**University of New Mexico, NM**

New Issue - Moody's Assigns Aa2 to University of New Mexico's Subordinate Lien System Series 2017; Outlook Negative

**Summary Rating Rationale**

Moody's Investors Service has assigned a Aa2 rating to UNM's proposed $46.4 million of Subordinate Lien System Improvement Revenue Bonds, Series 2017 to be issued by the Board of Regents of the University of New Mexico (final maturity in 2046). The outlook is negative. We maintain Aa2 and Aa2/VMIG 1 ratings on approximately $365 million of outstanding debt.

University of New Mexico's Aa2 rating reflects the university's essential role as the state's flagship public university and major healthcare service provider, its diverse revenue and large scope of operations. UNM also has a modest debt burden due to historically healthy state capital support, and good debt service coverage. Meaningful exposure to state funding through a variety of sources combined with a weakening state economy, highly competitive health care market with the departure of major commercial insurers, as well as a large pension liability, and thin liquidity are key credit challenges.

Exhibit 1

UNM Has Moderate Leverage Due to Historically Strong State Capital Support

Source: Moody's Investors Service
Credit Strengths

» Highly essential role as one of the largest employers and major research and economic development engine in New Mexico, as well as in Albuquerque and Bernalillo County

» UNMH serves a critical role, both as a safety net provider and the state’s only Level 1 Trauma Center, with mill levy support from the county supporting fiscal stability

» Strong matriculation rate of 40% with state lottery scholarships supporting high in-state demand

» Manageable direct debt burden with limited additional debt plans and regular principal amortizations resulting in a low 30% debt to revenue

» Strong contingency planning; and UNMH is well positioned for potential changes to the Affordable Care Act

Credit Challenges

» Weakening economy in New Mexico will continue to pressure UNM’s state operating support, Medicaid reimbursements, as well as impact students and patients

» Weak cash flow margins in the 6-8% range, and challenge of managing expenses in the face of lower appropriations and discontinued mill levy from Sandoval County

» Thin unrestricted liquidity, with only 67 days monthly cash

» Substantial and growing pension liability, with rising pension contributions mandated by the state eroding appropriations for operations

Rating Outlook

The negative outlook reflects our expectation of increased pressure on university operating performance from FY 2017 and likely FY 2018 funding reductions for operating support and Medicaid, as the state copes with revenue shortfalls and resulting budget gaps from weaker than anticipated tax revenue.

Factors that Could Lead to an Upgrade

» Ability to absorb state funding cuts leading to consistently stronger cash flow generation

» Substantial increase in balance sheet reserves and liquidity

» Sustained growth of net tuition revenue and research activity

Factors that Could Lead to a Downgrade

» Further deterioration of state's credit fundamentals, with repeated budget cuts

» Discontinuation of the mill levy supporting UNMH

» Inability to produce stable operating cash flow

» Continued erosion of liquidity

» Sustained and deep enrollment declines with trend of contracting net tuition revenue

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moodys.com for the most updated credit rating action information and rating history.
Key Indicators

Exhibit 2

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<tr>
<td>Total FTE Enrollment</td>
<td>23,480</td>
<td>23,617</td>
<td>23,154</td>
<td>23,068</td>
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<td>Operating Revenue ($000)</td>
<td>1,711,538</td>
<td>1,800,670</td>
<td>1,856,295</td>
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<td>Annual Change in Operating Revenue (%)</td>
<td>-2.0</td>
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<td>Total Cash &amp; Investments ($000)</td>
<td>1,019,410</td>
<td>1,009,639</td>
<td>1,093,670</td>
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<td>Total Debt ($000)</td>
<td>737,378</td>
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<td>700,060</td>
<td>614,472</td>
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<td>Spendable Cash &amp; Investments to Total Debt (x)</td>
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<td>Monthly Days Cash on Hand (x)</td>
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<td>67</td>
<td>94</td>
<td>75</td>
<td>67</td>
<td>67</td>
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<td>Operating Cash Flow Margin (%)</td>
<td>7.8</td>
<td>5.7</td>
<td>6.0</td>
<td>7.2</td>
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<td>Total Debt to Cash Flow (x)</td>
<td>5.6</td>
<td>7.0</td>
<td>6.3</td>
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<td>Annual Debt Service Coverage (x)</td>
<td>3.6</td>
<td>2.8</td>
<td>3.0</td>
<td>3.7</td>
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Fiscal Year End June 30, Fall Enrollment Numbers. The Series 2017 sensitivity includes $46 million of Series 2017 bonds. Pro forma annual debt service coverage uses FY 2016 operating cash flow and FY 2018 debt service (first year incorporating Series 2017 debt service).

Source: Moody's Investors Service

Detailed Rating Considerations

Market Profile: Dominant Higher Education Provider and Sole Academic Medical Center in State

University of New Mexico will continue to demonstrate solid student demand for its undergraduate and graduate programs as the state’s flagship university. UNM’s integral role as dominant higher education provider, research and economic hub, and sole academic medical center in the Aa1-rated State of New Mexico, Aa1-rated City of Albuquerque and Aaa-rated County of Bernalillo provide the backbone for its very good strategic positioning and stable long-term demand. Overall enrollment is relatively stable at 22,855 full-time equivalents (down -0.9% in Fall 2016), comprised of undergraduate, graduate and professional students, as well as some modest growth in on-line programming. Enrollment will remain generally stable with some potential modest declines due to flat demographics for graduating high school students over the next several years and a softening state economy. UNM has very high reliance on in-state students (over 80% of incoming freshmen).

Further strengthening resident enrollment is the state’s Lottery Tuition Fund providing scholarships to New Mexico high school graduates attending a state public college or university, including University of New Mexico, for seven semesters. Each year, the university has between 7,000 - 8,000 scholarship recipients, representing a material segment of its student population. The lottery scholarship is in place until FY 2018, and any cuts to the program would be credit negative for UNM.

The University of New Mexico Hospital (UNMH), a 537-bed facility in Albuquerque plays an essential role in providing health care within the state. It is the state’s only Level 1 trauma center for children and adults and a key provider of indigent care as Bernalillo County’s public hospital. Albuquerque is a highly competitive healthcare market, with flagship facilities for three systems within two miles of each other in the downtown section. UNMH’s primary service area includes Bernalillo and Valencia counties, as well as portions of Sandoval, Torrance, and Santa Fe counties.

While UNMH only holds about a quarter of the total Albuquerque market share, it is the primary Medicaid and indigent care provider and only partially competes for commercial patients. While this contributes to some market share stability it also adds operating risk and vulnerability to Medicaid reimbursement changes. Following implementation of the Affordable Care Act and the state’s expansion of Medicaid eligibility, UNMH’s role as an essential provider to Medicaid patients has grown. Over the last three years, the hospital’s payor mix has changed significantly with Medicaid exposure reaching a very high 43% in FY 2016 due to Medicaid expansion in New Mexico. The initial positive impact of expansion has begun to recede, especially with the state’s Medicaid cuts in FYs 2016 and 2017.

In addition to the UNM Hospitals, UNM has two other clinical healthcare entities which we include in its operations, the UNM Medical Group (UNMMG) and the Sandoval Regional Medical Center (SRMC). SRMC opened in FY 2014 in Rio Rancho, an area with a more...
favorable payor mix than the one UNM Hospitals serves. SRMC’s operating performance continues to improve modestly. The UNMMG is a faculty practice plan that practices at UNM Hospitals and, to a lesser extent, at SRMC.

The university’s research enterprise is relatively smaller than other flagship universities at $181 million of research expenditures in FY 2016, but has experienced slow funding growth due to diversified funding sources and niche programming. Primary cluster areas for research include quantum physics and new manufacturing initiatives. Federal funding represents approximately half of overall funding, with the remainder coming through state, local and private sources. At this time there are no anticipated cuts to state, local or federal research funding.

Operating Performance: Pressures on Cash Flow with State Funding Cuts
Sustained fiscal pressures at the state are a key credit risk for University of New Mexico given already weak cash flow relative to peers, and potential for the state economy to directly and indirectly impact most lines of UNM’s business. We project that state funding cuts to both the university and UNMH and other reimbursement pressures at UNMH will contribute to weaker than usual cash flow in the 5-6% range, with a slight operating deficit in FY 2017. Both the university and UNMH have identified one-time and recurring cuts to balance operations, and the university may use a small amount (up to $6 million) of reserves to handle the appropriation cuts. Debt service coverage will remain solid at above 2.0 times due to the university’s low leverage. The university has some pricing flexibility with relatively low net tuition per student of $8,075 and solid demand.

State funding was cut by 5% in FY 2017, following a 0.6% cut to base appropriations in FY 2016, and is likely to remain flat at best for FY 2018. Although state appropriations represent only 15% of total operating revenue in FY 2016 and total cuts to operating support and Medicaid represent less than $35 million of lost revenue for FY 2017, the university and hospitals receive state and county funding in a variety of other ways. These include: direct state grants for research ($36 million); state lottery scholarships ($34 million included in net tuition revenue); Medicaid reimbursement for patient care (47% of $868 million of net patient revenue) and state land grant fund revenue ($9.9 million). These multiple exposures add operating vulnerability should the state sustain a prolonged economic downturn.

Operating performance at all healthcare divisions, including the hospitals, UNMH and SRMC, represent about 41% of consolidated university revenue, and is a key driver of overall operating performance. The healthcare divisions broke even, with a very modest surplus in FY 2016 despite state cuts to Medicaid disproportionate share payments (DSH) and rates to Medicaid managed care companies. FY 2017 will be challenging for UNMH and SRMC with a 5% cut to state inpatient Medicaid fee-for-service payments and 3% cut to outpatient Medicaid reimbursements (an expected $10 million revenue decline). The largest Medicaid contractor also reduced its reimbursements by $24 million in FY 2017, adding additional pressure to cashflow. The healthcare team continues to focus on expense reduction and revenue cycle improvements and expects to break even in FY 2017. Through November 30, 2016 UNMH was managing with a thinly positive bottom line, due to a modest increase in patient days and Case Mix Index (1.962).

UNMH continues to benefit from a mill levy from Bernalillo County which represented about $97 million in FY 2016 and greatly bolsters healthcare operations. The SRMC approximately $6.2 million annual mill levy was not renewed by Sandoval County in the November 2016 elections, but management is meeting with the County to understand what might be the opportunity for mill levy tax support for identified programs into the future. The soonest the mill levy could be put on the ballot would be 2018. Due to the smaller size, SRMC’s mill levy is not a primary driver of its operations.

Wealth and Liquidity: Adequate Coverage of Debt, but Thin Liquidity
Still generous state operating and capital support from the State of New Mexico help mitigate the university’s low liquidity position relative to peers. Total cash and investments of over $1.2 billion as of FYE 2016 (including foundation investments), covers pro-forma debt by a solid 1.8 times. Further growth is anticipated as the university pursues a $1 billion comprehensive capital campaign, with expected conclusion in FY 2020. The university has raised $868 million as of November 30, 2016, with $403 million received in cash.

The university has two public-private partnerships for housing facilities with American Campus Communities (ACC), that represent a meaningful 43% of UNM’s overall student housing. 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 portion of the university’s overall housing stock. Currently these facilities provide important and attractive housing for UNM’s undergraduate population. UNM is currently working with a developer to complete Innovate ABQ, a major economic development
initiative in downtown Albuquerque to be funded by UNM, the City of Albuquerque and Bernalillo County. Innovate ABQ is being developed as an innovation district for researchers, investors and entrepreneurs. The site will include approximately 310 housing units for upperclassmen and graduate students, which UNM plans to fund through a master lease with the developer.

**LIQUIDITY**

UNM’s thin liquidity is a key credit challenge given the university's recent weak cash flow. In FY 2016, the university had just 67 monthly days cash on a consolidated basis compared to the Aa2 median of 145. The university is expecting to use approximately $6 million of reserves in FY 2017, further straining its liquidity, as it identifies longer-term cuts to offset state appropriation cuts. Continued solid state support and the ability to request monthly appropriations in advance of regularly scheduled disbursements to support cash flow are important mitigants to the university’s weak liquidity. However, further deterioration of liquidity failure to sustain cash flow at least at historic levels will pressure the rating.

**Leverage**

Historic state capital support has also allowed the university to maintain a relatively low debt burden. Proforma debt to operating revenue is just 0.3 times, and we expect it to remain low with regular principal amortizations and revenue growth keeping pace with additional debt issuances. The university was approved for $27 million in capital funding this fiscal year through a state GO bond issuance for the interdisciplinary science building it is building with the proceeds from the Series 2017 bonds. State capital support has averaged about $25 million a year in FYs 2015 and 2016.

Substantial capital plans could shift UNM’s leverage position over the next several years, and credit impact will be evaluated as funding sources are clarified. The university's five-year capital plans call for approximately $235 million of capital expenditures across the main campus, Health Sciences Center and branch campuses, including the projects funded by the current bond issuance. At this point, these plans are manageable in the context of the university’s cash flow and capital plans. UNM had approximately $75 million of annual capital expenditures in FY 2016. Given state funding cuts, relatively weaker cash flow and thinner liquidity than peers, future debt capacity will depend upon the university’s ability to demonstrate strong expense containment, and ability to generate growth of operating cash flow to absorb additional debt service.

**DEBT STRUCTURE**

UNM’s debt structure is comprised of 88% fixed rate bonds, including debt of the hospital and a component unit of UNM. The variable rate debt, specifically the Series 2001, 2002B and 2002C, are backed by standby bond purchase agreements (SBPAs) provided by US Bank, N.A. that all expire on December 29, 2017. This debt structure carries additional risks as, under certain circumstances, the bank could require an acceleration of the bonds and terminate the agreements. However, UNM’s FY 2016 monthly liquidity of $363 million provides a healthy 4.6 times coverage of demand debt.

**DEBT-RELATED 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. The swaps are with RBC Capital Markets and JPMorgan and are conterminous with the maturity of the debt, with swap payments on parity with debt service payments. At the current rating level, the university must post collateral at a $20 million threshold but has not been required to do so. Requirement to post collateral would potentially further stress available UNM’s already thin liquidity. At December 31, 2016, the swap portfolio’s market valuation, including the swap overlays, was an $8 million liability for university.

**PENSIONS AND OPEB**

We expect UNM’s significant debt-like obligations through a large pension liability and other post-retirement health benefit (OPEB) liability to rise with FY 2016 pension reporting, given weak investment returns. Contributions for the multiple employer state-run pension plan are rising for the university and are paid by the state through state appropriations. Though the university currently alleviates significant operating risk, it will mean lower appropriations to cover general university operations if state appropriations continue to decline.

The over $2 billion three-year average Moody's adjusted net pension liability (ANPL, FYs 2013-2015) is substantial, but due to UNM’s relatively low debt burden, increases adjusted debt to operating revenue to just 1.2 times, below many peers. The state is expected to continue to fund contributions in the near term, and there is some positive pension reform being considered, which would shift
approximately 3.5% of contributions to employees from the employer, although the university notes that there are strong unions in New Mexico that could stymie this action. In 2014, UNM established a voluntary trust for its OPEB plan, with UNM matching employee contributions toward funding a trust for retirement health benefits. Contributions will hit 1% in FY 2017 and are expected to remain there. After 10 years, the university anticipates that it will be able to use the earnings from the trust to pay annual benefits.

**Governance and Management: Careful Implementation of New Initiatives and Integral Role in State Bolster Strategic Positioning; Presidential Transition at Critical Time**

UNM’s board and senior management’s careful budgetary oversight and integrated strategic planning help to offset some of the challenges of state funding cuts and growing exposure to more volatile health care revenue. The hospital and university are well integrated through the Health Sciences Center and that center’s separate board of directors. The university’s key strategic initiatives, including a new branding initiative and Innovate ABQ, capitalize on UNM’s unique and essential role within the state.

UNM’s president announced his resignation in December 2016, and will leave when his term is complete at the end of fiscal year 2017. While a presidential transition at this crucial period for managing through state funding cuts could be disruptive, the board acted quickly to appoint the provost as acting president to ensure continuity. A national search for president is underway.

**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 $11.6 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. For FY 2016, the university had approximately $414 million of net revenues available for debt service of $31.7 million, or 13.1 times coverage. Proforma coverage is expected to remain at or above 11 times for the next several years, including the Series 2017 bonds.

The university’s hospital revenue 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 $237 million in FY 2016 (including SRMC bonds).

**Use of Proceeds**

Proceeds from the Series 2017 bonds will be used as follows: 1) toward project costs associated with the renovation, constructing or equipping of several facilities on UNM’s campus including the Physics and Astronomy Interdisciplinary Sciences building, the Biology Annex, the Art Annex, the Student Health and Counseling Center, and Smith Plaza; 2) to acquire a reserve fund insurance policy to fund a debt service reserve fund for the bonds; and 3) to pay costs of issuance.

**Obligor Profile**

University of New Mexico is a large, comprehensive public research university located in Albuquerque with almost 23,000 students and over $2.1 billion in operating revenue. 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. The university operates several health care facilities, including the state’s only academic medical center.

**Methodology**

The principal methodology used in this rating was Global Higher Education published in November 2015. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.
Ratings

Exhibit 3

University of New Mexico, NM

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<td>Subordinate Lien System Improvement Revenue Bonds Series 2017</td>
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Source: Moody’s Investors Service
MJKK and MSFJ also maintain policies and procedures to address Japanese regulatory requirements. Ranging from JPY200,000 to approximately JPY350,000,000.

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