

MOODY'S

RATINGS

Rating Update: MOODY'S AFFIRMS P-1 RATING ON UNIVERSITY OF WASHINGTON'S GENERAL REVENUE NOTES IN CONJUNCTION WITH SUBSTITUTION OF SELF-LIQUIDITY FOR BANK FACILITY AND AFFIRMS LONG-TERM RATINGS; RATING OUTLOOK IS STABLE

25 Jun 2009

UNIVERSITY HAS \$1.27 BILLION OF RATED DEBT OUTSTANDING WITH COMMERCIAL PAPER PROGRAM AT FULL SIZE

Higher Education
WA

Opinion

NEW YORK, Jun 25, 2009 -- Moody's Investors Service has affirmed the P-1 rating on the University of Washington's General Revenue Notes in conjunction with a substitution of self-liquidity for a Standby Note Purchase Agreement from KBC Bank, NV (rated Aa3 with a negative outlook). At the same time we have affirmed the University's Aa1 issuer rating as well as the ratings on various other debt securities detailed at the end of this report. The rating outlook is stable.

LEGAL SECURITY: The General Revenue Notes are payable from General Revenues of the University, including all non-appropriated and non-restricted revenues and fund balances. The Notes are on parity with \$301 million of General Revenue Bonds rated Aa1, reflecting the broad revenue pledge, the University's debt management practices, and frequent need for market access by the University. For FY 2009, the University added to the pledged revenues its auxiliary systems, including the University of Washington Medical Center, the parking system, the intercollegiate athletic system, student services and the housing and dining system. If added in 2008, proforma pledged revenues would increase to \$1.94 billion from the previous \$806 million for the year; the general revenue balances would increase to \$885 million from \$501 million.

For other series of debt, please see SECURITY PLEDGE section for specific debt service coverage levels.

DEBT STRUCTURE AND DEBT-RELATED INTEREST RATE DERIVATIVES: The University has not entered into any interest rate swaps. The University's long-term debt is all fixed-rate debt. The General Revenue Notes commercial paper program is for a total of \$250 million and can be issued as either tax-exempt or taxable commercial paper. No more than \$50 million of commercial paper can mature in a single day and no more than \$100 million can mature in any given consecutive five (5) day period.

STRENGTHS

* Excellent market position as the flagship public university for Washington - with 46,228 full-time equivalent (FTE) students in its diversified undergraduate and graduate programs at three campuses and a provider of medical education and clinical care to the region through its Medical Center, although undergraduate enrollment will be constrained due to state funding cuts.

* Nationally prominent research enterprise with over \$1 billion in annual grants and contracts during the past two years and expectations of achieving that goal again in FY 2009.

* Good financial flexibility, with total financial resources reaching over \$3.3 billion at the end of fiscal year (FY) 2008 and over \$1.0 billion of unrestricted resources.

* Generally balanced operating performance, with a three-year operating margin of 1.2%, derived from a well-diversified revenue stream. Operating cash flow provides good debt service coverage on an entity-wide basis, with average actual debt service coverage of 2.8 times.

*Sufficient self-liquidity, solid treasury management, and appropriate liquidation procedures (see SHORT-TERM RATIONALE).

CHALLENGES

* Substantial debt increase in recent years reflecting the University's investment in strategic initiatives, with total proforma direct debt of \$1.27 billion assuming \$250 million of full issuance of its commercial paper program. The University has modest debt plans over the next twelve months and is assessing debt and capital projects as to timing.

*Significant cuts in state funding (State of Washington rated Aa1 with a stable outlook) approved for the upcoming 2010-2011 biennium - 26%; the University intends to offset the reduction in part with a 14% tuition increase that results in a net decrease of \$50 million for each year.

*Exposure to health care sector at University of Washington Medical Center (UWMC), with patient care revenues representing 30% of total operating revenues for FY 2008. UWMC intends to make major investments in its facilities, expected to total \$250 million over several phases.

MARKET/COMPETITIVE POSITION: FLAGSHIP PUBLIC UNIVERSITY FOR STATE AND ONE OF NATION'S LEADING RESEARCH ORGANIZATIONS

We believe the University's excellent market position - anchored by good underlying student demand and strong research fundamentals - will be maintained for the foreseeable future. As the flagship public university for the State, the University offers a broad array of undergraduate, graduate and professional programs, with graduate and professional enrollment accounting for over 30% of total enrollment in fall 2008. For fall 2008, the University reported 46,228 full-time equivalent (FTE) students at its three campuses in Seattle, Bothell, and Tacoma. The state provided funding for up to 1,700 new students for the current biennium (2007-2009), including 500 for high-demand programs of science, mathematics and engineering. Although demand remains strong with applications for the upcoming Fall 2009 entering class up from the previous year, the University expects to enroll 200 fewer freshmen due to state funding cuts for the next 2010-2011 biennium. As University of Washington draws over 80% of its students from the State of Washington, it should benefit as the state is projected to experience a modest increase in high school graduates over the next decade.

The University is one of the nation's largest research organizations, receiving over \$1 billion in sponsored research grants in FY 2007 and 2008, with expectations of reaching that level again in FY 2009, the current fiscal year. Of the research awards, about 49% was awarded by the Department of Health and Human Services (HHS). The second largest source is the National Science Foundation at about 8% of total awards. With its strong reputation and research faculty, programmatic and funding diversification, as well as planned capital expenditures for research facilities, we believe the University remains well-positioned to attract increased research funding for the foreseeable future, albeit at slower growth levels primarily because of a slowdown in federal funding in the near-term. We expect the University to benefit from the NIH grant funding as part of the federal stimulus package.

The University of Washington Medical Center, which is consolidated in the University's financial statements, is a 450 bed academic medical center, nationally ranked and offering tertiary/quaternary services. It receives referrals from throughout the Pacific Northwest as well as from its over 100 primary and specialty clinics. As an enterprise, University of Washington's health care activities are substantial, with net patient revenues alone standing at \$968 million or 30% of total operating revenues for the consolidated entity. The contribution from the health system would be more significant if related revenues are considered- e.g., tuition and fees for the Medical School and revenues from the physician groups and other activities. The University's

faculty physicians are the exclusive providers of its health care services, with over 4,800 clinical faculty. The University's Board of Regents has approved extensive capital plans for the health care enterprise amounting to a projected total of \$250 million to be phased over two phases. Part of the current series of bonds will be used to fund Phase I.

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

The University has consistently generated balanced operating performance, with a three year average operating margin of 1.2% for FY 2008. The University benefits from its diversified revenue base, with the largest contributors being 31% from grants and contracts, 30% from patient care, 11% from student charges, and 12% from state appropriations. We expect the University to continue to produce continued balanced performance, driven by growth in tuition revenue, enhanced state funding, and favorable medical center performance. State operating funding for the 2007-2009 biennium was increased 15% from the prior biennium, including the funding for enrollment growth. However, the State is reducing its appropriation by 26% for the upcoming 2010-2011 biennium and has approved the University to increase undergraduate tuition by 14%. As a result, the University will incur a net revenue loss of about \$50 million for each year, and is taking steps to address the revenue shortfall such as hiring freezes, leaving open positions unfilled, and direct layoffs. We expect the University to continue to produce generally balanced operating performance going forward.

The University'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 have risen to nearly 19,000 in FY 2008 from 18,121 in FY 2006 and have risen modestly for the current fiscal year. For FY 2008, total revenues related to patient care were about \$968 million, with the Medical Center accounting for \$687 million of total revenue; the remainder is related to revenues of the faculty practice plan. UWMC's operating margin was 4.5% for FY 2008, with expectations of another good operating year for FY 2009; debt service coverage has likewise been strong at 5.2 times for FY 2008. The Medical Center shows generally a good payer mix, with about 18% from Medicaid. UWMC has not experienced reductions in either the State's reimbursement rate or timing for the Medicaid payments. We expect the healthcare enterprise to continue to perform generally well financially with the University's oversight, and will continue to be an important strategic component of the University's overall market position, both in terms of research and clinical operations.

Pledged General Revenues in support of debt service grew to \$806 million for FY 2008 and provided nearly 15 times coverage for the debt service. In FY 2009, the University expanded its General Revenues pledge to the bonds to include all of its auxiliary systems, including the University of Washington Medical Center, the parking

system, the intercollegiate athletic system, student services and the housing and dining system. As a result, FY 2008 general revenues would have risen to \$1.9 billion. The University will refinance certain series of outstanding bonds under existing indentures when possible to bring them under the General Revenue platform.

The State of Washington currently has an Aa1 G.O. rating with a stable outlook. The rating and outlook reflect institutionalized conservative budgetary controls, improved financial flexibility as state builds its rainy day fund, and strong demographic trends. Offsetting these strengths are noted challenges of economic weakness and a steeper-than-forecasted housing downturn which could hurt economic and revenue performance, exposure to the cyclical commercial aerospace industry, debt ratios above average and likely to increase, and fiscal uncertainty due to voter initiative activity. For more information on the State, please see Moody's report of June 2, 2009.

BALANCE SHEET POSITION: GROWING RESERVES PROVIDE SIGNIFICANT FINANCIAL CUSHION AND FLEXIBILITY

Total financial resources grew to \$3.2 billion at the end of FY 2007, up 19% from the previous year, driven by investment performance and gift revenues. We expect stable to modest growth in financial resources due to investment losses for FY 2009 offset by ongoing fundraising. With over \$1.0 billion of unrestricted resources as of fiscal year-end 2007, the University of Washington maintains significant financial flexibility. FY 2008 expendable resources provide a good cushion of 1.9 times to proforma debt and 0.7 times for annual operations. However, the cushion declines significantly if expendable resources are reduced to absorb a 30% decrease in total financial resources to reflect investment losses and endowment spending since the end of the fiscal year. Assuming a 30% decline, the expendable resource cushion of proforma debt and operations is reduced to 1.1 times and 0.4 times, respectively, representing lower but still good coverage.

The annual return on investments for FY 2008 was a positive 1.9% and for FY 2009 through 3/31/2009, the University estimates the return on investments to be down 27%. The endowment portfolio's allocation is 14% in domestic equities; 21% in international equities; 21% in absolute return, 16% fixed income, 12% in real assets, and 16% in non-marketable alternatives. The University uses Cambridge Associates as its investment advisor. In addition to the endowment, the University has nearly one-third of its operating funds, or about \$500 million, in cash and fixed income.

The University plans to issue at least \$55 million in debt in summer 2009 for a Molecular Engineering Building. However, this amount is subject to change depending upon board approval and the timing of other proposed projects.. The Board of Regents have reviewed the student housing master plan to add up to 4,150 new beds by 2020 to the University's housing system and approved Phase 1 for \$160M in May 2009. Total costs for all phases are currently estimated to be \$850 million with an intention to fully fund the project costs through debt issuance. Any impact on the

University's credit profile will be determined once plans are finalized regarding the amount and timing of the debt issuances, as well as operating performance and cash flow for the University coupled with the revenue stream and reserve balances for the General Revenue pledge.

SECURITY PLEDGE: PLEDGED REVENUES PROVIDE ADEQUATE SECURITY UNDER VARIOUS REVENUE SECURITIES

Moody's approach to rating the University's various series of bonds includes analyzing both the sufficiency of legally pledged revenues as well as the essentiality of the financed projects to the University. The University is expected to continue to produce sound debt service coverage from pledged revenues on its outstanding bonds

* Lease Revenue Bonds are secured by lease payments made by the University. Lease payments will be made from General Revenues of the University, including all non-appropriated and non-restricted revenues and fund balances.

* Student Facilities Fee Revenue Bonds are secured by a mandatory student fee charged to all full and part-time students for student services; the bonds have a first claim on those revenues before inclusion in the General Revenues pledge. For FY 2008, pledged revenues were \$15.4 million providing 4.5 times debt service coverage.

* Parking System Bonds are secured by the net revenues of the parking system and have a first claim on those revenues before inclusion in the General Revenues pledge. For FY 2008, pledged revenues totaled \$9.2 million and provided coverage of 6.9 times.

* Housing and Dining Revenue Bonds are secured by a pledge of the net revenues of the housing and dining system

and have a first claim on those revenues before inclusion in the General Revenues pledge. For FY 2008, pledged revenues totaled \$14.3 million and provided 2.5 times debt service coverage.

* Intercollegiate Athletics Revenue Bonds are secured by net revenue and operating reserves of the Department of Intercollegiate Athletics (Athletic Department) and have a first claim on those revenues before inclusion in the General Revenues pledge. Additionally, pursuant to a financing agreement, the University will pay the Athletic Department for approximately one-third of the debt service to finance the seismic retrofit portion of the arena renovation. For FY 2008, pledged revenues totaled \$6.3 million and provided debt service coverage of 5.5 times.

SHORT-TERM RATIONALE:

The University of Washington has its \$250 million of commercial paper program supported by its self-liquidity; there is no other variable rate debt outstanding.

At May 31, 2009, the University held \$619 million in investments with same-day liquidity on a non-discounted basis: \$53 million in the Aaa-rated SSgA US Treasury Money Market Fund and \$566 million in US Treasury and Agency securities held in custody in its own name. Additionally, the University has approximately \$211 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.

Moody's applies its Standard Approach to the self-liquidity analysis, as detailed in our November 2006 report, "Variable Rate Debt Instruments Supported By An Issuer's Own Liquidity." Under the Standard Approach, the University of Washington's same-day liquid investments must cover its daily and weekly liabilities (i.e. its commercial paper); as of May 31, 2009, coverage is 5.5 times of the \$100 million that can mature in a single five day period. Additionally, the University's same-day and weekly liquid investments must cover its daily and weekly liabilities; as of May 31, 2009, the coverage is 6.6 times. 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 rating outlook reflects the University's continued strong market, good operating cash flow and manageable debt plans.

What could change the rating-UP

Substantial growth in financial reserves, with limited additional borrowing.

What could change the rating--DOWN

Notable deterioration in medical center operations, significant expansion of borrowing plans.

KEY INDICATORS (FY 2008 Financial results, Fall 2008 enrollment data)

*Figures in parentheses represent FY2008 financial data with a reduction in expendable financial resources reflecting a 30% estimated decline in total financial resources driven by investment losses combined with endowment spending

Total FTE Enrollment: 46,228

Total Proforma Direct Debt: \$1.24 billion (including commercial paper program at full size of \$250 million)

Expendable Financial Resources: \$2.4 billion (\$1.4 billion)

Total Financial Resources: \$3.3 billion (\$2.3 billion)

Total Revenues: \$3.3 billion

Expendable Financial Resources to Proforma Direct Debt: 1.9 times (1.1 times)

Expendable Resources to Operations: 0.7 times (0.4 times)

Three-Year Average Operating Margin: 1.2%

Reliance on State Funding: 12% of Total Operating Revenues

State Rating: Aa1, stable

RATED DEBT

University of Washington Issuer Rating: Aa1.

General Revenue Notes: P-1 (based on a Standby Note Purchase Agreement from KBC Bank, NV, rated Aa3 with a negative outlook).

General Revenue Bonds, Series 2007: Aa1, insured by Ambac (Current financial strength rating is Ba3 with a developing outlook).

Lease Revenue Bonds, Series 2006J: Aa2, insured by National Public Guarantee (Current financial strength rating is Baa1 on Watchlist for possible upgrade).

TSB Properties Lease Revenue Bonds, Series 2006: Aa3, insured by National Public Guarantee (Current financial strength rating is Baa1 on Watchlist for possible upgrade).

Lease Revenue Bonds, Series 2005E: Aa2, insured by National Public Guarantee (Current financial strength rating is Baa1 on Watchlist for possible upgrade).

Student Facilities Fee Refunding Revenue, Series 2005: Aa2, insured by Financial Security Assurance (Current financial strength rating is Aa3 on Watchlist for possible downgrade).

General Revenue Bonds, Series 2004A and 2004B: Aa1, insured by Ambac (Current financial strength rating is Ba3 with a developing outlook).

Lease Revenue Bonds, Series 2004A: Aa2, insured by Financial Guaranty Insurance Company

Student Facilities Fee Revenue, Series 2000: Aa2; insured by Ambac (Current financial strength rating of Ba3 with a developing outlook).

Parking System Bonds, Series 2004: Aa2, insured by Ambac (Current financial strength rating is Ba3 with a developing outlook).

Housing and Dining Revenue Bonds, Series 2004, 2002: Aa2; insured by Ambac (Current financial strength rating is Ba3 with a developing outlook).

Housing and Dining Revenue Bonds, Junior Lien Series 1996: Aa2; insured by National Public Guarantee (Current financial strength rating is Baa1 on Watchlist for possible upgrade).

Department of Intercollegiate Athletics, Series 2000: Aa3, insured by Ambac (Current financial strength rating is Ba3 with a developing outlook).

Housing & Dining Revenue Bonds, Series 1991 and 1994: insured by National Public Guarantee (Current financial strength rating is Baa1 on Watchlist for possible upgrade).

State of Washington General Obligation Bonds: rated Aa1 long-term (Secured by State but University pays actual debt service)

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METHODOLOGY

The principal methodology used in rating University of Washington was Moody's Rating Approach for Public College and Universities, which can be found at www.moodys.com in the Credit Policy & Methodologies directory, in the Ratings Methodologies subdirectory. Other methodologies and factors that may have been considered in the process of rating this issuer can also be found in the Credit Policy & Methodologies directory.

The last rating action was on June 4, 2009 when the ratings and outlook of the University of Washington were affirmed.

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