Moody's INVESTORS SERVICE

New Issue: Moody's assigns Aa1 to University of Missouri System's up to $200 million of Series 2013A & B bonds; outlook stable

Global Credit Research - 17 Oct 2013

$1.8B of rated debt, including commercial paper at the full authorized amount

UNIVERSITY OF MISSOURI SYSTEM, MO
Public Colleges & Universities
MO

Moody's Rating

ISSUE	RATING
System Facilities Revenue Bonds, Series 2013A	Aa1
Sale Amount $140,000,000	
Expected Sale Date 11/13/13	
Rating Description Revenue: Public University Broad Pledge	
Taxable System Facilities Revenue Bonds, Series 2013B	Aa1
Sale Amount $60,000,000	
Expected Sale Date 11/13/13	
Rating Description Revenue: Public University Broad Pledge	

Moody's Outlook STA

Opinion

NEW YORK, October 17, 2013 --Moody's Investors Service has assigned Aa1 ratings to The Curators of the University of Missouri's (the system or the university) System Facilities Revenue Bonds Series 2013A and Taxable System Facilities Revenue Bonds Series 2013B (both fixed rate) for up to $200 million, subject to market conditions. Moody's has affirmed the Aa1 ratings on the system's other fixed-rate bonds, P-1 rating on the system's commercial paper program and Aa1/VMIG1 ratings on variable-rate demand bonds supported by self liquidity. The system's outlook is stable. The Aa1 rating reflects the university's established market position as the public university system for the Aaa-rated state of Missouri, with a history of positive operations, and growing financial resources.

SUMMARY RATING RATIONALE:

The system's Aa1 rating and stable outlook reflect its importance in providing educational and health services in the Aaa-rated State of Missouri, with four campuses located throughout the state. The system is well managed with consistently positive operations, diverse revenues, and growing financial resources, which provide adequate coverage of operations and debt, but limited additional capacity at this rating level. The rating also incorporates recent volatility in state funding and the likely tempering of enrollment growth given projections for declining in-state high school graduates. The system's short-term ratings (P-1 on the commercial paper program and Aa1/ VMIG 1 rating on the variable-rate demand bonds) reflect the system's ample daily liquidity coverage in its self-liquidity program.

STRENGTHS

*The university's strong market position as a large public university system serving the Aaa-rated State of Missouri, is reflected in its increased ability to attract students from a broad geographic area (29% enrollment from outside of Missouri in fall 2013), growing net tuition per student and overall enrollment growth each of the past five years.

*Growing resources and flexible reserves ($1.8 billion of monthly liquidity) are particularly important given the university's rapidly increasing debt, self-liquidity supported variable-rate demand bonds, healthcare exposure (29% of operating revenue), and a research profile that consists largely of federal funding.

* Prudent fiscal management with a focus on cost containment enabled the university to continue to produce consistently positive operations (5.5% operating margin in FY 13) despite declining state appropriations.

*A well diversified revenue base helps insulate the university from sharp declines in any one revenue source.

CHALLENGES

*The university has limited additional debt capacity beyond the $350 million total contemplated for the next three years. Debt has grown faster than financial resources over the last five years, resulting in a more leveraged balance sheet; expendable financial resources of $1.8 billion cover pro-forma debt just one time (with $375 million of fully authorized commercial

paper).

*The university's exposure to the potentially more volatile health care market is expected to grow as the health care enterprise seeks to expand collaborations to ensure statewide coverage. The university manages a complex health care system including multiple hospitals, clinic affiliations and a large faculty practice plan of over 500 employees.

*In the future, the ability to grow enrollment at the pace of the last decade will depend upon recruitment out of state students from an already highly competitive Midwest market. Demographic projections show a decline in high school graduates in Missouri over the next several years.

*The university's growing pension liability (Moody's adjusted net pension liability of $2.2 billion for FY 2013) adds additional risk, but is mitigated by a proactive plan to manage and contain the liability

DETAILED CREDIT DISCUSSION:

USE OF PROCEEDS: The proceeds from the Series 2013 A and B bonds will be used to pay a portion of the costs of multiple projects across the system's four campuses and to pay the costs of issuance of the Series 2013 Bonds. A portion of the proceeds may also be used to refund certain maturities of outstanding bonds depending on market conditions.

LEGAL SECURITY: The System Facilities Revenue Bonds are secured by a first lien on System Revenues, which includes gross income from auxiliary activities as well as from the Health System, and various mandatory student fees, including a portion of Tuition and Fees equal to maximum annual debt service on System Facilities Revenue Bonds. In FY 2013, System Revenues pledged to bondholders were $1.07 billion.

DEBT STRUCTURE: The Series 2013 bonds will be fixed rate bonds with a final maturity of up to forty years. With this issuance, the university will have approximately 18% of variable rate demand debt, including $100.3 million of Series 2007B bonds and $177 million of commercial paper, both backed by self-liquidity.

DEBT-RELATED DERIVATIVES: The system has three debt related interest rate swap agreements. Two of the swaps are with JPMorgan Chase and have a combined notional amount of $141 million. The market valuation of these two swaps as of June 30, 2013 was negative $31 million to the system. The system must post collateral to the swap counterparty if the combined valuation of the swaps exceeds a threshold of negative $30 million. In addition, the system acquired a floating to fixed rate swap agreement on the notional amount of $51.57 million with Bank of America Merrill Lynch when it purchased a residential facility near the University of Missouri at Kansas City campus in March 2012. The market valuation on that swap as of June 30, 2013 was negative $8.5 million. For this swap, the counterparty is required to post collateral with the university if the market value calculated on each valuation date exceeds a ratings-dependent threshold. The university is not required to post collateral with the swap counterparty. Given the system's strong financial reserves, this level of swap exposure is manageable and any risks associated with the swaps are incorporated into the system's Aa1 long-term rating.

MARKET POSITION: LARGE MULTI-CAMPUS PUBLIC UNIVERSITY SYSTEM WITH SIZEABLE HEALTH CARE OPERATION

The system has a strong fundamental market position as a large multi-campus public university system serving as both the flagship and land grant mission for the State of Missouri (State G.O. rating is Aaa). The four campuses include Columbia (which enrolls approximately 45% of headcount enrollment and conducts the largest amount of research activity), Kansas City, St. Louis, and the Missouri Science and Technology campus (formerly Rolla). In addition to educating over 58,163 full-time equivalent (FTE) students (75,272 headcount) across its four campuses in fall 2013, the system is engaged in research and economic development, as well as the provision of health care services for the state. The system enrolls a large undergraduate student body (nearly 80% of enrollment), offers graduate and professional degrees, and also operates a statewide cooperative extension program located in each county in the state.

After a decade of considerable growth, we expect enrollment growth at the system to slow given flattening in-state high school student demographics. In fall 2013, 77% of freshman students were drawn from the state of Missouri. All but the St. Louis campus experienced modest enrollment growth in fall 2013. St. Louis faces the highest level of competition as a largely commuter school with several local private institutions in the city. Over the next four years, management is targeting approximately 3% annual growth through increases in out-of-state recruitment, strengthening articulation agreements with community colleges and a focus on initiatives to improve retention and recruitment of low-income and minority students. Demand across the system remains fairly strong given the system's mixed profile of local, regional and flagship campuses. In fall 2013, the system accepted approximately 76% of freshmen applicants and, of those accepted, 33% chose to enroll. The system also accepts a large number of transfer students annually.

The university's Health Care enterprise continues to grow in reputation and scope throughout its primary seven county service area and secondary 18-county service area. In addition to a 505 physician faculty practice plan, the major health care entities include University Hospital and Clinics, Women and Children's Hospital, the Ellis Fischel Cancer Center, Missouri Rehabilitation Center, and Missouri Psychiatric Center. Further, the Medical Alliance, a not-for-profit health care delivery system, has affiliations with other medical facilities, including Capital Region Medical Center (rated A3/stable) as a sole corporate member, and is a component unit of the university, although not included in the system financial ratios included in this report. In total, the health system has 545 staff beds, with 24,028 inpatient admissions in FY 2013, up from 22,203 in FY 2012. The university reports that it gained 3% market share over its main competitor, Boone Hospital Center (a part of BJC Health System, rated Aa2 stable) in FY 2013.

The system has a well diversified, but limited research base relative to other public university systems, with $206 million of research expenses in FY 2013. That amount is down slightly from the peak of $219.9 in FY 2011 and is expected to remain flat to slightly contracted as competition for federal grants increases. The bulk of federally sponsored research activity is concentrated at UM-Columbia, which is a member of the Association of American Universities (AAU).

OPERATING PERFORMANCE: CONTINUED POSITIVE OPERATIONS THROUGH EXPENSE MANAGEMENT, ENROLLMENT GROWTH AND STRONG HEALTH CARE MARGINS

We expect that the system, on a consolidated basis, will continue to generate healthy operating performance and strong debt service coverage based on its history of conservative fiscal management and planned efforts to increase operating efficiency through consolidation of administrative services. In FY 2013, the system achieved a 5.5% operating margin, with 14.4% operating cash flow on a consolidated basis covering annual debt service 5 times (4.5 times coverage when adding back the Build America Bond Federal interest subsidy). The system's revenue base is diversified, with 35% from student charges, 29% from health-care related activities, 15% from state funding, and 11% from grants and contracts (excluding Pell grants). The system is in the process of reducing its endowment spend rate from 5% to a more conservative 4.5% over the next several years.

We expect University of Missouri Health Care to continue to contribute to the university's positive operations due to recent expansion of market share with the opening of the new hospital tower and cancer center, and rigorous cost management and dedication to performance improvement. The operations of the health system operation and a 505 physician faculty practice plan are consolidated within the system's audited financial statements. All debt issued on behalf of the health system is issued as System Facilities Revenue Bonds. Health system related revenue represents 29% of university-wide operating revenue in FY 2013. Medicare represented 34.3% of patient service revenue, while Medicaid was 25% in FY 2013.

The system continues to focus on expense containment and operational efficiencies in response to longer term pressure on state operating support. After several years of cuts and flat appropriations, the system received a 4.9% increase to state operating support for FY 2014. The funding includes $12.5 million for performance based funding, $10 million for expansion of the medical school class and operations, and $14.4 million of appropriations restricted for special programs. The university is allocating this additional funding to each of the campuses in accordance with their strategic priorities. For FY 2013, state appropriations were relatively flat (0.8% increase). Future increases on state appropriations will be dependent upon Missouri's revenues, which to date, has been positive, but lackluster. For more information on the state's credit profile, please refer to our last report published on September 23, 2013.

With the increase in state appropriations, the state mandated that the university cap tuition increases at approximately the rate of inflation for resident undergraduate students. The state's control over tuition setting is a credit challenge for the university as limits the university's ability to grow net tuition revenue in the face of likely slowed enrollment growth. Net tuition per student has grown at a healthy average pace of 4.4% over the last five years, despite flat tuition increases in FYs 2009 and 2010, pointing to strong fiscal management. Due to the tuition increase cap for undergraduate resident students, future net tuition per student growth will be dependent upon the university's ability to recruit out of state students.

BALANCE SHEET POSITION: DEBT INCREASED SIGNIFICANTLY WITH ACCELERATED PACE OF CAPITAL INVESTMENT; GROWING PENSION LIABILITY OFFSET BY STRATEGIC MANAGEMENT

The system's $2.65 billion of total financial resources in FY 2013 provide adequate support for near-term debt plans and operations, but limited additional capacity absent strong resource growth. Including the fully authorized commercial paper amount, the system will have $1.78 billion of debt (including up to $200 million of new debt issuance for the Series 2013 A&B bonds), although management does not anticipate using the full authorized CP amount in the near term. As of June 30, 2013, the system had approximately $177 million of CP outstanding). Expendable financial resources of $1.8 billion in FY 2013 cover pro-forma debt 1.21 times (including $177 million of CP) and operations 0.66 times, on par with the FY 2012 median for Aa-rated public universities of 1.04 times coverage of debt and 0.55 times coverage of operations. The system does not have a separate fundraising foundation and all assets are held at the system, providing additional financial flexibility. Fundraising across the system remains healthy, with the various campuses undertaking individual efforts.

The system's long-term investment pool experienced a 12.6% investment return in FY 2013, with an asset allocation of approximately 57% in long-only equities, 19.4% fixed income instruments, 22.7% in alternatives (private equity, hedge funds, and real estate) and 1.2% in cash. In addition to the endowment, the system has a sizeable short-term cash pool, with a large amount managed in house to meet operating needs and liquidity for outstanding variable-rate debt. As of June 30, 2013, the system reports $1.8 billion of unrestricted cash and investments which could be liquidated within a one month timeframe. This liquidity would cover nearly 260 days cash expenses and cover pro-forma demand debt (including full authorization of CP) approximately 3.7 times.

The university has growing liability for its defined benefit, single employer plan that is partially mitigated by the system's closure of the plan to new participants as of October 2012 and the introduction of a hybrid plan at that time. While it is unusual for a public university to have a single employer plan, it does provide them more flexibility to reduce future liabilities. For example, beginning in FY 2010, employees were required to make contributions to the pension plan in order to help cover future increases in the system's required contributions to the plan. The Moody's adjusted net liability grew to $2.2 billion in FY 2012 (using a 4.13% adjusted discount rate) from $1.1 billion in FY 2011.

The system's actuarial accrued liability of its other post-retirement benefit liability (OPEB) was assessed at $543 million as of July 1, 2011, with just $48 million in actuarial value of assets (8.4% funded). The FY 2013 assessment is in progress and expected to be announced later this year. The OPEB liability currently carries less risk than the pension plan since the system has no obligation to make contributions in advance of when insurance premiums or claims are due for payment and currently funds postemployment benefits at a level no less than the pay-as-you-go basis.

The university currently has approximately $177 million outstanding on its commercial paper program, which it has used to fund various projects and purchases. There are no immediate plans to issue more commercial paper.

In addition, the university has potential capital planning needs of up to $150 million over the next two to three years for a variety of projects across the four campuses, including $35 million for an ambulatory facility. Funding for these projects will come largely through donations, facility revenues, and new debt.

GOVERNANCE AND MANAGEMENT: STRONG MANAGEMENT TEAM WITH GOOD PLANNING AND COST CONTROL

The system's strong senior management team with in-depth strategic planning, careful budgeting and financial management is essential to the successful oversight of a complex and diverse multi-campus system with a large university health system and a statewide cooperative extension service with centers in almost all of Missouri's 114 counties. The university is governed by the Board of Curators of the University of Missouri, a nine-member board that is appointed by the Governor and representative of the eight congressional districts of the state.

The university recently completed an in-depth strategic planning initiative that tied priorities at each campus to financial goals and objectives. The system president announced that all increases to state funding will be directed to those strategic initiatives. Because the system has focused more on cost containment measures over the last several years, rather than expenditure cuts, we expect that it may have more operating efficiency to gain than peers in the next few years.

SHORT-TERM RATING: VARIABLE-RATE DEMAND BONDS AND NEW COMMERCIAL PAPER PROGRAM SUPPORTED BY THE SYSTEM'S OWN LIQUIDITY

Moody's maintains an Aa1/VMIG1 rating on the system's variable rate demand bonds ($100.33 million currently outstanding and in weekly mode) and a P-1 rating to the system's commercial paper program. The tender feature of the bonds and CP are not supported by any bank liquidity facility. Rather, the system maintains a self-liquidity program and would cover the purchase price of any unremarketed bonds or CP with its own liquid assets.

In January 2012, the university established the commercial paper program with authorization for up to $375 million to provide a flexible tool for interim financing of capital projects as well as general working capital needs. The university currently has approximately $177 million outstanding in commercial paper and anticipates having a maximum amount of $200 million outstanding at any point over the next 12-18 months and the maximum amount of CP that can mature within 5 business days is $100 million, with the limitation defined in the Issuing and Paying Agent Agreement.

As of September 30, 2013, the system had $699 million of discounted daily liquidity which could be used to purchase unremarketed bonds (providing a healthy 3.5 times coverage of variable-rate demand bonds). This daily liquidity is largely comprised of U.S. Treasuries and Agency Securities, which are managed in-house, 2a-7 compliant money market funds, and a small amount of repurchase agreements, all of which could be liquidated on a same-day basis. Aside from its self-liquidity supported variable-rate demand bonds and the commercial paper program, the system does not have any other variable rate debt.

OUTLOOK

The stable outlook reflects our expectation that the University of Missouri System will continue to grow financial resources to offset the expectations of near-term additional debt, and that it will continue to produce positive operations through careful fiscal management and strategic enrollment initiatives.

WHAT COULD MAKE THE RATING GO UP

Positive rating action would likely result from significant growth of the system's financial resource base, especially relative to debt, and continued improvement of market position through enrollment and research growth.

WHAT COULD MAKE THE RATING GO DOWN

A material decline of financial resource coverage of debt, sustained weakening of student demand, or deterioration of the state's rating or support for the system could pressure the rating.

KEY INDICATORS (FY 2013 financial data, fall 2013 enrollment data)

Full-Time Equivalent Enrollment: 58,163 students

Primary Selectivity: 79.7%

Primary Matriculation: 38.6%

Net Tuition per Student: $10,211

Educational Expenses per Student: $24,252

Average Gifts per Student: $1,951

Total Expendable Financial Resources: $1.79 billion

Total Cash and Investments: $3.0 billion

Total Pro-Forma Direct Debt: $1.58 billion ($1.78 billion with CP at full authorization)

Total Pro-Forma Comprehensive Debt*: $2.23 billion

Expendable Financial Resources to Pro-Forma Direct Debt: 1.13 times (1 time with CP at full authorization)

Expendable Financial Resources to Operations: 0.66 times

Monthly Days Cash on Hand: 259 times

Monthly Liquidity to Demand Debt: 645% (377% with CP at full authorization)

Operating Revenue: $2.88 billion

Operating Cash Flow Margin: 14.4%

Three-Year Average Debt Service Coverage: 4.65 times (4.2 times when adding back Build America Bonds federal interest subsidy)

Reliance on Tuition & Auxiliary Fee Revenue (% of Moody's Adjusted Operating Revenue): 34.9%

Reliance on State Appropriation Revenue (% of Moody's Adjusted Operating Revenue): 29.5%

State of Missouri Issuer Rating: Aaa, stable outlook

* Comprehensive Debt includes direct debt, operating leases, and pension obligation, if applicable.

RATED DEBT

System Facilities Revenue Bonds: 2003B, 2006A, 2007A, 2009A (Build America Bonds), 2009B, 2010A (Build America Bonds), 2011, 2012A, 2013A and 2013B: Aa1

System Facilities Revenue Bonds: 2007B: Aa1/VMIG1 (self liquidity)

Commercial Paper Notes Series A and Series B: P-1

RATING METHODOLOGY:

The principal methodology used in this rating was U.S. Not-for-Profit Private and Public Higher Education published in August 2011. An additional methodology used in the short term rating was Rating Methodology for Municipal Bonds and Commercial Paper Supported by a Borrower's Self-Liquidity published in January 2012. Please see the Credit Policy page on www.moodys.com for a copy of these methodologies.

REGULATORY DISCLOSURES

For ratings issued on a program, series or category/class of debt, this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the rating action on the support provider and in relation to each particular rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

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