University of Minnesota, MN

Update to credit analysis

Summary

University of Minnesota’s (UM, Aa1 stable) maintains excellent brand and strategic positioning derived from its strong student and research market positions and ample financial resources. UM receives good support from the State of Minnesota (Aa1 positive), including payment of debt service on $230 million of Special Purpose Revenue Bonds (Aa2 positive) which adds to its favorable operating environment. The university benefits from strong wealth boosted by sound fundraising, and investment returns. Moderate leverage is enhanced by amortization that largely offsets planned borrowing for future capital expenditures. Offsetting challenges are relatively thin operating performance compared to peers, indirect exposure to patient care revenue and a competitive landscape which somewhat dampens enrollment prospects.

Exhibit 1

Substantial and growing cash and investments provide strong support for leverage

2021 column is projected.

Source: Moody’s Investors Service
Credit strengths
» Excellent brand and strategic positioning as Minnesota's flagship research and land grant university and Big Ten Conference member
» Ample total cash and investments estimated at $7.4 billion in fiscal 2021 including the Foundation with unrestricted monthly liquidity of $1.7 billion supporting its self-liquidity program and other needs
» Fundraising strength evidenced by around $218 million of fiscal 2020 gift revenue
» Excellent operating environment bolstered by state appropriations and debt service support as well as federal research funding
» Conservative debt amortization, with approximately $236 million of principal repayment for fiscal 2022-2024, offsetting future borrowing plans

Credit challenges
» Modest operating performance compared to peers with an 8% operating cash flow margin in fiscal 2020
» Constrained revenue growth from highly competitive student market pressuring operations
» Exposure to healthcare operations through its affiliated practice plan as well as with Fairview Health System (A3/negative) partially mitigated by favorable agreement in place
» Ongoing capital plans with a potential of up to $277 million of planned new debt through fiscal 2024

Rating outlook
The stable outlook reflects Moody's expectations of continued favorable student demand, tuition revenue and sponsored research trends. The outlook also incorporates longer term stable to improving operating cash flow and debt service coverage. The outlook also reflects Moody's expectations that UM will continue to manage through challenging conditions related to the coronavirus, mitigating fiscal impacts through appropriate budgetary responses.

Factors that could lead to an upgrade
» Substantial growth in financial resources
» Sustained, notable improvement in operating performance

Factors that could lead to a downgrade
» Sustained weakening of operations and cash flow generation
» Additional substantial net new debt without improved operating performance
Key indicators

Exhibit 2

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<th>UNIVERSITY OF MINNESOTA, MN</th>
<th>2016</th>
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<th>2018</th>
<th>2019</th>
<th>2020</th>
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<td>Total FTE Enrollment</td>
<td>61,121</td>
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<td>61,321</td>
<td>61,009</td>
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<td>Operating Revenue ($Billion)</td>
<td>3.4</td>
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<td>3.5</td>
<td>3.7</td>
<td>3.7</td>
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<td>Annual Change in Operating Revenue (%)</td>
<td>3.3</td>
<td>-0.4</td>
<td>4.2</td>
<td>3.6</td>
<td>1.2</td>
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<td>Total Cash &amp; Investments ($Billion)</td>
<td>4.7</td>
<td>4.8</td>
<td>5.2</td>
<td>5.5</td>
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<tr>
<td>Total Debt ($Billion)</td>
<td>1.4</td>
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<td>1.5</td>
<td>1.5</td>
<td>1.5</td>
<td>1.4</td>
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<td>Total Adjusted Debt ($Billion)</td>
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<td>3.1</td>
<td>3.4</td>
<td>3.4</td>
<td>3.1</td>
<td>3.1</td>
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<tr>
<td>Total Cash &amp; Investments to Operating Expenses (x)</td>
<td>1.4</td>
<td>1.4</td>
<td>1.5</td>
<td>1.5</td>
<td>1.5</td>
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<td>Monthly Days Cash on Hand (x)</td>
<td>180</td>
<td>180</td>
<td>174</td>
<td>173</td>
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<td>159</td>
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<td>EBIDA Margin (%)</td>
<td>7.8</td>
<td>7.0</td>
<td>7.0</td>
<td>8.1</td>
<td>8.2</td>
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<tr>
<td>Total Cash &amp; Investments to Total Adjusted Debt (x)</td>
<td>1.6</td>
<td>1.5</td>
<td>1.5</td>
<td>1.6</td>
<td>1.8</td>
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<tr>
<td>Annual Debt Service Coverage (x)</td>
<td>2.0</td>
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<td>1.8</td>
<td>2.3</td>
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Proforma includes series 2021C in the amount of $34 million and debt maturities in fiscal 2021.
Source: Moody's Investors Service

Profile

The 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 $3.7 billion with nearly $875 million of research awards for fiscal 2020. With campuses in the Twin Cities, Duluth, Morris, Crookston, and Rochester the university reported enrollment of around 67,000 headcount students for fall 2020.

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. Enrollment declined a moderate 2.4% in fall 2020 due to fewer nonresident students as a result of the coronavirus pandemic, and is also forecast to decline slightly in fall 2021. This trend follows several years of generally flat trends reflecting a highly competitive environment in the state of Minnesota. This partially mitigated by a draw of 31% of non-resident and international students systemwide out of the 59,556 FTEs. However a lower proportion of students are non-resident non-reciprocity (NRNR) students that pay tuition higher than resident undergraduate students; for example at the Twin Cities campus only 20% of undergraduate students were NRNR.

UM is one of the nation's leading comprehensive research universities, demonstrating success in growing sponsored awards with diverse sources including NIH, other federal agencies and private sources. Awards are estimated at a record $1.1 billion in fiscal 2021, up from $875 million in fiscal 2020. Substantial grants for covid related research in fiscal 2021 further demonstrate the university's important research role; this followed grants to participate in state-wide coronavirus testing program and clinical trials for therapeutic cures in fiscal 2020.

Operating performance: thin cash flow generation, with well-diversified revenue base

The university's revenue base is diverse and will continue to support operating stability, although with EBIDA margins that hover between 7% and 8%, narrow compared to peers.

University of Minnesota's operating performance will narrow in fiscal 2021, from an already thin position, due to the impact of the coronavirus pandemic on tuition and auxiliary revenues, including losses in housing, dining, parking and athletic revenues. Offsetting these losses were $60 million of federal relief funding and lower expense growth, along with some use of reserves. Fiscal 2022 revenues will be supported by remaining federal relief funding and a rise in auxiliary revenues as housing returns to 95% capacity. State funding,
accounting for about 20% of revenue, is projected to rise by 2.9% in the 2022-2023 biennium appropriation. With increased spending on strategic initiatives and some restoration of the prior year's cuts, we expect a return to balanced but modest operating performance post-covid in fiscal 2022.

While the university does not own a hospital it has exposure to the health care operations of Fairview, the company that owns and operates the University of Minnesota Medical Center (UMMC), and the University of Minnesota Physicians group, given their critical importance to the university’s medical school and research. These entities face challenges related to heightened competition in the region and the negative impact of coronavirus on elective procedures. UM and Fairview, with University of Minnesota Physicians operate under an agreement that benefits the university through financial support from Fairview to the university's medical school in partial recognition of the franchise value and human capital the university brings to the partnership. At the same time the close relationship between the entities exposes the university to potential reputational risks of the hospitals.

The Physicians group is treated as a discretely presented component unit in the university's financial statements and its activities are directed by a board controlled by the university. It has substantial operations with revenues and expenses amounting to around $690 million, which would add about 19% to the university's revenues and expenses if included, ultimately depressing operational metrics.

**Wealth and liquidity: ample balance sheet reserves and liquidity**

UM’s strong financial resource profile will improve further in fiscal 2021, bolstered by fundraising and investment returns, providing a growing buffer for debt and operations. Total cash and investments, at $5.6 billion in fiscal 2020, estimated at $7.4 billion in fiscal 2021, with about one half held by University of Minnesota Foundation, are sizeable and support the university’s excellent strategic positioning.

The university’s own investments of over $2.9 billion at June 30, 2020 were primarily comprised of the Consolidated Endowment Fund (CEF, $1.4 billion) and the short-term reserves (TIP, $1.1 billion). 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 estimated return was 49% in fiscal 2021. The TIP portfolio is held in cash and treasuries and agency bonds.


**Liquidity**

Unrestricted liquidity is good at $1.7 billion, translating to 159 monthly days cash on hand, but lower than the median for Aa1-rated public universities of 215 days. It provides a strong 506% buffer to demand debt.

UM’s commercial paper program is supported by its own liquidity. At June 30, 2021 the university had just over $1 billion of discounted daily liquidity, largely treasuries with some deposits at P-1 rated banks. The internal daily liquidity provides a strong 5.8x coverage of its commercial paper. 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 new borrowings offset by amortization**

University of Minnesota's debt is moderate relative to its financial resources and cash flow; however, total adjusted debt inclusive of the unfunded net pension liability is substantially higher and a credit constraint.

Future debt levels will remain manageable with debt repayment offsetting future new issuance. Over the period of 2022 to 2024 debt issuance of $277 million is planned offset by amortization of $236 million. The university expects to use CP to provide the initial funding of the projects until taken out by long-term debt. The current planned issuance of $33 million will be funded under the state’s appropriation backed debt per an agreement with the state, resulting in no impact to the university’s budget. The proceeds will be used for pre-construction and design of a clinical research facility.
Debt includes $45 million of University Gateway Corporation (USG) debt (Aa1 based on a guarantee of the University of Minnesota Foundation) and $230 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.

Total cash and investments provide a strong buffer to proforma total adjusted debt at 1.8x and 2.0x when state supported debt is excluded. Debt affordability is less favorable with total debt to cash flow at 4.7x fiscal due to relatively modest operating cash flow margins and compares to Aa1-rated median of 3.5x.

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. The university also has special purpose revenue bonds enhanced by a state appropriation pledge.

Debt structure
UM's only exposure to variable rate debt is its commercial paper, with $178 million outstanding at June 30, 2021 and projected to decrease to $147 million in fiscal 2022. 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 7/01/2025.

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 that could pressure operations as 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. Moodys adjusted net pension liability (ANPL) at June 30, 2020, using a standard discount rate is $1.6 billion, much higher than the reported unfunded liability of $206 million. UM's pro forma total adjusted debt of $3.1 billion is elevated but manageable given the university's scope. Contributions remain a 4% manageable amount of expenses.

ESG considerations

Environmental
Environmental considerations are not currently a key credit driver. For its largest campus in the Twin Cities in Minnesota, according to Moodys affiliate Four-Twenty-Seven, there is moderate risk for heat and water stress but low risk for extreme rainfall. Given the inland location the university has no exposure to rising sea levels or to hurricanes and typhoons.

Social
The state faces demographic challenges with slow projected growth in high school graduates and significant competition with other public universities and community colleges. It employs a strategy of seeking out of state residents that is having mixed results. Pricing capacity is limited for nonresidents that are located in non reciprocity states. More regionally located campuses including Duluth and Crookston, while accounting for a lower portion of students, are facing greater enrollment challenges than the Twin Cities campus. The capacity to maintain program relevance and meet state priorities will entail investments that are part of the university's strategic plan.

We regard the coronavirus outbreak as a social risk under our ESG framework as it continues to add to operational uncertainty given the substantial implications for public health and safety.

Governance
University of Minnesota's Board of Regents and leadership team display good fiscal oversight reflected in the strengthened unrestricted liquidity and balance sheet reserves. An engaged board support the university and one third are elected by a joint convention of both branches of the Legislature biennially to six year terms. A sound institutional framework that includes oversight and financial support, including annual appropriation and capital support by the state, supports sound governance.

The leadership team has good tenure diversity between long-serving and recently appointed management. A new President began her term in July 2019, joined by a new Provost and Senior VP of Finance during 2020. One of the key focuses of the new President is on strategic planning with a new plan, "M Pact 2025" approved in June 2020. The strategy includes increasing innovative education
delivery modes, greater collaboration with industry and community, innovation in health and fiscal stewardship including greater attention to risk management. Sound financial management and strategy includes sound expense controls and response to revenue shortfalls. Conservative debt management practices include amortization schedule that largely offsets new borrowing.

Rating methodology and scorecard factors

The Higher Education 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 Policy and Strategy on a qualitative basis, as described in the methodology.

university of minnesota

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<tr>
<th>Scorecard Factors and Sub-factors</th>
<th>Value</th>
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<td>Factor 1: Scale (15%)</td>
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<td>Adjusted Operating Revenue (USD Million)</td>
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<td>Factor 2: Market Profile (20%)</td>
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<td>Operating Environment</td>
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<td>Factor 3: Operating Performance (10%)</td>
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<tr>
<td>EBIDA Margin</td>
<td>8%</td>
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<td>Factor 4: Financial Resources and Liquidity (25%)</td>
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<tr>
<td>Total Cash and Investments (USD Million)</td>
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<td>Factor 5: Leverage and coverage (20%)</td>
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<td>Total Cash and Investment to Total Adjusted Debt</td>
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<td>Annual Debt Service Coverage</td>
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<td>Factor 6: Financial Policy and Strategy (10%)</td>
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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.

Fiscal 2020 results with pro forma debt of $34 million and debt maturities in fiscal 2021.

Source: Moody’s Investors Service
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