MOODY'S INVESTORS SERVICE

New Issue: MOODY'S ASSIGNS Aa2 RATING TO UNIVERSITY OF MASSACHUSETTS BUILDING AUTHORITY'S $567.6 MILLION OF SERIES 2010-1, 2010-2, AND 2010-3 REVENUE BONDS; OUTLOOK IS STABLE

Global Credit Research - 08 Oct 2010

UNIVERSITY OF MASSACHUSETTS WILL HAVE $1.1 BILLION OF DEBT WITH AN UNDERLYING RATING INCLUDING THE CURRENT OFFERING AND $2.4 BILLION OF TOTAL DEBT

University of Massachusetts Building Auth.
Higher Education
MA

Moody's Rating

ISSUE		RATING
Project Revenue Bonds, Series 2010-1		Aa2
Sale Amount	$126,335,000	
Expected Sale Date	10/21/10	
Rating Description	Public University Revenue Bonds	
Federally Taxable Project Revenue Bonds (Build America Bonds), Series 2010-2		Aa2
Sale Amount	$438,255,000	
Expected Sale Date	10/21/10	
Rating Description	Public University Revenue Bonds	
Federally Taxable Project Revenue Bonds, Series 2010-3		Aa2
Sale Amount	$3,020,000	
Expected Sale Date	10/21/10	
Rating Description	Public University Revenue Bonds	

Moody's Outlook Stable

Opinion

NEW YORK, Oct 8, 2010 -- Moody's Investors Service has assigned an Aa2 rating to the University of Massachusetts Building Authority's combined $567 million of fixed-rate Series 2010-1, 2010-2 (Federally Taxable Build America Bonds), and 2010-3 bonds (Federally Taxable). The bonds will be issued by the Authority on behalf of and payable from the University of Massachusetts (see Legal Security section below). The Building Authority is consolidated within the University's audited financial statements. The University's outlook remains stable. Moody's maintains an Aa2 underlying rating on $1.1 billion of the University's debt (see Rated Debt section below). Including the current offering, the University will have approximately $2.4 billion of debt outstanding.

RATINGS RATIONALE

USE OF PROCEEDS: Bond proceeds will be used to finance a variety of capital projects across all campuses. Some of the larger projects include an academic building on the Boston campus ($100 million), new student housing at Amherst ($182 million), infrastructure projects at Boston ($78 million), and a marine science building at Dartmouth ($48 million total project cost, $25 million of which will be financed with bond proceeds). Bond proceeds will also finance capitalized interest of approximately $22.3 million through May 2013, as well as costs of issuance.

LEGAL SECURITY: Under a Contract for Management and Services between the University and the University of Massachusetts Building Authority, the University is required to remit to the Authority annually an amount sufficient to pay debt service and other costs associated with operating and maintaining the financed projects during the next year. The annual certified amount shall be payable from a variety of revenue streams, including all legally available revenues and funds (including unrestricted net assets which are estimated to be $600.5 million in FY 2010 based on draft unaudited financial statements). The amounts remitted are derived from University available revenues, including state appropriations and auxiliary revenues associated with the financed projects but excluding other amounts such as revenues from sales and services and grants and contracts. The federal interest subsidy payment expected to be received by the Authority for the Series 2009-2 and 2010-2 Build America Bonds is not pledged to pay debt service on the bonds.

DEBT STRUCTURE AND DEBT-RELATED DERIVATIVES:

Including this borrowing, the University will have $2.4 billion of debt outstanding that has been issued in three forms: MHEFA issuance on behalf of the University; MHEFA issuance on behalf of the Worcester City Campus Corporation; and University of Massachusetts Building Authority issuance on behalf of the University.

Of the pro-forma debt outstanding, approximately 21% is in an underlying variable rate mode, including $20 million of Series 2000A long-mode put bonds which have a mandatory tender scheduled for April 1, 2013 which is backed by the University's own liquidity. Variable rate demand obligations totaling $485 million are secured by letters of credit (LOCs) or standby bond purchase agreements (SBPAs). Two LOCs in combination total $358 million ($221 million with Lloyd's TSB Bank, PLC; rated Aa3/P-1) and $137 million with Bank of America, N.A.; rated Aa3/P-1). Two SBPAs totaling $128 million are both with Bank of America, N.A. The liquidity and credit support agreements expire in 2011 and 2013. Under these agreements, bank bonds would be subject to repayment over a compressed time frame and an event of default could result in acceleration of the outstanding debt.

The University of Massachusetts Building Authority is party to three variable to fixed rate interest rate swap agreements with a current total notional amount of $484 million that are designed to hedge the interest rates of a portion of its variable rate debt. Under the agreements, the Authority pays a fixed rate and receives a variable rate from the counterparty that is based on a percentage of either one-month or three-month LIBOR. One swap for $237 million is with Citibank, N.A. (rated A1/P-1), a second swap for $221 million is with UBS AG (rated Aa3/P-1), and the third swap is for $26 million with Deutsche Bank AG (rated Aa3/P-1). Under the swaps, the Authority is not currently required to post collateral. The swap with Citibank is insured by Ambac, and the Authority would potentially be subject to collateral posting requirements if Ambac became insolvent . The counterparties can terminate the swaps if the Authority's long-term unsecured senior debt rating is withdrawn, suspended, or falls below Baa2 (or the equivalent from another credit rating agency). The combined market valuations of the swaps has swung further negative representing a nearly $90 million liability to the Authority as of August 31, 2010. Moody's has incorporated the risks associated with the swaps into the current rating.

STRENGTHS

*Large and growing enrollment of 55,740 full-time equivalent (FTE) students in fall 2009 and estimated 58,434 FTE in fall 2010, with a statewide presence through the System's five campuses as well as UMass Online and an important economic development role in Worcester and the Commonwealth.

*Strong annual operating performance as demonstrated by a three-year average operating margin of 3.3% and average debt service coverage of 3.1 times through Fiscal Year (FY) 2009. Based on draft FY 2010 financial statements, we expect that the University generated another surplus in FY 2010, including growth of net tuition revenue, ongoing focus on expense containment, and receipt of federal stimulus funding to supplant cuts in state funding.

*High degree of revenue diversity with no single revenue stream exceeding 30% of total revenues and reliance on Commonwealth appropriations for just 22% in FY 2009.

*Growth in financial resources in recent years, with total financial resources increasing 12% between FY 2005 and 2009, to $903 million and further growth of resources in FY 2010 as a result of improved investment performance (12.35% endowment return in FY 2010) and another year of healthy operating cash flow (12% cash flow margin estimated for FY 2010 based on draft financials).

CHALLENGES

*Rapid growth in debt levels, with this $567 million of borrowing occurring much sooner than originally anticipated, as the University takes advantage of low interest rates and competitive construction costs. Including the Series 2010 bonds, the University's operating leverage will grow, with ratio of pro-forma debt to FY 2010 operating revenue increasing to 89%, and expendable financial resources to pro-forma debt declining to an estimated 0.4 times. The University's pro-forma debt of $2.4 billion represents a 235% increase over FY 2006 debt levels. We expect the pace of future borrowing will slow considerably.

*Vulnerability to reduced state appropriations and need to continue to focus on expense containment. In FY 2010, the University's state appropriations (Commonwealth carries a Aa1/stable G.O. rating) declined 21% (per the draft financial statements) but were largely backfilled with federal stimulus (ARRA) funding. In FY 2010, the University received $150.6 million of federal stimulus funds, with that amount expected to decline to $37.8 million in FY 2011.

*Although the Commonwealth is expected to provide increasing levels of capital support under the Higher Education Bond Bill which was passed in 2008, in recent years the University has received relatively low levels of state capital support, compared to some peer large public universities in the northeast. Annual capital appropriations averaged approximately $34 million between FY 2005 and 2010. Further, the University is in the midst of a significant amount of capital investment and will face the challenge of successfully managing a variety of large-scale projects at the same time.

*The University's fundraising is relatively low for the rating category and for its size. Gift revenue at the University's foundations was approximately $29 million in FY 2009. Improvement in philanthropy would be a positive credit factor, and we will continue to monitor the University's fundraising success especially during a period of presidential transition, with the current president stepping down at the end of FY 2011.

MARKET/COMPETITIVE STRATEGY: LARGE AND GROWING ENROLLMENT WITH STATEWIDE PRESENCE

The University of Massachusetts is the flagship public university for the Commonwealth (G.O. rating of Aa1 with a stable outlook). It comprises five campuses serving distinct populations located throughout the state as well as UMass Online, which offers individual courses and full degrees in certain fields. The University's broad position within the Commonwealth, status as a flagship system, and importance in the public higher education system of the Commonwealth provide a strong underpinning to its market position.

In fall 2009, total full-time equivalent (FTE) enrollment stood at 55,740, of which approximately 45% were enrolled at the flagship campus in Amherst. Enrollment growth has been steady in recent years, with an increase of 16% from the fall of 2005 to 2009. The University estimates 58,434 FTE enrolled in fall 2010, and projects further growth across the System, in particular at Amherst which attracts the largest proportion of out-of-state students. Undergraduates make up the majority of students, representing 80%, while graduate students make up the remainder, including 469 students at the Medical School on the Worcester campus.

Student demand remains healthy, with a sustained trend of increasing freshmen application volume allowing the University to become increasingly competitive. However, moderate pressure on the matriculation ratio (percent of accepted students who enroll) highlights a competitive student market, including a multitude of higher education institutions in the northeast and strong public university systems in the northeast states. An approximately 40% increase in undergraduate applications between fall 2005 and fall 2009 to 48,564 allowed the University to lower its selectivity ratio to 67% from 75%. Management estimates further improvement in fall 2010 selectivity, with the University accepting

65.8% of freshmen applicants in fall 2010. The matriculation ratio has declined from approximately 31% in fall 2006 to 25% in fall 2009.

Dependence on Massachusetts students, particularly at the undergraduate level where they account for 87% of first-year enrollment, is a vulnerability given the anticipated 9% decline in high school graduates in the state over the next decade. Net tuition and fees per student continues to rise; the $9,368 figure for FY 2009 was 14% higher than in 2005. We expect net tuition revenue increases to continue as the University grows across all campuses, including UMass Online, and raises tuition pricing. Although the Board approved a $1,500 fee increase in fall 2009, the University rebated $1,100 of the $1,500 back to students as a result of receipt of ARRA funding. Although fees for in-state students have not been increased for fall 2010, the University will not be providing the same rebate as in fall 2009, so we expect net tuition per student in FY 2011 to demonstrate healthy growth.

Research is an increasing focus for the University, and it has achieved success in expanding its research enterprise in recent years. In FY 2009, the University reported $489 million in research expenditures, an increase of 40% over FY 2005. The University has received ARRA funded grants and contracts totaling close to $112 million. The bulk of research expenditures are in the life sciences (55%), which activity is concentrated at the Amherst and Worcester campuses. Grants and contracts revenue (excluding Pell Grants) totaled $476 million in FY 2009, of which approximately 64% was from federal government sources, 21% from private sources, and 15% from the State. Federal grants and contracts are concentrated with the Department of Health and Human Services (48%), the Department of Education (17%), and the National Science Foundation (13%). The $400 million Albert Sherman Center at the Worcester campus, which is currently under construction, will double research capacity on that campus and add space for an additional 110 researchers. Licensing revenue has grown due to greater emphasis on the commercialization of research products. In FY 2009, the University reported $73 million in licensing revenue, including a $60 million upfront payment under an agreement from a pharmaceutical company that is expected to continue to produce royalties in future years.

In February 2010, the Board approved the establishment of the UMass School of Law at the Dartmouth campus, the first public law school in the Commonwealth. The school opened in fall 2010 and was established through the donation of assets from the Southern New England School of Law, an existing private law school. The law school is in the process of securing accreditation.

OPERATING PERFORMANCE: POSITIVE OPERATING PERFORMANCE, WITH ONGOING EXPENSE CONTAINMENT AND REVENUE DIVERSIFICATION TO OFFSET CUTS IN STATE FUNDING

The University has produced healthy operating performance in recent years, resulting in a three-year average operating margin of 3.3% through FY 2009. In FY 2009, operating cash flow margin of 10.6% generated debt service coverage of 2.5 times. With $548 million of new debt issued by the University of Massachusetts Building Authority in fall 2009 and this issuance of $567 million of debt, we expect debt service coverage to decline. Draft FY 2010 operating cash flow (unaudited) would cover pro-forma maximum annual debt service a thinner 1.8 times, although certain debt-financed projects (such as the student housing) should generate additional revenue in the future.

Revenue diversity is a positive credit factor for the University. In FY 2009, student charges (primarily fees and auxiliary revenues, as the University remits most tuition to the Commonwealth) represented 30% of operating revenues, while state appropriations accounted for 22%, grants and contracts revenue comprised 19%, and investment income was just 2%. Another 25% of revenues were from revenues associated with sales and services activity, chiefly services provided by Commonwealth Medicine, a public, non-profit consulting organization, and Massachusetts Biologic Laboratories, a public, non-profit FDA-licensed manufacturer of vaccines and other products. The University is affiliated with UMass Memorial Medical Center, at which its medical students are trained. Revenues from the Medical Center for services provided totaled $124 million in FY 2010 (per the draft financial statements). Moody's rates the debt of UMass Memorial Health System Baa1 with a stable outlook. For more information on the hospital's credit profile, please refer to our last report published on May 5, 2010.

State appropriations have been under pressure at the University as a result of the impact of the current recession on Commonwealth revenues. Annual state operating appropriations declined a steep 21% in FY 2010 (per the draft financial statements). However, the impact of these cuts was largely mitigated through the receipt of a significant amount of federal ARRA funding, with the University receiving nearly $151 million of ARRA funding in FY 2010. The University expects to receive $37.8 million of federal stimulus funding in FY 2011 as a well as an 11% increase in state appropriations (including retention of out-of-state student tuition for students at Amherst). In response to this reduction, the University has increased fees in fall 2009 and 2010, as described above. In addition, the University implemented a number of budget reductions, including elimination of positions (over $40 million of annual salary and benefit cost savings), consolidation of departments and services, furloughs, reduction of overtime, and freezing salaries for certain employees. We believe the actions taken by the University in response to reduced state funding display proactive management of a financial environment that has shifted over a short time period. Based on the FY 2011 budget, we expect operating performance to tighten in the current fiscal year, although we expect the University to maintain at least close to balanced operating performance in the near term.

Moody's currently rates the Commonwealth of Massachusetts' General Obligation Bonds Aa1 with a stable outlook (for last report on the Commonwealth, please read our report dated August 18, 2010). Credit strengths of the Commonwealth include effective management during economic downturns, adequate budget reserves, high wealth and educational attainment levels within the state, as well as some concentration of highly rated higher education and healthcare organizations in the Boston area which has provided some economic stability. These strengths are offset by credit challenges, which include ongoing management of expenditure pressures, persistence of high unemployment (although lower than national averages), low pension funding, and high debt levels.

Going forward, the University is looking to the sales and services activity, particularly from Commonwealth Medicine, as a growth opportunity. A division of the Medical School, this entity assists state agencies and other organizations to maximize health care reimbursement and improve access and delivery of health care to at-risk and uninsured populations. For FY 2009, revenue from Public Service Activities, which includes Commonwealth Medicine, was $507 million, an increase of about 40% from FY 2008 due in part to initial inclusion of a reorganized consulting entity in the University's financial statements. Total revenue from sales and service activity in FY 2009 was $623 million, and is estimated to have grown to $665 million in FY 2010. While we acknowledge the increased revenue generated from this activity to date, Moody's notes the potential volatility in this revenue source, especially relative to historically highly stable student charges and research funding. We believe management's ability to respond to future fluctuations in revenues will be critical to the rating.

BALANCE SHEET POSITION: SIGNIFICANT INCREASE IN DEBT RESULTING IN HIGH BALANCE SHEET AND OPERATING LEVERAGE; SLOWED PACE OF BORROWING ANTICIPATED

The University is in the midst of a period of significant capital investment to support recent enrollment growth trends as well as projections for further strong growth across all campuses. Pro-forma debt of $2.4 billion represents a 235% increase over FY 2006 debt. Although the University's balance sheet resources have grown during this timeframe, the pace of increase in debt has far exceeded total financial resources, which grew 43% between FY 2006 and 2010 (with an estimate of $1.1 billion of total financial resources in FY 2010). Further, the University's operating leverage has increased, with pro-forma debt representing 89% of estimated FY 2010 operating revenue and a high 100% of FY 2009 operating revenue. Future maximum annual debt service, including Series 2010, would represent 6.7% of FY 2010 operating expenses.

Given its level of financial resources and debt, the University's balance sheet is leveraged compared to its peers, with this $567 million of borrowing occurring much sooner than Moody's had originally anticipated, as the University takes advantage of low interest rates and competitive construction costs. We expect the pace of future borrowing to slow significantly with management projecting approximately $230 million of additional borrowing spread across FY 2011 and 2015. As of June 30, 2009, total financial resources were $903 million, a decrease of 7% from the peak of $966 million in FY 2007 due in particular to losses on investments managed by the University of Massachusetts Foundation in FY 2009. Expendable financial resources of $661 million in FY 2009 cushion pro-forma direct debt by 0.3 times and operations by 0.27 times. In comparison, the medians for Moody's portfolio of Aa2-rated public colleges and universities for FY 2009 were stronger at 1.05 times and 0.42 times, respectively.

The University's debt structure creates some additional risks to its financial position. Of the total $2.4 billion of outstanding direct debt, $485 million are variable rate debt bonds that carry credit or liquidity support. Two standby bond purchase agreements (SBPAs) from Bank of America, N.A. (rated Aa3/P-1) support unremarketed tenders of two debt series totaling $128 million and expire in 2011 and 2013. Two letters of credit (LOCs) support two bond series that total $358 million. The LOCs are with Bank of America, N.A. and Lloyds TSB Bank, PLC (rated Aa3/P-1) and expire in 2011 and 2013. The support agreements carry no financial covenants and ratings levels that would trigger an event of default are in the Baa-equivalent range. Nevertheless, the University would be required to pay bank bonds within a compressed time period (generally five years from the bank's purchase, rather than the scheduled maturity of the bonds) and certain events of default would allow for immediate termination and mandatory tender and/or acceleration of the bonds.

Investments are managed by the University of Massachusetts Foundation (both the long-term investments and the Intermediate Term Investment Fund, a separate fund created from surplus working capital) and the University (operating cash). After incurring investment losses in FY 2009, the endowment of the University and Foundation experienced a 12.35% positive investment return in FY 2010. As of June 30, 2010, the endowment had a market value of nearly $460 million and asset allocation of 28% in equities, 48% in cash and fixed income (including high yield), 21% in hedge funds, 2% in commodities, and 1% in private equity. In FY 2009 and 2010, the campuses invested in increasing fundraising staff levels. In Moody's opinion improvement in fundraising would be a positive credit factor, with approximately $29 million of gift revenue at the foundations in FY 2009, relatively low for the rating category and given the University's size.

Based on Moody's methodology for analyzing monthly liquidity and annual liquidity, the University held nearly $629 million in monthly liquidity and $667 million of liquidity available within one year. This liquidity profile translates into 100 "monthly days cash on hand" (days cash on hand from investments liquid within one month) and 106 "annual days cash on hand" (days cash on hand from investments liquid within one year). Annual liquidity covers demand debt (outstanding variable rate debt with a put feature) by 1.3 times.

Outlook

The stable outlook reflects an expectation of continued growth of enrollment and financial resources to better support increased debt levels. We also anticipate at least balanced operating performance as the University adjusts to the end of federal stimulus funding and potentially lower levels of state operating support going forward, as well as no additional borrowing expected in the next two years.

What could change the rating-UP

Substantial increase in financial resources over time and improved student market position coupled with improvement of the Commonwealth's credit profile

What could change the rating-DOWN

Significant deterioration in operating performance; weakening student enrollment; borrowing in excess of amounts currently planned; deterioration of the Commonwealth's credit profile

KEY INDICATORS (FY 2009 financial data and fall 2009 enrollment data; figures in parentheses represent draft unaudited FY 2010 data and fall 2010 enrollment estimates)

Total FTE Enrollment: 55,740 (58,434 FTE)

Pro-Forma Direct Debt: $2.4 billion

Expendable Financial Resources to Pro-Forma Direct Debt: 0.3 times (0.4 times)

Expendable Financial Resources to Operations: 0.27 times (0.34 times)

Monthly Liquidity: $629 million

Monthly Days Cash on Hand (unrestricted funds available within 1 month divided by operating expenses excluding depreciation, divided by 365 days): 100 days

Average Operating Margin: 3.3% (3.6%)

% of Revenues from State: 21.6%

Commonwealth Rating: Aa1, stable outlook

RATED DEBT

MHEFA, University of Massachusetts: Series A: Aa2

University of Massachusetts Building Authority:

Senior Series 2009-1, 2009-2, 2009-3, 2010-1, 2010-2, 2010-3: Aa2

Senior Series 2004-A: Baa1 rating based on insurance from National Public Finance Guarantee Corp, formerly MBIA (current financial strength rating is Baa1 with a developing outlook)

Senior Series 2008-2: Aa2 rating based on insurance from Assured Guaranty (formerly Financial Security Assurance, Inc; (current financial strength rating is Aa3 with a negative outlook)

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LAST RATING ACTION:

The last rating action with respect to University of Massachusetts was on March 24, 2010 when a municipal finance scale rating of Aa3 with a stable outlook was assigned. That rating was subsequently recalibrated to Aa2 with a stable outlook on May 7, 2010.

METHODOLOGY:

The principal methodology used in rating University of Massachusetts was Public College and Universities rating methodology published in November 2006. Other methodologies and factors that may have been considered in the process of rating this issuer can also be found on Moody's website.

REGULATORY DISCLOSURES

Information sources used to prepare the credit rating are the following: Parties involved in the ratings and public information.

Moody's Investors Service considers the quality of information available on the credit satisfactory for the purposes of assigning a credit rating.

MOODY'S adopts all necessary measures so that the information it uses in assigning a credit rating is of sufficient quality and from sources MOODY'S considers to be reliable including, when appropriate, independent third-party sources. However, MOODY'S is not an auditor and cannot in every instance independently verify or validate information received in the rating process.

Please see ratings tab on the issuer/entity page on Moodys.com for the last rating action and the rating history.

The date on which some Credit Ratings were first released goes back to a time before Moody's Investors Service's Credit Ratings were fully digitized and accurate data may not be available. Consequently, Moody's Investors Service provides a date that it believes is the most reliable and accurate based on the information that is available to it. Please see the ratings disclosure page on our website www.moodys.com for further information.

Please see the Credit Policy page on Moodys.com for the methodologies used in determining ratings, further information on the meaning of each rating category and the definition of default and recovery.

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