University of Minnesota, MN

Update to credit analysis

Summary

University of Minnesota's (UM, Aa1 stable) excellent credit profile reflects strong student and research market positions and ample balance sheet reserves, all incorporated in the university's excellent strategic position. UM receives good support from the State of Minnesota (Aa1 stable), including payment of debt service on $242 million of Special Purpose Revenue Bonds (Aa2 stable). The university also continues to benefit from strong fundraising. Offsetting challenges are relatively thin operating performance compared to peers and substantial capital plans. However University of Minnesota's conservative debt amortization will offset most or all of the planned issuance.

Exhibit 1

University of Minnesota's ample financial reserves provide strong debt buffer

2018 Sensitivity incorporates Series 2019, CP issuance and principal repayment since June 30, 2018

Source: Moody's Investors Service
Credit strengths

» Excellent strategic positioning as Minnesota's flagship research and land grant university and Big Ten Conference member

» Ample balance sheet reserves with unrestricted monthly liquidity of $1.6 billion or 174 monthly days cash on hand supporting its self-liquidity program and other needs

» Fundraising strength with $232 million of fiscal 2018 gift revenue

» Conservative debt amortization, with approximately $350 million of principal repayment for fiscal 2019-2022, offsetting much of future debt plans

» New agreement with Fairview Health System (Fairview, A2 negative) results in more closely aligned academic health system and greater university funding

Credit challenges

» Modest operating performance compared to Aa1 peers with a 7% operating cash flow margin in fiscal 2018

» Ongoing capital plans with a potential of up to $171 million of planned new debt through fiscal 2022

» Constrained revenue growth from highly competitive student market and research funding environments pressuring operations

Rating outlook

The stable outlook reflects continued favorable student demand and sponsored research trends, growing tuition revenue, stable to improving operating cash flow and debt service coverage despite additional debt plans.

Factors that could lead to an upgrade

» Substantial growth in balance sheet reserves

» Sustained, notable improvement in operating performance

Factors that could lead to a downgrade

» Sustained weakening of operations and cash flow generation

» Additional net new debt without improved operating performance

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Key indicators

Exhibit 2
UNIVERSITY OF MINNESOTA, MN

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<tbody>
<tr>
<td>Total FTE Enrollment</td>
<td>60,950</td>
<td>60,620</td>
<td>61,121</td>
<td>61,995</td>
<td>61,321</td>
<td>61,321</td>
<td>30,085</td>
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<tr>
<td>Operating Revenue ($000)</td>
<td>3,223,417</td>
<td>3,286,315</td>
<td>3,394,128</td>
<td>3,380,569</td>
<td>3,524,194</td>
<td>3,524,194</td>
<td>1,136,474</td>
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<tr>
<td>Annual Change in Revenue (%)</td>
<td>3.1</td>
<td>2.0</td>
<td>3.3</td>
<td>-0.4</td>
<td>4.2</td>
<td>4.2</td>
<td>3.3</td>
</tr>
<tr>
<td>Total Cash &amp; Investments ($000)</td>
<td>4,624,713</td>
<td>4,900,605</td>
<td>4,936,644</td>
<td>5,072,473</td>
<td>5,418,924</td>
<td>5,418,924</td>
<td>1,296,900</td>
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<tr>
<td>Total Debt ($000)</td>
<td>1,261,057</td>
<td>1,389,443</td>
<td>1,440,148</td>
<td>1,409,404</td>
<td>1,455,620</td>
<td>1,485,775</td>
<td>663,840</td>
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<tr>
<td>Spendable Cash &amp; Investments to Total Debt (%)</td>
<td>2.7</td>
<td>2.6</td>
<td>2.5</td>
<td>2.5</td>
<td>2.7</td>
<td>2.6</td>
<td>1.4</td>
</tr>
<tr>
<td>Spendable Cash &amp; Investments to Operating Expenses (%)</td>
<td>1.0</td>
<td>1.1</td>
<td>1.1</td>
<td>1.1</td>
<td>1.1</td>
<td>1.1</td>
<td>0.7</td>
</tr>
<tr>
<td>Monthly Days Cash on Hand (%)</td>
<td>176</td>
<td>178</td>
<td>180</td>
<td>180</td>
<td>174</td>
<td>174</td>
<td>168</td>
</tr>
<tr>
<td>Operating Cash Flow Margin (%)</td>
<td>7.1</td>
<td>7.7</td>
<td>7.6</td>
<td>7.0</td>
<td>7.0</td>
<td>7.0</td>
<td>11.4</td>
</tr>
<tr>
<td>Total Debt to Cash Flow (%)</td>
<td>5.5</td>
<td>5.5</td>
<td>5.4</td>
<td>5.9</td>
<td>5.9</td>
<td>6.0</td>
<td>4.7</td>
</tr>
<tr>
<td>Annual Debt Service Coverage (%)</td>
<td>2.0</td>
<td>2.2</td>
<td>2.0</td>
<td>1.8</td>
<td>1.8</td>
<td>1.8</td>
<td>2.9</td>
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</table>

2018 Sensitivity incorporates Series 2019, CP issuance and principal repayment since June 30, 2018
Source: Moody’s Investor Service

Profile

University of Minnesota, founded in 1851, has a national market position as the state’s flagship and land grant university and member of the Big Ten Academic Alliance (Big 10). One of the nation’s largest research universities, total revenues were over $3.5 billion with nearly $800 million of research awards for fiscal 2018. With campuses in the Twin Cities, Duluth, Morris, Crookston, and Rochester the university reported enrollment of nearly 67,000 headcount students for fall 2018.

Detailed credit considerations

Market profile: strong student demand and major research role

The University of Minnesota’s excellent strategic positioning will continue to bolster credit strength, reflected in strong student demand as the state’s Big 10 flagship and land grant institution. Fall 2018 enrollment was over 61,000 FTEs, with about 34% non-resident and international students systemwide. Roughly 20% of the fall 2018 undergraduate students at the Twin Cities campus are non-resident non-reciprocity (NRNR) students paying tuition higher than resident undergraduate students. UM has increased tuition prices at all campuses in fall 2018 and plans another increase for fall 2019. The university looks for modest enrollment growth in the STEM (science, technology, engineering and mathematics) academic areas.

UM is one of the nation’s leading comprehensive research universities, demonstrating success in growing sponsored awards. It received nearly $800 million of research awards in fiscal 2018, up from 2017. Year-to-date in fiscal 2019, awards are higher compared to the same period last year.

The university does not own a hospital, although it does have a multi-campus medical school. The University of Minnesota Medical Center (UMMC), the clinical training site for UM’s medical school students and its research partner, is owned and operated by Fairview. UM and Fairview, with University of Minnesota Physicians, entered into a new agreement effective January 1, 2019. The agreement expands the relationship into a Joint Clinical Enterprise with a focus on research, education and patient care. The agreement provides for increased Fairview financial support for UM’s medical school. It also brings into a shared care delivery network the entire Fairview system under the brand “M Health Fairview”.

Source: Moody’s Investor Service
Operating performance: thin cash flow generation, with well-diversified revenue base
University of Minnesota is expected to generate balanced but modest operating performance still providing adequate debt service coverage. Fiscal 2018's operating cash flow margin of 7% was comparable to fiscal 2017. The thin operations reflect program investments and other one-time expenses. UM is completing a six-year program in fiscal 2019 to reduce administrative and other costs, with savings to be reinvested in new initiatives.

The university's revenue base is diverse and supports operating stability. State funding, accounting for about 20% of revenue, increased in fiscal 2018 by $32 million including $10 million in non-recurring funding, resulting in a net increase of $22 million recurring funds carried over into fiscal 2019. The upcoming fiscal 2020-2021 biennium budget is not approved and UM's increase in state funding not yet determined. Revenue in both fiscal 2019 and 2020 should be higher from tuition increases, the increased transfers from Fairview and growth in research grant funding.

Wealth and liquidity: ample balance sheet reserves and liquidity
UM's financial resource profile will remain strong, helping support debt and operations. Fiscal 2018 total cash and investments of $5.4 billion includes $2.8 billion held by University of Minnesota Foundation and is up slightly from the combined total of $5.1 million in fiscal 2017. The university's investments of over $2.6 billion at June 30, 2018 were primarily comprised of the Consolidated Endowment Fund (CEF, $1.4 billion) and the short-term reserves (TIP, $1.11 billion). The university projects higher cash and investments for June 30, 2019 fiscal year-end.

The university's endowment is managed by its Office of Investments and Banking in conjunction with external managers. The CEF portfolio allocation is diversified and consistent with that of comparably sized endowments. The pool's reported return was 8.6% in fiscal 2018. The TIP portfolio is held in cash and treasuries and agency bonds.

Fundraising is strong, with $239 million of three-year average gift revenue for fiscal years 2016-2018, as reported in the financial statements. The University of Minnesota Foundation reports $343 million in gifts and commitments for fiscal 2018, the second highest total in the foundation's history. UM publicly launched its 10-year $4 billion "Driven" comprehensive campaign in September 2017. Reporting $3.1 billion raised as of August 2018 the campaign is targeted to end in June 2021.

Liquidity
Unrestricted liquidity is ample at $1.58 billion, translating to 174 monthly days cash on hand. Unrestricted liquidity provides a strong 521% buffer to demand debt, including $33 million of University Gateway Corporation's (UGC) variable rate bonds supported by a bank SBPA and guaranteed by University of Minnesota Foundation.

UM's commercial paper program is supported by its own liquidity. At December 31, 2018 the university had $729 million of discounted daily liquidity, largely treasuries with some deposits at P-1 rated banks. The internal daily liquidity provides a strong 4.2x coverage of its commercial paper excluding the largest market investment with one sponsor. The calculation is based on the limitation of $175 million of commercial paper that can mature in a 5 business day period in its Amended and Restated Issuing and Paying Agency Agreement.

Leverage: moderate direct leverage, with significant other long-term liabilities
University of Minnesota's leverage for direct debt is moderate relative to its balance sheet reserves and cash flow. However it is higher when including the adjusted net pension liability for the state pension plans. Fiscal 2018 spendable cash and investments buffer pro forma total debt 2.6x, with pro forma debt-to-cash flow a more leveraged 6.0x due to the relatively modest cash flow.

Pro forma debt includes $47 million of University Gateway Corporation debt (Aa1 based on a guarantee of the University of Minnesota Foundation) and $242 million of Special Purpose debt paid by the State of Minnesota and secured by a pledge of specified debt service transfers to university from a standing state general fund appropriation. Removing the state-supported debt materially reduces leverage, with 3.1x spendable cash and investments-to-debt.

Leverage will show a small improvement with debt repayment offsetting future new issuance. Through fiscal 2022 UM could issue up to $171 million to fund various capital projects, including its contribution to costs of three projects approved by the state for funding. The borrowings are subject to construction timing, expected gifts and UM's planned use of its own reserves for portions of the projects. The university expects to use CP to provide the initial funding of the projects until taken out by long-term debt. These new borrowing
plans will be offset by $303 million of scheduled debt repayment from 2019 through 2022, excluding the Special Purpose debt paid by the state.

**Debt structure**
Currently UM's only variable rate debt is its commercial paper, current with $320 million currently outstanding and projected to decrease to $223 million by mid-July after repayments. UGC has three variable rate bonds with the tender feature supported by a Standby Bond Purchase Agreement from Wells Fargo Bank, N.A. expiring on 8/31/2021.

**Legal security**
All General Obligation bonds and commercial paper are unconditional, direct and general obligations of the university. There are no debt service reserve funds for the bonds.

**Debt-related derivatives**
None

**Pensions and OPEB**
University of Minnesota has substantial debt-like liabilities through pensions, and its unfunded share of the state's defined benefit plans could pressure operations if longer-term pension funding needs emerge. UM employees participate in federal and state defined benefit pension plans (DBP), including the State Employees Retirement Fund (SERF). UM also offers defined contribution plans. Changes in actuarial assumptions of the DBPs resulted in a decrease in UM's reported pension liability to $1.1 billion from $1.9 billion in fiscal 2017. Moodys adjusted net pension liability (ANPL) at June 30, 2018, using a standard discount rate, is $1.9 billion, bringing total adjusted pro forma debt to $3.4 billion which remains manageable.

UM also provides retiree healthcare benefits, funding on a pay-as-you-go basis with a $8 million contribution in fiscal 2018. It reported a $35 million OPEB liability at June 30, 2018.

**Governance and management: good fiscal oversight**
University of Minnesota's Board of Regents and leadership team display good fiscal oversight reflected in the strengthened unrestricted liquidity and balance sheet reserves. The leadership team has good tenure diversity between long-serving and recently appointed management. Board members are elected biennially to six year terms.
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