

NEW YORK--([BUSINESS WIRE](#))--Fitch Ratings has affirmed the ratings on the following series of general revenue bonds (GRB) issued by the Board of Governors of the University of North Carolina on behalf of The University of North Carolina at Chapel Hill (UNC-CH):

--\$100 million GRBs, series 2012A (index floating rate notes - three-year put structure) at 'AAA';--\$100 million GRBs, series 2012B (index floating rate notes - five-year put structure) at 'AAA';--\$1.06 billion fixed-rate GRBs at 'AAA';--\$53.9 million variable-rate GRBs at 'AAA/F1+'.

The Rating Outlook is Stable.

SECURITY

GRBs are secured by legally defined available funds of UNC-CH (pledged revenues), including unrestricted general fund balances and unrestricted quasi-endowment fund balances (\$1.82 billion in fiscal 2013). Specifically excluded from pledged revenues are state appropriations, tuition and fees, and restricted funds.

KEY RATING DRIVERS

STRONG CREDIT PROFILE: The 'AAA' primarily reflects UNC-CH's substantial financial cushion; consistently sound operating performance, supported by a diverse revenue base and robust fundraising; strong student demand and academic quality; and experienced senior leadership team.

MANAGEABLE DEBT BURDEN: Typical of similarly rated institutions, UNC-CH utilizes bullet maturities for certain debt issuances that result in a moderately high pro forma maximum annual debt service (MADS) burden. However, the university's debt burden is low after adjusting for bullets. Offsetting the pro forma MADS burden is UNC-CH's

consistent ability to generate good debt service coverage from operations; a conservative capital structure, with mostly fixed-rate debt; and manageable forward capital plans.

MODERATE CAPITAL NEEDS: Major initiatives to construct, expand or renew academic and research facilities and infrastructure have been funded and implemented by the university, with capital improvement plan (CIP) related debt needs of up to \$450 million over the next five years considered very manageable.

INTERNAL LIQUIDITY: The 'F1+' rating is based on UNC-CH's ability to cover the maximum potential liquidity demands presented by its variable-rate debt programs by at least 1.25 times (x) from internal resources, including cash; highly liquid, highly rated investments; and dedicated liquidity facilities.

RATING SENSITIVITIES

FUNDING ENVIRONMENT: As implied by the 'AAA' rating, overall credit risks are minimal relative to UNC-CH's operating and financial profiles. However, similar to other public research universities, UNC-CH remains exposed to potential cuts to federal research funding, as well as state funding reductions, which together typically make up about 40% of the university's operating revenue.

CREDIT PROFILE

Established in 1789, UNC-CH is the flagship of the 17-member University of North Carolina System. For fall 2013, headcount enrollment totaled 29,127 students, of which 63% were undergraduates. Full-time equivalent enrollment totaled 26,989, nearly flat with the prior year. UNC-CH's demand indicators continue to reflect its market position as a highly selective, research oriented public university. For fall 2013, the freshman acceptance rate was an impressive 26.6%, with a solid 48.2% of accepted students choosing to enroll. Both of the metrics were consistent with the fall 2012 levels.

BALANCE SHEET CUSHION REMAINS HEALTHY

UNC-CH's substantial resource base is fueled by generally positive operations and substantial fundraising ability. Between fiscal 2009 and fiscal 2013, available funds, or cash and investments less restricted non-expendable and certain expendable net assets, increased at an average annual rate of 10%, to \$3.7 billion as of June 30, 2013. As a percentage of fiscal 2013 operating expenses (\$2.6 billion) and pro forma debt (about \$1.5 billion), available funds represented a strong 140% and 240%, respectively.

Similar to many well-endowed institutions, UNC-CH maintains considerable exposure to alternative, illiquid asset classes (approximately 76% of total investments in fiscal 2013). Concern over the university's exposure to alternative investments is partially mitigated by the fact that it does not rely on these holdings for potential liquidity needs and instead maintains a temporary investment pool and, by statute, an investment in the state treasurer's short-term investment fund for this purpose. However, recent legislation authorized the university to invest its operating cash at its discretion under delegated authority from the UNC Board of Governors. Management indicated this will be a gradual process with the intent of investing in mostly fixed-income securities. Fitch continues to view UNC-CH liquidity and investment management practices favorably.

REVENUE DIVERSITY SUPPORTS OPERATING PERFORMANCE

The university's generally positive operating results have helped bolster its financial resources. For fiscal 2013, the operating margin improved to a solid 4.8%, exceeding the 1.7% average over the prior five fiscal years (2008-2012). UNC-CH's primary revenue streams include grants and contracts (34.3% of fiscal 2013 operating revenue); student generated revenues (28.2%); state appropriations (18.7%) and net patient service revenues (10.6%).

The operating improvement in fiscal 2013 was largely the result of improved investment income, and state appropriations following a significant (9%) decline in fiscal 2012, which included the end of ARRA funding. The fiscal 2012 appropriation cut and tighter margin were expected at the time of Fitch's last long-term rating review. To manage the effect of state funding reductions, UNC-CH implemented various budgetary cuts and utilized its considerable demand and pricing flexibility to back-fill the loss in state aid with student revenues.

Following a significant 18.5% increase in undergraduate resident tuition in fall 2010, the university raised tuition between 5% and 10% from fall 2011 to fall 2013. For fall 2014 undergraduate resident tuition will be held mostly flat, while non-resident tuition will increase 11.6%. This was a state-mandated increase that will effectively offset a state appropriation cut of a like amount. UNC-CH still remains affordable relative to peer institutions, which Fitch views favorably. Resident undergraduate and graduate tuition both rank among the lowest of its peer group of large public research universities.

For fiscal 2014, UNC-CH expects another positive operating result, though likely less than the fiscal 2013 level due to another reduction in state appropriations and some expense growth. Following a 6% increase in fiscal 2013, total state appropriations are expected to have declined about 6% to \$482.6 million in fiscal 2014. Fitch rates North Carolina GOs 'AAA' with a Stable Outlook.

MANAGEABLE DEBT LEVELS AND CAPITAL PLANS

UNC-CH's debt structure is conservative, with the majority (81%) of outstanding bonds issued with fixed interest rates. However, not unlike many similarly rated institutions, UNC at times utilizes large bullet maturities. Including bullets, pro forma MADS totals approximately \$202.5 million (fiscal 2042). Average annual debt service (AADS) equates to about \$82 million. Total debt outstanding of \$1.5 billion includes revenue bonds, notes payable, commercial paper (CP) and non-cancellable operating leases. The university has three interest rate swaps for a total notional value of \$267.8 million. The current mark-to-market valuation of the swaps is negative \$79.4 million, though collateral posting is not presently required. Fitch believes the various risks attendant to variable-rate debt, swaps and bullet maturities remain manageable for UNC-CH's sophisticated management team.

UNC-CH's pro forma debt burden remains manageable. Pro forma MADS (including bullets) would consume a moderately high 7.5% of fiscal 2013 operating revenues, but when adjusting for bullets, the AADS burden is a low 3%. Importantly, Fitch notes that UNC-CH covered pro forma MADS by a sound 1.5x from fiscal 2013 net operating income, with AADS coverage of a strong 3.9x. While up to \$450 million of additional debt may be issued over the next five fiscal years to fund various academic, research, student life and athletic projects, the university's debt capacity at the current rating level sufficiently supports these financings. Certain projects may also be part or fully funded by gifts.

LIQUID RESOURCES SUPPORT SHORT-TERM DEBT

As of May 31, 2014, UNC-CH's liquid investments, consisting primarily of cash, U.S. government and agencies securities, and investment grade U.S. corporate debt, totaled approximately \$310.5 million (after discounts based on asset type and maturity per Fitch's short-term rating criteria). To supplement internal liquidity, the university maintains the ability to draw on two dedicated lines of credit in the aggregate amount of \$400 million. On a combined basis, these liquid assets would cover the university's \$53.9 million of variable-rate demand bonds and full \$350 million of authorized CP (including \$100 million for North Carolina State University) by a solid 1.76x, exceeding the 1.25x coverage Fitch expects for an 'F1+' rating. To limit potential calls on its liquidity, UNC-CH restricts the amount of CP that may come due on any given day to \$50 million.

Additional information is available at 'www.fitchratings.com'.

Applicable Criteria and Related Research:

--'U.S. College and University Rating Criteria' (May 12, 2014);--'Rating U.S Public Finance Short-Term Debt' (Dec. 9, 2013);--'Fitch Affirms University of North Carolina at Chapel Hill's Short-Term Rating at 'F1+' (June 25, 2013);--'Fitch Rates North Carolina's \$319MM GO Bonds 'AAA' (April 3, 2014).

Applicable Criteria and Related Research:U.S. College and University Rating Criteria http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=748013
Rating U.S. Public Finance Short-Term Debt
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=724680

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