Moody's Investors Service

Rating Action: Moody's assigns Aa3 to University of Kentucky's (KY) Series 2019A&B COPs and affirms ratings; outlook stable

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New York, June 10, 2019 -- Moody's Investors Service has assigned Aa3 ratings to the University of Kentucky's (UK) proposed $25.1 million Certificates of Participation, Series 2019A (University of Kentucky Mixed-Use Parking Project) (fixed rate, maturing in 2049) and $7.3 million Certificates of Participation, Taxable Series 2019B (University of Kentucky Mixed-Use Parking Project) (fixed rate, maturing in 2031). Concurrently, we have affirmed the ratings on $1.1 billion of outstanding debt - specifically the Aa2 ratings on outstanding General Receipts Bonds and Notes and the Aa3 rating on the Kentucky State Property and Buildings Commission's Agency Fund Revenue Refunding Bonds, Project No. 102, Series A. The outlook is stable.

RATINGS RATIONALE

The Aa3 rating on the Certificates of Participation is based on the lease structure of the debt between the third party facility lessor and the university, with University of Kentucky (Aa2 stable) providing lease payments directly to the trustee to cover debt service on the certificates. The rating is one notch lower than the university's Aa2 seniormost rating, reflecting the subordinate interest of the lease payments from UK's general receipts, as well as more limited essentiality associated with the financed mixed-use parking facility project. Favorably, UK's obligation to make lease payments is unconditional and absolute and UK covenants to include lease payments in its annual budgets, although the payments are not subject to appropriation. UK will commence lease payments in October 2020 regardless of the project's completion.

The University of Kentucky’s seniormost Aa2 rating reflects its large scope of operations as the flagship university for the Commonwealth of Kentucky (Aa3 stable issuer rating) with steady enrollment and net tuition revenue growth, combined with improved student geographic diversification and rising reserves. Favorably, the rating also incorporates solid operating cash flow, from both the university and its highly integrated academic medical center, UK HealthCare. Cash flow from operations in concert with partnerships and donor support continues to fuel UK's capital investment program. That program is substantial with $1.6 billion in property, plant and equipment invested over the last half decade. Leverage is modest relative to peers, with no exposure to defined benefit pension plans. While not expected in fiscal 2020, the university may see decreased state operating support as Kentucky addresses its own budgetary challenges and significant pension underfunding.

The Aa3 rated Agency Fund Bonds reflects the debt structure, as the debt service is paid through a lease between the Kentucky State Property and Buildings Commission (SPBC) and UK. Lease payments are budgeted by UK and subject to biennial commonwealth approval of the university's budget.

RATING OUTLOOK

The stable outlook reflects the university's favorable operating cash flow including performance of its patient care enterprise, good student demand and some pricing flexibility, with capacity to adjust to potential state funding cuts.

FACTORS THAT COULD LEAD TO AN UPGRADE

- Substantial improvement in financial reserves relative to debt and operations
- Significant strengthening of UK's brand and geographic reach

FACTORS THAT COULD LEAD TO A DOWNGRADE

- Sustained deterioration of operating performance either at the university or UK HealthCare
- Decline in unrestricted liquidity especially if combined with softening of operating performance

LEGAL SECURITY

UK's general receipts bonds are secured by general receipts that include student tuition and fees, housing and
dining revenues, hospital revenues (excluding professional clinical fees), state operating appropriations, non-
restricted gifts and non-governmental grants and contracts, investment income, indirect cost recoveries from
research activity, and Department of Intercollegiate Athletics revenues. Fiscal 2018 pledged revenues
(General Receipts) of $2.6 billion cover parity debt pro forma maximum gross annual debt service of $97.2
million by 27 times.

The Series 2019A and Taxable Series 2019B certificates of participation will be secured by UK's General
Receipts, subordinate only to the university's general receipt bonds, and superior and prior to all other liens
and claims against its general receipts. Annual debt service on the 2019 COPs is estimated at $2.1 million
annually.

The university's general receipt bonds benefit from the presence of a state intercept program. If the university
fails to make debt service payments 10 days in advance of the debt service payment date, the Secretary of
the Finance and Administration Cabinet of the Commonwealth is obligated to use any funds that have been
appropriated to the university but not yet expended to make debt service payments. Moody's does not rate any
of the university's debt under the intercept program.

USE OF PROCEEDS

Proceeds of the Series 2019A and 2019B certificates of participation will be used to: construct a five-story
mixed use facility for parking, retail and educational space on University of Kentucky land; pay capitalized
interest through May 1, 2020; and pay costs of issuance.

PROFILE

The University of Kentucky is the flagship and land-grant public higher education institution for the
Commonwealth of Kentucky, and includes UK HealthCare and the associated academic medical center and
clinics. The university and the UK HealthCare hospitals are located in Lexington. In fiscal 2018, the university
recorded operating revenue (Moody's adjusted) of $3.4 billion and enrolled a fall 2018 FTE of 28,376 students.

METHODOLOGY

The principal methodology used in these ratings was Higher Education published in May 2019. Please see the

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