MOODY'S INVESTORS SERVICE

New Issue: Moody's assigns Aa1 to University of Minnesota's $10M Series 2015B GO Bds; outlook stable

Global Credit Research - 03 Aug 2015

$1.4B rated debt (including full CP and University Gateway Corp.)

UNIVERSITY OF MINNESOTA, MN
Public Colleges & Universities
MN

Moody's Rating

ISSUE	RATING
General Obligation Taxable Bonds, Series 2015B	Aa1
Sale Amount $10,055,000	
Expected Sale Date 08/11/15	
Rating Description Revenue: Public University Broad Pledge	

Moody's Outlook

NEW YORK, August 03, 2015 --Moody's Investors Service assigns a Aa1 rating to the University of Minnesota's Taxable General Obligation Bonds, Series 2015B. The rating outlook is stable.

SUMMARY RATING RATIONALE

The Aa1 rating reflects University of Minnesota's (UM) strong student and research market positions and ample financial resources and liquidity. Although state operating support has been modest in recent years, the university receives good capital support in the form of debt service on $333 million of its debt.

These are offset by weakening operating performance and expected additional debt issuance.

OUTLOOK

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

WHAT COULD MAKE THE RATING GO UP

- Substantial growth in balance sheet reserves combined with sustained, notable improvement in operating performance.

WHAT COULD MAKE THE RATING GO DOWN

- Failure to improve operations and cash flow

- Additional debt increase without improved operations

STRENGTHS

- Strong market position as state's flagship research and land grant university and Big Ten member

- Large research university with total research awards of $741 million for fiscal year (FY) 2014

- Ample balance sheet reserves with unrestricted monthly liquidity of $1.5 billion or 176 days.

- Strong fundraising despite no formal campaign underway, with $282 million of FY 2014 gift revenues

- Ample university self-liquidity supporting the P-1 commercial paper rating

CHALLENGES

- Weaker operations and cash flow in FY 2014 with a 5.6% operating cash flow margin due to several non-recurring expenses, with performance expected to improve in FY2015

- Ongoing capital and debt plans of up to $150 million through FY 2017

- Challenges to grow research funding, important with the addition of four research buildings

RECENT DEVELOPMENTS

Recent developments are included in DETAILED RATING RATIONALE.

DETAILED RATING RATIONALE

MARKET POSITION: STRONG STUDENT DEMAND AND MAJOR RESEARCH ROLE

The University of Minnesota will maintain a strong market position driven by student demand for the state's flagship and land grant institution and Big 10 conference member. Fall 2014 enrollment was 60,950 FTEs, with 29% non-resident and international students. Growth of enrollment at the Twin Cities campus has been limited, but the university intends to modestly expand its enrollment in the STEM (science, technology, engineering and mathematics) academic areas.

UM is one of the nation's leading research universities, with $741 million of research awards in FY 2014. Research activity will grow as its Minneapolis biomedical research facilities open or are completed through 2016. The State Legislature enacted legislation providing state support for debt service on 75%, or about $220 million, of a total $292 million of the facilities. The state funding provides UM time to recruit researchers for the facilities and grow its research activities and indirect cost recovery to pay for the facilities' operating costs.

OPERATING PERFORMANCE, BALANCE SHEET, AND CAPITAL PLANS: WEAKER CASH FLOW GENERATION, WITH WELL-DIVERSIFIED REVENUE BASE; GROWING FINANCIAL RESERVES AND LIQUDITY SUPPORT DEBT AND OPERATIONS

The University of Minnesota is expected to generate balanced, but not strong, operating performance and cash flow generation in FY 2015. For FY 2014, operating performance weakened, with the cash flow margin declining to 5.6% from 8.9% in FY 2013, which itself was down from over 10% the prior two years. However, the cash flow margin improves to 7.6% in FY 2014 when excluding non-recurring expenses. The university expects FY 2015 cash flow to be at least comparable if not improved.

Revenue sources are diverse, contributing to operating stability. But revenue growth will be modest. Although the state provided UM additional state operating appropriations (approximately 20% of total operation revenue) in FY 2014 and FY 2015, the increases were tied to a university commitment to hold undergraduate in-state tuition flat for those years. For the FY 2016-2017 biennium, the state approved a $26.6 million increase in state operating appropriations for FY 2016, with no additional increase in FY 2017. The board approved only a 1.5% tuition increase for fall 2015 (FY 2016) for resident undergraduate students. Both will constrain cash flow growth.

The State of Minnesota is rated Aa1 with a stable outlook for its general obligation bonds. For more information, see Moody's report of July 31, 2015.

UM's balance sheet profile will remain strong, helping support the current debt issuance. For FY 2014, total resources of $4.3 billion included $2.2 billion of foundation resources. Expendable resources of $3.0 billion cushion total pro-forma debt a sound 2.2 times. Total debt includes $51 million of University Gateway Corporation (UGC) debt and $301 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.

However, the university has significant debt plans over the next two to three years, currently considering issuing up to $329 million of debt over the current FY 2016 through FY 2018.

Projects include $100 million to fund construction of its Combined Heat and Power plant (CHP), about $44 million to fund its one-third share of state-approved capital requests, and $66 million in land purchases. An additional project is the Athletic Village for athletic facilities. The borrowings are subject to construction timing, gifts and UM's use of its own reserves for the projects. The debt plans are substantial, particularly in light of thin cash flow. Moody's will assess the impact of new debt issuance in light of operations and project funding sources.

Fundraising is strong, with rising gift revenue even though the university is not conducting a university-wide campaign. For FY 2014, annual gift revenues were $282 million, the highest in at least five years. UM reports record fundraising for the recently completed FY 2015. The university is planning for a comprehensive campaign but the timing and goals have not yet been finalized.

Liquidity

Unrestricted liquidity is ample at $1.46 billion, translating to 176 days. Unrestricted liquidity provides a strong 489% cushion to demand debt, including UGC's bonds.

The university's endowment is managed by its Office of Investments and Banking in conjunction with external managers. The portfolio allocation is favorably diversified, with 23% in global equities, 25% in marketable alternatives, 11% in real assets, 22% in private equity and 19% in bonds and cash.

DEBT STRUCTURE AND LEGAL COVENANTS

Debt Structure

Included in UM's total debt are $272 million of Special Purpose Revenue Bonds issued by the university, supported by a standing appropriation from the state, subject to the governor's unallotment authority, for full payment of debt service. Also included is $51 million of University Gateway Corporation (rated Aa1 based on a guarantee of the University of Minnesota Foundation). Currently UM's only variable rate debt is its commercial paper (Series A, B, C, D and current E) with pro forma $233 million outstanding. UGC has three variable rate bonds with the tender feature supported by a Standby Bond Purchase Agreement from Wells Fargo Bank, N.A. (rated Aa1/P-1) expiring on 8/31/2016. For more information on UGC, see Moody's report dated February 2, 2015

Debt-Related Derivatives

UM has one $70 million notional interest rate swap with JPMorgan Chase Bank, N.A. (rated Aa3/P-1) maturing in August 2017 and with a negative $7.2 million fair market value at June 30, 2015. No collateral posting is required unless UM's rating is below Baa2 by Moody's and BBB by Standard and Poor's.

Pensions and OPEB

UM's retirement benefits are currently manageable at about 4% of total expenses for FY 2014. University of Minnesota's faculty and staff receive retirement benefits through a number of plans provided by the federal government, the state and by the university. Most of the UM's employees participate in the State Employee's Retirement Fund (SERF), a defined benefit plan with equal contributions by both the university and employees. For FY 2014, UM contributed $20 million to SERF. The university also contributes to a number of defined contribution plan, the large the Faculty Retirement Plan, to which UM contributed $99 million in FY 2014. The university also provides retiree healthcare benefits, funding on a pay-as-you-go basis and making a $5 million contribution in FY 2014.

GOVERNANCE AND MANAGEMENT

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.

KEY STATISTICS (FY 2014 financial data, fall 2014 enrollment data)

- Full-Time Equivalent Enrollment: 60,950 students

- Total Financial Resources: $4.3 billion

- Total Cash & Investments: $2.3 billion (university only)

- Total Pro-forma Direct Debt: $1.37 billion

- Total Operating Revenue: $3.2 billion

- Reliance on Tuition & Auxiliaries Revenue (% of Moody's Adjusted Operating Revenue): 35%

- Reliance on State Appropriations Revenue (% of Moody's Adjusted Operating Revenue): 19%

- Monthly Days Cash on Hand: 176 days

- Operating Cash Flow Margin: 5.6%

- Three-Year Average Debt Service Coverage: 2.3 times

- State of Minnesota GO Rating: Aa1, stable outlook

OBLIGOR PROFILE

University of Minnesota, founded in 1851, has a national market position as the state's flagship and land grant university and a Big 10 conference member. One of the nation's largest research universities, total revenues exceed $3 billion and enrollment was over 60,000 FTE students for fall 2014 at its Twin Cities, Duluth, Crookston, and Rochester campuses.

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.

USE OF PROCEEDS

Proceeds of the Series 2015B bonds will be used to fund the predesign and design of improved health education and clinical research facilities on the Twin Cities campus and pay issuance costs.

RATING METHODOLOGY

The principal methodology used in this rating was U.S. Not-for-Profit Private and Public Higher Education published in August 2011. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

For ratings issued on a program, series or category/class of debt, this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the rating action on the support provider and in relation to each particular rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

The following information supplements Disclosure 10 ("Information Relating to Conflicts of Interest as required by Paragraph (a)(1)(ii)(J) of SEC Rule 17g-7") in the regulatory disclosures made at the ratings tab on the issuer/entity page on www.moodys.com for each credit rating:

Moody's was not paid for services other than determining a credit rating in the most recently ended fiscal year by the person that paid Moody's to determine this credit rating.

Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

Please see www.moodys.com for any updates on changes to the lead rating analyst and to the Moody's legal entity that has issued the rating.

Please see the ratings tab on the issuer/entity page on www.moodys.com for additional regulatory disclosures for each credit rating.

Analysts

Diane F. Viacava
Lead Analyst
Public Finance Group
Moody's Investors Service

Eva Bogaty
Additional Contact
Public Finance Group
Moody's Investors Service

Contacts

Journalists: (212) 553-0376
Research Clients: (212) 553-1653

Moody's Investors Service, Inc.
250 Greenwich Street
New York, NY 10007
USA

consequently, the rated obligation will not qualify for certain types of treatment under U.S. laws. MJKK and MSFJ are credit rating agencies registered with the Japan Financial Services Agency and their registration numbers are FSA Commissioner (Ratings) No. 2 and 3 respectively.

MJKK or MSFJ (as applicable) hereby disclose that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by MJKK or MSFJ (as applicable) have, prior to assignment of any rating, agreed to pay to MJKK or MSFJ (as applicable) for appraisal and rating services rendered by it fees ranging from JPY200,000 to approximately JPY350,000,000.
MJKK and MSFJ also maintain policies and procedures to address Japanese regulatory requirements.