERF funds, Fitch expects UH to maintain generally balanced operations and steady cash flow going forward. After addressing a $70 million budgetary shortfall for fiscal 2021 with operating adjustments and reduced capital outlay, UH has expanded capital plans over several years aimed at reducing deferred maintenance with a substantial level of external funding support from the state and meaningful flexibility as to timing.

UH's cash flow has been somewhat inconsistent in recent years, driven in part by shifts in pension and OPEB expenses. Better performance in fiscal year 2021 reflects enhanced financial management policies implemented in prior years that have since resulted in improved cash flow, as well as stronger state support of operations and fringe benefit expenditures and spending of federal stimulus funding under HEERF. Going forward, Fitch expects generally balanced operations at levels sufficient to produce steady and sufficient coverage and incremental improvement in leverage.

UH continues to focus its resources on deferred maintenance ahead of projects. The university has a material level of deferred maintenance near $800 million, up slightly from prior year, and an average age of plant just over 14 years. The current six-year capital improvement plan (CIP) calls for nearly $1.6 billion in total spending from FY20-FY25, funded in part with state support.

UH receives state GO bond proceeds for capital as well as capital appropriations approved by the legislature in support of its capital needs; $500 million in capital appropriations were received for fiscal years 2020 - 2022, with another $102 million in state capital appropriation in FY 2023. The majority of needs are at UH Manoa, which is the oldest campus (1907). Manoa carries nearly 60% of the deferred maintenance needs and will accordingly receive nearly 60% of CIP outlays.

Overall, the majority of UH's CIP is slated for routine maintenance rather than project spending, with the exception of its on-campus stadium expansion project, which is not part of the existing CIP. After the state-run Aloha Stadium closed for spectators three years ago, UH started an expansion project on-campus to accommodate and preserve its Division I athletics under NCAA requirements. The $30 million expansion project is expected to be completed for fall 2023 and will be funded out of operations and state funding.

UH has a history of steady fundraising under its foundation. The Foundation CEO joined in 2019 with a strong track record of campaign work and annual philanthropy. UH's last major campaign was for $500 million (Journey Beyond, FY12-18), which was achieved 15 months ahead of schedule. Annual giving is relatively steady, with an average $40 million in operating gifts/contributions over the prior four years along with an additional $10 million in capital gifts.

FINANCIAL PROFILE

As of FYE 2021, the university had $454 million in revenue bonds ($267.5 million in revenue bonds, $98.9 million in cancer center bonds, and $87.6 million in medical school bonds) outstanding. It has an entirely fixed rate bond debt mix, with somewhat front-loaded debt service through 2041 and MADS of about $38 million.

Approximately 40% of future debt service is supported by non-university revenues including Tobacco and Cigarette Tax revenue ($16.9 million in debt service against $21.4 million in revenue). The state also issues its own general obligation bonds in support of certain university projects, for which funds are directly appropriated by the state to pay debt service.

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

RATING ACTIONS

ENTITY / DEBT ⬍	RATING ⬍	PRIOR ⬍

University of Hawaii (HI)	LT IDR	AA Rating Outlook Stable	Affirmed	AA Rating Outlook Stable
University of Hawaii (HI) /General Revenues/1 LT	LT	AA Rating Outlook Stable	Affirmed	AA Rating Outlook Stable

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Public Sector, Revenue-Supported Entities Rating Criteria (pub. 01 Sep 2021) (including rating assumption sensitivity)

U.S. Public Finance College and University Rating Criteria: Effective 11/4/2021 to 9/22/2022 (pub. 04 Nov 2021) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Portfolio Analysis Model (PAM), v1.3.4 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

University of Hawaii Board of Regents (HI)	EU Endorsed, UK Endorsed

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