

**Rating Update: MOODY'S AFFIRMS UNIVERSITY OF NEW MEXICO'S Aa2 AND Aa2/VMIG 1 RATINGS; OUTLOOK IS STABLE**

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**UNIVERSITY HAS \$652 MILLION OF RATED DEBT OUTSTANDING**

Board of Regents of the Univ. of New Mexico  
Higher Education  
NM

**Opinion**

NEW YORK, Aug 25, 2011 -- Moody's Investors Service has affirmed the University of New Mexico's (UNM) Aa2 and Aa2/VMIG 1 ratings on its outstanding rated debt (see RATED DEBT for specific debt issues). The rating outlook is stable.

**SUMMARY RATING RATIONALE:** The Aa2 rating for University of New Mexico reflects its position as the State's flagship public university and major healthcare service provider, history of good state support for operations and capital, as well as good operating cash flow and debt service coverage. The rating also incorporates UNM's significant exposure to the volatile healthcare industry through the ownership of two hospitals and a faculty practice plan and its high reliance on in-state enrollment, with the number of New Mexico high school graduates showing generally no growth through 2022. The stable outlook reflects maintenance of the University's strong student and healthcare market positions, stable to rising enrollment, continued good debt service coverage, and no near-term borrowing plans.

**STRENGTHS**

\*Solid market position as the State's flagship public university serving a growing enrollment of 23,115 full-time equivalent (FTE) students across six campuses. UNM provides a broad array of undergraduate, graduate and profession programs, including New Mexico's only public schools of law, architecture and planning, and pharmacy.

\*History of consistent operating and capital support from the State of New Mexico (General Obligation rating of Aaa with a negative outlook) and state lottery revenues dedicated for scholarships, with operating appropriations representing 19% of Moody's adjusted operating revenue. The University currently does not expect reductions in state funding for FY 2012 following a total of \$43.6 million in cuts for fiscal years 2009 through 2011.

\*Balanced operating margins and good cash flow, with an annual operating margin of 0.8% for both fiscal year (FY) 2009 and 2010 and a three year average operating margin of 2.3%; the operating cash flow margin of 8.1% for FY 2010 is higher due to adjustments for the non-cash depreciation and OPEB expenses of \$89.3 million and \$7.0 million, respectively. The University projects generally comparable performance for FY 2011.

\*Good liquidity supporting the University's variable rate debt, with monthly liquidity to demand debt of 338%. Monthly liquidity relative to operations is moderate but still adequate at 82 days.

\*Success to date in fundraising, with over \$391 million raised to date in the "Changing Worlds" campaign with a goal of \$675 million.

**CHALLENGES**

\*High reliance on healthcare operations, with patient care representing 46% of the University's FY 2010 operating revenues. This revenue source is reliant on federal and state funding with 55% of gross revenue derived from Medicare and Medicaid. Healthcare exposure is expected to continue to increase with the addition of the 68-bed Sandoval Regional Medical Center.

\*Reliance on state funding for capital and operations, with operating appropriations representing 19% of FY 2010 operating revenues and leaving UNM vulnerable to state budget challenges and reductions in operating and capital support.

\*Relatively weak demographic projections for the number of New Mexico high school graduates, which accounted for 88% of first-time freshmen students in Fall 2010, although improved retention and recruiting strategies should mitigate pressures from the declining pool of potential applicants from the state. High school graduates are projected to decline 6% from 2010 to 2014 but then rise 9% through 2022 back to that in 2010.

**DETAILED CREDIT DISCUSSION**

**LEGAL SECURITY:** University of New Mexico's rated bonds are payable from a subordinate lien on Pledged Revenues which include tuition and fees; auxiliary revenues derived from the bookstore, parking, housing; indirect cost recovery; and income from the permanent and land funds. Pledged Revenues exclude state appropriations, restricted funds, and hospital revenue. The senior lien is associated with \$23.8 million of outstanding Series 1992A bonds and is closed. The subordinate bonds are further secured by a debt service reserve fund, sum sufficient rate covenant, and additional bonds test of at least 1.75 times coverage of pro-forma peak debt service coverage. Total pledged revenues of \$337.7 million for FY 2010 provided 9.5 times coverage of maximum annual debt service (MADS). Net revenues provided 2.6 times MADS coverage. UNM's hospital revenues bonds are secured solely by hospital revenue and the mortgage insurance from the Federal Housing Administration's Section 242 mortgage insurance program, with no recourse to the revenue streams supporting debt service on the System Revenue Bonds. The Hospital provides good debt service coverage of its outstanding \$183.4 million of debt by 5.4 times in FY 2010.

**DEBT STRUCTURE:** UNM's debt structure is comprised 87% fixed rate bonds, including debt of the hospital and a component unit of UNM. The University has hedged the interest rates on 81% of the variable rate debt outstanding. The demand features of the variable rate debt - specifically the Series 2001, 2002A and 2002B - are backed by standby bond purchase agreements (SBPAs) provided by JPMorgan Chase

Bank, N.A. (rated Aa1/P-1). All SBPAs expire on July 16, 2012. We believe this debt structure carries additional risks as under certain circumstances, the bank could require an acceleration of the bonds and terminate the agreement. With Moody's calculation of unrestricted monthly liquidity for FY 2010 providing 338% of demand debt, we are comfortable with the risks associated with the variable rate debt structure at the current rating level.

**INTEREST RATE DERIVATIVES:** The University has floating to fixed rate swap agreements related to its Series 2002B, 2002C, and a portion of its 2001 variable rate bonds. There are two synthetic fixed rate swaps hedging the 2001 bonds with RBC Capital Markets and JPMorgan. The University has entirely synthetically fixed the Series 2002B and 2002C bonds through swaps with JP Morgan. The swaps are contemporaneous with the maturity of the debt, with the University's swap payments on parity with debt service payments. In 2006, the University entered into two swap overlays with JP Morgan on the Series 2001 and 2002C bonds under which it pays SIFMA and receives a percentage of five-year LIBOR plus a fixed basis point spread. At the current rating level, the University must post collateral at a \$20 million threshold. As of June 30, 2011, the swap portfolio's market valuation, including the swap overlays, is \$5.9 million against the University.

#### RECENT DEVELOPMENTS/RESULTS

##### GROWING HEALTHCARE OPERATIONS EXPOSES UNIVERSITY TO RISKS OF SECTOR

UNMs has a large and growing exposure to the volatile healthcare industry through the ownership of a hospital and a faculty practice plan, with the construction of an additional small hospital underway. Representing 46% of FY 2010 operating revenues, as calculated by Moody's, patient care represented the single largest contributor to revenues. The University's Health Sciences Center (HSC) payor mix has a high Medicaid load and operates in a highly competitive healthcare market. However, we believe this sector risk is mitigated by the Hospital's market position, good volume trends, and positive operating performance. Continuation of healthy operating margins at the University Hospital will be a key factor in maintaining the credit rating of the University.

The HSC clinical facilities include the 518 licensed bed UNM Hospital, the State's only Level-1 trauma center for children and adults and as Bernalillo County's (rated Aaa with a negative outlook) public hospital, a key provider of indigent care. The Hospital benefits from tax support through a mill levy from the County that represented \$90.6 million in FY 2010 or nearly 12% of Moody's adjusted hospital revenue, although we note the tax support must be renewed by voters every eight years. As the safety net hospital for the region, the Hospital has a challenging payor mix. In FY 2010, Medicaid represented 24% of gross patient revenues, Medicare 16%, Managed Care and Insurance represented 13%, while self pay and other accounted for 33%. Due to the high level of indigent care provided, the Hospital has recognized substantial bad debt expense of \$98.0 million and \$69.5 million in FY 2009 and FY 2010, respectively. As a provider of a high number of Medicaid patients, HSC received Upper Payment Limit (UPL) payments of \$21.3 million and \$39.0 million for FY 2009 and FY 2010, respectively, to supplement the Medicaid reimbursement. Additionally, it received disproportionate share (DSH) payments of \$21.4 million and \$22.5 million for FY 2009 and FY 2010, respectively. This includes UNM Hospital, UNM Psychiatric Center, and UNM Children's Psychiatric Center.

Despite the payor mix, operating performance at the Hospital has been positive, although down in FY 2010 from the past two years. The operating margin was 4.4% for FY 2010 compared to 8.8% in FY 2009, while the operating cash flow margin of 10.6% is less than the 14.8% in FY 2009. The decrease in the operating margin reflects in part compensation and benefit expenses related to compensation increases and new staff for recently opened areas and for supplies expenses for the higher utilizations. The Hospital continues to experience good volume growth with admissions of 27,452, down only 1.4% from the prior year. Fiscal year-to-date the Hospital is reporting utilization and operating performance higher than for the same period the preceding year. The Hospital's primary service area includes Bernalillo and Valencia counties, as well as portions of Sandoval, Tarrant, and Santa Fe counties. Continued growth is expected in the Hospital's primary service area and should contribute to ongoing volume increases.

Albuquerque is a highly competitive healthcare market with the for-profit Lovelace Health System (owned by Nashville-based Ardent Health Services, with 26% market share), Presbyterian Healthcare Services (rated Aa3 with 44% market share), the University of New Mexico's University Hospital (with 27% market share), and the Heart Hospital of New Mexico (a specialty hospital with a stable 2% of the market). Albuquerque is in large part the destination for healthcare services for much of the State with the flagship facilities for three systems in downtown Albuquerque within two miles of each other. However, there is clear market segmentation, with UNM Hospital being the primary provider for Medicaid recipients and indigent residents, so actual competition in the commercial market is moderate. In FY 2010, Medicaid patients represented more than 28% of the UNMs gross payor mix.

The University is currently constructing a new 68-bed teaching hospital and medical office building at its Rio Rancho campus, located in the west side of the Albuquerque metropolitan area and the fastest growing town in New Mexico. The Sandoval Regional Medical Center, Inc. (SRMC) is a wholly owned subsidiary of the University with a majority of board membership from the University. The Sandoval Regional Medical Center has an estimated project cost of \$159.9 million with an expected completion date of spring 2012, with \$143.4 million financed through the Series 2010 FHA mortgage bonds. The UNM Medical Group, a blended component unit of the University, expects to make a \$23 million contribution (including \$3.5 million from unrestricted funds), to fund start-up costs in the first few years until the project is self-sufficient.

For future operating support, SRMC will receive 60% of a property tax established by Sandoval County once the hospital is opened and licensed, with current estimates that the tax receipts will cover approximately 75% of the debt service on the bonds issued to finance the hospital. The other 40% of the tax collections will be paid to Presbyterian Health Services, which is planning to construct a 66 bed facility in another location in Rio Rancho. With two new facilities opening in Sandoval County within the same general time period, we expect pressure on UNMH's and UNMs reported operating results until the new facility becomes profitable. Moody's will monitor the impact of the new facility on UNM to determine the extent and length of time of any reduction in operating performance and cash flow.

##### SIGNIFICANT RELIANCE ON STATE OF NEW MEXICO RATED Aaa WITH NEGATIVE OUTLOOK

The University is reliant on the State of New Mexico for both direct state operating support (19% of FY 2010 operating revenues) as well as Medicaid funding for UNMH's patient care revenues (24% of gross patient revenues or 40% of net patient revenues of \$593 million for FY 2010). The State of New Mexico's general obligation rating is Aaa with a negative outlook due to its above-average exposure to sovereign risk factors that leads to greater vulnerability to changes in the U.S. government rating. For more information, please see Moody's reports regarding the rating actions related to the State of New Mexico dated July 19, 2011 and August 4, 2011.

##### PRIVATIZED STUDENT HOUSING REPRESENTING GROWING SHARE OF UNIVERSITY'S AVAILABLE STUDENT HOUSING

UNM is continuing to expand its housing capacity through the use of public private partnerships. Given the material share of student housing represented by the public private partnerships, we believe that the University has a strong incentive to see these projects succeed. Based on

the specific structure of the transactions, which includes no obligation of the University to support the project, we have not included the development costs in direct debt calculations for the University. The credit impact of these projects could change if the projects encountered operating difficulties in the future and UNM provided financial or other significant support.

UNM entered into an agreement with American Campus Communities, Inc. (ACC) to construct student housing and is now moving to construct the Phase Two of its overall plans. Phase One (Lobo Village), on schedule to open for this fall semester, is located on UNM's south campus adjacent to the main campus and provides 864 beds for upperclassmen. With its location, University services provided are minimal, including a shuttle to the main campus. Phase Two, however, will be located on UNM's main campus with the university-owned student housing facilities and will provide 1,027 beds for UNM's freshmen, and will replace 257 beds from the University's halls. Due to its location on the main campus, UNM will provide for the Phase Two residents parking, as well as dining services and access to campus facilities including the library and recreation center. There is currently no freshman housing requirement. We believe with the location on the main campus and the importance of providing critical housing to freshmen students, Moody's believes UNM would have a strong incentive for Phase Two to succeed.

The site on the main campus will be ground leased to ACC for 40 years with three 10-year extension options. The project cost for Phase Two is projected to be \$35 million and is expected to be completed by August 2012. ACC will issue no project-specific debt at this time, instead investing its own equity; however, the lease agreement allows ACC to enter into a mortgage for up to 65% of the fair market value of the project and up to 75% of the combined fair market value of the first two phases and the future phase three.

For the third phase, UNM is currently planning the construction of an additional 1,000 beds with ACC on its main campus, but would result in a net increase of 400 beds after taking 600 of its own beds offline. After the opening of phase two in August 2012, the ACC beds will represent 43% of the University's beds available for students. Following phase three, the ACC beds will represent 60% of proforma available student housing assuming the University constructs no housing, although it would represent only 17% of current headcount enrollment at the main campus. Moody's continues to monitor the University's involvement in all of the projects and levels of ongoing support, financial and other. We view these projects as part of the University's broader credit profile, especially as management explores the possibility of additional privatized student housing and these facilities become an increasingly large proportion of the University's overall housing stock.

### **Outlook**

The stable outlook reflects maintenance of the University's strong student and healthcare market positions, stable enrollment levels, continued good debt service coverage, and no near-term borrowing plans.

#### **WHAT COULD MAKE THE RATING GO UP**

Substantial financial resource growth through successful fundraising combined with enhanced market position reflected in enrollment growth and tuition flexibility; consistently favorable operating performance and stronger cash flow generation

#### **WHAT COULD MAKE THE RATING GO DOWN**

Sustained deterioration of Hospital or University operations resulting in lower operating cash flow and flat or declining financial reserves; significant reductions in state operating and capital support not offset by other revenue growth; significant additional borrowing without commensurate growth in financial resources and revenues

#### **KEY INDICATORS (FY 2010 financial results; Fall 2010 enrollment)**

Total Enrollment: 23,115 full-time equivalent students

Total Debt: \$863.0 million

Total Comprehensive Debt: \$956.0 million

Expendable Financial Resources: \$575.3 million

Expendable Financial Resources to Debt: 0.7 times

Expendable Financial Resources to Operations: 0.4 times

Monthly Liquidity: \$348.1 million

Monthly Days Cash on Hand (unrestricted funds available within 1 month divided by operating expenses excluding depreciation, multiplied by 365 days): 84 days

Monthly Liquidity to Demand Debt: 338%

Reliance on State Funding (% of Operating Revenue): 19%

Reliance on Patient Care Revenue (% of Operating Revenue): 44%

State of New Mexico G.O. Rating: Aaa, negative outlook

#### **RATED DEBT**

Superior Lien System Revenue Bonds

Series 1992A: Aa2

Subordinate Lien System Revenue Bonds

Series 2001, 2002B, 2002C: Aa2/VMIG1 (VMIG1 rating based on SBPA with JPMorgan Chase Bank, N.A. that expires on stated expiration date of July 16, 2012)

Series 2002A, 2003A, and 2007B (Taxable): Aa2

Series 2000A, 2000B: Aa2, insured by National Public Finance Guarantee Corp.

Series 2003B, 2003C, 2005: Aa2, insured by Ambac

Series 2007A: Aa2, insured by Assured Guaranty Municipal Corp. (formerly FSA)

Hospital Revenue Bonds

Series 2004: insured by Assured Guaranty Municipal Corp. (formerly FSA)

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## PRINCIPAL RATING METHODOLOGY

The principal methodology used in this rating was Public Colleges and Universities published in September 2002. Please see the Credit Policy page on [www.moodys.com](http://www.moodys.com) for a copy of this methodology.

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