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Regents of the University of Minnesota University of Minnesota; CP; Public Coll/Univ - Unlimited Student Fees

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Table Of Contents

Rationale

Outlook

Enterprise Profile

Financial Profile

Regents of the University of Minnesota

University of Minnesota; CP; Public Coll/Univ - Unlimited Student Fees

Credit Profile		
US\$400.0 mil comm pap nts (University of Minnesota) ser G, H, I due 02/01/2042		
<i>Short Term Rating</i>	A-1+	New
Regents of the University of Minnesota, Minnesota		
University of Minnesota, Minnesota		
Regents of the University of Minnesota (University of Minnesota) comm pap nts (University of Minnesota) ser G, H, I due 02/01/2042		
<i>Short Term Rating</i>	A-1+	Affirmed
Univ of Minnesota ser 2004A, 1996A		
<i>Long Term Rating</i>	AA/Stable	Affirmed
University of Minnesota at Morris, Minnesota		
University of Minnesota, Minnesota		
University of Minnesota at Morris rev bnds ser 72 A B		
<i>Long Term Rating</i>	AA/Stable	Affirmed

Rationale

S&P Global Ratings assigned its 'A-1+' short-term rating to the Regents of the University of Minnesota's commercial paper (CP) notes series G, H, and I (taxable). At the same time, S&P Global Ratings affirmed its 'A-1+' short-term rating on the University of Minnesota's (UM) CP series A, B,C, D, E (taxable), and F CP notes. All previously issued CP notes (series A-F) plus the notes to be issued (series G-I) are encompassed within the university's \$400 million revolving CP Facility. S&P Global Ratings also affirmed its 'AA' long-term rating on the university's existing debt. The outlook on the long-term rating is stable.

We have assessed the University of Minnesota's enterprise and financial risk profiles as very strong. The enterprise risk profile reflects stable enrollment, with very good selectivity and student quality, and a solid management team. The financial risk profile reflects the university's consistent financial performance on a cash basis, with some weakening in fiscal 2017 due primarily to increased pension expenses and a decline in grants and contracts. Available resources to operations and debt are somewhat low for the rating category (offset by just over 20% of debt supported by state funds) and UM's maximum annual debt service (MADS) burden is moderate. The combined enterprise and financial risk profiles lead to an indicative stand-alone credit rating of 'aa+'. Our criteria indicate the final rating can be within one notch of the indicative credit level. In our view, the final long-term rating of 'AA' on the university's bonds better reflects UM's somewhat modest available resources for the rating category compared with medians and peers.

The 'A-1+' short-term rating, which applies to the university's authorized CP program, reflects our opinion of UM's

credit quality and its provision of self-liquidity in the event of failed CP rollovers. As of March 31, 2018, the university held cash, high quality, short-term fixed-income assets, U.S. Treasury and Agencies and investment grade debt totaling more than \$ 1 billion that when discounted comprised more than \$900 million. These assets provide ample coverage for the maximum authorized \$400 million CP program. S&P Global Ratings will monitor the sufficiency and the liquidity of assets identified for self-liquidity monthly.

The 'AA' long-term rating reflects our view of UM's:

- Position as Minnesota's flagship research university and land-grant institution;
- Stable enrollment with rising freshman applicants and matriculants such that enrollment should rise slowly in the near future, with the school's membership in the Big 10 Conference enhancing its solid academic, research, and sports programs;
- Manageable pro forma MADS burden of about 3.9% of adjusted operating expenses in fiscal 2017; and
- Favorable philanthropic support with slightly in excess of \$300 million in pledges and contributions received in each of the past three fiscal years.

Offsetting factors include our view of UM's:

- Weakened financial operations in fiscal 2017, primarily because of increased pension expenses;
- Significant pro forma debt of approximately \$1.5 billion (including the total \$400 million in approved CP notes that could be issued during our outlook period, plus planned principal repayments in that time); and
- Modest unrestricted available resources for a public flagship institution, with adjusted unrestricted net assets (UNA) of \$1.4 billion equal to 37.5% of 2017 adjusted operating expenses and about 95% of pro forma debt (including state-supported debt).

Management expects to use the CP program's net proceeds for various capital projects. All of the university's debt is fixed-rate, except for its CP program, which has \$238.5 million outstanding and could reach \$400 million during our outlook period.

Outlook

The stable outlook reflects our view that, over the next two years, UM's enrollment and demand trends will remain firm and its adjusted full-accrual financial operating performance will return to break-even or positive in fiscal 2018 and become more robust over time. This will facilitate growth in available resources, and we expect additional debt issuance, net of principal amortization on debt outstanding, to be modest.

Downside scenario

Credit factors that could lead to a negative rating action during the outlook period include a significant downturn in enrollment, or another adjusted full-accrual operating deficit due in part to an increase in pension expense or further decline in grant funding. In addition, reduced available resource to operations and debt ratios relative to peer institutions, or significant additional debt issuance without a commensurate increase in resources, could trigger a

negative rating action.

Upside scenario

We believe an upgrade is unlikely during the outlook period. However, we could consider a positive rating action beyond then if enrollment increases substantially and adjusted full-accrual financial performance is consistently positive while available resources increase significantly and additional debt is held to a minimum.

Enterprise Profile

UM, established in 1851, is both the flagship university in Minnesota and the state's designated land-grant college for agriculture. The main campus is in Minneapolis-St. Paul, and the university has four smaller campuses in Duluth, Crookston, Morris, and Rochester. UM receives about the same amount of state appropriations as the Minnesota State Colleges and Universities system. In addition to its undergraduate programs, the university offers graduate and professional programs in medicine, law, engineering, business, dentistry, pharmacy, and veterinary medicine. We understand from management that UM has one of the top chemical engineering programs in the world and that several of its schools or other programs are highly ranked nationally, including business, pharmacy, economics, political science, and public affairs.

We understand the university, UM Physicians (UMP)--a component unit of the university--and Fairview Health Services are finalizing terms of a letter of intent before June 30, 2018 to create an integrated academic health system to include the Fairview system and portions of UMP. The university has represented to S&P Global Ratings that both parties began the negotiation process last summer. However, negotiations were delayed somewhat after a leadership change at the university's school of medicine. UM management has indicated it anticipates a new agreement will result from this process, which will likely extend through 2026 and should improve the financial support to UM's medical school to support its research activities.

Management and governance

Eric Kaler has been UM's president since 2011. A board of regents that includes 12 members elected by the state legislature governs the university. The management team is very stable and has a history of conservative budgeting and finance practices. In November 2016, Dr. Brian D. Burnett was appointed senior vice-president for finance and operations; in December 2016, the board of regents confirmed his appointment as treasurer as well. Previously, Dr. Burnett held a similar position at the University of Missouri System. UM also welcomed Douglas R. Peterson in September 2016 as its new general counsel. Mr. Peterson has a background in both public and private law. The university made a change in its football coach, in 2016, and according to management, has had a major culture shift in its sports program after allegations of sexual violence against some of its football players. In this regard, we understand that UM is being more aggressive in complying with the Cleary Act.

Industry risk

Industry risk addresses the higher education sector's overall cyclical and competitive risk and growth by applying various stress scenarios and evaluating barriers to entry, levels and trends of profitability, substitution risk, and growth trends observed in the industry. We believe the higher education sector represents a low credit risk when compared to other industries and sectors.

Economic fundamentals

We view the university's geographic diversity as good, with about 34% of students coming from outside the state. Given that the majority of students are in-state, we base our assessment of UM's economic fundamentals on the local GDP per capita.

Market position and demand

Enrollment is stable, in our view, with favorable demand metrics. The university is increasingly selective in its admissions process, which we view positively. Enrollment for fall 2017 was 67,949, an increase of 0.7% from the fall 2016 enrollment of 67,480. About 65% of students are undergraduates, approximately 71% of whom come from Minnesota. With about 52,000 students in fall 2017, the Twin Cities campus is the largest in the UM system. Management reports expectations for stable enrollment in fall 2018.

In our view, demand is firm at the flagship Twin Cities campus, while admissions have generally been flat or declining slightly at other system campuses. The number of high school graduates in Minnesota is declining, but the number of applications has continued rising.

Freshmen applications for fall 2017 declined by 7.5% to 58,348 from the 62,072 applications received for the fall 2016 enrollment period, but acceptances and matriculants increased. Also, the university's freshmen applicants are academically better qualified, as indicated by an average ACT score of about 27 for fall 2017 (the national average is about 21) across all campuses. At the Twin Cities campus, the average ACT scores are even higher, at 28.4.

UM also has a favorable fundraising record and reports that fiscal years 2016 and 2017 were solid fundraising years, with over \$300 million raised in each year. The university is in the midst of a \$4 billion comprehensive campaign, which had raised over \$2.5 billion as of June 30, 2017.

Financial Profile

Financial management policies

UM has extensive financial policies, including investment policies and a debt policy, which we view favorably. It operates according to a five-year strategic plan and has a formal reserve liquidity policy. The university meets standard annual disclosure requirements. The financial policies assessment is neutral, reflecting our opinion that, while there may be some areas of risk, the organization's overall financial policies are not likely to impair its ability to pay debt service. Our analysis of financial policies includes a review of the organization's financial reporting and disclosure, investment allocation and liquidity, debt profile, contingent liabilities, and legal structure; and a comparison of these policies to those of comparable providers.

Financial performance

UM's financial performance had been improving, with positive adjusted full-accrual results recorded for each of the past two years, and cash financial performance has been consistently positive over the past five years. However, in fiscal 2017, significant pension expenses related to changes made at the state level to pension-related assumptions caused a significant increase in overall expenses and affected full-accrual adjusted operations.

In referring to an adjusted full-accrual basis, we take into account adjustments we make for investment gains and

losses, as well as certain other items consistent with our revised higher education criteria. After we adjusted UM's fiscal 2017 operations for realized and unrealized gains and losses for the year, as well as for approximately \$56.4 million in endowment draws, and \$20.9 million in recurring capital appropriations for operating expenses, we estimate that the university produced an \$81 million deficit for the year on a full-accrual basis, or a negative operating margin of 2.2%. However, including about \$208 million of depreciation expense in fiscal 2017, the cash results are much more favorable. Management reports that fiscal 2018 operating results are tracking to the current-year budget, and are likely to be better than fiscal 2017 given there have been no unexpected pension-related items in fiscal 2018.

For the fiscal 2016-2017 biennium, state funding levels were up (4.4% for fiscal 2016 and another 0.1% for fiscal 2017). Fiscal 2016 state funding was about \$625 million; the fiscal 2018 state appropriations increased 5.2% from the fiscal 2017 base level to \$659 million. UM is also a major research university and funds from grants and contracts account for 24% of total adjusted operating revenue. It reports its sponsored grants and contract awards totaled \$787.6 million in fiscal 2016, up 4.5% from the \$753.6 million awarded in fiscal 2015. In fiscal 2017, UM's award amounts from its grants and contracts decreased \$43.1 million to \$744.5 million or 5.5% from fiscal 2016 with over half of its research related to the health sciences.

Available resources

Available resources are modest, in our view, for a public flagship university, but adequate to support the rating, although lagging somewhat compared with those of other comparably rated flagship institutions. However, this is due in part, we believe, to approximately \$428 million in debt on UM's balance sheet supported by third parties, the largest component of which is \$273 million supported by state funds.

At June 30, 2017, the university had only about \$271.5 million of UNA, down from \$812 million in fiscal 2014, due to the implementation of GASB 68 in fiscal 2015. Adjusted UNA (which includes \$230 million of UNA of all component units, as well as a pension adjustment for GASB 68 and a long term OPEB liability adjustment) totaled about \$1.4 billion, equal to 37.5% of 2017 adjusted operating expenses, and 95% of pro forma post-issuance debt (about \$1.5 billion). Excluding third-party supported debt from our calculations, the university's adjusted UNA-to-debt ratio rises significantly and is more in line with that of comparably rated flagship universities.

UM benefits from a substantial endowment. As of June 30, 2017, it had \$1.35 billion in the university-held endowment and an additional \$2.15 billion in the University of Minnesota Foundation. In addition, it had an additional \$1.1 billion in its temporary investment pool (short-term reserve) fund. The endowment draw on the university-held endowment is 4.5% of a rolling 60-month market value average, which we consider standard.

Debt and contingent liabilities

UM has approximately \$1.5 billion in pro forma debt (including the \$400 million maximum allowed under the CP program). The pro forma MADS burden remains moderate, in our view, at about 3.9% of fiscal 2017 expenses.

The university and its employees contribute to pension plans characterized as either a defined benefit or defined contribution. The majority of university employees participate in The State Employees Retirement Fund (SERF), which the Minnesota State Retirement System administers. SERF provides coverage to approximately 16 employers within the State of Minnesota. UM's participation in SERF covers approximately 8,900 active civil service and non-faculty bargaining unit employees. Participation is mandatory and begins from the first day of employment. The plan provides

retirement, survivor, and disability benefits. Benefit provisions are established by state statute and can only be modified by state legislature. UM also participates in the defined-benefit pension plan of the Public Employee Police and Fire Fund (for its 63 active law enforcement staff). In addition, the university has other defined-contribution plans in which it participates that it funds on a pay-as-you-go basis.

UM made the required pension contributions of \$135.3 million, or a manageable 4% of operations, for these plans in fiscal 2017. However, the potential for growth in required contributions will require significant planning to manage obligations. We believe the university has contingent liability risk exposure associated with future pension obligations due to the low 47.5% funded ratio of the SERF pension plan. We also understand it has a \$156.7 million net other postemployment benefit obligation at fiscal year-end 2017 (June 30).

Notable factors affecting UM's total net pension liability reported for at fiscal year-end 2017, involved changes to SERF's actuarial valuation assumptions. Part of the assumption changes included changes to the single discount rates. For example, for SERF, the single discount rate changed to 7.90% from 4.17%.

University of Minnesota--Enterprise And Financial Statistics						
--Fiscal year ended June 30--						
	2018	2017	2016	2015	2014	Medians for 'AA' rated public colleges and universities, 2016
Enrollment and demand						
Headcount	67,949	67,480	66,651	67,477	68,047	MNR
Full-time equivalent	61,994	61,119	60,620	60,950	61,481	32,506
Freshman acceptance rate (%)	54.9	50.2	49.8	50.9	49.7	69.3
Freshman matriculation rate (%)	28.2	27.6	28.8	29.5	31.3	MNR
Undergraduates as a % of total enrollment (%)	65.6	65.1	65.2	64.3	64.1	77.7
Freshman retention (%)	89.4	89.8	88.0	88.2	86.9	86.0
Graduation rates (six years) (%)	74.9	73.6	73.3	78.7	N.A.	MNR
Income statement						
Adjusted operating revenue (\$000s)	N.A.	3,682,080	3,688,071	3,577,057	3,508,009	MNR
Adjusted operating expense (\$000s)	N.A.	3,763,405	3,593,598	3,534,219	3,511,617	MNR
Net adjusted operating income (\$000s)	N.A.	(81,325)	94,473	42,838	(3,608)	MNR
Net adjusted operating margin (%)	N.A.	(2.16)	2.63	1.21	(0.10)	1.46
Estimated operating gain/loss before depreciation (\$000s)	N.A.	127,320	307,442	261,403	189,097	MNR
Change in unrestricted net assets (UNA; \$000s)	N.A.	(186,010)	182,409	(537,259)	(7,790)	MNR
State operating appropriations (\$000s)	N.A.	650,749	663,705	642,069	614,791	MNR
State appropriations to revenue (%)	N.A.	17.7	18.0	17.9	17.5	19.4
Student dependence (%)	N.A.	39.6	38.8	39.0	38.7	41.8

University of Minnesota--Enterprise And Financial Statistics (cont.)

--Fiscal year ended June 30--

	2018	2017	2016	2015	2014	Medians for 'AA' rated public colleges and universities, 2016
Research dependence (%)	N.A.	24.5	24.3	24.4	23.9	MNR
Endowment and investment income dependence (%)	N.A.	2.5	2.6	2.7	2.6	0.8
Debt						
Outstanding debt (\$000s)	N.A.	1,411,264	1,441,043	1,389,652	1,209,982	698,540
Total pro forma debt (\$000s)	N.A.	1,482,622	N.A.	N.A.	N.A.	MNR
Pro forma MADS	N.A.	144,160	N.A.	N.A.	N.A.	MNR
Current debt service burden (%)	N.A.	3.75	3.67	3.51	3.35	MNR
Pro forma MADS burden (%)	N.A.	3.83	N.A.	N.A.	N.A.	MNR
Financial resource ratios						
Endowment market value (\$000s)	N.A.	3,490,000	3,306,000	3,297,000	3,183,000	748,837
Related foundation market value (\$000s)	N.A.	2,684,387	2,572,548	2,557,373	2,404,742	606,279
Cash and investments (\$000s)	N.A.	2,528,495	2,587,253	2,558,385	2,402,331	MNR
UNA (\$000s)	N.A.	271,496	457,506	275,097	812,356	MNR
Adjusted UNA (\$000s)	N.A.	1,412,960	1,336,429	1,225,336	1,100,696	MNR
Cash and investments to operations (%)	N.A.	67.2	72.0	72.4	68.4	54.7
Cash and investments to debt (%)	N.A.	179.2	179.5	184.1	198.5	159.6
Cash and investments to pro forma debt (%)	N.A.	170.5	N.A.	N.A.	N.A.	MNR
Adjusted UNA to operations (%)	N.A.	37.5	37.2	34.7	31.3	31.9
Adjusted UNA plus debt service reserve to debt (%)	N.A.	100.1	92.7	88.2	91.0	89.7
Adjusted UNA plus debt service reserve to pro forma debt (%)	N.A.	95.3	N.A.	N.A.	N.A.	MNR
Average age of plant (years)	N.A.	15.3	14.2	13.1	13.8	12.9
OPEB liability to total liabilities (%)	N.A.	3.6	5.0	4.3	5.2	MNR

Note: Total adjusted operating revenue equals unrestricted revenue less realized and unrealized gains/losses and financial aid. Total adjusted operating expense equals unrestricted expense plus financial aid expense. Net operating margin equals 100*(net adjusted operating income/adjusted operating expense). Student dependence equals 100*(gross tuition revenue plus auxiliary revenue) / adjusted operating revenue. Current debt service burden equals 100*(current debt service expense/adjusted operating expenses). Current MADS burden equals 100*(maximum annual debt service expense/adjusted operating expenses). Cash and investments equals cash plus short-term and long-term investments. Adjusted UNA equals Unrestricted net assets plus unrestricted net assets of the foundation. Average age of plant equals accumulated depreciation/depreciation and amortization expense. Adjusted UNA equals UNA plus UNA foundation, pension liability adjustment, and long-term OPEB liability adjustment. Pro forma debt equals total debt outstanding at June 30, 2018, plus the full issuance of \$400 million in commercial paper, minus principal repayments through January 2020. OPEB--Other postemployment benefits. UNA--Unrestricted net assets. MNR--Median not reported. N.A.--Not available.

Ratings Detail (As Of May 24, 2018)

Univ of Minnesota Crookston Dorm bonds ser AB

Long Term Rating

AA/Stable

Affirmed

Ratings Detail (As Of May 24, 2018) (cont.)

Regents of the University of Minnesota, Minnesota

University of Minnesota, Minnesota

Regents of the University of Minnesota (University of Minnesota)

Long Term Rating AA/Stable Affirmed

Regents of the University of Minnesota (University of Minnesota) commercial paper nts (University of Minnesota) ser F dtd 02/15/2017 due 02/15/2042

Short Term Rating A-1+ Affirmed

Regents of the University of Minnesota (University of Minnesota) CP

Short Term Rating A-1+ Affirmed

Regents of the University of Minnesota (University of Minnesota) CP - 2007

Short Term Rating A-1+ Affirmed

Regents of the University of Minnesota (University of Minnesota) GO bnds

Long Term Rating AA/Stable Affirmed

Regents of the University of Minnesota (University of Minnesota) GO bnds (University of Minnesota) ser 2017A due 09/01/2042

Long Term Rating AA/Stable Affirmed

Regents of the University of Minnesota (University of Minnesota) GO rfdg bnds (University of Minnesota) ser 2017B due 12/01/2036

Long Term Rating AA/Stable Affirmed

Regents of the University of Minnesota (University of Minnesota) GO taxable rfdg bnds (University of Minnesota) ser 2017C due 04/01/2029

Long Term Rating AA/Stable Affirmed

University of Minnesota Regents (University of Minnesota) CP - D

Short Term Rating A-1+ Affirmed

University of Minnesota Regents (University of Minnesota) CP - 2005

Short Term Rating A-1+ Affirmed

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