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CREDIT OPINION
13 October 2022

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University of Connecticut, CT

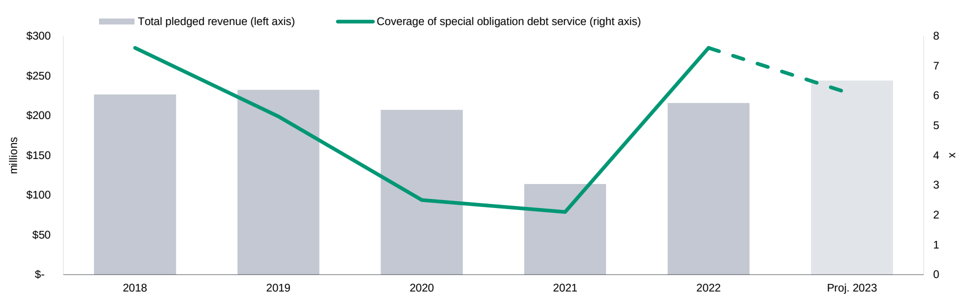
Update following upgrade on Special Obligation bonds to Aa3

Summary

The University of Connecticut's (UCONN; Aa3 stable) credit quality is supported by its excellent brand and strategic positioning, strong state financial support, and substantial wealth and scale. It maintains a regionally important role as a flagship land-grant university with favorable student demand, growing research activity, and comprehensive academic programming. Credit quality is aided by its strong ties to the State of Connecticut (Aa3 stable), which provides generous operating support and fully covers the debt service on about 86% of the university's debt obligations. Strong financial management and significant economies of scale will support a return to balanced operations following a moderate pandemic-driven deficit in fiscal 2021. Ongoing favorable student demand and a full return of students on campus will drive a rebound of pledged revenue coverage of special obligation bond debt service to a robust 6x. Credit challenges include the very high adjusted and direct leverage, modest liquidity, and moderate financial reserve coverage of expenses.

On October 13, 2022, Moody's upgraded the university's Special Obligation Bonds to Aa3 from A1 and affirmed its Aa3 issuer rating.

Exhibit 1
Rebound in pledged revenues drives materially stronger coverage of special obligation debt service



Fiscal 2022 results are unaudited
Source: UCONN's preliminary offering statement

Credit strengths

- Excellent brand and strategic positioning as a flagship land-grant public university with favorable student demand and a growing research enterprise
- Strong financial support from the state, which provides generous operating appropriations and fully covers debt service on 86% of the university's direct debt
- Substantial scale and absolute wealth scale with about $1.4 billion in operating revenue and total cash and investments of $1 billion
- Demonstrated sound financial management reflected in the track record of stable operating results

Credit challenges

- Very high direct debt obligations relative to financial reserves and operations, but mitigated by the generous state debt service commitment
- Modest unrestricted liquidity and capital reserve to operations, with 84 monthly days cash on hand and total cash and investments to expenses at 0.7x
- Substantial exposure to postretirement benefit obligations, including both pension and healthcare retiree benefits
- Exposure to a potential shift in state conditions, given the high reliance on state financial support and Connecticut students

Rating outlook

The stable outlook reflects Moody's expectations of continued favorable student demand, strong state financial support, and a return to balanced operations. It also reflects Moody’s expectations of continued active management of pledged revenue to provide robust coverage of special obligation bond debt service at around 6x.

Factors that could lead to an upgrade

- Strengthening of state’s credit profile, along with an ongoing commitment to providing strong financial support to the university for operations and general obligation debt service
- Substantial growth in financial reserves providing for materially stronger coverage of both adjusted debt and expenses

Factors that could lead to a downgrade

- Deterioration in state credit quality or sustained reductions in state financial support
- Material softening in coverage of pledged revenue relative to special obligation debt service
- Meaningful erosion in the liquidity profile or downturn in operating performance

Key indicators

Exhibit 2
UNIVERSITY OF CONNECTICUT, CT

	2017	2018	2019	2020	2021	Median: Aa Rated Public Universities
Total FTE Enrollment	29,211	29,284	29,260	29,590	29,201	32,387
Operating Revenue ($000)	1,300,219	1,318,541	1,399,395	1,414,523	1,369,020	1,374,020
Annual Change in Operating Revenue (%)	-2.4	1.4	6.1	1.1	-3.2	1.5
Total Cash & Investments ($000)	834,007	869,660	952,663	926,857	1,023,324	1,970,591
Total Debt ($000)	1,653,885	1,987,026	2,019,297	1,862,858	1,868,212	733,584
Total Cash & Investments to Total Adjusted Debt (x)	0.3	0.2	0.3	0.2	0.2	1.0
Total Cash & Investments to Operating Expenses (x)	0.7	0.7	0.7	0.7	0.7	1.3
Monthly Days Cash on Hand (x)	117	105	111	95	84	203
EBIDA Margin (%)	16.1	13.5	15.1	13.6	10.8	13.1
Total Debt to EBIDA (x)	7.9	11.2	9.6	9.7	12.6	3.9
Annual Debt Service Coverage (x)	1.4	1.1	1.2	1.0	0.9	3.7

Source: Moody's Investors Service

Profile

University of Connecticut, established in 1881, is Connecticut's flagship research and land grant university with a total headcount enrollment of about 32,000 students. UCONN has its main campus in Storrs, four undergraduate regional campuses, the School of Law in Hartford, and the medical and dental schools at University of Connecticut Health Center's Farmington campus outside of Hartford. UCONN Health (UCHC) is a state-owned academic health center and organizational unit of the university with $1.5 billion of operating revenue. UCHC's financials are not consolidated within UCONN's audit and patient care revenue is not pledged to bondholders.

Detailed credit considerations

Market profile: flagship land-grant university with favorable student demand and close ties to the state

UCONN's strong regional brand as a large, flagship land-grant university with a growing research enterprise will continue to support favorable student demand. Total enrollment of just under 30,000 full-time equivalent students is diversified across programs, geography, and degree type. Students from outside of Connecticut account for about 27% of total enrollment, while about one-fifth of students are graduate or professional degree seeking. Ongoing investments in academic programs, corporate partnerships, and facilities will help the university maintain its market share within the highly competitive region. Further, an excellent 83% four-year graduation rate underscores the strong academic quality of the undergraduate students and the institutional focus on student success.

The university's very close ties to the state are reflected in its governance structure, funding mix, and important role in advancing various policy objectives. State funding accounts for about 39% of total operating revenue, which includes support for operations, fringe benefits and capital renewal. Combined state support for operations and fringe benefits increased by an annual 16% in fiscal 2022. With comprehensive academic programming, substantial research activity, and a large statewide footprint, the university will maintain its essential role in boosting the state's educational, healthcare, and economic development goals. As part of a long-standing initiative, the university has made substantial strides in growing the number of science, technology, engineering, and math (STEM) graduates since 2013.

The university has indirect healthcare exposure through UCONN Health, its research partner and the clinical practice site for its students. UCHC is a legally distinct entity from the university for the purposes of budgeting, maintaining operating funds, and receiving state appropriations. Through the rebound in clinical volume and patient care revenue, and the implementation of targeted expense reductions, UCHC is projected to return to balanced operations in fiscal 2022 following a period of pandemic-driven deficits.

Operating performance: sound financial management will support stable operations

Disciplined budget management will support a return to balanced operations. The university generated a moderate operating deficit in fiscal 2021, which was largely due to the pandemic's negative impact on net tuition and auxiliary revenue. Favorably, net student revenue, which typically represents about 45% of total operating revenue, is poised to edge up in fiscal 2023 following a significant increase in fiscal 2022. With state funding also trending up, the university is well positioned to absorb the significant forecasted expense increases through fiscal 2024. Wage adjustments for collective bargaining units are the primary driver of these expense increases, though the state has committed to provide supplemental funding to cover these incremental new costs through at least fiscal 2024.

Wealth and liquidity: substantial nominal wealth, but moderate liquidity and capital reserve to expenses

Financial reserves, while sizeable on a nominal basis, will remain considerably more limited relative to flagship public university peers. Total cash and investments of $1 billion in fiscal 2021 provided a moderate 0.7x coverage of a substantial and growing expense base. A mix of retained cash flow, investment returns, and strengthening philanthropic support will drive steady longer-term growth. However, current investment market volatility along with the ongoing strategic deployment of financial resources to advance strategic priorities will temper gains in the near-term.

Liquidity

Liquidity will remain thin, though the return of more normal business conditions following the pandemic enhance prospects for restoring measured gains following two consecutive years of draw downs. Unrestricted monthly liquidity of $297 million provided 84 days cash on hand in fiscal 2021 compared to 111 days in fiscal 2019. Favorably, with an all fixed rate debt structure and sound budget management, the university's exposure to potential liquidity risks is modest.

Leverage: very high direct and adjusted leverage mitigated by exceptional state capital support

Uncommonly strong state capital support will continue to mitigate the university's very high direct and adjusted leverage profile. Total cash and investments covered direct and adjusted debt by a respective 0.5x and 0.2x in fiscal 2021, which are both well below peers. Favorably, the debt service on the general obligation bonds issued under the UCONN 2000 Program, which represents about 86% of total university debt, is fully covered by an annual state appropriation. Near-term debt plans include up to $504 million of state authorized general obligation bonds through fiscal 2027. With this new debt, the university's leverage position is unlikely to materially improve in the foreseeable future, even after incorporating the rapid amortization of existing debt.

Legal security

The special obligation student fee revenue bonds are payable from a lien on pledged revenues, which include certain mandatory student fees and net revenues of the student housing, dining and parking facilities. Pledged revenue totaled $216 million in fiscal 2022, or about 15% of Moody's adjusted operating revenue. The university projects total pledged revenue of $244 million in fiscal 2023. Total revenue net of auxiliary expenses covered debt service on the student fee revenue bonds by 7.6x in fiscal 2022. The university is projecting coverage to remain around 6x for the foreseeable future. The university's board has the ability to broaden the pledge if needed to ensure maintenance of sufficient debt service coverage.

UCONN's general obligation bonds are secured by both the full faith and credit of the university as well as a lien on the state's debt service commitment as part of the UCONN 2000 Infrastructure Improvement Program. Under the master indenture, the state commits to annually appropriate sufficient funds from its general fund to fully cover debt service payments on bonds issued under this program. Payments by the state for debt service are deposited directly to the bond trustee on behalf of UCONN. The rating on the UCONN 2000 general obligation bonds is based on the state's Aa3 long-term senior general obligation rating.

Debt structure

The fixed rate debt structure with regular amortization and level annual debt service provides for minimal credit risk. The university is scheduled to retire about two-thirds of its outstanding debt over the next decade.

The proposed $50 million of 2022 Refunding Series A bonds will be used to refund the majority of the outstanding Series 2012A bonds for economic savings. There will be no extension of the final maturity of the bonds and savings will be realized on a level basis.

Debt-related derivatives

There are no debt-related derivatives.

Pensions and OPEB

The very high exposure to postretirement benefit obligations will continue to introduce credit risk. Nearly all university employees participate in one of two statewide cost-sharing defined benefit pension plans, or a defined contribution plan. UCONN's Moody's three-year average adjusted net pension liability was a sizeable $2.4 billion in fiscal 2021, while the defined benefit pension plans were funded at just 22% on a Moody's adjusted basis.

In addition to the unfunded pension liabilities, UCONN also has substantial healthcare retiree benefit (OPEB) obligations. The steadily growing OPEB liability topped $2 billion on an as-reported basis in fiscal 2021. University OPEB contributions to eligible recipients are funded on a pay-go basis. The combined defined benefit pension and OPEB expenses represented an elevated 14% of total expenses in fiscal 2021.

ESG considerations

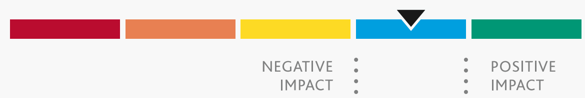
University of Connecticut, CT's ESG Credit Impact Score is Neutral-to-Low CIS-2

Exhibit 3

ESG Credit Impact Score

CIS-2

Neutral-to-Low



For an issuer scored CIS-2 (Neutral-to-Low), its ESG attributes are overall considered as having a neutral-to-low impact on the current rating; i.e., the overall influence of these attributes on the rating is non-material.

Source: Moody's Investors Service

University of Connecticut's ESG credit impact score is neutral-to-low (**CIS-2**). The CIS score accounts for neutral-to-low scores across all three Issuer Profile Scores despite the exposure to moderately negative human capital and board structure risks. State support and sound financial management help offset some of the university's exposure to ESG risks.

Exhibit 4

ESG Issuer Profile Scores

ENVIRONMENTAL

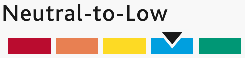
E-2

Neutral-to-Low

SOCIAL

S-2

Neutral-to-Low



GOVERNANCE

G-2

Neutral-to-Low

Source: Moody's Investors Service

Environmental

Environmental risks are neutral-to-low (**E-2**) across all categories. The university's multiple locations in Connecticut provide for varying, but manageable levels of environmental risks. Its issuer profile score is therefore neutral-to-low, in-line with exposures of the higher education sector. The university's robust sustainability framework includes various strategies to reduce its environmental footprint including specific efforts to conserve water, reduce waste, and implement green standards throughout procurement, construction, and transportation networks. Under its climate action plan, the university is seeking to achieve carbon neutrality by 2050.

Social

UConn's social risks are neutral-to-low (**S-2**) across most categories with moderately-negative exposure to human capital challenges. Consistent with the higher education sector, the university has a mission aligned with positive social impact through education, research and service. Its brand strength as a flagship land-grant university, location in a state with strong higher education participation rates, and ability to attract significant out-of-state students largely mitigate the weak in-state demographic outlook. Good customer relations is supported by its favorable student demand, excellent state funding levels per student, sound donor support, and substantial sponsored research activity. The university's robust academic program mix, comparatively high graduation rates, and strong postgraduate earnings relative to debt also offsets customer relations risks. Like many public universities, human capital risks are introduced by its high exposure to collective bargaining, faculty tenure, and postretirement defined benefit obligations.

Governance

UConn's governance risk is neutral-to-low (**G-2**). Close and coordinated financial and treasury oversight supports good predictability in financial results. The credit risk introduced by the university's very high leverage is largely mitigated by the strong capital support from the state, which has a demonstrated history of advancing higher education initiatives. A high portion of the debt on the university's balance sheet is issued through programs whereby the state secures repayment through a debt service commitment. Public universities typically have some board structure and governance risks given their lack of full independence from the state. Favorably, individual board members have diverse backgrounds and areas of expertise as well as a track record of effective advocacy on behalf of the university to advance its institutional priorities.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click here to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

Rating methodology and scorecard factors

The Higher Education rating methodology includes a scorecard that summarizes the factors that are generally most important to higher education credit profiles. Because the scorecard is a summary and may not include every consideration in the credit analysis for a specific issuer, a scorecard-indicated outcome may or may not match an assigned rating. We assess brand and strategic positioning, operating environment, and financial strategy on a qualitative basis, as described in the methodology.

Exhibit 5

UCONN

Scorecard Factors and Sub-factors		Value	Score
Factor 1:	**Scale (15%)**		
	Adjusted Operating Revenue (USD Million)	1,376	Aa
Factor 2:	**Market Profile (20%)**		
	Brand and Strategic Positioning	Aa	Aa
	Operating Environment	A	A
Factor 3:	**Operating Performance (10%)**		
	EBIDA Margin	11%	A
Factor 4:	**Financial Resources and Liquidity (25%)**		
	Total Cash and Investments (USD Million)	1,023	Aa
	Total Cash and Investments to Operating Expenses	0.7	A
Factor 5:	**Leverage and coverage (20%)**		
	Total Cash and Investments to Total Adjusted Debt	0.2	A
	Annual Debt Service Coverage	0.9	Ba
Factor 6:	**Financial Policy and Strategy (10%)**		
	Financial Policy and Strategy	Aa	Aa
	Scorecard-Indicated Outcome		A1
	Assigned Rating		Aa3

Data is based on most recent fiscal year available. Debt may include pro forma data for new debt issued or proposed to be issued after the close of the fiscal year.

For non-US issuers, nominal figures are in US dollars consistent with the Higher Education Methodology.

Source: Moody's Investors Service

REPORT NUMBER 1342899

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