

University of New Mexico Board of Regents

University of New Mexico; Public Coll/Univ - Unlimited Student Fees

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Table Of Contents

Rationale

Outlook

Stable Enrollment

Finances

University Hospital Operations

Debt

Debt Derivative Profile (DDP)

Government-Related Entities (GREs)

Related Criteria And Research

University of New Mexico Board of Regents University of New Mexico; Public Coll/Univ - Unlimited Student Fees

Credit Profile

University of New Mexico Brd of Regents, New Mexico

University of New Mexico, New Mexico

New Mexico Brd of Regents (Univ of New Mexico) gross rev bnds ser 1992A-C

Long Term Rating

AA/Stable

Affirmed

Rationale

Standard & Poor's Ratings Services affirmed its 'AA' long-term rating and underlying rating (SPUR) on the University of New Mexico Board of Regents' various senior- (closed) and subordinate-lien system revenue bonds, issued for University of New Mexico (UNM). The 'A-1+' short-term rating on the series 2001, 2002B, and 2002C variable-rate demand bonds is based on bank liquidity support from J.P. Morgan Chase in the event of an unremarketed tender. The long-term rating affirmation reflects our view of:

- Continued financial support from New Mexico (AA+/Stable general obligation rating), with operating appropriations comprising about 18% of fiscal 2010 operating revenues;
- UNM's broad undergraduate, graduate, and professional program offerings and its co-flagship status in the state's higher-education system;
- Consistently balanced operating performance on a full-accrual basis and a hospital that has modest surpluses and is not a drain on the university;
- Adequate financial resource ratios for the rating category, with adjusted 2010 unrestricted net assets (UNA) equal to 81% of outstanding debt (about \$637 million, including hospital debt that we do not rate) and 28% of operations;
- Stable enrollment at the both the main and branch campuses, and, in our view, competitive in-state tuition that benefits from a state scholarship program; and
- A manageable consolidated debt burden of under 3% of fiscal 2010 operating expenses.

Partially offsetting the preceding credit strengths is our view of UNM's comparatively small endowment relative to other U.S. public flagship universities of about \$338 million at June 30, 2010 and a growing but relatively modest research base (\$161 million of research expenses in fiscal 2010) compared to peer flagship institutions.

We view the university's financial resource ratio relative to debt as somewhat overstated, as it does not include two large privatized housing projects that are, or will be, funded by a third party from equity. Consistent with our published criteria, we consider both housing projects, both of which are integral to the university's academic strategies, are located directly on campus, and will be owned by the university upon the completion of lease terms, to have high connectivity to the university.

The university's subordinate- and senior-lien system improvement bonds totaled \$458 million at June 30, 2010, and

are secured by a broad mix of pledged revenues of the university, including housing facilities, revenues from all other buildings owned or operated by the university, and student fees. Specifically excluded from the system bond pledge are hospital revenues and state operating appropriations. The university has no taxing authority. We view the security as an unlimited student fee obligation of the university due to the broad pledge. The subordinate-lien bonds are rated on par with the senior-lien bonds (only \$26 million outstanding) because the senior-lien indenture is closed, the revenue pledge is broad, and the senior-lien portion is proportionately small.

UNM is the largest of New Mexico's seven four-year universities in terms of enrollment, which was 36,510 headcount in fall 2010, of which 28,757 were at the main Albuquerque campus or associated with the Health Sciences Center (HSC). UNM offers bachelor's, master's, and doctorate degrees, as well as various professional degrees (medicine, law, pharmacy, and architecture). We understand that the university is known for the school of medicine's rural medicine program, as well as the law school's clinical law training program. There are four branch campuses in Gallup, Los Lunas, Taos, and Los Alamos, and two graduate studies centers in Santa Fe and Los Alamos. A new academic center in Rio Rancho that opened in January 2010 is considered a satellite branch of the main Albuquerque campus. The HSC is the state's largest integrated health care treatment, research, and education organization. Management reports that UNM is one of only six institutions in the U.S. classified as both a minority and a Carnegie Doctoral/Research University Extensive institution. The university is in a \$675 million comprehensive campaign, announced in 2006, which we understand has raised more than \$390 million in gifts and pledges to date.

The university has had leadership challenges in recent years. The current president, David Schmidly, started a five-year contract in June 2007, and has announced his retirement at the end of that contract in 2012. A search process has begun for a new president. We understand that other senior staff positions have experienced unusually high turnover -- there have been five provosts in the last eight years, and an interim is currently in place. Turnover has also occurred in admissions and fundraising. The university is managed by a seven-member board appointed by the governor for six-year staggered terms.

Outlook

The stable outlook anticipates our expectation during the two-year outlook period of continued balanced or positive operating performance on a full-accrual basis as the university manages through a constrained state funding environment, positive operations in the extensive HSC operations, maintenance of financial resources ratios consistent with the rating category, and relatively stable enrollment. The outlook also reflects our expectation that the hospital debt will continue to be supported by net hospital operations. We expect that additional debt issuance will parallel growth in financial resources or revenues.

We do not view consideration of a positive rating action in the outlook period as likely. However, factors that could lead to such action outside the outlook period could include consistently stronger university and HSC operating margins, as well as growth in financial resource ratios relative to the rating category.

Consideration of a negative rating action in the outlook period could be triggered by significant enrollment declines, operating deficits, slim or negative operating margins in the extensive HSC operations, or the issuance of a significant amount of additional debt.

Stable Enrollment

Headcount has historically been stable, averaging about 25,000 on the main campus over the last eight years, but with stronger growth in the last two years. Main campus enrollment was 28,757 (about 23,100 full-time equivalent, or FTE) for fall 2010. Graduate student enrollment has also grown in the last several years, reversing flat or modest declines. Graduate FTE was 4,683 in fall 2010, up from 4,343 in fall 2004. Professional enrollment (law, medicine, etc.) remains fairly stable at 1,043 headcount. Management attributes fluctuations in both undergraduate and graduate enrollment to economic cycles. Overall headcount for fall 2010, including regional and branch campuses, was 36,510 students (27,762 FTE).

University officials expect continued enrollment growth, and expect undergraduate enrollment for fall 2011 will increase modestly. Tuition and fee increases for in-state undergraduate students have averaged about 1% to 3% in the last years, but that followed on a large 29% increase in fall 2007. The tuition increase for the 2011/2012 academic year was approved at 5.5%. In-state, undergraduate tuition and fees remain quite competitive, in our view, totaling about \$5,500 for the 2010/2011 academic year at the main campus. The state-sponsored scholarship program, funded by lottery revenues, also helps to make student charges competitive. The lottery fund was established in 1996 for scholarships and is funded by 40% of net proceeds of lottery sales in New Mexico. The fund supports tuition, but not mandatory fees or room and board charges.

Freshman applications doubled between fall 2005 and fall 2010 to 11,066. About two-thirds of the applicants are typically admitted and between 50% and 59% of freshmen matriculate, indicating, in our view, a solid academic niche. Transfer students remain a smaller but still important component of each entering class, and in fall 2010 comprised 1,340 of the total 4,840 new undergraduate students. Student quality is slightly above the national average, with entering freshman average ACT scores typically around 22.

Finances

The university's revenue mix is a credit strength, in our opinion. For the fiscal year ended June 30, 2010, consolidated operating revenues included patient services and clinical income (40%), state operating appropriations (18%), grants and contracts (18%), net tuition and fees (6.4%), and state lottery scholarships (1%). State operating appropriations to the university have historically been fairly consistent, but in recent years have been cut. Operating appropriation levels dipped slightly to \$323 million in 2009 due to a midyear reversion, declined another 6.5% in fiscal 2010 (excluding a modest amount of stimulus funds) to \$301 million, and dropped a further 8.6% in fiscal 2011 to \$287 million. At this time, university officials are budgeting for a fiscal 2012 appropriation of \$275 million. We understand that New Mexico will be changing the funding formula for its universities effective in fiscal 2013 (fiscal 2012 is a transition year). The prior formula was driven by enrollment and physical space while the new formula is expected to be more performance based. Management expects that, as the state's flagship institution, it will operate successfully under the new funding system. In addition, in recent years the university reports that in response to state cuts, it has reduced operating expenses in general, budgeted no raises for four years (including fiscal 2012), raised miscellaneous fees (such as parking), strategically reduced service levels, and evaluated when and whether to refill vacant positions. We understand there have been no layoffs or furloughs, although some small capital projects have been deferred.

Consolidated financial operations for the university (including substantial HSC clinical revenues) are consistently

positive on a full-accrual basis, although margins were slimmer in fiscals 2009 and 2010. In fiscal 2010, the audited net change in operations before capital was \$45.7 million. We adjusted that for realized/unrealized gains/losses of \$42.4 million on university-held cash and investments (about \$891 million, a mix of endowment, long-term investments, and working capital), and estimated operating results of positive \$4.4 million on a full-accrual basis. Fiscal 2010 operations on a cash basis before depreciation expense of \$55 million are even stronger. Using similar adjustments, fiscal 2010 operating results compared to positive \$5.6 million in fiscal 2009 and \$67 million in fiscal 2008. Management expects that results for the fiscal year just ended June 30, 2011 will be similar to fiscal 2010.

Total university net assets at June 30, 2010, were \$1.45 billion, of which \$480 million was UNA, \$681 million was invested in capital assets, and the balance was restricted. We calculate financial ratios using UNA, as adjusted by UNA held by the foundation and debt service reserves, which totaled \$518 million. This was equal to 28% of operating expenses and 81% of outstanding debt (including the hospital bonds). We view these financial resource ratios as consistent with the rating category. However, we consider the financial resource ratio relative to debt to be overstated as it does not include two large privatized housing projects.

At July 31, 2011, UNM's university-held endowment, not including the university's share of the State Permanent Fund, was about \$342 million. Most university and foundation endowments are consolidated for investment purposes in a consolidated investment fund. Not included in this total was about \$214 million of operating funds invested in shorter-term investments. The foundation's spending draw for quasi and permanent endowment is a fairly standard formula varying between 4% and 6% of a trailing 20-quarter market value. As is typical of many public universities, endowment draw does not represent a significant source of general operating income.

Current market value in the consolidated investment fund was estimated at \$342 million at May 31, 2011. Invested funds were, in our opinion, diverse, and included a mix of equities (41%), fixed income and cash (22%), and alternative investments (36%, including hedge funds, private equity, and commodities).

University Hospital Operations

We view hospital operations as slim but balanced, and net income sufficient to support hospital-secured debt service on about \$179 million of bonds. While the majority of revenues come from patient service income, the positive operating margin remains dependent on proceeds of a voted mill levy from Bernalillo County (AAA/Stable). Hospital operations include revenues from a 384-bed tertiary hospital and related hospitals, including a children's hospital, adult psychiatric center, child psychiatric center, orthopedic hospital, cancer research and treatment center, adult substance abuse program, and center for developmental disabilities. The hospital produced a modest operating surplus of \$21 million in fiscal 2010, after adjustment for interest expense, state appropriations, and including the county mill levy, but excluding capital initiatives. This compares with \$42.7 million in fiscal 2009. University management projects that fiscal 2011 operations will again be positive, but slimmer than fiscal 2010 results. The hospital is supported in part by revenue from a property tax levy in Bernalillo County. Management reports that the levy for fiscal 2011 was down very slightly from that in fiscal 2010, when the HSC audit recorded about \$79.7 million in levy revenues. The mill levy was renewed in a referendum in 2008, and is subject to voter extension every eight years (the next is scheduled for November 2016). Management reports that after several years of growth, the underlying county tax base has flattened out due to the economic downturn, and as a result the HSC is conservatively assuming a slight decline or no growth in levy proceeds for fiscal 2012. For more information on the county, see the article published June 2, 2010 on RatingsDirect on the Global Credit Portal.

Debt

Outstanding system improvement bonds of the university total \$458 million, of which only \$26 million is senior lien. When the separately secured hospital revenue bonds are included, total university debt increases to about \$637 million. We view UNM's debt burden, including the hospital debt, as manageable at less than 3.0% of fiscal 2010 operating expenses. The university's debt profile (including the fixed-rate hospital bonds) is about 84% fixed rate and 16% variable rate. Approximately 80% of the variable-rate debt has been synthetically swapped to fixed (see "Debt Derivative Profile," below).

The \$179 million outstanding of series 2004 hospital mortgage revenue bonds were issued to fund a 395,425-square-foot Children's Hospital and Critical Care Pavilion. It was the hospital's first debt issuance and is not rated by Standard & Poor's. Hospital revenue bonds are secured by net income from the hospital and a Federal Housing Administration mortgage. Internally, hospital operations are distinct from general academic operations, and net hospital revenues have not been used to secure university debt. While other revenues of the university are not pledged to the hospital debt, we view the hospital as an integral part of the university, and in fiscal 2010, patient care and clinical revenues were 40% of combined operating revenues, which we consider substantial.

The university initiated a large privatized housing project at its South Campus, located on land with a long-term ground lease to a third party, American Campus Communities (ACC). The approximate 864-bed housing will open for the fall 2011 semester, and ACC will manage the housing. UNM management estimates the project cost at around \$42 million; construction of the project was financed by ACC using internal equity. The university has also contracted with ACC for new housing on the main campus, about 1,027 beds, which will also be funded and managed by ACC. Construction for the Phase II housing is expected to be completed for fall 2012 occupancy. We view the projects as having strong connectivity to UNM, as the university initiated them, they are located directly on parts of the UNM campus through ground leases, and upon repayment of the applicable lease agreements, full ownership of the projects reverts to UNM. Because of the ACC financing structure, we have not included related debt estimates in our projections of debt burden or financial resource ratios for UNM. However, we note that the effect is to overstate fiscal 2010 financial resource ratios relative to debt.

Debt Derivative Profile (DDP)

Standard & Poor's assigned the university a Debt Derivative Profile (DDP) overall score of a '2.0' on a scale of '1' to '4', with '1' representing the lowest risk. The university has entered into six swap agreements: five with JP Morgan Chase Bank N.A. (AA-) and one with Royal Bank of Canada (AA-). The score of '2.0' represents a minimal degree of issuer termination risk due to the wide spread between the college's rating and the termination trigger, limited counterparty risk due to a highly rated counterparty, and moderate economic viability of the swap portfolio over stressful economic cycles.

Government-Related Entities (GREs)

In accordance with our criteria for GREs, our view of a "moderate" likelihood of extraordinary government support is based on our assessment of UNM's "limited" link with New Mexico. The state has a history of regular, ongoing operating support, as well as periodic capital support for academic facilities. However, the state does not have the

administrative capacity to respond to a potential financial distress by UNM in a timely manner as any extraordinary support would be subject to legislative approval. In addition, our assessment is based on UNM's "important" role in the state's economy compared with that of other state GREs, given its position as a co-flagship institution of higher education, its provision of health care-related education and clinical services, and its role as a general contributor to economic development in the state. The university is a state educational institution created pursuant to the state constitution and statutes.

Related Criteria And Research

- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, Dec. 9, 2010
- USPF Criteria: Higher Education, June 19, 2007
- USPF Criteria: Debt Derivative Profile Scores, March 27, 2006

Ratings Detail (As Of August 15, 2011)		
University of New Mexico Brd of Regents, New Mexico		
University of New Mexico, New Mexico		
New Mexico Brd of Regents (Sub Lien Bonds) ser 2002A, 2003A		
<i>Long Term Rating</i>	AA/Stable	Affirmed
University of New Mexico Brd of Regents (Univ of New Mexico) (Sub Lien Sys Rev Bnds) (Ser 2003B, taxable 2003C, 2005) AMBAC		
<i>Unenhanced Rating</i>	AA(SPUR)/Stable	Affirmed
Univ of New Mexico Brd of Regents subord lien sys Improv ser 2007A, 2007B		
<i>Unenhanced Rating</i>	AA(SPUR)/Stable	Affirmed
Univ of New Mexico Brd of Regents (Univ of New Mexico) sub lien sys rev bnds ser 2000B		
<i>Unenhanced Rating</i>	AA(SPUR)/Stable	Affirmed
Univ of New Mexico Brd of Regents (Univ of New Mexico) var rate sub lien sys imp rev bnds ser 2001		
<i>Long Term Rating</i>	AA/A-1+/Stable	Affirmed
Univ of New Mexico Brd of Regents (Univ of New Mexico) (Variable) (Liquidity) (Ser 2002B)		
<i>Long Term Rating</i>	AA/A-1+/Stable	Affirmed
Univ of New Mexico Brd of Regents (Univ of New Mexico) (Variable) (Liquidity) (Ser 2002C)		
<i>Long Term Rating</i>	AA/A-1+/Stable	Affirmed
Many issues are enhanced by bond insurance.		

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