Fitch Rates University of Virginia's Series 2018 Rev Bonds 'AAA'; Outlook Stable

Fitch Ratings-New York-19 April 2018: Fitch Ratings has assigned a 'AAA' rating to the following series of bonds to be issued by The Rector and Visitors of the University of Virginia (UVA):

--$200 million general revenue pledge (GRP) bonds, (tax-exempt) series 2018.

The series 2018A bonds are expected to sell via negotiation the week of April 23. The series 2018 bonds will permanently finance commercial paper issued to fund various capital expenditures; and pay issuance expenses. The 2018 bonds are expected to be sold with a final maturity of 2049.

In addition, Fitch affirms its ratings on UVA's outstanding debt as follows:

--Approximately $1.637 billion GRP bonds at 'AAA';
--$300 million authorized taxable and tax-exempt commercial paper (CP) program at 'F1+'.

The Rating Outlook is Stable.

SECURITY

The general revenue pledge revenue bonds and CP are unsecured general obligations of UVA, payable from all legally available funds.

KEY RATING DRIVERS

STRONG FINANCIAL PROFILE: The 'AAA' rating is supported by UVA's strong financial profile that is driven by a broad revenue base, substantial balance sheet resources consistent with peer institutions, strong fundraising ability, and a manageable debt burden.

EXCEPTIONAL DEMAND: UVA's excellent academic reputation drives its consistently strong student demand, evidenced by highly selective admissions, strong student quality, and growing application volumes.

MANAGEABLE DEBT BURDEN: UVA's strong balance sheet cushion and fundraising ability support its manageable capital plan, which will likely include another $400 million in total debt issuance in 2020 and 2022 to completely refund CP that will have been used to cover capex.

HEALTHCARE EXPOSURE: The University of Virginia Medical Center, which comprises nearly half of UVA's operating revenues, makes UVA more susceptible to the potentially volatile healthcare sector. This concern is partly mitigated by consistently positive medical center operating margins.

SUFFICIENT LIQUID RESOURCES: UVA has the ability to cover the maximum potential liquidity demands presented by its variable rate debt programs from internal resources, well in excess of Fitch's minimum expected 1.25x coverage. Such resources include cash; highly liquid and highly rated investments; and dedicated liquidity facilities.

RATING SENSITIVITIES
SHIFT IN OVERALL PROFILE: Material deviation from the University of Virginia's (UVA) strong credit characteristics, while not anticipated, could pressure the rating. Similar to other public flagship institutions, particularly those with academic medical centers, the university remains exposed to federal funding pressures and healthcare changes.

CREDIT PROFILE

Chartered in 1819, UVA is a highly selective, comprehensive public flagship university and academic medical center located in Charlottesville, Virginia. The university offers 85 bachelor's degrees, 89 master's degrees and 55 doctoral degrees. Its fall 2017 undergraduate acceptance rate was 27% based on 36,799 applications, with a solid 38% of accepted students matriculating. UVA's graduate programs, including the Darden School of Business and the School of Law maintain equal or higher admissions selectivity. Fall 2017 full-time equivalent enrollment was 23,077, up slightly (2.6%) from fall 2016.

The University of Virginia Medical Center is an integrated network of primary and specialty care services. It serves as the main teaching facility for UVA's medical and nursing schools, and is comprised of several tertiary and quaternary care facilities including University Hospital, UVA Children's Hospital, Emily Couric Clinical Cancer Center, and UVA Cancer Care.

FLAGSHIP CREDIT CHARACTERISTICS
The long-term 'AAA' rating reflects UVA's impressive undergraduate and graduate student demand, consistently positive operations, diverse operating revenues, and substantial balance sheet resources. UVA's long-term investment pool is managed by the University of Virginia Investment Management Company (UVIMCO).

The university is also a successful fundraiser, having concluding a $3 billion campaign several years ago, UVA launched the quiet phase of a new capital campaign in July 2017. UVA benefits from the strong competitive and financial position of the University of Virginia Medical Center, a fully integrated division of the university that provides nearly half of total operating revenues.

Fitch views UVA's growing and broad revenue base as a credit strength. The largest revenue component is from the university's medical center, which made up 48% of fiscal 2017 operating revenue, followed by student-derived tuition, fees and auxiliary revenues (21%).

STRONG FINANCIAL CUSHION
Available funds, defined by Fitch as cash and investments less restricted non-expendable and certain expendable net assets, were a significant $6.4 billion as of June 30, 2017. Available funds equaled a robust 201% of fiscal 2017 operating expenses ($2.9 billion) and 229% of pro forma debt (approximately $2.79 billion). Fitch considers these balance sheet ratios as strong for a public university.

Pro forma debt includes outstanding revenue bonds, bond premium, operating leases, notes payable, the full amount of authorized CP notes, and about $600 million of additional long term debt issuance through fiscal 2022(including the current financing). Typical of well-endowed institutions, UVA has some exposure to alternative, illiquid asset classes in its long-term investment pool (approximately 30% as of Jan. 31, 2018). UVA's endowment is managed by UVIMCO, along with the assets of the university's various related foundations. UVIMCO had about $9.2 billion under management in January 2018. The liquid portion remained substantial relative to UVA's endowment draw and operating budget.

POSITIVE OPERATING RESULTS
UVA consistently generates GAAP operating surpluses. Its operating margin was thinner but positive at $28.6 million in fiscal 2017, a margin of about 1.0%, compared to 2.4% in fiscal 2016.
The annual endowment distribution totaled $196 million in fiscal 2017, less than 4% of UVA's investments at fiscal year-end 2017. This level of endowment spending has been fairly consistent year-over-year and is within UVA's stated endowment spending policy of between 4% and 6%. Fitch views the endowment draw as being sustainable in the long term.

University management expects another positive operating result for fiscal 2018 due to modest tuition rate increases and positive operating performance at UVA's medical center (which comprises about half of UVA's operating revenues). The medical center reported a 5.1% operating margin for fiscal 2017 (over the last 10 years, the margin has averaged 5.7%, according to management. These results are supported by an increasing market share and an upward trending case mix index.

The state's operating appropriations have fluctuated in recent years and were slightly below budget in fiscal 2017, but increased over 2016 levels. Overall these amounted to a modest amount of revenues (5.3%) in fiscal 2017. Appropriations are flat in fiscal 2018 and management is expecting appropriations to be flat again in fiscal fiscal 2019.

MANAGABLE CAPITAL PLANS AND DEBT BURDEN
UVA's approved multi-year capital program included $500 million of debt-financed projects issued in two tranches over a 12-month period (includes both the 2017C bonds and 2018A current financing). The university's use of a "shelf"-like registration process for the fiscal 2017C bonds provides flexibility over the timing and structure of future bond issuance. The university's ongoing capital plan includes housing, academic related projects and medical center-related projects. After the shelf program expires, management estimates that an additional $400 million may be issued ($200 million in 2020 and $200 million in 2022) to completely refund CP that will have been used to cover capex; Fitch has included these amounts in its pro forma debt calculations.

Unlike the series 2017C debt, which is structured as a long-dated bond to fund future capital projects with a back-ended final bullet maturity of $300 million in 2117, the 2018 debt (which is also back-ended) will have one-to-two maturities in or around 2049. UVA's overall debt structure has several periodic bullet maturities which Fitch views as manageable given UVA's liquidity, fundraising track-record and positive operating margins. Most of UVA's $2.79 billion pro forma debt is fixed rate. Only the $300 million CP program is floating. Management reports no expected change in $300 million CP authorization.

UVA maintains a manageable debt burden, although pro forma maximum annual debt service (MADS) of about $344 million in 2040 represents a high 10.7% of fiscal 2017 operating revenues (including another $400 million in total issuance expected in 1-5 years) and adequate coverage just under 1.00x. However, as MADS includes a large 2040 bullet maturity, Fitch also analyzed average debt service (ADS) based on a modified long-term debt schedule provided by UVA which smoothed out bullets over a 30 year period. Post issuance, UVA's ADS is about $139.4 million, or a much more moderate 4.35% burden. UVA also consistently generates strong current and ADS coverage, about 5.25x and 2.32x, respectively, in fiscal 2017.

Fitch considers potential debt issuance manageable given UVA's solid operating track record, significant balance sheet resources, moderate AADS burden and strong fundraising ability.

SELF LIQUIDITY FOR CP
The 'F1+' rating is based on the availability of highly liquid, highly rated securities to cover potential maximum liquidity demands presented by UVA's authorized $300 million CP notes. To supplement internal liquidity sources, UVA also maintains a mix of dedicated and general lines of credit totaling $500 million.
Self-liquidity coverage for the CP program at Dec. 31, 2017, the most current available, including highly liquid cash equivalents, and U.S. government and agencies securities and the dedicated bank lines, more than provided the minimum 1.25x coverage expected by Fitch for an 'F1+' short-term rating.

To limit potential demands on its liquidity, UVA limits the amount of CP notes that can come due on a given day to $40 million. The university's procedures for handling a CP rollover are regularly reviewed and updated, reflecting favorably on management.

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Applicable Criteria
Fitch Internal Liquidity Worksheet (pub. 13 Jun 2013)
https://www.fitchratings.com/site/re/710906
Rating Criteria for Public-Sector, Revenue-Supported Debt (pub. 26 Feb 2018)
https://www.fitchratings.com/site/re/10020113
U.S. Public Finance College and University Rating Criteria (pub. 26 Apr 2017)
https://www.fitchratings.com/site/re/897285
U.S. Public Finance Short-Term Debt Rating Criteria (pub. 01 Nov 2017)
https://www.fitchratings.com/site/re/905637

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