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

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Regents of the University of Minnesota

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

Credit Profile

US\$50.1 mil commercial paper nts (University of Minnesota) ser F dtd 02/15/2017 due 02/15/2042

Short Term Rating A-1+ New

Regents of the University of Minnesota, Minnesota

University of Minnesota, Minnesota

Univ of Minnesota ser 2004A, 1996A

Long Term Rating AA/Stable Affirmed

University of Minnesota at Morris, Minnesota

University of Minnesota, Minnesota

University of Minnesota at Morris rev bnds ser 72 A B

Long Term Rating AA/Stable Affirmed

Rationale

S&P Global Ratings assigned its 'A-1+' short-term rating to \$50.1 million Regents of the University of Minnesota (UM) commercial paper (CP) notes series F. In addition, we affirmed our 'A-1+' short term rating on UM's outstanding CP series A, B, C, and D, and taxable CP notes series E. Finally, we affirmed our 'AA' long-term rating on the university's existing debt, various series. The outlook on UM's long-term rating is stable.

We have assessed the university's enterprise and financial risk profiles as very strong. The enterprise risk profile reflects stable enrollment with very good selectivity and student quality. The financial risk profile reflects the university's improved financial performance with positive results on an adjusted full-accrual basis for each of the past two years following essentially break even performance in fiscal years 2012 through 2014, available resources to operations and debt that we view as somewhat low for the rating category (offset by just over 20% of debt supported by state funds), and a moderate maximum annual debt service (MADS) burden. 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 CP rollovers. As of Dec. 31, 2016, the university held cash and high-quality, short-term fixed-income assets of approximately \$993.30 million that when discounted total \$861.44 million, which provides ample liquidity at 3.3x pro forma coverage of the approximately \$262.32 million in CP that will be outstanding after the current issuance.

The 'AA' long-term rating further reflects our view of the university's:

- Position as Minnesota's flagship research university and land-grant institution;
- Stable enrollment with rising freshman applicants and matriculants such that enrollment should grow slowly in the near future with the school's membership in the Big 10 Conference enhancing its solid academic, research and sports programs;
- Improved financial performance on an adjusted full-accrual basis in fiscal years 2015 and 2016;
- Manageable pro forma MADS burden of about 3.8% of adjusted operating expenses in fiscal 2016; and
- Favorable philanthropic support with slightly in excess of \$300 million in pledges and contributions received in each of the past two fiscal years.

Offsetting factors include our view of UM's:

- Just under a 20% increase in debt to \$1.44 billion in fiscal 2016 on a pro forma basis (including the current issuance) from \$1.21 billion at the end of fiscal 2011 and planned additional debt issuance of \$248.5 million over the next two fiscal years while we note the university will pay off slightly in excess of \$160 million in debt over that same period; and
- Modest unrestricted available resources for a public flagship institution, with adjusted unrestricted net assets (UNA) of \$1.3 billion equal to 37% of 2016 adjusted operating expenses and about 93% of post-issuance debt \$1.44 billion (including state-supported debt).

All of the university's debt is fixed rate, except for its CP program, which has \$212.2 million currently outstanding. Therefore, at this time, about 82% of the university's total pro forma debt (including the current CP issuance) is fixed rate.

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, UM offers graduate and professional programs in medicine, law, engineering, business, dentistry, pharmacy, and veterinary medicine, among others. Research activity is substantial, with \$898 million in grants and contracts revenue received in fiscal 2016, up from \$872.4 million in fiscal 2015.

We understand the university remains in dialogue with UMP (UM Physicians), a component unit of the university, and Fairview Health Services to create a single, integrated academic health system to include the Fairview system and the entirety of UMP. An attempt to create such an integrated system last year that was to be known as M Health, a separate legal entity, did not come to fruition.

Outlook

The stable outlook reflects our continued view that over the next two years, UM's enrollment and demand trends will remain firm and its financial operating performance on an adjusted full-accrual basis will remain positive and become more robust. This will facilitate growth in available resources while additional debt issuance, net of principal amortization on outstanding debt, is expected to be modest.

Downside scenario

Credit factors that could lead to a negative rating action during the outlook period include an unexpected decline in enrollment, operating deficits on a full-accrual adjusted basis, a decline in available resource to operations and debt ratios relative to peer institutions, or significant additional debt issuance.

Upside scenario

We believe a positive rating action is unlikely during the outlook period. However, we could consider a positive rating action if the university's enrollment grows substantially and its financial performance remains positive and firm on an adjusted full-accrual basis while available resources increase significantly and additional debt is held to a minimum.

Enterprise Profile

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 39% of students coming from outside the state. Given that the majority of students are in-state, our assessment of UM's economic fundamentals is based on the local GDP per capita.

Market position and demand

Enrollment is stable, in our view, with favorable other demand metrics. The university is increasingly selective in its admissions process, which we view positively. University enrollment for fall 2016 was 67,480, an increase of 1.2% from the fall 2015 enrollment of 66,651. About 65% of students are undergraduates, approximately 71% of whom come from Minnesota. With about 52,000 students in fall 2016, the Twin Cities campus is the largest in the UM system. Management indicates that the UM-Twin Cities campus is in the second year of a five-year enrollment management program that has a goal of adding approximately 2,000 additional undergraduates to total enrollment.

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

Applications for fall 2016 rose by 6.1% to 62,072 from the 58,530 applications received for the fall 2015 enrollment period. Also, the university's freshmen applicants are academically better qualified students, as indicated by an average ACT score of about 27 for fall 2016 (the national average is about 21) across all campuses. At the Twin Cities campus, the average ACT scores are even higher at 28.3.

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.

The university also has a favorable fundraising record and continues to raise funds on a project-by-project basis. Management reports that fiscal years 2015 and 2016 were solid fundraising years with over \$300 million raised in each year.

Management and governance

Eric Kaler has been the university's president since 2011. The university is governed by a board of regents that includes 12 members elected by the state legislature. We understand 4 of the 12 regent seats are up for election this year. However, it's possible that some of the same members currently filling these seats may be re-elected. 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 and 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. The university 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 currently has an interim appointee in the role of vice president and chief information officer. It also made a change in its football coach late last year 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 the university is being more aggressive in its compliance with the Cleary Act.

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 future 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 comparable providers.

Accounting change

In line with our Dec. 15, 2015 publication "Assessing The Impact Of GASB 68 On U.S. Public Universities And Charter Schools," we have recorded adjustments starting in audit fiscal year-end 2015 to adjust out the effects of Governmental Accounting Standards Board (GASB) statement 68, "Accounting and Financial Reporting for Pensions—An amendment of GASB Statement No. 27." We believe these adjustments result in financial metrics more fairly representative of the legal obligations and expenses for which the operating entity is responsible.

Financial performance

UM's financial results are improving with positive financial results recorded on an adjusted full-accrual basis for each of the past two years after essentially break even operations in fiscal years 2012 through 2014. Financial performance has been consistently positive over the past five years on a cash basis. When we refer to an adjusted full-accrual basis, this takes 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 2016 operations for realized and unrealized gains and losses for the year, as well as for approximately \$54 million in endowment draws, and \$40 million in recurring capital appropriations for operating expenses, we estimate that the university produced a \$94 million surplus for the year on a full-accrual basis, or an operating margin of positive 2.63%. However, when we include about \$213 million of depreciation expense in fiscal 2016, the results on a cash basis are much more favorable. We estimate that the university produced an adjusted full-accrual surplus of \$43 million, or positive 1.21% in fiscal 2015.

Management reports that fiscal 2017 operating results are tracking to the current-year budget.

State operating appropriations remain an important source of university revenue at 18% of total adjusted fiscal 2016 operating revenue. 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 request is for an increase of 7.8% from the beginning fiscal 2018 base level to \$675 million. At the same time, the university raised tuition for resident undergraduate students at its Twin Cities campus in fiscal 2017 by 2.5% to \$12,546. In the prior year, the tuition increase for resident undergraduates at that campus was 1.5%. Tuition accounted for 28% of fiscal 2016 total adjusted operating revenue. UM is also a major research university and funds from grants and contracts account for 24% of total adjusted operating revenue. The university 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.

Available resources

Available resources are modest, in our view, for a public flagship university, but adequate to support the rating, although lagging somewhat in comparison to other comparably rated flagship institutions. However, this is due in part, we believe, to approximately \$441 million in debt on the university's balance sheet that is supported by third parties, the largest component of which is \$283 million supported by state funds. At June 30, 2016, the university had only about \$458 million of UNA, down from \$812 million in fiscal 2014, due to the implementation of GASB 68 in fiscal 2015. Adjusted UNA (which include \$223 million of UNA of all component units, as well as an adjustment for GASB 68) totaled about \$1.3 billion, equal to 37% of 2016 adjusted operating expenses, and 93% of pro forma post-issuance debt (\$1.4 billion). With the university's improved financial performance over the past two years its UNA-to-expenses ratio and UNA-to-debt ratios are now comparable to our 'AA' rating category medians of 30.3% and 86.7%, respectively. If we exclude third-party supported debt from our calculations, the university's adjusted UNA-to-debt ratio would rise to 134% from 93% and be more in line with comparably rated flagship universities.

UM benefits from a substantial endowment. As of June 30, 2016, it had \$1.3 billion in the university-held endowment and an additional \$2 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

The university has approximately \$1.4 billion in pro forma debt (including the current CP issuance). The pro forma MADS burden remains moderate, in our view, at about 3.8% of fiscal 2016 expenses. The university's capital spending has been somewhat high for the past three years, totaling \$288.7 million, \$277.9 million, and \$225.8 million in fiscal years 2016, 2015, and 2014, respectively, compared to its annual depreciation of \$213.0 million in fiscal 2016. The CP

offering statement notes that as of Nov. 30, 2016, the university has approximately \$906.2 million (unaudited) in regent-approved capital improvements in various stages of design and construction and had paid approximately \$358.5 million toward the cost of these projects with the balance of \$547.7 million, including both contracted and intended future obligations that will be funded by university- and state-supported debt, fundraising, and other funding sources.

The university's last bond issue, the series 2016A issue, funded capital projects including improvements to the combined heat and power plant, renovation of the Tate Science and Teaching Building, research laboratory improvements, and construction of a James Ford Bell Museum and Planetarium (all at the Twin Cities campus), and construction of a wellness center at the Crookston campus. Typically, the university uses CP for bridge financing for initial project costs, retiring it later from more permanent funding sources. The current CP issuance of approximately \$50 million is being used for completion of the renovation and improvements to the combined heat and power plant. The \$248.5 million additional debt currently planned for the next two fiscal years includes funding of approximately \$120 million for the athletic village, \$29.2 million in property purchases under consideration, and \$52 million for a portion of a student housing and dining renovation.

The university participates in the defined-benefit pension plans of the Public Employee Police and Fire Fund (for its 64 active law enforcement staff) and the State Employees' Retirement Fund. Its proportionate share of the net pension liability of these funds as of fiscal 2016 is \$244.4 million. The university made the required contributions of \$23.9 million for these plans in fiscal 2016. We understand the state is ultimately statutorily responsible for these plans. In addition, the university has other defined-contribution plans in which it participates that it funds on a pay-as-you-go basis. We also understand it has a \$138.2 million net other postemployment benefit obligation at fiscal year-end 2016.

University of Minnesota -- Selected Financial Statistics

	Fiscal year ended June 30					Medians
	2017	2016	2015	2014	2013	Public colleges and universities 'AA' 2015
Enrollment and demand						
Headcount	67,480	66,651	67,477	68,047	68,418	MNR
Full-time equivalent	61,119	60,620	60,950	61,481	61,794	32,632
Freshman acceptance rate (%)	50.3	50.2	51.1	50.0	54.5	71.7
Freshman matriculation rate (%)	28.0	28.9	29.5	31.3	31.2	MNR
Undergraduates as a % of total enrollment (%)	65.1	65.2	64.3	64.1	64.0	77.7
Freshman retention (%)	90.0	88.0	88.2	86.9	86.8	85.5
Graduation rates (five years) (%)	N.A.	N.A.	N.A.	N.A.	N.A.	MNR
Income statement						
Adjusted operating revenue (\$000s)	N.A.	3,688,071	3,577,057	3,508,009	3,361,735	MNR
Adjusted operating expense (\$000s)	N.A.	3,593,598	3,534,219	3,511,617	3,347,317	MNR
Net adjusted operating income (\$000s)	N.A.	94,473	42,838	(3,608)	14,418	MNR
Net adjusted operating margin (%)	N.A.	2.63	1.21	(0.10)	0.43	2.10
Estimated operating gain/loss before depreciation (\$000s)	N.A.	307,442	261,403	189,097	207,557	MNR

University of Minnesota -- Selected Financial Statistics (cont.)

	Fiscal year ended June 30					Medians
	2017	2016	2015	2014	2013	Public colleges and universities 'AA' 2015
Change in unrestricted net assets (UNA; \$000s)	N.A.	182,409	(537,259)	(7,790)	92,798	MNR
State operating appropriations (\$000s)	N.A.	663,705	642,069	614,791	575,491	MNR
State appropriations to revenue (%)	N.A.	18.0	17.9	17.5	17.1	21.0
Student dependence (%)	N.A.	38.8	39.0	38.7	39.4	42.4
Healthcare operations dependence (%)	N.A.	N.A.	N.A.	N.A.	N.A.	MNR
Research dependence (%)	N.A.	24.3	24.4	23.9	24.9	MNR
Endowment and investment income dependence (%)	N.A.	2.6	2.7	2.6	1.4	0.8
Debt						
Outstanding debt (\$000s)	N.A.	1,391,043	1,389,652	1,209,982	1,300,730	646,050
Proposed debt (\$000s)	N.A.	50,100	N.A.	N.A.	N.A.	MNR
Total pro forma debt (\$000s)	N.A.	1,441,143	N.A.	N.A.	N.A.	MNR
Pro forma MADS	N.A.	136,043	N.A.	N.A.	N.A.	MNR
Current debt service burden (%)	N.A.	3.67	3.51	3.35	3.43	MNR
Current MADS burden (%)	N.A.	3.76	3.46	N.A.	N.A.	3.70
Pro forma MADS burden (%)	N.A.	3.79	N.A.	N.A.	N.A.	MNR
Financial resource ratios						
Endowment market value (\$000s)	N.A.	3,307,000	3,298,000	3,183,000	1,075,466	642,929
Related foundation market value (\$000s)	N.A.	2,572,548	2,557,373	2,404,742	2,155,332	612,539
Cash and investments (\$000s)	N.A.	2,587,253	2,558,385	2,402,331	2,259,701	MNR
UNA (\$000s)	N.A.	457,506	275,097	812,356	820,146	MNR
Adjusted UNA (\$000s)	N.A.	1,336,429	1,225,336	1,100,696	1,033,639	MNR
Cash and investments to operations (%)	N.A.	72.0	72.4	68.4	67.5	51.7
Cash and investments to debt (%)	N.A.	186.0	184.1	198.5	173.7	162.6
Cash and investments to pro forma debt (%)	N.A.	179.5	N.A.	N.A.	N.A.	MNR
Adjusted UNA to operations (%)	N.A.	37.2	34.7	31.3	30.9	30.3
Adjusted UNA plus debt service reserve to debt (%)	N.A.	96.1	88.2	91.0	79.5	86.7
Adjusted UNA plus debt service reserve to pro forma debt (%)	N.A.	92.7	N.A.	N.A.	N.A.	MNR
Average age of plant (years)	N.A.	14.2	13.1	13.8	13.1	12.4
OPEB liability to total liabilities (%)	N.A.	5.0	4.3	5.2	4.3	MNR

N.A.--Not available. MNR--Median not reported.

Ratings Detail (As Of February 9, 2017)

Univ of Minnesota Crookston Dorm bonds ser AB

Long Term Rating

AA/Stable

Affirmed

Regents of the University of Minnesota, Minnesota

University of Minnesota, Minnesota

Ratings Detail (As Of February 9, 2017) (cont.)

Regents of the University of Minnesota (University of Minnesota)		
<i>Long Term Rating</i>	AA/Stable	Affirmed
Regents of the University of Minnesota (University of Minnesota) CP		
<i>Short Term Rating</i>	A-1+	Affirmed
Regents of the University of Minnesota (University of Minnesota) CP - 2007		
<i>Short Term Rating</i>	A-1+	Affirmed
Regents of the University of Minnesota (University of Minnesota) GO bnds		
<i>Long Term Rating</i>	AA/Stable	Affirmed
University of Minnesota Regents (University of Minnesota) CP - D		
<i>Short Term Rating</i>	A-1+	Affirmed
University of Minnesota Regents (University of Minnesota) CP - 2005		
<i>Short Term Rating</i>	A-1+	Affirmed

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