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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

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| *Long Term Rating* | AA/Stable | New |
| US$10.13 mil General Receipts Bnds ser 2018B dtd 02/20/2018 due 10/01/2025 | | |
| *Long Term Rating* | AA/Stable | New |

## Rationale

S&P Global Ratings assigned its 'AA' long-term rating to University of Kentucky's (UK) $210.56 million series 2018A tax-exempt general receipts bonds and $10.13 million series 2018B taxable general receipts bonds. In addition, S&P Global Ratings affirmed its 'AA' long-term rating and underlying rating on almost $900.09 million in various existing general receipts bonds issued for and by UK. The outlook is stable on all rated issues.

As of UK's fiscal year end, June 30, 2017, its outstanding long-term debt, inclusive of capitalized leases and notes, totaled $1.01 billion, and with the issuance of the series 2018 A and B bonds we estimate pro forma long-term debt will rise to $1.23 billion.

The rating reflects our view of UK's very strong enterprise and financial profile characterized by steadily rising enrollment in most recent years, an increasing amount of students from out of state, good revenue diversity in large part due to its health care system that now accounts for just over half of total adjusted operating revenue, consistent production of positive financial operating surpluses, adequate financial resources, and a low debt burden. In addition, in our view UK's management and governance is robust and as Kentucky's flagship higher educational institution, the university enjoys the commonwealth's support for its operations and on a limited basis for some capital needs while these needs are also met, in part, by very strong philanthropic support.

In our view, UK's growing reputation as a comprehensive research-based university is enabling it to attract students from beyond the state's borders with approximately one-third of its students coming from out of state. Also, UK HealthCare (UKHC) continues to rise in prominence in the state and region with a positive patient volume trend, delivery of increasingly more complex health services including ongoing national recognition of its Markey Cancer Center-a designated comprehensive cancer center and a growing medical staff.

The long-term rating and stable outlook 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;
- Rising student enrollment with total full-time equivalent (FTE) enrollment increasing 7.7% to 29,112 in fall 2017 from the level recorded five years earlier in fall 2012 of 27,037;
- Favorable revenue diversity with its health system accounting for 52.5% of total adjusted operating revenue in fiscal 2017, 14.9% of tuition and fees, 9.5% of grants and contracts, and 8.1% 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 2017 equal to 35.7% of adjusted operating expenses and 93.7% of pro forma debt coupled with a relatively low pro forma maximum annual debt service (MADS) burden of 3.1%;
- Robust management and governance that budgets conservatively, utilizes an enterprise risk management program, and plans proactively for hypothetical disruptive environment scenarios while also following sound investment practices; and
- Impressive philanthropic support as it reported securing gift receipts of $175.6 million in fiscal 2017 and with an endowment that has increased 33.9% to $1.3 billion at fiscal year-end 2017 from $947.4 million five years earlier at the end of fiscal 2012.

Credit factors offsetting some of the preceding credit strengths include:

- State budgetary pressure in Kentucky resulting in declining state operating appropriations to $267.0 million in fiscal 2017 from a recent year high of $297.6 million in fiscal 2012 (fiscal 2018's appropriation is flat at $267.1 million); and
- University budgetary pressure with a 2.4% increase in the $3.7 billion budget for fiscal 2018 compared with the prior year's $3.6 billion budget that we view as somewhat constraining since total FTE enrollment rose 1.2% in fall 2017 (fiscal 2018) to 29,112 compared with fall 2016 and capital spending has been high to address infrastructure and deferred capital needs.

A pledge of the university's general receipts, and for the university's series 2009B 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 2018A and series 2018B general receipts bonds will together provide monies for various expansion and/or renovation projects and to address deferred maintenance. The largest project funded from the series 2018A bond proceeds is a $150 million renovation and upgrade of various health care facilities at UKHC.

The university continues to invest heavily in capital as part of its campus transformation initiative. Capital spending in fiscal 2017 and 2016 totaled $370.9 million and $416.8 million, respectively, while the annual cash flow realized from depreciation for each of these years totaled $151.4 million. We understand that over $2.2 billion in investment has occurred on the campus since July 2011. Some of this investment has been funded by public-private partnerships, e.g., since 2013 UK has extensively overhauled its student residence facilities through a privatized housing program with a third-party developer, Education Realty Trust (EdR) with a total of 14 new residence halls opening containing 6,850 new beds having come on line since that time at a cost of $449.3 million funded by EdR. Similarly, in 2014, UK entered into a 15-year P3 arrangement with Aramark valued at $250 million by UK for its dining services that has resulted in Aramark providing $70 million in capital for new and existing facilities improvements. The other major project that constitutes a significant portion of the overall capital spend is a $412.6 million multiphase expansion and renovation of

UKHC's facilities that are expected to be fully completed by 2022.

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 17 academic and professional colleges 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, Social Work, and the Honors College. We also understand that during the last academic year the university awarded over 6,900 undergraduate and graduate degrees.

## Outlook

The stable outlook reflects our expectation that over the next two years, UK's enrollment will increase modestly, its health care system will experience strong patient utilization growth and financial operating results while financial results for the entire university on a consolidated basis are expected to remain positive and additional debt issuance will be balanced with financial resources growth.

### Downside scenario

A negative rating is possible if enrollment or patient volumes decline significantly 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 due to ongoing budgetary constraints, could be considered in the future if the enrollment and patient utilization trend both remain firm, financial performance remains positive and there is significant financial resource growth while additional debt issuance is modest.

## 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 celebrated its 150th anniversary in 2015 and continues to grow in stature among comparable comprehensive research based institutions in our view.

Total FTE enrollment rose 1.2% in fall 2017 to 29,112 students from the prior year's 28,768 students while the annual growth in total FTE enrollment for the past several years in most instances has exceeded 2%. Undergraduate, graduate, and professional (and other) students make up 76%, 21%, and 3% of FTE enrollment, respectively.

Freshman applications decreased 7.3% in fall 2017 to 18,978 from the 20,480 applications received for the fall 2016 enrollment period. However, in each of the preceding three fall enrollment periods applications increased nearly or in excess of 10% and management attributes the fall 2017 application decline to a change in methodology with how applications are being counted.

Selectivity has declined somewhat increasing to 95.7% in fall 2017 from 90.8% in fall 2016. Typical matriculation rates have been in the 25% to 30% range. Student quality is above average with an average 25.4 ACT score for the entering freshman class in fall 2017.

The university enjoys favorable philanthropic support, securing gift receipts of more than $175 million in fiscal 2017 from 50,000 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 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. In December 2017, Dr. David Blackwell was named the university's new provost effective Jan. 8, 2018. Dr. Blackwell had been dean of the university's Gatton College of Business and Economics since 2012 and replaces Dr. Timothy Tracy who served in that position for a short time following his tenure as the Dean of the Pharmacy Program. Also, on Sept. 18, 2017, UKHC welcomed Dr. Mark F. Newman as UKHC's new executive vice president for health affairs replacing Dr. Michael Karpf who retired from that position after a long and distinguished career at UKHC. Dr. Newman is a native of Kentucky and comes to UKHC from Duke University Medical Center. 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.

### University of Kentucky HealthCare System

University of Kentucky HealthCare is a major component of the overall university, constituting 52.5% of fiscal 2017 total adjusted operating revenue and supports approximately $589.8 million of the university's overall pro forma debt, including leases. UKHC is a 945-licensed-bed tertiary and quaternary facility consisting 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 2017, UKHC staffed a total of 883 available beds at an 81.8% occupancy rate that we consider strong.

UKHC is a leading health care provider in central and southern Kentucky and 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 four years, inpatient discharges have increased 9% to 38,706 in fiscal 2017 from 35,511 in fiscal 2013. Strong patient utilization growth and a generally favorable payor mix have enabled UKHC to produce fairly strong financial results and transfer an increasing amount of funds to support the university. Over the past three years beginning with fiscal 2017 these transfers totaled $92.0 million, $78.3 million, and $58.3 million, respectively.

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 expands the original Chandler Hospital and serves as the centerpiece of the longer term expansion of the medical campus according to university sources.

UKHC is now in its fifth 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 over 60 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 resulted in SHC building a new $40 million five-story health facility that was completed and opened on UK's campus in 2017. UKHC is leasing two of those stories for their ophthalmology practice and provides orthopedic physicians for the SHC pediatric services.

## 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 with comparable providers.

### Financial performance

Commonwealth budgetary pressure has resulted in gradually declining funding for higher education over the past several years and UK's appropriation declined to $267.0 million in fiscal 2017 from a recent high of $297.6 million in fiscal 2012. We understand in the current year the appropriation is essentially flat at $267.1 million. Also, the state's governor has recently suggested that in the 2019-2020 biennium significant additional cuts in funding may be necessary to balance the budget. While the university has managed to shoulder the reductions in state operating support without incurring deficits it remains to be seen how long it can continue to do so. While the declining state operating appropriation is a credit concern, UK has received considerable state support on the capital front. The state funded 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 almost two-thirds of the estimated $56 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 $64.2 million (2.0%) in fiscal 2017 and $118.9 million (3.9%) in fiscal 2016. Operations are much stronger on a cash flow basis. Total adjusted operating revenue has increased 31.8% over the past five years to $3.3 billion in fiscal 2017 from $2.5 billion in fiscal 2012 as the university has grown in stature.

Net tuition revenue increased 6.3% to $339.7 million in fiscal 2017 from the level received in 2016 due to enrollment growth and a 5% increase in tuition and mandatory fees for residents and an 8.5% increase for non-residents. For fall 2017 (fiscal 2018), resident tuition and mandatory fees increased 4% for residents and 6.5% for nonresidents. Management believes UK's tuition and fees are competitive with its peer group schools. Tuition and fees for residents were $11,942, and for nonresidents were $28,046 for fall 2017.

UK is a major research university and research grants and contracts have increased approximately 22% over the past three years to $312.5 million in fiscal 2017 from $256.2 million in fiscal 2014.

### Available resources

While financial resource levels are depressed slightly by the current debt issuance, they nevertheless remain sound for the current rating in our view, with adjusted unrestricted net assets totaling $1.2 billion at fiscal year-end 2017 equating to 35.7% of adjusted operating expense and 93.7% of pro forma debt (114.2% of debt outstanding at fiscal year-end 2017).

The market value of the endowment as of June 30, 2017, increased 15.1% to $1.3 billion from the $1.1 billion value at fiscal year-end 2016 reflecting a positive investment return of 10.3% for fiscal 2017. The university had followed a 4.25% spending policy based on a five-year-moving average for fiscal 2012 and 2013; however, beginning in fiscal 2014 it moved to a hybrid spending policy 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 draw from the endowment to support operations was 3.5% or $1.3 million in 2017. 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

UK's debt issuance has been at a fairly rapid clip over the past few years, to support the university's corresponding growth, almost doubling to an estimated $1.2 billion on a pro forma basis for fiscal 2017 (inclusive of the series 2018 A and B issuances) from $647.8 million at fiscal year-end 2013. However, most recent debt issuances are designed to be self-supporting by either department of intercollegiate athletics revenues, UK HealthCare, private gifts, or general funds of the university or some combination thereof. In our view the university's debt management practices remain conservative evidenced by a low 3.1% pro forma debt burden based on MADS. In addition, UK's debt portfolio in our view is very conservative with no variable rate debt, swaps and direct placement debt outstanding.

Over the next two years we understand UK may issue $275 million of additional debt with the expectation that $125 million of state supported capital would be received.

UK has a defined-contribution pension plan and makes annual contributions at the required full funding amount. UK does not participate in the state's (underfunded) defined-benefit pension plan. The university's contributions and cost in fiscal 2017 was $112.6 million, a 5.1% increase from the prior year's $107.1 million contributions and cost.

UK has a net other postemployment benefits (OPEB) liability of $232.6 million as of fiscal year end 2017. In July 2007, UK implemented an OPEB trust. As of fiscal year end 2017, net trust fund assets totaled $143.9 million up from $120 million in the prior year. 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 Enterprise And Financial Statistics

| | --Fiscal year ended June 30-- | | | | | Medians for 'AA' rated public colleges and universities |
|---|---|---|---|---|---|---|
| | **2018** | **2017** | **2016** | **2015** | **2014** | **2016** |
| **Enrollment and demand** | | | | | | |
| Headcount | 30,562 | 30,761 | 30,720 | 30,131 | 29,385 | MNR |
| Full-time equivalent | 29,112 | 28,768 | 29,318 | 28,550 | 27,634 | 32,506 |
| Freshman acceptance rate (%) | 95.7 | 90.8 | 89.1 | 91.6 | 94.6 | 69.3 |
| Freshman matriculation rate (%) | 27.0 | 27.5 | 31.2 | 34.7 | 34.5 | MNR |
| Undergraduates as a % of total enrollment (%) | 73.8 | 73.5 | 73.9 | 73.8 | 73.0 | 77.7 |
| Freshman retention (%) | 83.3 | 81.7 | 82.7 | 82.2 | 82.5 | 86.0 |
| Graduation rates (six years) (%) | 65.1 | 64.0 | 61.7 | 60.6 | 60.8 | MNR |
| **Income statement** | | | | | | |
| Adjusted operating revenue ($000s) | N.A. | 3,288,092 | 3,173,653 | 2,986,886 | 2,670,812 | MNR |
| Adjusted operating expense ($000s) | N.A. | 3,223,913 | 3,054,749 | 2,759,813 | 2,570,343 | MNR |
| Net adjusted operating income ($000s) | N.A. | 64,179 | 118,904 | 227,073 | 100,469 | MNR |
| Net adjusted operating margin (%) | N.A. | 1.99 | 3.89 | 8.23 | 3.91 | 1.46 |
| Estimated operating gain/loss before depreciation ($000s) | N.A. | 215,624 | 267,013 | 361,447 | 231,731 | MNR |
| Change in unrestricted net assets (UNA; $000s) | N.A. | 48,843 | 106,002 | 203,600 | 106,719 | MNR |
| State operating appropriations ($000s) | N.A. | 267,029 | 279,611 | 279,611 | 283,869 | MNR |
| State appropriations to revenue (%) | N.A. | 8.1 | 8.8 | 9.4 | 10.6 | 19.4 |
| Student dependence (%) | N.A. | 20.8 | 20.5 | 20.1 | 20.3 | 41.8 |
| Health care operations dependence (%) | N.A. | 52.5 | 51.9 | 51.8 | 48.9 | MNR |
| Research dependence (%) | N.A. | 9.5 | 9.3 | 9.7 | 9.6 | MNR |
| Endowment and investment income dependence (%) | N.A. | 0.9 | 0.7 | 0.6 | 0.8 | 0.8 |
| **Debt** | | | | | | |
| Outstanding debt ($000s) | N.A. | 1,012,749 | 1,043,655 | 930,443 | 838,179 | 698,540 |
| Proposed debt ($000s) | N.A. | 220,685 | N.A. | N.A. | N.A. | MNR |
| Total pro forma debt ($000s) | N.A. | 1,233,434 | N.A. | N.A. | N.A. | MNR |
| Pro forma MADS | N.A. | 98,955 | N.A. | N.A. | N.A. | MNR |
| Current debt service burden (%) | N.A. | 2.96 | 2.90 | 3.07 | 3.09 | MNR |

## University of Kentucky Enterprise And Financial Statistics (cont.)

| | --Fiscal year ended June 30-- | | | | | Medians for 'AA' rated public colleges and universities |
|---|---|---|---|---|---|---|
| | **2018** | **2017** | **2016** | **2015** | **2014** | **2016** |
| Current MADS burden (%) | N.A. | 2.94 | 3.65 | 2.65 | N.A. | 3.60 |
| Pro forma MADS burden (%) | N.A. | 3.07 | N.A. | N.A. | N.A. | MNR |
| **Financial resource ratios** | | | | | | |
| Endowment market value ($000s) | N.A. | 1,268,396 | 1,101,772 | 1,231,557 | 1,215,226 | 748,837 |
| Related foundation market value ($000s) | N.A. | N.A. | N.A. | N.A. | N.A. | 606,279 |
| Cash and investments ($000s) | N.A. | 2,478,844 | 2,510,273 | 2,465,743 | 2,170,677 | MNR |
| UNA ($000s) | N.A. | 1,152,479 | 1,103,636 | 997,634 | 794,034 | MNR |
| Adjusted UNA ($000s) | N.A. | 1,152,479 | 1,103,636 | 997,634 | 891,351 | MNR |
| Cash and investments to operations (%) | N.A. | 76.9 | 82.2 | 89.3 | 84.5 | 54.7 |
| Cash and investments to debt (%) | N.A. | 244.8 | 240.5 | 265.0 | 259.0 | 159.6 |
| Cash and investments to pro forma debt (%) | N.A. | 201.0 | N.A. | N.A. | N.A. | MNR |
| Adjusted UNA to operations (%) | N.A. | 35.7 | 36.1 | 36.1 | 34.7 | 31.9 |
| Adjusted UNA plus debt service reserve to debt (%) | N.A. | 114.2 | 105.7 | 107.3 | 106.4 | 89.7 |
| Adjusted UNA plus debt service reserve to pro forma debt (%) | N.A. | 93.7 | N.A. | N.A. | N.A. | MNR |
| Average age of plant (years) | N.A. | 12.3 | 11.7 | 12.6 | 12.3 | 12.9 |
| OPEB liability to total liabilities (%) | N.A. | 10.4 | N.A. | N.A. | 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 January 8, 2018)

| | | |
|---|---|---|
| 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 |
| **Univ of Kentucky** | | |
| *Long Term Rating* | AA/Stable | Affirmed |
| **Kentucky Asset Liability Comm, Kentucky** | | |
| University of Kentucky, Kentucky | | |

| Ratings Detail (As Of January 8, 2018) (cont.) | | |
|---|---|---|
| **Kentucky Asset Liability Comm (Univ of Kentucky)** | | |
| *Long Term Rating* | AA/Stable | Affirmed |