Summary:

University Of Kentucky; Appropriations; Public Coll/Univ - Unlimited Student Fees

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Credit Profile		
US$25.05 mil certs of part (sub gen rcpts) (Univ Of KY Mixed-use pkng Proj) ser 2019A dtd 06/26/2019 due 05/01/2049		
Long Term Rating	AA-/Stable	New
US$7.33 mil taxable cert of part (Mixed Use Pkg Proj) ser 2019B dtd 06/26/2019 due 05/01/2049		
Long Term Rating	AA-/Stable	New

Rationale

S&P Global Ratings assigned its 'AA-' long-term rating to University of Kentucky's (UK) $25.05 million series 2019A tax-exempt and $7.33 million series 2019B taxable certificates of participation (COP) issued for the University of Kentucky mixed-use parking project. In addition, S&P Global Ratings affirmed its 'AA' long-term rating on UK's outstanding general receipts bonds totaling $1.20 billion. The outlook is stable on all rated issues.

The rating on the COP's reflects UK's subordinated pledge of general receipts, i.e. a one-notch adjustment from UK's senior secured debt, on its obligation as lessee to make base rent payments pursuant to a facilities lease agreement with Signet KY RE, LLC (Signet; lessor and holder of lease-hold interest in land underlying project from ground lease with UK). Signet in turn has assigned its right to receive base rent payments from UK to the trustee for the benefit of the COP's holders.

The long-term rating on UK's senior secured general receipts bonds reflects our view of its very strong enterprise and financial profile. The enterprise profile is characterized by a healthy market position and demand with relatively stable FTE enrollment and rising applications in most recent years. The enterprise profile also reflects a slightly elevated industry risk profile due to exposure to health care in addition to higher education as UK HealthCare (UKHC) accounts for about half of the university's total adjusted operating revenue. Nevertheless, UKHC enjoys a favorable patient utilization trend. The financial profile reflects recurring positive financial operating surpluses, good revenue diversity largely due to UKHC, excellent financial resources and healthy debt and contingent liabilities with a low debt burden. In addition, in our view, UK's management and governance is robust and as Kentucky's flagship higher education institution, the university enjoys the commonwealth's support for its operations and for some capital needs, although the support for operations has declined in each of the past five years. UK also enjoys very strong philanthropic support. Combined, we believe these credit factors lead to an initial indicative rating of 'aa' and final bond issue rating of 'AA' for UK's senior secured general receipts bonds.

In our view, UK's reputation as a comprehensive research-based university with diverse educational offerings and a first class health system enables it to attract about one-third of its students from beyond the state's border.

The long-term rating and stable outlook of the senior secured general receipts bonds reflect our assessment of the

university's:

- Flagship status within the Commonwealth of Kentucky higher education system and its broad program offerings and nationally recognized academic medical center;
- Firm student demand with full-time equivalent (FTE) enrollment of 28,376 in fall 2018 just slightly below the prior year's enrollment of 28,550;
- Favorable revenue diversity with its health system accounting for 53.5% of total adjusted operating revenue in fiscal 2018, 14.5% of tuition and fees, 8.9% of grants and contracts, and 7.5% of commonwealth operating support;
- Positive financial operating performance on a full accrual basis with surpluses realized in each of the last five fiscal years and an average 4.2% net operating margin over this period;
- Excellent financial resources for the rating with adjusted unrestricted net assets as of fiscal year-end 2018 equal to 36.9% of adjusted operating expenses and 92.6% of pro forma debt coupled with a relatively low pro forma maximum annual debt service (MADS) burden of 2.9%;
- Robust management and governance that budgets conservatively, utilizes an enterprise risk management program, and plans proactively for hypothetical disruptive environment scenarios and follows sound investment practices; and
- Impressive philanthropic support as it has realized gifts, non-exchange grants, capital grants and gifts and additions to permanent endowment that have averaged $194.57 million annually over the past five fiscal years and with a relatively new capital campaign launched in September 2018 that seeks to raise a total of $2.1 billion.

Credit factors offsetting some of the preceding credit strengths include:

- State budgetary pressure in Kentucky resulting in declining state operating appropriations to $264.42 million in fiscal 2018 from a recent yearly high of $297.6 million in fiscal 2012 (fiscal 2019's appropriation is budgeted at $258.6 million and for fiscal 2020 a 1% increase is anticipated); and
- University budgetary pressure with a 4.89% increase in the $3.89 billion budget for fiscal 2019 compared with the prior year's revised $3.71 billion budget while capital spending remains high to address infrastructure and deferred capital needs.

UK's general receipts are defined as certain operating and non-operating revenues of the university, including student tuition and fees; nongovernmental grants and contracts; recoveries of facilities and administrative costs; sales and services; hospital revenues; housing and dining revenues; and auxiliary enterprises, which includes athletics and other auxiliaries, other operating revenues, state appropriations for general operations, gifts and non-exchange grants, investment income, and other non-operating revenues. We deem this pledge equivalent to an unlimited student fee pledge.

The rating on the senior secured general receipts bonds for UK factors in the planned additional debt issuance over the next two years of approximately $125.0 million, that will cause pro forma long-term debt to rise to approximately $1.36 billion.

The University of Kentucky is a comprehensive land-grant and flagship institution of the commonwealth's higher education system located in Lexington. The university has more than 200 academic programs spread across 16

degree-granting colleges in addition to the Lewis Honors College, Graduate School and the UK Library system. The colleges include Agriculture, Food & Environment; Arts & Sciences; Business & Economics; Communications and Information Studies; Dentistry; Design; Education; Engineering; Fine Arts; Health Sciences; Law; Medicine; Nursing; Pharmacy; Public Health; and Social Work. We also understand that during the last academic year the university awarded over 7,000 undergraduate and graduate degrees. For additional information on UK, please see University of Kentucky, published Jan. 8, 2019, on RatingsDirect

University of Kentucky Mixed-Use Parking Project

We understand the majority of COP proceeds will fund construction of a five-story mixed-use parking facility with limited retail, educational, administrative, support and other uses. The land underlying the proposed facility is located near the main entrance to the campus and owned by UK. The mixed-use parking facility provides an additional 918 parking spaces to the university's existing 22,220 total parking spaces campus-wide and is a critical piece of the UK transportation master plan implemented in 2015. UK will be responsible for the ongoing operation and management of the parking facility.

A pledge of the university's subordinated general receipts, secures its obligation to make base rental payments beginning on Oct. 20, 2020, under the facilities lease with Signet for the mixed-use parking project. We understand capitalized interest from bond proceeds will be sufficient to cover the interest payments due for the COPs on Nov. 1, 2019, and May 1, 2020. It is also our understanding that UK is obligated to make base rent payments on every subsequent Oct 20 and April 20, i.e., 10 days in advance of semi-annual principal and interest payments that are due on the COP's each Nov. 1 and May 1 through final maturity of May 1, 2049.

The financing structure supporting the funding for this project includes the aforementioned facilities lease, a ground lease (between UK and Signet) and a sub-lease (between UK and Signet KY Retail, LLC-for just over 10,000 square feet of a total project square footage in excess of 308,000 square feet). In our view, the legal documents supporting this structure contain no appropriation or abatement risk. In addition, we believe construction risk is fully mitigated since UK's obligation to make base rent payments begins on Oct. 20, 2020, after capitalized interest funds the payments due on Nov. 1, 2019 and May 1, 2020, and is not reduced or eliminated if the project exceeds its estimated cost or is delayed beyond the intended substantial completion date of Aug. 1, 2020. UK also has an option to purchase the project on any date on or after May 1, 2029, with the purchase price equal to the principal amount outstanding on the COP's and accrued interest and any additional rent, e.g. for taxes, that may be due.

Outlook

The stable outlook on the COP's issues mirrors the outlook on UK's general receipts secured bonds and reflects our belief that over the next two years, UK's enrollment will increase modestly, its health care system will continue to experience strong patient utilization growth and profitable financial operations while financial results for the entire university on a consolidated basis should remain positive. In addition, we anticipate additional debt issuance will be balanced with financial resources growth. With specific respect to the COP's issues we assume capitalized interest will fund the first two interest payments and base rent payments will be made in timely fashion and in full to assure complete and timely debt service payments on this obligation.

Downside scenario

A negative rating action on the COP's issues would be predicated upon a negative rating action occurring on UK's senior secured bonds and is possible if enrollment or patient volumes decline significantly or if financial performance weakens or financial resources to operations or debt decline relative to median ratios for the rating category. However, any significant covenant violation on the COP's issues could trigger a lower rating on this obligation independent of the rating applicable to the senior secured general receipts bonds.

Upside scenario

A positive rating action on the COP's issues over the two-year outlook is not anticipated, as the project will just be operating in its first full year of completion following the expiration of capitalized interest. However, while not likely in our view during this period, a positive rating action is possible if UK's senior general receipts secured bonds' outlook or rating improves based upon an improved enrollment and patient utilization trend, stronger financial performance and significant financial resource growth while additional debt issuance is modest.

Ratings Detail (As Of June 10, 2019)		
University of Kentucky General Receipts Rfdg Bnds		
Long Term Rating	AA/Stable	Affirmed
University of Kentucky PCU-USF		
Long Term Rating	AA/Stable	Affirmed
University of Kentucky PCU-USF		
Long Term Rating	AA/Stable	Affirmed
University of Kentucky PCU-USF		
Long Term Rating	AA/Stable	Affirmed
University of Kentucky PCU-USF		
Long Term Rating	AA/Stable	Affirmed
University of Kentucky PCU-USF (BAM) (SECMKT)		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed
University of Kentucky PCU-USF		
Long Term Rating	AA/Stable	Affirmed
University of Kentucky PCU-USF		
Long Term Rating	AA/Stable	Affirmed
Univ of Kentucky		
Long Term Rating	AA/Stable	Affirmed

Many issues are enhanced by bond insurance.