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University of Kentucky; Public Coll/Univ - Unlimited Student Fees

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University of Kentucky; Public Coll/Univ - Unlimited Student Fees

Credit Profile		
US$30.625 mil gen receipts rfdg bnds ser 2017A due 10/01/2022		
Long Term Rating	AA/Stable	New
US$7.48 mil gen receipts rfdg bnds ser 2017B due 10/01/2024		
Long Term Rating	AA/Stable	New
Asset/Liability Comm, Kentucky		
University of Kentucky, Kentucky		
Asset/Liability Comm (Univ of Kentucky)		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed

Rationale

S&P Global Ratings assigned its 'AA' long-term rating to University of Kentucky's (UK) $30.63 million 2017 series A general receipts refunding bonds and $7.48 million 2017 series B general receipts refunding bonds. In addition, S&P Global Ratings affirmed its 'AA' long-term rating and underlying rating on UK's various existing general receipts bonds that are currently outstanding totaling approximately $971.12 million. The outlook is stable on all rated issues.

As of UK's fiscal year end, June 30, 2016, its outstanding long-term debt, inclusive of capitalized leases and notes, totaled $1.04 billion, with a similar amount outstanding as pro forma debt post issuance of the series 2017A and series 2017B issues.

The rating reflects our view of UK's very strong enterprise and financial profile characterized by an increasing enrollment trend, good revenue diversity due in large part to its health care system that accounts for roughly half the university's revenue, recurring financial operating surpluses, excellent financial resources and a low debt burden. In addition, we believe UK's management and governance are healthy, and as Kentucky's flagship higher educational institution, it enjoys the commonwealth's support for its operations, albeit at a declining rate, and on a limited basis for some capital needs supplemented by very strong philanthropic support.

In our view, UK continues to gain recognition as a comprehensive research-based university enabling it to attract an increasing number of students from beyond the state's borders with approximately 33% of its students from out of state. Also, UK HealthCare (UKHC) has a rising patient volume trend and receives national recognition for its clinical care in a number of fields, including its Markey Cancer Center that in 2013 was designated as a comprehensive cancer center by the National Cancer Institute-one of just a few such centers nationally.

The long-term rating and stable outlook reflect our assessment of the university's:

- Flagship status of the Commonwealth of Kentucky higher education system coupled with its broad program offerings and nationally recognized academic medical center. The medical center's inpatient discharges increased

2% to 37,789 in fiscal 2016 from the level recorded in fiscal 2015;
- Rising student enrollment with total headcount increasing 6.8% to 30,884 in fall 2016 from the level recorded five years earlier in fall 2012 of 28,928, with some favorable student demand characteristics including freshman applications that rose in each of the past five years by an average annual increase of 5.3%, with strong retention in excess of 80%;
- Good revenue diversity with its health system accounting for 52% of total operating revenue in fiscal 2016, 14% of tuition and fees, 9% of grants and contracts, and 9% of commonwealth operating support;
- A trend of robust financial performance on a full accrual basis with surpluses realized in each of the last five fiscal years;
- Excellent financial resources for the rating with adjusted unrestricted net assets as of fiscal year-end 2016 equal to 40% of adjusted operating expenses and 117% of pro forma debt coupled with a relatively low pro forma maximum annual debt service (MADS) burden of 3.7%;
- Healthy management and governance that budgets conservatively, follows sound investment practices and continues to refine its enterprise risk management program; and
- Favorable philanthropic support as it reported securing gift receipts of $208 million in fiscal 2016 and with an endowment that has increased about 28.3% over the past five years to $1.22 billion at fiscal year-end 2016 from approximately $952,000 in 2011.

Credit factors offsetting some of the preceding credit strengths include:

- Ongoing revenue funding pressure from a decline in state operating appropriation from $297.6 million in fiscal 2012 to $279.6 million in fiscal 2016, and a 4.5% reduction enacted by the Kentucky General Assembly for the current year with funding pressures also evident for national research funding and health care reimbursement; and
- Budgetary pressure owing to the rising enrollment trend the university has realized, with the fiscal year 2017 budget growing 4.3% to $3.5 billion from the prior year's budget and continuing high capital spending to address infrastructure and deferred capital needs.

A pledge of the university's general receipts, and for the university's series 2009B, 2010A (this series is being refunded), and 2010B bonds only, the federal subsidy for the Build America Bonds and Qualified Energy Conservation Bonds, secure the bonds. 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 understand proceeds from the series 2017A and series 2017B general receipts bonds will together provide $38.105 million of funds that will be used to refund series 2006A notes and series 2010A bonds.

The university continues to invest heavily in capital as part of a campus transformation initiative. Management indicates $2.1 billion in investment has occurred on the campus over the past five years. Projects underway or in the planning stage include a new $201.3 million student center scheduled to come on line in January 2018, a renovation/expansion of the college of law building that could cost up to $65 million, and that the university intends to issue up to $30 million in additional bonds for in calendar year 2018 for the renovation/expansion after the Commonwealth of Kentucky issues a $35 million bond in support of the project.

UK has also been engaged in an extensive overhaul of its student residence facilities through a privatized housing program with a third party developer, Education Realty Trust (EdR) who in its most recent phase II-C brought on line 1,141 beds in August 2016 at an approximate cost of $83.9 million with a phase III-A and III-B underway and expected to come on line in August 2017 adding slightly over 1,100 beds and combined expected to cost just over $100 million. We understand that a total of 6,850 new beds, totaling $449.3 million with 100% equity funding from EdR is expected to be operational by August 2017 according to bond offering documents. Similarly, in 2014, UK entered into a 15-year P3 arrangement with Aramark valued at $250 million by UK for its dining services that will result in Aramark providing $70 million in capital for new and existing facilities improvements.

The University of Kentucky is a comprehensive land-grant and flagship institution of the commonwealth's higher education system located in Lexington. The university includes 16 colleges and the graduate school and offers over 200 majors and degree programs. 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 in the 2015-2016 academic year the university awarded over 6,600 undergraduate and graduate degrees.

Outlook

The stable outlook reflects our expectation that over the next two years, UK's enrollment will experience modest growth while its health system will likely enjoy strong patient utilization growth, financial results will remain positive on a full accrual basis, and additional debt issuance will be balanced with financial resources growth.

Downside scenario

A negative rating is possible if enrollment or patient volumes decline unexpectedly in a significant manner or if financial performance weakens or financial resources decline.

Upside scenario

A higher rating, while not likely in our view over the two-year outlook period, could be considered in the future with significant financial resource growth.

Enterprise Profile

Industry Risk

Industry risk addresses the higher education sector's and the health care 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 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

In our view, the university has good geographic diversity; however, it is mostly regional. About two-thirds of its students are from Kentucky. As such, our assessment of the university's economic fundamentals is anchored by the local GDP per capita.

Market position and demand

The university's enrollment had been fairly stable before fiscal 2011 at just under 28,000 students but began accelerating since that time and continues with each passing year to break enrollment records. Enrollment increased 0.5% to a new record of 30,884 in fall 2016, breaking the prior year's record enrollment of 30,720. Undergraduate, graduate, and professional students make up 74%, 23%, and 3% of enrollment, respectively.

The university celebrated its 150th anniversary in 2015 and in our view continues to grow in stature among comparable comprehensive research based institutions. Freshman applications increased 8% in fall 2016 to 24,300 from the 22,521 applications received for the fall 2015 enrollment period. However, selectivity has declined somewhat increasing to 77% in fall 2016 from 69% in fall 2010 with a gradual reduction in matriculation from 47% in fall 2010 to 28% in fall 2016. Student quality is above average with an average 25.6 ACT score for the entering freshman class in fall 2016.

The university enjoys favorable philanthropic support, securing gift receipts of more than $208 million in fiscal 2016 from more than 50,400 donors. We also understand the university received its largest single gift ever, $23 million, in 2015. The university completed its last capital campaign in fiscal 2007 and raised $1.1 billion, all of which has been collected in cash. The university is currently in the development stage of its next capital campaign.

Management and governance

Dr. Eli Capilouto became the 12th President of the University of Kentucky on July 1, 2011. Dr. Capilouto was previously the Provost of the University of Alabama at Birmingham (UAB), an organization that is one of the nation's leading academic medical centers. In December of 2012, Dr. Eric Monday was named the university's new executive vice president of finance and administration coming from Louisiana State University where he held a comparable position and early in 2015 Dr. Timothy Tracy, former Dean of the Pharmacy Program, was appointed Provost. We understand the current executive vice president of health affairs, Dr. Michael Karpf, is planning to retire later this year and that President Capilouto will be announcing a search committee for a replacement shortly. Other senior management positions have generally been stable with what we view as normal turnover.

We believe UK's management and governance are healthy and follow conservative budgeting practices and fully embrace a risk based enterprise management approach to running the institution. We also understand in mid-October of 2015, the university finalized its new strategic plan that runs through 2020 and continues to implement a new value-based financial model to improve accountability and transparency.

University of Kentucky HealthCare System

University of Kentucky HealthCare is a major component of the overall university, constituting 52% of fiscal 2016 operating revenues and supporting approximately $468 million of the university's overall debt. UKH is an 901-licensed-bed tertiary and quaternary facility composed of two hospitals: UK Albert B. Chandler Hospital and Good Samaritan Hospital, located on the campus of the University of Kentucky in Lexington. At fiscal year-end 2016, UKH staffed a total of 816 available beds and an 82.5% occupancy rate that we consider strong.

UKH is a leading health care provider in central and southern Kentucky and in more recent years, owing to its growing clinical affiliations, has expanded its market to include portions of West Virginia, eastern Tennessee, southern Ohio, and western Kentucky. Over the past 12 years, inpatient discharges have increased 70% to 37,789 in fiscal 2016 from

22,269 in 2005 aided in part by the acquisition in fiscal 2008 of Good Samaritan Hospital, now known as UK Good Samaritan Hospital.

UKH's senior management team led by its executive vice president for health affairs Dr. Michael Karpf is assisted by the vice president & chief clinical operations officer, Dr. Robert "Bo" Cofield who was recruited from the University of Virginia in 2015. Also, Dr. Robert S. DiPaola dean of the College of Medicine and vice president for clinical academic affairs, was recruited from Rutgers Cancer Institute in April 2016 to replace Dr. Fredrick C. DeBeer who retired. Mr. Craig C. Collins, vice president for health affairs and chief financial officer, was recruited from Mayo Clinic in 2015 and replaced Murray Clark, who retired in June of 2016. As was mentioned previously, although Dr. Karpf will be retiring in 2017 we believe these changes represent normal turnover and are not indicative of any fundamental leadership problem at the UK HealthCare system.

In May 2011, a new lobby, concourse, and two patient care floors of UK Albert B. Chandler Hospital's new Pavilion A opened (phase 1A). Pavilion A is a facility of more than one million square feet and is the cornerstone of a 20-year, $2.5 billion plan to construct the commonwealth medical campus of the future. Pavilion A, is essentially a replacement hospital for the original Chandler Hospital and serves as the centerpiece of the longer term expansion of the medical campus according to university sources. We understand further renovations and upgrades of the health facilities were approved during the 2016 legislative session and the university intends in calendar year 2017 to issue $150 million of additional bonds to complete these projects.

UKHC is now in its fourth year of a contract with the commonwealth to operate and manage the $129 million, 239-licensed bed psychiatric facility that Kentucky funded and built on UK's 735-acre Coldstream Research Campus; a campus that includes 66 companies on site in biotech, pharmaceutical, equine health, and service industries that also includes a hotel, several restaurants and a 225-acre park. Also, UKHC in 2014 finalized an agreement with the Shriners Hospital for Children (SHC) that is resulting in SHC building a new $40 million five story health facility on UK's campus with UKHC leasing two of those stories and providing the medical staff of the entire facility. We understand construction of this facility is nearly complete.

Financial Profile

Financial management policies

UK has formal policies for endowment, investments, and debt. It operates according to a five-year strategic plan, and has a formal reserve liquidity policy and both cash and debt are centrally managed. The university meets standard annual disclosure requirements. The financial policies assessment reflects 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 comparable providers.

Financial performance

Ongoing commonwealth budgetary pressure has resulted in gradually declining funding for higher education over the past several years. Accordingly, UK's appropriation has generally trended downward since fiscal 2008 and in fiscal

2016 was $279.6 million approximately the same amount as was received in fiscal 2015. We understand in the current year the appropriation is to decline by 4.5% as enacted by the Kentucky General Assembly. While the university has struggled to manage the depressed commonwealth operating appropriation, it has been pleased with support it has received from the state on the capital front. The state is funding half of the cost of a new $265 million 306,000 square foot medical research facility under construction and scheduled for completion in the summer of 2018. Also, the state is funding over half of the $65 million total cost for a renovation/expansion of the college of law building.

The University of Kentucky's financial operations, in our view, are robust on a full accrual basis, with net adjusted operating income of $142.1 million (4.7%) in fiscal 2016 and $250.8 million (9.1%) in fiscal 2015. Operations are much stronger on a cash flow basis. Total operating revenue has risen considerably in recent years as the university has grown in stature, having increased approximately 28.2% to $3.2 billion from $2.5 billion during the five-year period ended in fiscal 2016.

Net tuition revenue increased 5.5% to $319.6 million in fiscal 2016 from the level received in 2015 due to enrollment growth and a 3% increase in tuition and mandatory fee for residents and a 6% increase for non-residents. For fall 2016, resident tuition and mandatory fees increased 5% for residents and 8% for non-residents. Management believes UK's tuition and fees are competitive with its peer group schools. Tuition and fees for residents were $11,484, and for non-residents were $26,334 for fall 2016.

Before 2012, research grants and contracts steadily increased on a year-over-year basis; however, as is the case nationally, since that time, research funding declined until fiscal 2014. Grants and contracts declined by an average annual rate of 10.2% in fiscal 2012, 2013, and 2014. However, they have risen 15.3% since then to reach $295.5 million in fiscal 2016.

Available resources

Financial resource levels are sound for the current rating, with adjusted unrestricted net assets increasing 10.6% to $1.2 billion for fiscal 2016 from $1.1 billion in 2015 and representing 40% of adjusted operating expense and 117% of existing and pro forma debt. However, these ratios would be diluted if we were to factor in the university's unfunded actuarial accrued liability for other postemployment benefits (OPEB) of $229.5 million at fiscal year-end 2016. The university implemented an OPEB Trust in July 2007 and has funded its annual OPEB cost to the trust since that time with $120 million of assets on hand at fiscal year-end 2016, up 10.2% in 2016 from the $108.8 million of assets that were on hand in the trust at fiscal year-end 2015.

The market value of the endowment as of June 30, 2016, decreased 0.8% to $1.22 billion from the $1.23 billion value at fiscal year-end 2015 reflecting a negative investment return of 1.5% for fiscal 2016. The university follows a 4.25% spending policy based on a five-year-moving average for fiscal 2012 and 2013; however, it is moved to a hybrid spending policy in fiscal 2014 that was fully implemented in fiscal 2015 to take into account the market value of the endowment and the current level of inflation in determining spending each year. The university has a target asset allocation of 40% global equity, 20% global fixed income, 20% real assets and 20% diversifying strategies.

Debt and contingent liabilities

While the university's debt issuance has ramped up over roughly the past four years, in many cases, the recent debt issuance is designed to be self-supporting by either department of intercollegiate athletics revenues, private gifts, or general funds of the university or some combination thereof. In our view the university's debt management practices are conservative, as evidenced by its 3% low debt burden. Bonds, notes, and capitalized leases outstanding in fiscal 2016 (inclusive of the current issuance on a pro forma basis) totaled just $1 billion compared with five years earlier at fiscal year-end 2010, when the total was $754.2 million, representing just a 38.3% increase. That is behind the 55.9% growth in net assets and the 47.8% growth in total adjusted operating revenue over the same period.

UK has a defined-contribution plan and makes annual contributions at the required full funding amount. UK does not participate in the state's defined-benefit pension plan. The university's contributions and cost in fiscal 2016 was $107.1 million, a 9.6% increase from the prior year's $97.7 million contributions and cost. In July 2007, UK implemented an OPEB trust. As of fiscal year end 2016, net trust fund assets totaled $120 million and as of July 1, 2016, UK had an unfunded (OPEB) actuarial accrued liability of $229.5 million. For each of the past three years UK has made contributions equal to or slightly in excess of 100% of its annual OPEB cost.

University of Kentucky Financial Statistics

	--Fiscal year ended June 30--					Medians for 'AA' rated public colleges and universities
	2017	**2016**	**2015**	**2014**	**2013**	**2015**
Enrollment and demand						
Headcount	30,884	30,720	30,131	29,385	28,928	MNR
Full-time equivalent	29,363	29,318	28,550	27,634	27,037	32,632
Freshman acceptance rate (%)	76.5	74.1	72.2	68.6	67.3	71.7
Freshman matriculation rate (%)	27.7	31.2	34.7	34.5	36.7	MNR
Undergraduates as a % of total enrollment (%)	73.9	73.9	73.8	73.0	72.0	77.7
Freshman retention (%)	82.0	82.7	82.1	82.5	81.3	85.5
Graduation rates (five years) (%)	N.A.	N.A.	N.A.	56.1	54.9	MNR
Income statement						
Adjusted operating revenue ($000s)	N.A.	3,196,927	3,010,649	2,670,812	2,538,217	MNR
Adjusted operating expense ($000s)	N.A.	3,054,749	2,759,813	2,570,343	2,460,466	MNR
Net adjusted operating income ($000s)	N.A.	142,178	250,836	100,469	77,751	MNR
Net adjusted operating margin (%)	N.A.	4.65	9.09	3.91	3.16	2.10
Estimated operating gain/loss before depreciation ($000s)	N.A.	207,366	316,384	166,693	147,259	MNR
Change in unrestricted net assets (UNA; $000s)	N.A.	106,002	203,600	106,719	110,046	MNR
State operating appropriations ($000s)	N.A.	279,611	279,611	283,869	283,869	MNR
State appropriations to revenue (%)	N.A.	8.7	9.3	10.6	11.2	21.0
Student dependence (%)	N.A.	20.3	20.0	20.3	20.4	42.4
Healthcare operations dependence (%)	N.A.	51.5	51.4	48.9	46.0	MNR
Research dependence (%)	N.A.	9.2	9.6	9.6	11.2	MNR
Endowment and investment income dependence (%)	N.A.	0.8	0.6	0.8	0.8	0.8

University of Kentucky Financial Statistics (cont.)

	--Fiscal year ended June 30--					Medians for 'AA' rated public colleges and universities
	2017	2016	2015	2014	2013	2015
Debt						
Outstanding debt ($000s)	N.A.	1,043,655	930,443	838,179	647,790	646,050
Proposed debt ($000s)	N.A.	38,105	N.A.	N.A.	N.A.	MNR
Total pro forma debt ($000s)	N.A.	1,042,735	N.A.	N.A.	N.A.	MNR
Pro forma MADS	N.A.	114,654	N.A.	N.A.	N.A.	MNR
Current debt service burden (%)	N.A.	2.90	3.07	3.09	3.49	MNR
Current MADS burden (%)	N.A.	3.65	2.65	N.A.	3.27	3.70
Pro forma MADS burden (%)	N.A.	3.75	N.A.	N.A.	N.A.	MNR
Financial resource ratios						
Endowment market value ($000s)	N.A.	1,221,579	1,231,557	1,215,226	957,784	642,929
Related foundation market value ($000s)	N.A.	N.A.	N.A.	N.A.	N.A.	612,539
Cash and investments ($000s)	N.A.	2,630,285	2,465,743	2,170,677	1,674,833	MNR
UNA ($000s)	N.A.	1,103,636	997,634	794,034	687,315	MNR
Adjusted UNA ($000s)	N.A.	1,223,648	1,106,449	891,351	762,677	MNR
Cash and investments to operations (%)	N.A.	86.1	89.3	84.5	68.1	51.7
Cash and investments to debt (%)	N.A.	252.0	265.0	259.0	258.5	162.6
Cash and investments to pro forma debt (%)	N.A.	252.2	N.A.	N.A.	N.A.	MNR
Adjusted UNA to operations (%)	N.A.	40.1	40.1	34.7	31.0	30.3
Adjusted UNA plus debt service reserve to debt (%)	N.A.	117.2	119.0	106.4	118.0	86.7
Adjusted UNA plus debt service reserve to pro forma debt (%)	N.A.	117.4	N.A.	N.A.	N.A.	MNR
Average age of plant (years)	N.A.	26.6	25.8	24.3	21.7	12.4

N.A.--Not available. MNR--median not reported. 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 times (net adjusted operating income/adjusted operating expense). Tuition dependence = 100 times (gross tuition revenue/adjusted operating revenue). Current debt service burden = 100 times (current debt service expense/adjusted operating expenses). Current MADS burden = 100 times (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 6, 2017)

University of Kentucky		
Long Term Rating	AA/Stable	Affirmed
University of Kentucky		
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

Ratings Detail (As Of January 6, 2017) (cont.)		
Univ of Kentucky		
Long Term Rating	AA/Stable	Affirmed
Kentucky Asset Liability Comm, Kentucky		
University of Kentucky, Kentucky		
Kentucky Asset Liability Comm (Univ of Kentucky) (MBIA) (National) (SEC MKT)		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed
Kentucky Asset Liability Comm (Univ of Kentucky)		
Long Term Rating	AA/Stable	Affirmed

Many issues are enhanced by bond insurance.