Moody's
INVESTORS SERVICE
New Issue: Moody's assigns Aa1 to University of Washington's $115.5M Lease Rev. Ref. Bonds, Series 2014; outlook stable

Global Credit Research - 15 Jul 2014

$2.4B rated debt including full CP

WASHINGTON ECONOMIC DEVELOPMENT FINANCE AUTHORITY
Public Colleges & Universities
WA

Moody's Rating

ISSUE RATING
Lease Revenue Refunding Bonds, Series 2014 (Washington Biomedical Research Properties II) Aa1

Sale Amount $115,490,000
Expected Sale Date 07/24/14
Rating Description Lease Rental: Other

Moody's Outlook STA

Opinion

NEW YORK, July 15, 2014 --Moody's Investors Service has assigned a Aa1 rating to University of Washington's (UW) $115.49 million of Lease Revenue Refunding Bonds, Series 2014. The bonds are issued by Washington Biomedical Research Properties II (WBRP II) through the Washington Economic Development Finance Authority.

SUMMARY RATINGS RATIONALE

The University of Washington's (UW) Aaa rating reflects the synergies of its large-scale research, healthcare and educational operations as well as the strength of each of its diversified revenues. The state's flagship public university, UW is one of the nation's largest research enterprises and one of the two largest healthcare providers in the Seattle region (and the only academic medical center in a five-state region) with generally balanced operating performance and well-diversified revenue streams. Offsetting challenges are growing healthcare operations with narrower margins, high reliance on federal research funding and rising debt levels. Although the university has an adequate balance sheet cushion, it is lower than peer institutions.

The Aa1 rating, one level below the Aaa rating for the General Revenue Bonds, reflects the lease structure for the transaction, which includes a ground lease for privately-owned property and a facilities lease with a sole purpose corporation as well as limited abatement risk.

STRENGTHS

* The university enjoys a strong market position with solid student demand, national research profile and a unique position as the major clinical care provider for the region.

* The board and senior leadership evidence best practices of governance for integrated planning, active management of debt issuance and capital projects, and regular reporting to the board regarding financed projects.

* Financial resources provide above average financial flexibility. For FY 2013, $1.6 billion of the total $4.1 billion of financial resources was unrestricted, with investments projected higher for FY 2014.

* Operations and cash flow are consistently favorable with an 11.7% operating cash flow margin for FY 2013.

CHALLENGES
Debt has substantially increased in recent years to total pro forma direct debt of $2.39 billion including full $250 million commercial paper issuance and debt of Northwest Hospital and the revenue bonds on Valley Medical Center, both component units.

University of Washington faces significant revenue and operating pressure from reductions in federal research funding resulting in greater competition for and fewer or smaller grant awards.

The university has significant healthcare exposure with declining margins. Patient care revenue represented 28% of FY 2013 total operating revenue but would be nearly 40% of total operating revenue if Northwest Hospital and Valley Medical Center (reported as component units) were consolidated into UW's revenues.

DETAILED CREDIT DISCUSSION

USE OF PROCEEDS: Proceeds from the Series 2014 Lease Revenue Refunding Bonds will be used to refund the outstanding Series 2005E and 2006J Lease Revenue Bonds and pay issuance costs.

LEGAL SECURITY

The Series 2005E, 2006J and Series 2014 Refunding Lease Revenue Bonds (for WBRP II) are secured by lease payments made by University of Washington solely from its General Revenues. The obligation to pay the lease payments is on parity with the Series 2013 Lease Revenue Bond (for WBRP I) and the Series 2010B (for WBRP 3.1), also rated Aa1. General Revenues include all non-appropriated and non-restricted revenues and fund balances and are pledged for the General Revenue Bonds (rated Aaa), General Revenue Notes (rated P-1) and for the lease payments for the TSB Lease Property Revenue Bonds (rated Aa2) For FY 2013, pledged General Revenues and the fund balance totaled $2.46 billion and $1.46 billion, respectively. Lease payments are not subject to appropriation or abatement. There is no debt service reserve fund for any bond series.

The borrower, WBRP II, is a single purpose not-for-profit corporation related by management to the National Development Council. The Council creates sole purpose subsidiaries that enter into financing leases with UW for individual projects. Given that each subsidiary is a sole-purpose entity with no operating risk, the lessor is deemed to be bankruptcy remote.

In June 2005, WBRP II entered into a ground lease with City Investors XII LLC, the property owner. As long as the Series 2014 bonds remain outstanding, WBRP’s obligations under the ground lease are subordinate to currently due payments under the bonds. Concurrently, WBRP entered into a facility lease with UW for two biomedical research buildings that opened in 2008 on the South Union campus. Both ground and facility leases run until December 31, 2043 subject to a 10-year extension. WBRP assigned its interest in the lease to the Trustee, including UW’s lease payments. At the end of the lease term, the property reverts to City Investors XII, the property owner. There is no debt service reserve fund.

For information on UW, including legal security for its other rated debt, please see Moody’s report of December 2, 2013.

DEBT-RELATED DERIVATIVE INSTRUMENTS: None

RECENT DEVELOPMENTS:

The university saw an increase in research awards for FY 2014 ending June 30, rising to $1.39 billion from $1.23 billion in 2013, due in part to the impact of sequestration. Student demand is expected to remain strong with modestly rising enrollment as UW saw rising applications, particularly from non-resident and international students. The university reports strong fundraising in FY 2014, including a $56 million gift for the law school. Investments and liquidity are also projected to be higher from 2013.

OUTLOOK

The stable outlook reflects expectations of a continued strong market position supported by a strong research profile, solid student demand, and health care presence as well as good gift revenue, manageable near-term borrowing plans and ability to navigate through cuts in federal funding.

WHAT COULD MAKE THE RATING GO UP

Not applicable

WHAT COULD MAKE THE RATING GO DOWN
A downgrade of UW's rating could be driven by substantial debt issuance without growth of financial resources and revenue; significant reduction in research funding and revenue, particularly with failure to adjust operating expenses for the revenue loss; sustained deterioration in university or medical center operating performance and cash flow; and/or downgrade in the State of Washington's general obligation rating.

KEY INDICATORS (FY 2013 financial data, fall 2013 enrollment data)

Full-Time Equivalent Enrollment: 53,380 students
Primary Selectivity: 57.8%
Primary Matriculation: 37.0%
Net Tuition per Student: $13,868
Educational Expenses per Student: $40,428
Average Gifts per Student: $3,365
Total Cash and Investments: $4.23 billion
Total Pro-Forma Direct Debt: $2.39 billion (including full issuance of commercial paper)
Expendable Financial Resources to Pro-Forma Direct Debt: 1.34 times
Expendable Financial Resources to Operations: 0.73 times
Monthly Days Cash on Hand: 157 days
Monthly Liquidity to Demand Debt: 5,922%
Operating Revenue: $4.2 billion
Operating Cash Flow Margin: 11.7%
Three-Year Average Debt Service Coverage: 4.25 times
Reliance on Grants and Contracts Revenue (% of Moody's Adjusted Operating Revenue): 31.3%
Reliance on Patient Care Revenue (% of Moody's Adjusted Operating Revenue): 27.7% (not including revenues of Northwest Hospital and Valley Medical Center)
State of Washington GO Rating: Aa1 stable

RATED DEBT

University of Washington:
University of Washington Issuer Rating: Aaa
General Revenue Notes: P-1 (based on self-liquidity)
General Revenue Bonds, Series 2007: rated Aaa, insured by Ambac
Lease Revenue Refunding Bonds, Series 2013, 2014: rated Aa1
Lease Revenue Bonds, Series 2010B: rated Aa1
Lease Revenue Bonds, Series 2005E, 2006J: rated Aa1, insured by National Public Finance Guarantee (to be refunded by Series 2014 bonds)
TSB Properties Lease Revenue Bonds, Series 2006: rated Aa2, insured by National Public Finance Guarantee
Student Facilities Fee Refunding Revenue, Series 2005: rated Aa1, insured by Financial Security Assurance

Public Hospital District #1 of King County (Valley Medical Center):


RATING METHODOLOGIES

The principal methodology used in this rating was U.S. Not-for-Profit Private and Public Higher Education published in August 2011. An additional methodology used in this rating was The Fundamentals of Credit Analysis for Lease-Backed Municipal Obligations published in December 2011. Please see the Credit Policy page on www.moodys.com for a copy of these methodologies.

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Analysts

Diane F. Viacava
Lead Analyst
Public Finance Group
Moody’s Investors Service

Eva Bogaty
Additional Contact
Public Finance Group
Moody’s Investors Service

Contacts

Journalists: (212) 553-0376
Research Clients: (212) 553-1653

Moody’s Investors Service, Inc.
250 Greenwich Street
New York, NY 10007
USA
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