New Issue: Moody’s assigns Aaa rating to the University of Washington’s $330 million of General Revenue Bonds, 2012C; outlook is stable

Global Credit Research - 25 Oct 2012

University will have $2.1 billion of rated debt outstanding state-issued debt, component units and commercial paper program at full authorized amount

UNIVERSITY OF WASHINGTON, WA
Public Colleges & Universities
WA

Moody's Rating

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<th>ISSUE</th>
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<td>General Revenue Bonds, Series 2012C</td>
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| Sale Amount | $330,000,000 |
| Expected Sale Date | 10/30/12 |
| Rating Description | Revenue: Public University Broad Pledge |

Moody's Outlook STA

Opinion

NEW YORK, October 25, 2012 --Moody's Investors Service has assigned an Aaa rating to the University of Washington’s $330 million of General Revenue Bonds, 2012C. We have affirmed existing ratings for all rated debt (see RATED DEBT). The rating outlook is stable.

SUMMARY RATINGS RATIONALE: University of Washington's 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, University of Washington (UW) is one of the largest research enterprises in the U.S. and is one of the two largest healthcare providers in the Seattle region (and the only academic medical center in a five state region). The university has good balance sheet flexibility and generally balanced operating performance due to well-diversified revenue streams. Offsetting challenges are growing healthcare operations, high reliance on federal research funding and rising debt levels.

STRENGTHS

* One of the nation's leading research enterprises with $1.47 billion in sponsored research awards for fiscal year (FY) 2012, up from the prior year excluding ARRA research awards.

* Good oversight of research operations to manage infrastructure and expense loads and ability to activate contingency plans, if necessary, including planning for the impact of automatic sequestration if they take effect beginning January 2013.

* Flagship university for Washington, with preliminary fall 2012 total enrollment of over 51,000 full-time equivalent (FTE) students; major clinical care provider to the region through UW Medicine and medical education as the sole public medical school for the Washington, Wyoming, Alaska, Montana and Idaho.

* Active management of debt issuance and capital projects, with ability to defer projects as necessary through Board-required checkpoints and "off ramps" to determine whether a project should proceed or be delayed.

* Good financial flexibility, with $1.4 billion unrestricted financial resources out of $3.7 billion of total financial resources for FY 2011; monthly operating liquidity for FY 2011 is $1.7 billion or 179 monthly days.
Further, remain well-positioned to attract increased programmatic impact of sequestration if activated. However, the Department of increased focus for research awards at the NIH provide the platform (including global issues) which smaller organizations already risen 10.7% from federal funding sources. With the size of its research activities, University of Washington is a leading position, and expect UW to continue to enjoy strong student demand for its academic programs, with preliminary total enrollment of 51,400 FTE students for fall 2012 at its three campuses in Seattle, Bothell, and Tacoma, up 1.3% from the previous year and 17.2% from fall 2007. Further, net tuition per student is expected to continue rising from tuition increases implemented to offset state funding cuts. For FY 2011, net tuition per student was $10,905, up 10.5% from the previous year that had already risen 10.7% from FY 2009; preliminary FY 2012 results indicate continued favorable tuition growth. We expect UW to continue to enjoy strong student demand as the state's flagship university, its prominent research position, and good demand from non-residents, including international students (nearly 30% of enrollment).

University of Washington offers a broad array of undergraduate, graduate, and professional programs, with preliminary total enrollment of 51,400 FTE students for fall 2012 at its three campuses in Seattle, Bothell, and Tacoma, up 1.3% from the previous year and 17.2% from fall 2007. Further, net tuition per student is expected to continue rising from tuition increases implemented to offset state funding cuts. For FY 2011, net tuition per student was $10,905, up 10.5% from the previous year that had already risen 10.7% from FY 2009; preliminary FY 2012 results indicate continued favorable tuition growth. We expect UW to continue to enjoy strong student demand as the state's flagship university, its prominent research position, and good demand from non-residents, including international students (nearly 30% of enrollment).

University of Washington will maintain its excellent market position, anchored by its outstanding research fundamentals and very strong student demand for its academic programs. UW offers a broad array of undergraduate, graduate, and professional programs, with preliminary total enrollment of 51,400 FTE students for fall 2012 at its three campuses in Seattle, Bothell, and Tacoma, up 1.3% from the previous year and 17.2% from fall 2007. Further, net tuition per student is expected to continue rising from tuition increases implemented to offset state funding cuts. For FY 2011, net tuition per student was $10,905, up 10.5% from the previous year that had already risen 10.7% from FY 2009; preliminary FY 2012 results indicate continued favorable tuition growth. We expect UW to continue to enjoy strong student demand as the state's flagship university, its prominent research position, and good demand from non-residents, including international students (nearly 30% of enrollment).

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University of Washington is a leading research enterprise, with $1.47 billion of research grants in FY 2012, with 68% from federal funding sources. With the size of its research activities, UW focuses on research areas (including global issues) which smaller organizations would be unable to address. Its healthcare operations provide the platform for translational research, while its culture enables cross-disciplinary research - both areas of increased focus for research awards at the NIH and other federal agencies. Of the research awards, the Department of Health and Human Services (HHS) accounted for about 42% of awards.

The high research activity exposes UW to federal funding pressures from planned budgetary reductions or the impact of sequestration if activated. However, we believe that with its strong reputation and research faculty, programmatic and funding diversification, as well as planned capital expenditures for research facilities, UW will remain well-positioned to attract increased research funding and maintain its national research prominence.

CHALLENGES

*Significant and increasing healthcare exposure with the recent affiliation with two community hospitals; patient care revenues represented 28% of FY 2011 total operating revenues; inclusive of Northwest Hospital (brought into UW Medicine in 2010) and Valley Medical Center (brought into UW Medicine in July 2011), patient care represents nearly 40% of total operating revenues in FY 2012 on a pro-forma basis.

*Dramatic reductions in state funding, with a 25% or $162 million reduction from the 2009-1011 biennium to the current 2011-2013 biennium resulting in funding of $421 million for 2011-2013. The state is projecting a deficit for the upcoming 2013-2015 biennium and it is likely that further cuts will be made in UW's funding as the state looks to fund Medicaid and K-12.

DETAILED CREDIT DISCUSSION

USE OF PROCEEDS: Proceeds from the Series 2012C General Revenue Bonds will be used to fund various capital projects, refund outstanding commercial paper, and pay issuance costs.

LEGAL SECURITY: Security of the University's General Revenue Bonds (rated Aaa) are the General Revenues of the university, including all non-appropriated and non-restricted revenues and fund balances. For FY 2011, pledged general revenues totaled $2.13 billion, with preliminary FY 2012 revenues of $2.3 billion. There is no debt service coverage covenant, no debt service reserve fund, and no additional bonds test. The pledge of General Revenues is subordinate to pledges on $33.3 million of outstanding indebtedness. As of June 2012, all of the bonds with subordinate pledges have been refunded. The university will refinance certain series of outstanding bonds under existing indentures when possible to bring them under the General Revenue platform.

DEBT-RELATED DERIVATIVE INSTRUMENTS: None

MARKET/COMPETITIVE POSITION: FLAGSHIP PUBLIC UNIVERSITY FOR STATE, LEADING NATIONAL RESEARCH PROFILE WITH GROWING HEALTHCARE EXPOSURE

University of Washington will maintain its excellent market position, anchored by its outstanding research fundamentals and very strong student demand for its academic programs. UW offers a broad array of undergraduate, graduate, and professional programs, with preliminary total enrollment of 51,400 FTE students for fall 2012 at its three campuses in Seattle, Bothell, and Tacoma, up 1.3% from the previous year and 17.2% from fall 2007. Further, net tuition per student is expected to continue rising from tuition increases implemented to offset state funding cuts. For FY 2011, net tuition per student was $10,905, up 10.5% from the previous year that had already risen 10.7% from FY 2009; preliminary FY 2012 results indicate continued favorable tuition growth. We expect UW to continue to enjoy strong student demand as the state's flagship university, its prominent research position, and good demand from non-residents, including international students (nearly 30% of enrollment).

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The high research activity exposes UW to federal funding pressures from planned budgetary reductions or the impact of sequestration if activated. However, we believe that with its strong reputation and research faculty, programmatic and funding diversification, as well as planned capital expenditures for research facilities, UW will remain well-positioned to attract increased research funding and maintain its national research prominence.
Further, the university closely oversees its research operations, monitoring and managing its infrastructure and expense loads to address potential funding reductions, and has substantial operating flexibility from a largely variable expense structure. It has contingency plans in place in the event of automatic sequestration and/or a federal government shut-down, and is planning for cuts in its federal funding.

UW has significant exposure to the healthcare industry with patient care representing 29% of FY 2011 total revenues that is expected to increase with the recent affiliation with two regional community hospitals. This exposes the university to operational pressures from rate reductions for state and federal government payer programs, including Medicare and Medicaid, as well as the uncertain impact of national healthcare reform. The University of Washington Medical Center (UWMC) with 450 beds is an operating division of the university and is a nationally ranked hospital offering tertiary/quaternary services. UW's faculty physicians are the exclusive providers of its health care services, with over 4,800 clinical faculty. The breadth of UW Medicine's service area is substantial, serving as the only academic health system and Level 1 trauma care provider for the northwestern states of Washington, Wyoming, Alaska, Montana and Idaho (WWAMI), providing critical care air medical transport to patients in the region. Further, UW's School of Medicine is the only public medical school for the region.

UW's board has invested in its healthcare operations both in capital and through strategic alliances. UW Medicine is comprised of four hospitals, including UWMC. UW Medicine expanded with the alliance with Northwest Hospital & Medical Center, a 281-bed community hospital in January 2010 and Valley Medical Center, a district hospital with 303 beds, in July 2011. UW Medicine also includes operation of Harborview Medical Center, a county hospital managed by UWMC under a management agreement. UW also shares ownership of the Seattle Cancer Care Alliance (rated A2/stable) together with Fred Hutchinson Cancer Research Center (A2/negative) and Seattle Children's Hospital (Aa3/positive).

As a result of the overall expansion of the healthcare enterprise, UW's FY 2011 patient care revenues were $1.12 billion on a pro forma basis including Northwest Hospital, and are a projected $1.61 billion for FY 2012, including Northwest Hospital and Valley Medical Center. UW is focused on both revenue enhancements and expense management efforts, as well as strategic initiatives to build its provider network and relationships with other hospitals. Further, it has mitigation strategies to address possible reductions in government-paid reimbursement. With its breadth of services - from primary to quaternary care - and active management and Board attention to enterprise risk, we believe UW will be able to manage its healthcare operations to provide continued favorable operating performance with no negative impact on the university's operations.

OPERATING PERFORMANCE: POSITIVE OPERATING PERFORMANCE AND GOOD CASH FLOW GENERATION, WITH DIVERSIFIED REVENUE STREAMS AND SOLID DEBT SERVICE COVERAGE

The university has consistently generated positive operating performance, with a three-year average operating margin of 3.6% for FY 2009 - FY 2011. Operating cash flow of 11.7% provided a strong 4.8 times coverage of FY 2011 annual debt service. UW benefits from its diversified revenue base which for FY 2011 included 34% from grants and contracts, 29% from patient care, 18% from student charges, and 7% from state appropriations. As noted, patient care revenue would account for nearly 40% of total operating revenues if Northwest Hospital and Valley Medical Center's revenues were included in the calculation.

UW's healthcare operations have performed well, experiencing modestly growing utilization and producing operating surpluses and good operating cash flow. Admissions for University of Washington Medical Center remained generally flat in FY 2011 at about 18,900. For FY 2011, UW’s total patient care revenues were $1.33 billion, with about $850 million attributable to UWMC. UWMC’s operating margin was 6.7% for FY 2011, down from 9.0% the prior year. UW estimates FY 2012 results to be at least comparable to FY 2011. The healthcare operations expose UW to issues arising from healthcare reform and payer reimbursement issues, particularly Medicare and Medicaid entailing risk to federal funding reductions for those government payers. Nonetheless, UW Medicine should continue to produce at least balanced performance while continuing to be an important strategic component of the university's overall market position in research and clinical operations. However, patient care revenues are the second highest component and will continue to increase from the growing healthcare activities, likely becoming the largest revenue component. Moody's will assess the growth of the healthcare activities to determine if there is any impact on UW's credit profile.

UW state funding was dramatically reduced in recent years, with a 25% or $162 million reduction from the 2009-1011 biennium to the current 2011-2013 biennium resulting in funding of $421 million for 2011-2013. Further, the state is projecting a deficit for the upcoming 2013-2015 biennium and it is likely that further cuts will be made in UW's funding as the state looks to fund Medicaid and K-12. However, state appropriations account for only 7% of FY 2011 revenues. Additionally, the state funding cuts were offset by tuition revenue and last year, the State granted
UW tuition setting authority for all student categories. The Legislature allowed UW to implement suitable tuition increases to offset funding cuts and UW's Board of Regents implemented a 20% and 16% tuition increase for fall 2011(FY 2012) and fall 2012 (the current FY 2013), respectively.

The State of Washington currently has an Aa1 general obligation rating with a negative outlook. The Aa1 general obligation rating incorporates Washington's sound management tools such as its quarterly consensus revenue forecasting process and demonstrated willingness to address budget shortfalls, along with strong demographic trends that will help propel the economic recovery once it takes hold. These strengths are tempered by exposure to the cyclical aerospace industry, above average debt ratios, and an economy that proved more vulnerable to the housing downturn than expected. Frequent voter initiative activity adds budget challenges although the state legislature has a history of responding effectively to maintain budget balance. As a state with heavy dependence on sales tax receipts and no personal income tax, Washington's revenues have been hit hard by the negative impact of the recession on consumer confidence and announced a revenue shortfall of $1.4 billion last fall amounting to about 5% of the biennial budget after the state closed a $4.9 billion budget gap going into the current 2011-2013 biennium that began on July 2, 2011. Forward-looking economic indicators are positive and high paying aerospace and technology jobs will eventually help Washington outperform the nation. While there are signs of stabilization, the state’s construction industry continues to have a drag on the state's recovery reflecting a housing downturn that hit Washington later than most states and was worse than the state expected. In addition, public sector employment is declining as the state and local governments downsize in response to budget challenges. For more information on the State, please see Moody's report of July 30, 2012.

**BALANCE SHEET POSITION: BALANCE SHEET RESOURCES PROVIDE SIGNIFICANT FINANCIAL FLEXIBILITY AND CUSHION SUPPORTING SUBSTANTIALLY HIGHER DEBT BURDEN**

University of Washington will continue to provide an ample cushion of balance sheet resources to support the growing debt burden and operations. For FY 2011, total and expendable financial resources were $3.7 billion and $2.6 billion, respectively, up from $3.3 billion and $2.2 billion, respectively the prior year. For FY 2012, preliminary results show generally stable results. The balance sheet profile shows good flexibility with $1.4 billion unrestricted assets. We expect stable to modest growth in financial resources from investment performance and ongoing fundraising. FY 2011 expendable resources provide a good cushion of 1.16 times total pro-forma debt (including debt of Valley Medical Center and Northwest Hospital, both secured by revenues of the facilities) and 0.7 times annual operations.

UW's pro-forma debt is substantial at $2.2 billion, with the recent increases consistent with assumed debt issuances. The calculated total debt includes the current Series 2012C General Revenue Bonds, the debt of Northwest Hospital and the revenue bonds of Valley Medical Center (the two medical centers are reported as component units of the university; Valley Medical Center's limited general obligation debt is excluded as it is fully supported by a tax levy specifically for debt service). UW has significant debt plans over the next few years, with plans to issue up to a total of $200 million during the next two years, about half in FY 2014, to fund a number of campus projects.

UW's Board of Regents has a thorough review and approval process for all capital projects and for all debt issuance. The board often requires that projects be staged, requiring checkpoints and "off ramps" at various points in the process, and prior to the issuance of additional debt. Capital projects are integrated into and centrally managed in UW's "One Capital Plan", its comprehensive ten-year strategic plan. The process includes financial review of revenue sources of funding for debt service repayment and related scenarios. The One Capital Plan is reviewed at least annually by the board. Upcoming projects, including the next phase of student housing, will be reviewed to determine if it should proceed or be delayed. Currently, assuming moderation of debt issuance balanced with continued growth in balance sheet resources and in revenues, Moody's believes the current debt plans are manageable. However, further issuance above the current plans, particularly with constrained growth in balance sheet resources or operating cash flow, could result in rating or outlook pressure. Moody's will monitor the university's capital and debt plans as they develop to determine any impact on the rating or the outlook.

For FY 2012 ending June 30, 2012, UW reported a negative 0.9% return on its Consolidated Endowment Fund (CEF), with $2.11 billion at fiscal year-end, down from $2.15 billion for the previous year. At June 30, 2012, asset allocations were 18% in emerging market equities, 41% in developed market equities, 11% in fixed income, 17% in absolute return, 5% in opportunistic investments, and 8% in real assets. The portfolio is liquid, with 44% of the CEF able to be accessed within one month or sooner. Outside the CEF, UW holds $1.39 billion in operating funds, largely cash and treasuries/agencies. As measured by Moody's, unrestricted monthly liquidity is rising and stood at $1.7 billion for FY 2011, translating to 179 monthly days cash.
Investment program oversight resides with the Finance, Audit and Facilities Committee of the Board of Regents. The board utilizes the UW Investment Committee (UWINCO), an advisory committee consisting of both Board members and external investment professionals. In 2004, the board approved the UW’s first Chief Investment Officer to manage the day-to-day activities of the investment portfolios.

Although not in an active comprehensive campaign, UW continues to show fundraising strength, with $158 million of average gift revenues and $197 million for FY 2011 alone. Notably, average gifts per student are strong at $3,130 for FY 2011, again without a large campaign underway. Preliminary FY 2012 results indicate gifts are $155.5 million, slightly lower than 2011. The university is conducting a smaller campaign to fund capital work at its Husky Stadium.

UNIVERSITY’S P-1 SHORT-TERM RATING FOR GENERAL REVENUE NOTES SUPPORTED BY AMPLE SELF-LIQUIDITY

The University of Washington maintains a $250 million of General Revenue Notes commercial paper program, rated P-1, supported by its self-liquidity. The university has no other variable rate debt outstanding. As documented in its Issuing and Paying Agreement, maturing commercial paper is limited to $100 million in a single five day period. It currently has $125 million outstanding that will be partially refunded with the Series 2012C bonds and intends to have no more than $90 million outstanding for the next twelve months.

At September 30, 2012, the university held $787 million of same-day liquidity on a non-discounted basis, including $5 million in the SSgA US Treasury Money Market (rated Aaa-mf) and $782 million in U.S. Treasury and Agency securities held in custody in its own name. Additionally, it holds $642 million of investments on a non-discounted basis that can be accessed within one week. We note that the funds are from the university’s operating funds and exclude investments in its Consolidated Endowment Fund.

As of September 30, 2012 daily liquidity provides a very strong 7.7 times coverage of the $90 million that could mature in a single five day period. Moody's believes the university’s treasury and financial management closely monitor and plan for the commercial paper’s maturity dates and will ensure sufficient same day liquidity in advance of maturing CP should a remarketing not occur. Moody's will monitor the investments to insure sufficient levels of same-day liquidity are held to meet the coverage tests.

OUTLOOK

The stable outlook reflects expectations of a continued strong research profile, solid student demand, good gift revenues, manageable near-term borrowing plans and ability to navigate through federal funding pressures from federal budget cuts from sequestration or an approved budget.

WHAT COULD MAKE THE RATING GO UP

Not applicable

WHAT COULD MAKE THE RATING GO DOWN

Downgrade of U.S. government's Aaa rating; significant reduction in research funding and revenues, particularly with failure to adjust operating expenses for the revenue loss; borrowing plans beyond those outlined without commensurate growth of financial resources and revenue; sustained deterioration in operating performance and cash flow from medical center operations; deterioration in student market position as evidenced by weakened selectivity or lower yield; downgrade in the State of Washington’s general obligation rating.

KEY INDICATORS (FY 2011 financial data, fall 2011 enrollment data)

Full-Time Equivalent Enrollment: 50,527 students

Primary Selectivity: 57.4%

Primary Matriculation: 40.3%

Net Tuition per Student: $10,905

Educational Expenses per Student: $38,051

Average Gifts per Student $3,130
Total Cash and Investments: $3.97 billion
Total Pro-Forma Direct Debt: $2.23 billion
Total Pro-Forma Comprehensive Debt*: $2.40 billion
Expendable Financial Resources to Direct Debt: 1.11 times
Expendable Financial Resources to Operations: 0.70 times
Monthly Days Cash on Hand: 179.1 days
Monthly Liquidity to Demand Debt: 3,310%
Operating Revenue: $2.49 billion
Operating Cash Flow Margin: 11.7%
Three-Year Average Debt Service Coverage: 4.41 times
Reliance on Grants and Contracts Revenue (% of Moody's Adjusted Operating Revenue): 33.9%
State of Washington GO Rating: Aa1, negative outlook
* Comprehensive Debt includes direct debt, operating leases, and pension obligation, if applicable.

RATED DEBT

University of Washington:
University of Washington Issuer Rating: Aaa
General Revenue Notes: P-1 (based on self-liquidity)
General Revenue Refunding Bonds, Series 2008: rated Aaa
General Revenue Bonds, Series 2007: rated Aaa, insured by Ambac
Lease Revenue Bonds, Series 2010B, 2010C: rated Aa1
Lease Revenue Bonds, Series 2006J: rated Aa1, insured by National Public Finance Guarantee
TSB Properties Lease Revenue Bonds, Series 2006: rated Aa2, insured by National Public Finance Guarantee
Lease Revenue Bonds, Series 2005E: rated Aa1, insured by National Public Finance Guarantee
Student Facilities Fee Refunding Revenue, Series 2005: rated Aa1, insured by Financial Security Assurance
Lease Revenue Bonds, Series 2004A: rated Aa1, insured by Financial Guaranty Insurance Company
Public Hospital District #1 of King County (Valley Medical Center):

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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.

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