S&P Global
Ratings

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University of Washington; CP; Lease; Public Coll/Univ - Unlimited Student Fees

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Table Of Contents

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Credit Profile		
US$133.9 mil gen rev bnds ser 2018 due 04/01/2048		
Long Term Rating	AA+/Stable	New
University of Washington CP Program Notes due 06/30/2036		
Short Term Rating	A-1+	Affirmed
Washington Biomedical Research Facilities 3, Washington		
University of Washington, Washington		
Washington Biomedical Properties 3.1 (University of Washington) lse		
Long Term Rating	AA+/Stable	Affirmed

Rationale

S&P Global Ratings assigned its 'AA+' long-term rating to University of Washington's (UW) $133.9 million series 2018 general revenue bonds. Additionally, S&P Global Ratings affirmed its:

- 'AA+' long-term rating and underlying rating (SPUR) on UW's parity general revenue bonds, and
- 'A-1+' short-term rating on UW's commercial paper (CP) notes.

The outlook, where applicable, is stable.

We assessed the UW's enterprise profile as extremely strong, characterized by its impressive market position and demand, and its financial profile as very strong, with adequate resources compared with the operating budget, moderate debt, but negative margins. Combined, we believe these credit factors lead to an indicative standalone credit profile of 'aa+' and a final rating of 'AA+'. We expect the university and its affiliated medical center will improve its operating margins over time and maintain its market position.

The 'AA+' unlimited student fee ratings reflect our view of the university's:

- Position as one of the nation's top research universities, with an estimated $1.6 billion in federal and nonfederal grant and contract awards in fiscal 2017;
- Solid enrollment and demand, with 58,155 full-time-equivalent (FTE) students for fall 2017;
- Manageable, 3.5% pro forma maximum annual debt service (MADS) burden; and
- Impressive fundraising efforts and a healthy endowment, with an estimated market value of $3.1 billion as of June 30, 2017.

Partly offsetting credit factors, in our opinion, are the university's:

- Negative adjusted operating results at the university and UW Medicine as calculated by S&P Global Ratings in fiscals 2016 and 2017, and
- Adequate available resource ratios for the rating category, with fiscal 2017 adjusted unrestricted net assets (UNA)

equal to 31% of expenses and 76% of pro forma debt.

Proceeds from the series 2018 bonds, along with other funds, are expected to provide the university with $30 million for project expenditures and $132 million to refund a portion of outstanding CP. Securing the parity general revenue bonds is a pledge of general revenue, which comprises all nonappropriated revenue not restricted by law or contract--excluding appropriations, grant direct costs, restricted gifts, some fees, Northwest Hospital and Valley Medical Center revenues, and certain auxiliary revenues. General revenue totaled an estimated $3.1 billion in fiscal 2017, including student tuition and fees ($837 million), auxiliary and patient services revenue ($1.68 billion), grant indirect cost recovery ($258 million), sales and services revenue ($217 million), investment income ($27 million), and other operating revenues ($52 million). These bonds do not carry a coverage covenant, debt service reserve requirement, or additional bonds test. Following this issuance, total pro forma debt is approximately $2.4 billion. We consider the security pledge to be equivalent to an unlimited student fee pledge.

The 'A-1+' short-term rating on the CP (up to $250 million in authorized amount) reflects our view of the university's general credit strengths and ability and experience to manage its own liquidity. In our view, the university demonstrates sufficient liquid assets of high credit quality to cover any unsuccessful CP rollovers. The university had $180 million of CP outstanding as of Jan. 10, 2018. We expect approximately $48 million of UW's CP will remain outstanding following the refunding.

Outlook

The stable outlook reflects our expectation that, during the next two years, the university and UW Medicine will improve operating results, financial resource measures will steadily strengthen, and demand measures will remain solid.

Downside scenario

We could consider a negative rating action if financial resources decline materially, operating margins deteriorate, or the university issues more additional debt than forecast.

Upside scenario

A positive rating change is unlikely during the two-year outlook period given UW's adequate operations and balance sheet metrics. However, one could be considered over time if UW's operating performance steadily improves, particularly at UW Medicine, and balance sheet metrics increase to levels more in line with those of other 'AAA' rated systems.

Enterprise Profile

Industry risk

Industry risk addresses the higher education sector's overall cyclicality and competitive risk and growth by applying various stress scenarios and evaluating barriers to entry, levels and trends of profitability, substitution risk, and growth trends observed in the industry. We believe the higher education sector represents a low credit risk when compared with other industries and sectors.

Economic fundamentals

The University of Washington was founded in 1861 in Seattle and has two additional campuses, in Tacoma and Bothell. In our view, the university has good geographic diversity but a mostly regional draw. About 67% of students are from the state of Washington, and as a result, our assessment of UW's economic fundamentals is anchored by the state GDP per capita.

Market position and demand

As the flagship university in the state of Washington, UW's credit profile benefits from its healthy and stable demand and enrollment. FTE enrollment continues to increase modestly, with 2% growth in fall 2017 to 58,155. Management expects demand and enrollment to remain stable in the near future. UW has effectively capped enrollment at its main campus, although there is room for expansion at the two smaller branch campuses. While the university has several graduate programs, the school is still primarily undergraduate, with approximately 72% of the student body consisting of undergraduate students. Although the university draws students from across the nation, it is still largely regional, with approximately 67% of students coming from the state, which is consistent with its mission to educate Washingtonians. First-year applications grew 3% for fall 2017 to a high of 50,007, following two years with each 17% growth. Due to the growth in applications, the acceptance rate fell to 50% in fall 2017 from 58% in fall 2014. The matriculation rate has declined over the past five years, but we still consider it good, at 33% for fall 2017. Student quality has improved and is strong, in our view, with average fall 2017 SAT scores of 1263. The retention rate is strong, at 92%, and the six-year graduation rate is approximately 82%.

UW Medicine is a leading health care provider throughout Washington. UW Medicine, through the School of Medicine faculty practice plans (UW Physicians), has approximately 2,200 employed faculty physicians and other health care providers practicing across a broad range of specialties. Key services include cardiology, trauma, oncology, transplants, and a broad array of adult and pediatric medical and surgical specialty and subspecialty services. UW Medicine includes the University of Washington School of Medicine, Harborview Medical Center, University of Washington Medical Center (UWMC), Northwest Hospital and Medical Center, Valley Medical Center, University of Washington Physicians, University of Washington Neighborhood Clinics, and Airlift Northwest. Along with the Fred Hutchinson Cancer Research Center and Children's Hospital, UW Medicine also has a one-third ownership interest in the Seattle Cancer Care Alliance, while the university and Seattle Children's each has one-half ownership interest in the Children's University Medical Group. Additionally, it maintains strategic collaborations with Peace Health and Capital Medical.

Management and governance

The university is governed by a 10-member board of regents and managed by President Ana Mari Cauce, who was named to the position in 2016 after former president Michael K. Young left to assume the presidency at Texas A&M University. The university also has announced a new provost, Mark Richards, who will start July 1, 2018. The university uses a six-year strategic capital plan, which it updates regularly and presents to the board on an annual basis. Furthermore, the regents review and approve all large capital projects. In our view, the culture of planning regarding debt issuance allows for a certain degree of predictability.

Financial Profile

Financial management policies

The university has formal policies for investment management and debt. It operates according to a 10-year strategic framework called the Sustainable Academic Business Plan. The university meets standard annual disclosure requirements. The financial policies assessment is neutral, reflecting our opinion that, while there may be some areas of risk, the organization's overall financial policies are not likely to negatively affect its future ability to pay debt service. Our analysis of financial policies includes a review of the organization's financial reporting and disclosure, investment allocation and liquidity, debt profile, contingent liabilities, and legal structure, and a comparison of these policies to those of comparable providers.

Financial performance

We estimate operating performance by removing unrealized gains/losses on investments, which resulted in estimated operating performance in fiscal 2017 of negative $165 million, or a net operating income of negative 2.8%. In fiscal 2016, the net operating income was negative 3.5%. We expect operating performance to improve in fiscal 2018, including expected improvement in the operating margin at UW Medicine, and we will review specific initiatives by management to address this risk. According to management, the fiscal 2017 operating margin at UW Medicine, at negative 4.0%, was affected by net revenue pressures due to shifts in payer mix and lower-than-expected reimbursement, higher-than-expected salaries and benefits expenses, and certain one-time expenses; management has implemented a multiyear financial improvement plan that focuses on initiatives designed to improve financial performance at UW Medicine, including clinical service growth, labor and productivity improvement, and supply chain standardization and cost reduction. Management indicates that fiscal 2018 results are showing improvement; we will monitor the results.

In fiscal 2017, total adjusted revenue included 33.6% from patient services (excluding Valley Medical Center), 23.6% from grants and contracts, 19.2% from net tuition and student fees, and only 5.9% from state operating appropriations. Approximately 64% of grants and contracts came from federal sources, with the School of Medicine being the biggest driver of research. The university is consistently among the nation's top university recipients for research grants and contracts each year. Based on the constrained federal funding outlook, we expect research to remain flat or grow modestly, although we expect grant and research funding for the university will remain strong in the long term.

State support has been somewhat variable over time, with the legislature increasing annual appropriations recently in exchange for the state public universities agreeing to limit the in-state undergraduate tuition rate. We consider the state's variability in support to be a credit risk but do recognize state appropriations are only a small portion of the university's total revenue.

The university utilizes an endowment spending formula of 4% of the endowment's five-year average market value for program distribution and 1% of the endowment's five-year average market value for administrative fees. Total endowment distribution in fiscal 2017 was approximately $141 million, which is equivalent to only 2.5% of total university revenues for the year.

Available resources

UW's consolidated endowment fund was approximately $3.1 billion as of June 30, 2017. The endowment's estimated return for fiscal 2017 was a strong 13.6%. The portfolio is fairly diverse, in our opinion, with 58% developed and emerging markets, 12% private equity, 15% absolute return, 7% fixed income, 6% real assets, and 2% opportunistic credit as of June 30, 2017.

S&P Global Ratings-adjusted UNA, adding UNA of component units and pension liability, was $1.8 billion in fiscal 2017, down 5% from a high of $1.9 billion in fiscal 2015 but the second highest year. In fiscal 2017, financial resources are adequate for the rating, in our opinion, with adjusted UNA equal to 30.8% of adjusted operating expenses ($5.9 billion in fiscal 2017) and 76.2% of pro forma debt.

Debt and contingent liabilities

As of June 30, 2017, the university had $2.3 billion of debt outstanding, and following the issuance of the series 2018 bonds, pro forma debt is expected to be approximately $2.4 billion. The debt service schedule is front loaded, with MADS of $207 million in fiscal 2018. The pro forma MADS burden is manageable, in our opinion, at 3.5%.

Securing the parity general revenue bonds is a pledge of general revenue, which comprises all nonappropriated revenue not restricted by law or contract--excluding appropriations, grant direct costs, restricted gifts, some fees, Northwest Hospital and Valley Medical Center revenues, and certain auxiliary revenues. For fiscal 2017, general revenues equaled an estimated $3.1 billion.

University of Washington

Enterprise And Financial Statistics

	--Fiscal year ended June 30--					Medians for 'AA' rated Public Colleges & Universities
	2018	**2017**	**2016**	**2015**	**2014**	**2016**
Enrollment and demand						
Headcount	57,855	56,809	55,767	54,670	53,072	MNR
Full-time equivalent	58,155	56,974	55,963	54,857	53,380	32,506
Freshman acceptance rate (%)	50.0	49.1	56.2	58.0	57.8	69.3
Freshman matriculation rate (%)	32.6	32.8	33.7	36.2	37.0	MNR
Undergraduates as a % of total enrollment (%)	72.0	71.9	72.0	71.9	71.4	77.7
Freshman retention (%)	92.0	92.0	92.0	92.0	91.0	86.0
Graduation rates (six years) (%)	82.0	83.0	82.5	82.0	N.A.	MNR
Income statement						
Adjusted operating revenue ($000s)	N.A.	5,748,253	5,102,768	4,905,125	4,597,556	MNR
Adjusted operating expense ($000s)	N.A.	5,912,954	5,287,866	4,927,584	4,615,687	MNR
Net adjusted operating income ($000s)	N.A.	(164,701)	(185,098)	(22,459)	(18,131)	MNR
Net adjusted operating margin (%)	N.A.	(2.79)	(3.50)	(0.46)	(0.39)	1.46
Estimated operating gain/loss before depreciation ($000s)	N.A.	198,327	139,504	288,501	290,059	MNR
Change in unrestricted net assets (UNA; $000s)	N.A.	(295,479)	(193,591)	(869,523)	139,716	MNR

University of Washington (cont.)

Enterprise And Financial Statistics

	--Fiscal year ended June 30--					Medians for 'AA' rated Public Colleges & Universities
	2018	**2017**	**2016**	**2015**	**2014**	**2016**
State operating appropriations ($000s)	N.A.	341,971	302,097	255,156	262,146	MNR
State appropriations to revenue (%)	N.A.	5.9	5.9	5.2	5.7	19.4
Student dependence (%)	N.A.	25.7	28.3	28.1	27.0	41.8
Health care operations dependence (%)	N.A.	33.6	29.1	28.7	27.0	MNR
Research dependence (%)	N.A.	23.6	25.4	26.1	27.7	MNR
Endowment and investment income dependence (%)	N.A.	2.5	2.8	2.7	2.5	0.8
Debt						
Outstanding debt ($000s)	N.A.	2,329,476	2,207,184	2,065,985	2,403,755	698,540
Proposed debt ($000s)	N.A.	133,900	N.A.	N.A.	N.A.	MNR
Total pro forma debt ($000s)	N.A.	2,390,476	N.A.	N.A.	N.A.	MNR
Pro forma MADS	N.A.	207,437	N.A.	N.A.	N.A.	MNR
Current debt service burden (%)	N.A.	3.96	2.91	3.12	4.39	MNR
Current MADS burden (%)	N.A.	3.51	3.75	3.47	3.45	3.60
Pro forma MADS burden (%)	N.A.	3.51	N.A.	N.A.	N.A.	MNR
Financial resource ratios						
Endowment market value ($000s)	N.A.	3,144,000	2,968,013	3,076,226	2,832,753	748,837
Related foundation market value ($000s)	N.A.	219,561	330,991	N.A.	N.A.	606,279
Cash and investments ($000s)	N.A.	5,370,871	4,902,455	5,059,567	4,823,947	MNR
UNA ($000s)	N.A.	380,050	675,529	869,120	1,738,643	MNR
Adjusted UNA ($000s)	N.A.	1,821,934	1,694,148	1,919,185	1,738,643	MNR
Cash and investments to operations (%)	N.A.	90.8	92.7	102.7	104.5	54.7
Cash and investments to debt (%)	N.A.	230.6	222.1	244.9	200.7	159.6
Cash and investments to pro forma debt (%)	N.A.	224.7	N.A.	N.A.	N.A.	MNR
Adjusted UNA to operations (%)	N.A.	30.8	32.0	38.9	37.7	31.9
Adjusted UNA plus debt service reserve to debt (%)	N.A.	78.2	76.8	92.9	72.3	89.7
Adjusted UNA plus debt service reserve to pro forma debt (%)	N.A.	76.2	N.A.	N.A.	N.A.	MNR
Average age of plant (years)	N.A.	11.8	11.7	11.5	10.8	12.9
OPEB liability to total liabilities (%)	N.A.	0.0	N.A.	N.A.	N.A.	MNR

N.A.--Not available. MNR--Median not reported. MADS--Maximum annual debt service. Total adjusted operating revenue = unrestricted revenue less realized and unrealized gains/losses and financial aid. Total adjusted operating expense = unrestricted expense plus financial aid expense. Net operating margin = 100*(net adjusted operating income/adjusted operating expense). Student dependence = 100*(gross tuition revenue + auxiliary revenue) / adjusted operating revenue. Current debt service burden = 100*(current debt service expense/adjusted operating expenses). Current MADS burden = 100*(maximum annual debt service expense/adjusted operating expenses). Cash and investments = cash + short-term and long-term investments. Adjusted UNA = Unrestricted net assets + unrestricted net assets of the foundation. Average age of plant = accumulated depreciation/depreciation and amortization expense.

Ratings Detail (As Of January 16, 2018)		
University of Washington gen rev bnds		
Long Term Rating	AA+/Stable	Affirmed
University of Washington gen rev & rfdg bnds		
Long Term Rating	AA+/Stable	Affirmed
University of Washington PCU_USF		
Long Term Rating	AA+/Stable	Affirmed
University of Washington gen rev bnds ser 2008		
Long Term Rating	AA+/Stable	Affirmed
Washington Econ Dev Fin Auth, Washington		
University of Washington, Washington		
Washington Econ Dev Fin Auth (University of Washington) PCU_USF		
Long Term Rating	AA+/Stable	Affirmed
Washington Econ Dev Fin Auth lse ser 2004		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed
Washington Econ Dev Fin Auth (University of Washington) lse rev bnds ser 2004A		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.