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

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## Credit Profile

US\$122.0 mil gen rev rfdg bnds (Delayed Delivery Bnds) ser 2020C due 04/01/2035		
<i>Long Term Rating</i>	AA+/Stable	New
US\$51.0 mil gen rev rfdg bnds ser 2020B due 04/01/2040		
<i>Long Term Rating</i>	AA+/Stable	New
US\$51.0 mil gen rev bnds ser 2020A due 04/01/2050		
<i>Long Term Rating</i>	AA+/Stable	New
University of Washington CP nts		
<i>Short Term Rating</i>	A-1+	Affirmed
University of Washington gen rev & rfdg bnds		
<i>Long Term Rating</i>	AA+/Stable	Affirmed

## Rationale

S&P Global Ratings assigned its 'AA+' long-term rating to the University of Washington's (UW) \$51.0 million series 2020A, \$51.0 million series 2020B, and \$122.0 million series 2020C 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 as well as significant research funding, and its financial profile as very strong, with adequate resources compared with the operating budget, moderate debt, and a return to positive margins. We believe these credit factors, combined, lead to an indicative stand-alone credit profile of 'aa+' and a final rating of 'AA+'.

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 currently has \$40 million of CP outstanding, which will be refunded by the 2020A and B bonds.

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

- Position as one of the nation's top research universities, with over \$1.5 billion in federal and nonfederal grant and contract awards in fiscal 2019;
- Solid enrollment and demand, with 59,659 full-time-equivalent (FTE) students for fall 2019;

- Manageable, 3% pro forma maximum annual debt service (MADS) burden; and
- Impressive fundraising efforts and a healthy endowment, with an estimated market value of \$3.6 billion as of June 30, 2019.

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

- Track record of negative full-accrual operating performance through fiscal 2017, although results improved to just over break even in fiscals 2019 and 2018, and
- Adequate available resource ratios for the rating category, with fiscal 2019 adjusted unrestricted net assets (UNA) equal to 34% of expenses and 87% of pro forma debt, slightly below category medians in fiscal 2018 of 35% and 97%, respectively.

Proceeds from the series 2020 bonds will be used to fund certain projects including Kincaid Hall, the Childbirth Center at UW Medical Center Northwest campus, and Destination One and to refund CP for prior spending on approved projects and certain outstanding debt. 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, Valley Medical Center revenues, Metro Tract revenue, and certain auxiliary revenue. General revenue totaled \$3.6 billion in fiscal 2019, including student tuition and fees (\$939 million), auxiliary and patient services revenue (\$1.9 billion), grant and contract revenue (\$270 million), sales and services revenue (\$260 million), investment income (\$66 million), and other operating revenues (\$117 million). These bonds do not carry a coverage covenant, debt service reserve requirement, or additional bonds test. Following this issuance, total pro forma debt will remain at approximately \$2.4 billion. We consider the security pledge to be equivalent to an unlimited student fee pledge.

## **Outlook**

The stable outlook reflects our expectation that, during the next two years, the university will continue to maintain break even to positive operating results, available resource measures will steadily strengthen, and demand measures will remain solid.

### **Downside scenario**

We could consider a negative rating action if available resources decline materially, operating margins deteriorate significantly, 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 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 and the health care sector's overall cyclical 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 each industry. We believe the health care services and higher education industries represent a low to intermediate 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 66% 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 0.3% growth in fall 2019 to 59,659. Management expects demand and enrollment to remain stable in the near future. UW has effectively capped enrollment at its main campus, although there is the possibility of limited expansion at the Bothell and Tacoma campuses. While the university has several graduate programs, the school is still primarily undergraduate, with approximately 73% of the student body consisting of undergraduate students. Although the university draws students from across the nation, it is still largely regional, with approximately 65% of students coming from the state, which is consistent with its mission to educate Washingtonians. First-year applications grew 2% for fall 2019 to a high of 51,847. Due to the growth in applications, the acceptance rate fell to 55% in fall 2019 from 61% in fall 2012. The matriculation rate has declined over the past six years, but we still consider it good, at 30% for fall 2019. Student quality has improved and is strong, in our view, with the average fall 2019 SAT score of 1289. The retention rate is strong, at 93%, and the six-year graduation rate is approximately 81%.

UW Medicine is a leading health care provider throughout Washington. UW Medicine, through the School of Medicine faculty practice plans (UW Physicians), has approximately 2,400 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, 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 October 2015 and has been a member of the UW faculty since 1986. The provost and executive vice president for academic affairs, Mark Richards, joined the university in July 2018; as provost, he is the university's chief academic and budget officer. The university uses a five-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 strategic framework called the Sustainable Academic Business Plan, which is updated every two years. The university meets annual disclosure requirements. The financial policies assessment is neutral, reflecting our opinion that, while there may be some areas of risk, the university'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 UW's financial reporting and disclosure, investment allocation and liquidity, debt profile, contingent liabilities, and legal structure, and a comparison of these policies with those of comparable institutions.

### **Financial performance**

We estimate operating performance by removing unrealized gains/losses on investments and adjusting for pension and other postemployment benefit (OPEB) contribution net of expense, which resulted in estimated operating performance in fiscal 2019 of \$23 million, or a net operating income of 0.4%. The net operating income in fiscal 2018 was 0.3%, as restated in fiscal 2019. In fiscals 2017 and 2016, the net operating income was negative 2.8% and negative 3.5%, respectively. According to management, the fiscal 2017 operating margin at UW Medical Center, 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 implemented a multiyear financial improvement plan that continues to focus 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. We expect operating performance to be positive.

In fiscal 2019, total adjusted revenue included 33.4% from patient services (excluding Valley Medical Center), 22.3% from grants and contracts, 18.9% from net tuition and student fees, and only 5.9% from state operating appropriations. Approximately 78% of grant and contract awards 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. The compound annual growth rate in grant and contract awards has been 4.8% for fiscal 2015 through 2019. We expect grant and research funding for the university will remain strong in the medium term.

State support has been somewhat variable historically, with the legislature increasing annual appropriations in exchange for the state public universities agreeing to limit the in-state undergraduate tuition rate. While considering the state's variability in support to be a credit risk, we recognize that appropriations have increased since fiscal 2015 and that state appropriations are only a small portion (5.9%) of the university's total adjusted revenue. The state

provided the university \$811 million in general funding over the state's biennium and continued the resident undergraduate tuition policy, which allowed increases of 2.2% in fiscal 2019 and 2.4% in fiscal 2020, with similar increases expected in the future.

During fiscal 2019, the university utilized 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 2019 was approximately \$163 million, which is equivalent to only 2.5% of total university adjusted revenue for the year. In February 2019, the Board of Regents approved a total spending reduction to 4.5% from 5.0%, phased in over a three-year period starting fiscal 2020.

### **Available resources**

S&P Global Ratings-adjusted UNA, adding UNA of component units and pension and OPEB liability adjustments, was \$2.1 billion in fiscal 2019, an increase of 11.0% over fiscal 2018 and the historical high. In fiscal 2019, financial resources are adequate for the rating, in our opinion, with adjusted UNA equal to 33.6% of adjusted operating expenses (\$6.4 billion in fiscal 2019) and 86.7% of pro forma debt.

UW's consolidated endowment fund was approximately \$3.6 billion as of June 30, 2019. The endowment's estimated return for fiscal 2019 was solid, at 5.8%. The portfolio is fairly diverse, in our opinion, with 51% developed and emerging markets, 13% private equity, 18% absolute return, 11% fixed income, 5% real assets, and 2% opportunistic as of June 30, 2019. Fundraising has been strong, in our opinion, reaching the \$5 billion goal of the Be Boundless Campaign two years ahead of schedule as of October 2018; the campaign continues through June 30, 2020. Gifts and private grants totaled a strong \$684 million in fiscal 2019.

### **Debt and contingent liabilities**

As of June 30, 2019, the university had \$2.4 billion of total debt outstanding, and following the issuance of the series 2020 bonds, pro forma debt is expected to continue to be \$2.4 billion (including retirement of debt). In our opinion, the debt profile is conservative; the portfolio is approximately 95% fixed rate. The debt service schedule is front loaded, with pro forma MADS of \$198 million in fiscal 2021. The pro forma MADS burden is manageable, in our opinion, at 3.1%. With future planned issuance almost balanced by debt retired, the total debt outstanding is expected to remain stable at \$2.4 billion through at least fiscal 2024.

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, Valley Medical Center revenues, Metro Tract revenues, and certain auxiliary revenues. For fiscal 2019, general revenues equaled an estimated \$3.6 billion.

The university provides retirement benefits through four contributory pension plans: the Washington State Public Employees' Retirement System (PERS) plan, the Washington State Teachers' Retirement System (TRS) plan, the Law Enforcement Officers' and Fire Fighters' Retirement System (LEOFF) plan, and the University of Washington Retirement Plan (UWRP). PERS, TRS, and LEOFF are cost sharing multiple-employer defined benefit pension plans administered by the Washington State Department of Retirement Systems (DRS). UWRP is a defined contribution plan. PERS reported what we consider a good 93.2% funding ratio as of June 30, 2019. The university's pension and OPEB expense relative to adjusted operating expense is 1.6%, which we view as manageable at this time and expected to

remain manageable. For more information on the DRS-administered plans, please see the debt and liabilities section in the Washington state report published Jan. 27, 2020, on RatingsDirect.

University of Washington--Enterprise And Financial Statistics						Medians for 'AA' rated public colleges & universities
	--Fiscal year ended June 30--					
	2020	2019	2018	2017	2016	2018
<b>Enrollment and demand</b>						
Headcount	59,381	59,252	57,855	56,809	55,767	MNR
Full-time equivalent	59,659	59,505	58,155	56,974	55,963	35,846
Freshman acceptance rate (%)	55.0	52.0	50.0	49.1	56.2	67.8
Freshman matriculation rate (%)	29.7	32.4	32.6	32.8	33.7	MNR
Undergraduates as a % of total enrollment (%)	71.6	71.9	72.0	71.9	72.0	78.6
Freshman retention (%)	92.5	92.0	92.0	92.0	92.0	86.0
Graduation rates (six years) (%)	81.3	80.8	82.0	83.0	82.5	MNR
<b>Income statement</b>						
Adjusted operating revenue (\$000s)	N.A.	6,403,885	6,058,371	5,748,253	5,102,768	MNR
Adjusted operating expense (\$000s)	N.A.	6,380,411	6,042,660	5,910,939	5,285,049	MNR
Net adjusted operating income (\$000s)	N.A.	23,474	15,711	(162,686)	(182,281)	MNR
Net adjusted operating margin (%)	N.A.	0.37	0.26	(2.75)	(3.45)	1.50
Estimated operating gain/loss before depreciation (\$000s)	N.A.	395,909	399,715	200,342	142,321	MNR
Change in unrestricted net assets (UNA; \$000s)	N.A.	256,920	(1,617,706)	(295,479)	(193,591)	MNR
State operating appropriations (\$000s)	N.A.	378,656	362,267	341,971	302,097	MNR
State appropriations to revenue (%)	N.A.	5.9	6.0	5.9	5.9	19.2
Student dependence (%)	N.A.	26.5	25.5	25.7	28.3	39.7
Health care operations dependence (%)	N.A.	33.4	33.1	33.6	29.1	MNR
Research dependence (%)	N.A.	22.3	23.3	23.6	25.4	MNR
Endowment and investment income dependence (%)	N.A.	2.5	2.5	2.5	2.8	1.4
<b>Debt</b>						
Outstanding debt (\$000s)	N.A.	2,391,638	2,424,633	2,364,476	2,245,784	828,692
Proposed debt (\$000s)	N.A.	224,030	N.A.	N.A.	N.A.	MNR
Total pro forma debt (\$000s)	N.A.	2,468,638	N.A.	N.A.	N.A.	MNR
Pro forma MADS	N.A.	19,187	N.A.	N.A.	N.A.	MNR
Current debt service burden (%)	N.A.	4.94	3.47	3.96	2.91	MNR
Current MADS burden (%)	N.A.	3.01	3.62	3.51	3.76	3.50
Pro forma MADS burden (%)	N.A.	0.30	N.A.	N.A.	N.A.	MNR
<b>Financial resource ratios</b>						
Endowment market value (\$000s)	N.A.	3,588,000	3,407,000	3,144,000	2,968,013	990,083

## University of Washington--Enterprise And Financial Statistics (cont.)

	--Fiscal year ended June 30--					Medians for 'AA' rated public colleges & universities
	2020	2019	2018	2017	2016	2018
Related foundation market value (\$000s)	N.A.	271,832	259,847	219,561	330,991	688,435
Cash and investments (\$000s)	N.A.	6,077,352	5,801,625	5,370,871	4,902,455	MNR
UNA (\$000s)	N.A.	(980,736)	(1,237,656)	380,050	675,529	MNR
Adjusted UNA (\$000s)	N.A.	2,146,692	1,933,549	1,821,934	1,696,231	MNR
Cash and investments to operations (%)	N.A.	95.3	96.0	90.9	92.8	54.0
Cash and investments to debt (%)	N.A.	254.1	239.3	227.1	218.3	168.3
Cash and investments to pro forma debt (%)	N.A.	246.2	N.A.	N.A.	N.A.	MNR
Adjusted UNA to operations (%)	N.A.	33.6	32.0	30.8	32.1	35.3
Adjusted UNA plus debt service reserve to debt (%)	N.A.	89.8	79.7	77.1	75.5	97.8
Adjusted UNA plus debt service reserve to pro forma debt (%)	N.A.	87.0	N.A.	N.A.	N.A.	MNR
Average age of plant (years)	N.A.	13.2	12.0	11.8	11.7	13.0
OPEB liability to total liabilities (%)	N.A.	18.7	21.7	0.0	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 February 12, 2020)

University of Washington gen rev bnds		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
University of Washington gen rev bnds		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
University of Washington gen rev bnds		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
University of Washington PCU_USF		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
<b>Washington Biomedical Research Facilities 3, Washington</b>		
University of Washington, Washington		
Washington Biomedical Properties 3.1 (University of Washington) lse		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
<b>Washington Econ Dev Fin Auth, Washington</b>		
University of Washington, Washington		
Washington Econ Dev Fin Auth (University of Washington) lse 2004A (FGIC)		
<i>Unenhanced Rating</i>	AA+(SPUR)/Stable	Affirmed
Washington Econ Dev Fin Auth (University of Washington) PCU_USF		

**Ratings Detail (As Of February 12, 2020) (cont.)**

<i>Long Term Rating</i>	AA+/Stable	Affirmed
Washington Econ Dev Fin Auth (University of Washington)	PCU_USF (FGIC)	
<i>Unenhanced Rating</i>	AA+(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.

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