

Rating Action: Moody's downgrades University of New Mexico (NM) bonds to Aa3; outlook stable

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New York, November 14, 2018 -- Moody's Investors Service has downgraded the underlying ratings on the University of New Mexico, NM's revenue bonds to Aa3 from Aa2 and affirmed the VMIG 1 ratings on the university's variable rate bonds backed by standby bond purchase agreements. The bonds were issued by the Board of Regents of the University of New Mexico. Total rated debt is approximately \$406 million, including \$69 million of variable rate bonds. The outlook is revised to stable from negative.

RATINGS RATIONALE

The downgrade to Aa3 is driven by the university's narrow prospects to significantly improve modest operating performance and thin reserves across both its academic and health care enterprises. In addition, growth in state operating support from the State of New Mexico, whose general obligation bond rating was downgraded to Aa2 stable on June 18, 2018, will be muted due to spending pressures from rising Medicaid needs, an economy that generally lags national averages, and high reliance on volatile oil and gas revenue.

The Aa3 rating reflects UNM's essential role as the state's flagship public university and major healthcare service provider, with a large \$2.4 billion scope of operations. UNM also has a modest debt burden and good debt service coverage due to historically healthy state capital support. Offsetting challenges include a sizeable 51% revenue exposure to a highly competitive healthcare market, lagging enrollment influenced by a price sensitive student population, modest reserves relative to expenses, and an elevated underfunded pension liability.

The Aa3/VMIG 1 rating on the variable rate bonds are based on the structure of the standby bond purchase agreements, short-term rating of the liquidity facility bank, and UNM's long-term rating.

RATING OUTLOOK

The stable outlook reflects our expectations that the university will maintain steady, though modest, operating performance with good debt service coverage. The stable outlook additionally incorporates UNM's expected adeptness in rebalancing operations across both academic and healthcare enterprises given healthcare funding and enrollment challenges.

FACTORS THAT COULD LEAD TO AN UPGRADE

- Substantial increase in financial reserves and liquidity
- Sustained increase in operating performance and cash flow generation
- Sustained growth of net tuition revenue and research activity

FACTORS THAT COULD LEAD TO A DOWNGRADE

- Sustained deterioration of operating performance at the university or healthcare enterprises
- Discontinuation of the mill levy supporting the hospitals
- Material weakening of state's credit quality
- Continued erosion of liquidity

LEGAL SECURITY

UNM's rated bonds are payable from a 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 the Series 1992A bonds, outstanding in the amount of \$7.1 million, and is closed. For fiscal 2017, the university had approximately \$514 million of pledged revenues available for total debt service. Fiscal 2017 coverage for the senior lien bonds' \$2.9 million of annual debt service is a very strong 177x.

The subordinate bonds, with \$399 million outstanding at June 30, 2018, are further secured by a debt service reserve fund, sum sufficient rate covenant, and additional bonds test of at least 1.75x coverage of pro-forma peak debt service coverage. Fiscal 2017 coverage for the subordinate lien bonds' \$32 million of annual debt service was roughly 16x.

The university's hospital revenue bonds are not rated, and are secured solely by hospital revenue and the mortgage insurance from the Federal Housing Administration's (FHA) Section 242 mortgage insurance program, with no recourse to the revenue streams supporting debt service on the university's senior and subordinate revenue bonds.

PROFILE

The University of New Mexico is the flagship public higher education institution for the State of New Mexico, and includes the University of New Mexico Hospital and consolidated operations of the UNM Health Sciences Center. Associated with UNM are four Branch Community College campuses - Gallup, Los Alamos, Taos and Valencia. In fiscal 2017, the university recorded operating revenue (Moody's adjusted) of \$2.4 billion and for fall 2018, enrolled 20,245 full-time equivalent (FTE) students.

METHODOLOGY

The principal methodology used in the long-term ratings was Higher Education published in December 2017. The principal methodology used in the short-term ratings was Variable Rate Instruments Supported by Conditional Liquidity Facilities published in March 2017. Please see the Rating Methodologies page on www.moodys.com for a copy of these methodologies.

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