University of Virginia
Rector & Visitors of the Univ. of Virginia

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Moody's Rating

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MOODY'S ASSIGNS Aaa RATING TO THE UNIVERSITY OF VIRGINIA'S $118 MILLION GENERAL REVENUE PLEDGE BONDS, SERIES 2003 B; OUTLOOK IS STABLE
UNIVERSITY WILL HAVE $454 MILLION OF DEBT OUTSTANDING FOLLOWING THIS ISSUE

Opinion

Moody's Investors Service has assigned a Aaa rating with a stable outlook to the University of Virginia's $118 million of General Revenue Pledge Bonds, Series 2003 B. Proceeds will provide financing for hospital expansions, research additions, dining facilities, a garage and various additional capital projects. The bonds will be secured by the irrevocable pledge of general revenues of the University, including student fees and tuition, auxiliary revenues, and unrestricted gifts, but excluding state appropriations.

Moody's highest quality rating of Aaa and stable outlook is based on the University's:

-- Superior balance sheet position, with over $2.7 billion in endowment and related foundations, and an easily manageable $454 million of total debt outstanding;

-- Excellent student demand for undergraduate and graduate programs, attracting a geographically diverse and academically strong applicant pool;

-- Recently improved operations at the region's academic medical center, and strong overall University operating performance from a well-diversified revenue base;
Manageable plans for additional borrowing.


SIZABLE ENDOWMENT AND OPERATING RESERVES REFLECT A STRONG FINANCIAL BASE:

Moody's believes the financial resources of UVA underpin excellent security expressed in the Aaa rating. Highly successful fundraising, a good long term record of investment management and consistent operating surpluses have contributed to the accumulation of substantial endowment and operating reserves.

The University of Virginia Investment Management Company (UVIMCO), a department within UVA consisting of 17 employees, invests the University’s and a portion of the Affiliated Foundation’s endowment, working capital and deferred giving accounts. Recent returns have well outperformed the market with a modest loss reported for fiscal year 2002 of only -1%. Results through December 2002 showed a small gain of 1.4%. Returns on the pooled investments managed by UVIMCO over the last five years averaged 14.6%, well above average for University endowments. Over the past decade, the pooled fund has moved away from domestic equities and fixed income to a heavy investment in hedge funds (51%) with an emphasis on long- short strategies for holding or selling stocks, rather than high-risk tactical strategies. In addition, the fund has 14% of assets in private equity. Liquidity is provided by 21% of the portfolio held in fixed income or cash.

Moody's believes that the risks of this unusually large allocation to private, largely unregulated hedge funds is counterbalanced by several factors. First, risk is mitigated by spreading the investments over 26 hedge fund managers, which reduces the risk of a single manager creating large losses for the portfolio as a whole. Second, significant oversight of each fund manager by a large staff of experienced UVIMCO professionals reduces the risk of external managers drifting toward unexpected strategies. Third, UVIMCO has very limited leverage of the portfolio and current policies favor selection of managers employing little or no leverage. Finally, although the long-short stock investment strategy (essentially stock-picking) used by most of UVIMCO's managers is not as transparent as public equity trades, it is a strategy that has shown results in preserving capital in a downmarket as long as managers are monitored closely and do not engage in strategy shifts toward more risky leveraged tactical investments.

Supplementing the $1.7 billion of endowment funds held by UVA are more than $648 million of financial resources controlled by nineteen affiliated foundations, including (alumni association, law school, Darden School, medical school). Although these foundations are legally separate from the University, UVA benefits from ultimate use of such funds through the limited charters of these foundations.

UVA is one of the nation’s leaders in fundraising among public and private universities. The capital campaign that ended in 2000 raised over $1.4 billion. Fundraising continues to be strong, as the University reached its annual goal of $250 million of giving in 2002, one year early. Tentative plans call for the formal start of a new comprehensive campaign in early 2004. Moody’s expects fundraising efforts to continue to exhibit notable success.

FAVORABLE STUDENT MARKET POSITION AND SIGNIFICANT MEDICAL RESEARCH PROGRAM HIGHLIGHT PRESTIGIOUS REPUTATION:

This flagship state university is likely to remain one of the nation's leading educational and research institutions. UVA enjoys selective undergraduate and graduate programs and enrolls approximately 19,000 full-time equivalent students. Almost two-thirds of the
students are undergraduates. The University has an extremely broad market draw for a
college of a public institution highlighted by its consistently high proportion (about one-third) of the
students from outside Virginia, even though the $19,805, nonresident tuition and fees
are more than four times higher than the in-state rate.

The stable freshman enrollment level of 3,000 freshmen, a selectivity rate of 39% with a
matriculation rate of 54% combined with high 95% of freshmen graduating in the top 20%
of high school class, affirms the school's strong draw of high-quality students. The out-of
state student demand is especially strong with 30% selectivity. Furthermore, UVA's
retention rate of 97% from freshman to sophomore year is outstanding. Undergraduate
competition comes mainly from other leading state schools within Virginia and from
selective private schools such as Duke, the University of Pennsylvania and other
prominent public institutions (for nonresident applicants).

As one of the nation's top 50 research universities in dollar volume of Federal awards,
UVA remains well positioned to continue garnering a strong share of the growing pool of
grant and contract funding from governmental and private sources. Grants and contracts
totaled approximately $260 million in 2002, an amount that has increased by 82% in the
past seven years. The National Institute of Health provides the largest share (nearly 50%)
of total research expenditures. Continuing capital investment in research facilities should
ensure that UVA would continue to attract significant external research funding.

WELL-DIVERSIFIED REVENUE BASE YIELDS POSITIVE OPERATING RESULTS;
TUITION RAISING FLEXIBILITY IMPORTANT TO OFFSET REDUCTIONS IN STATE
SUPPORT:

Consistently positive annual operating results reflect a sustained ability to control costs
and build revenue streams. Major operating revenues stem from patient care (37.8%),
student charges for tuition and auxiliary services (17%), grants and contracts (17.4%),
and state appropriations (13%).

The Commonwealth of Virginia (general obligation rating of Aaa with a negative outlook)
continues to face significant operating deficits. As a result, the state reduced aid by 25%,
or $42 million in the current fiscal year. Further reductions in 2003-2004 are expected to
be 35% or over $50 million. Management was able to meet the current reductions
through tuition increases of 9% while implementing cost reductions. The University
maintains a strong potential for tuition growth as a history of state regulations on tuition
caps and freezes leaves the current in-state undergraduate tuition at $4,595, lower in real
terms than in 1995. Out-of-state undergraduates and professional school students
provide well over half of net tuition revenue for the University, and Moody's believes UVA
has additional pricing power in these segments.

MEDICAL CENTER FINANCIAL PERFORMANCE SHOWS MID-YEAR IMPROVEMENT
AFTER A TWO YEAR DECLINE:

The University of Virginia Medical Center (UVMC) comprises 38% of the university's
revenues. While UVA's health care component remains an integral component to UVA's
research and clinical mission, we believe that it also represents a notable risk factor for
UVA given the challenges facing the health care industry. Our concern has been born out
by the two-year slump in financial performance following a record year in FY 2000. After
posting a 4.4% operating margin in FY 2000, operating margin declined to 2.4% in FY
2001 and 0.8% in FY 2002. However, through six-month performance ending December
31, 2002, financial performance has rebounded with a 6.6% operating margin;
management expects to maintain a 5.0% margin by fiscal year end 2003.

The downturn in FY 2001 and FY 2002 was in part due to expense challenges such as
salary and staffing pressures and escalating pharmaceutical costs. Also, UVMC
continued to experience declining admissions, which were replaced with short-stay patients that are typically associated with lower reimbursement rates. The improvement in year-to-date FY 2003 performance reflects a host of initiatives that will cumulate in $28 million of mainly expense reduction strategies to correct financial performance, including staffing adjustments to compare favorably with other teaching hospital peers.

We are also pleased to report that management divested its health care insurance product that was suppressing historical bottom line performance and was a prior concern of Moody’s. The plan was sold to another insurer with which UVAMC has favorable rates as a hospital provider. Additionally, management negotiated increased rates with its other managed care contracts, which is also contributing to the improved financial performance. Medicaid Disproportionate share funds have remained steady ($40 million in FY 2001 and FY 2002), although these funds remain subject to government legislation or changes in the funding formula in the future. Management also reports that a recent re-basing of the Virginia Medicaid rates will also benefit UVAMC with a slight increase in funding. Moody’s views UVAMC’s exposure to Medicaid and self-pay as more manageable than most other academic medical centers, with Medicaid representing 12% of net patient revenue and self pay, 12%.

While less quantifiable, we also believe that historical performance may have been reflective of the absence of CEO at the medical center. A new CEO was hired in FY 2002; previously an individual in the senior management of the university devoted a portion of his time to the medical center. A new Dean of the School of Medicine was also hired following the retirement of his predecessor. Concurrently, a new medical center operating board was established which we view as particularly encouraging as the board’s sole focus is health care operations; this function was previously a part of the University’s Board of Visitor’s focus. While the Board of Visitors has reserve powers over the operating board, we view this new governance and oversight function as favorable. Finally, a new agreement was formulated with the faculty practice plan and medical school to clarify reimbursement among the various health care parties. We view all of these changes as building a solid foundation to ensure better financial performance over the near term at UVAMC.

**BALANCE SHEET TO REMAIN STRONG DESPITE FUTURE BORROWING:**

Moody’s expects UVA’s debt burden to remain easily manageable despite capital plans. A traditionally infrequent borrower, UVA has recently undertaken numerous capital projects, the largest are a new arena, hospital expansions and new research facilities. The current issue of $118 million will provide financing for several of these projects. Management expects to borrow up to $100 million in commercial paper starting in the spring to provide bridge financing for the remaining portion, and anticipates issuing long-term debt in 2004. Additionally, UVA will be issuing $82 million of Series 2003 A bonds in several weeks. This issuance will be a refunding of the Series 1993 A and 1993B and 1992B to variable rate debt and the University will provide internal liquidity for the bonds.

**Outlook**

The stable outlook is based on Moody’s expectation that under its strong leadership, UVA will maintain and strengthen its reputation as one of the nation’s leading public universities in terms of financial resource base, academic reputation and student demand. We consider it unlikely that UVA’s hedge fund investment strategy will result in substantially adverse investment performance. We believe that, despite the inherent risks associated with the health care industry, the combination of management’s focus and the University Medical Center’s favorable location in a fundamentally sound market limits the
potential for any significant future downturn. The outlook also reflects our expectation that future borrowing will be manageable.

KEY DATA AND RATIOS (Fiscal year 2002 financial data; Fall 2002 enrollment data):

Total Enrollment: 20,454 full-time equivalent students

Total Debt: $454 million (including Commonwealth of Virginia and College Building Authority bonds)

Expendable Resources to Debt: 5.0x

Expendable Resources to Operations: 1.58x

2002 Operating Margin: 4.6%

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