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

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

Credit Profile		
US$10.0 mil GO bnds (University of Minnesota) ser 2015B due 08/01/2031		
Long Term Rating	AA/Negative	New
Regents of the University of Minnesota, Minnesota		
University of Minnesota, Minnesota		
Regents of the University of Minnesota (University of Minnesota)		
Long Term Rating	AA/Negative	Outlook Revised
Regents of the University of Minnesota (University of Minnesota) CP - 2007		
Short Term Rating	A-1+	Affirmed

Rationale

Standard & Poor's Ratings Services revised its outlook to negative from stable and affirmed its 'AA' long-term rating on the University of Minnesota's (UM) existing debt. At the same time, Standard & Poor's assigned its 'AA' long-term rating to UM's series 2015B general obligation (GO) bonds, issued by the Regents of the University of Minnesota. Finally, Standard & Poor's affirmed its 'A-1+' short-term rating on UM's existing commercial paper (CP) notes.

The negative outlook reflects our opinion that the university's growth in total debt over time, combined with recent weakness in financial operations, could pressure the rating during the outlook period. The university's total debt outstanding has increased modestly during the past few years and UM has plans to issue approximately $260 million in gross new debt during our two-year outlook period, which may weaken its financial resource ratios to debt, in our opinion. At the same time, UM's financial results in fiscal 2014 were considerably weaker than in prior years, with a full accrual deficit on an adjusted basis, and preliminary expectations for fiscal 2015 indicate another potential full-accrual deficit.

The affirmation of the 'AA' rating on UM's existing debt reflects our view of the university's strong enterprise profile, solid demand metrics, positive operations on a cash basis, and financial resources to expenses that remain about average for the rating category. In fiscal 2014, the university's pro forma maximum annual debt service (MADS) is 3.7% of operating expenses (including state-supported debt), which we consider moderate. Excluding state-supported debt, it is even lower at 3.0%.

The 'A-1+' short-term rating, which applies to the university's authorized commercial paper (CP) program, reflects our opinion of UM's credit quality and its provision of self-liquidity in the event of CP rollovers. As of June 30, 2015, the university held cash and high-quality, short-term fixed-income assets of approximately $1 billion, which provides ample liquidity at 4.2x coverage, in our view, for the approximately $233 million in CP outstanding. The university's CP program was set up with regular principal reductions, and any future issuance of CP requires Board of Regents authorization.

The 'AA' rating reflects our view of the university's:

- Position as Minnesota's flagship research university and land-grant institution;
- Competitive demand trends and stable enrollment, supported by a Big 10 Conference demand niche, substantial research, and competitive professional and graduate programs;
- Consistently positive operations on a cash basis, although weakened financial operations in fiscal 2014 and expected fiscal 2015 results, on a full-accrual basis;
- Manageable pro forma MADS burden of about 3.7% of adjusted operating expenses in fiscal 2014; and
- History of solid fundraising.

Offsetting factors include our view of UM's:

- Increase in debt during the past few years, with plans to issue approximately $260 million in additional debt during our two-year outlook period; and
- Modest unrestricted financial resources for a public flagship institution, with adjusted unrestricted net assets of $999.4 million equal to 30.2% of 2014 adjusted operating expenses and about 71% of post-issuance debt ($1.4 billion, including state-supported debt).

The university plans to use the $10 million in net proceeds from the series 2015B bonds to finance the design of improved health education and clinical research facilities for the Medical School and Academic Health Center. At this time, management reports additional debt plans totaling approximately $260 million through fiscal 2017, including about $100 million for a combined heat and power plant, $66 million for land purchases, and approximately $40 million for classroom buildings and a wellness center. When we include the university's anticipated $260 million in gross debt plans during our two-year outlook period, total pro forma debt equals approximately $1.66 billion. However, we do note that the university amortizes about $70 million annually or roughly $138 million during the same period. All of the university's debt is fixed rate, except for its CP program, which has $233 million currently outstanding. Therefore, at this time, about 85% of the university's total pro forma debt is fixed rate.

Outlook

We expect that during the two-year outlook period, the university will continue to experience favorable demand trends and steady enrollment, steady state financial support, positive operating performance on a cash basis, and maintain a manageable debt burden. We would view growth in financial resources relative to debt positively.

Credit factors that could lead to a negative rating action could include significant deterioration of enrollment, continued operating deficits on a full-accrual basis beyond fiscal 2015, failure to improve financial resource ratios when compared with debt relative to peer institutions, or substantial debt issuances beyond the current capital program.

A return to stable outlook is possible if the university's financial operations improve on a full-accrual basis and the university maintains or grows its financial resources relative to debt.

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 located 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, including medicine, law, engineering, business, dentistry, pharmacy, and veterinary medicine. Research activity is substantial in our view, with $836.8 million in grants and contracts revenue received in fiscal 2014, up slightly from $836.4 million in fiscal 2013.

Enrollment

Enrollment has been stable for the past few years and demand remain strong. The university has become increasingly selective, which we view as a credit positive. University enrollment was 67,477 for fall 2014. About 64% of students are undergraduates, approximately 70% of which come from Minnesota. With about 51,000 students in fall 2014, the Twin Cities campus is the largest in the UM system. Management expects that total enrollment in fall 2015 will be similar to fall 2014.

In our view, demand is strong at the flagship Twin Cities campus, and admissions continue to become more selective. Despite a declining number of high school graduates in Minnesota, the university has continued to see an increased number of applications, and its freshmen applicants are better qualified -- as indicated by an average ACT score of about 27 for fall 2014 (the national average is about 21). Freshman demand continues to grow, and management reports that applications are up for fall 2015.

Management

Eric Kaler has been the university's president since 2011. In our opinion, senior management has been stable with normal turnover of deans and senior staff members. UM has extensive financial policies in place, including investment policies, a swap management policy, and debt policy, which we view favorably.

Financial Profile

State appropriations

State operating appropriations remain an important source of university revenue. For the fiscal 2014 and fiscal 2015 biennium, state funding levels were up in both years. Fiscal 2014 state funding was about $576.8 million, up 5.8% from fiscal 2013; fiscal 2015 state appropriations were about $600 million, a 4% increase from fiscal 2014. At the same time, the university held tuition flat for resident undergraduate students in fiscals 2014 and 2015. State operating appropriations for fiscals 2016 and 2017 are expected to rise by 4% to $625 million.

Finances

UM's financial results have been consistently positive on a cash basis during the past few years, although operations fluctuate on a full accrual basis, after we make adjustments for investment gains and losses. In fiscal 2013 and fiscal 2014, the university posted operating losses on a full accrual, adjusted basis, demonstrating some financial weakness and inconsistency compared to historical results. After we adjusted UM's fiscal 2014 operations for realized and unrealized gains and losses for the year, as well as for approximately $46.6 million in endowment draws and $42 million in one-time non-recurring expenses, we estimate that the university produced a $91 million deficit for the year on a full-accrual basis or an operating margin of negative 3%. These results were weaker than prior years, and only part of this was due to the $42 million in extraordinary one-time expenses. However, when we include about $193 million of depreciation expense in fiscal 2014, the university's results are very positive on a cash basis. Comparatively, after we adjusted UM's fiscal 2013 operations for realized and unrealized gains and losses for the year, as well as for approximately $46.3 million in endowment draws, we estimate that the university produced a $29.8 million deficit for the year (operating margin of negative 0.9%). Management reports that fiscal 2015 operating results are expected to be better than our adjusted "normalized" fiscal 2014 results, but may result in another operating deficit on a full-accrual basis. We would view improvement in financial operations on a full-accrual basis during the outlook period positively.

Financial resources and endowment

Financial resources remain adequate, in our view, for a public flagship university. At June 30, 2014, the university had $3.8 billion of total net assets, about $812 million of which were unrestricted. Adjusted unrestricted net assets (which include $187 million of unrestricted net assets of all component units) totaled about $999 million, equal to 30.2% of 2014 adjusted operating expenses, which we consider adequate, and 71% of pro forma post-issuance debt ($1.4 billion). When we include the expected $260 million in gross future debt, this ratio weakens to 60%; when we take into consideration the net effect of principal repayment over the same period, the same ratio is about 65%. While the university's UNA-to-expenses ratios is comparable to our 'AA' rating category median of 36%, its current UNA-to-debt ratio is weaker than our rating category median of 102%. We do note that approximately $300 million of the university's debt is state-supported, providing an external source for debt service payments. When we exclude this debt from our calculations, the university's ratios are more in line with our rating category medians.

UM benefits from a substantial endowment: as of March 31, 2015 (unaudited), it had $1.3 billion in the university-held endowment and an additional $2.0 billion in the University of Minnesota Foundation. In addition, the university 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. The university also has a demonstrated strong fundraising track record and management reports that the university continues to fundraise on a project-by-project basis. Management reports that fiscals 2014 and 2015 were solid fundraising years.

Table 1

University of Minnesota, Minn.						
	-- Fiscal year ended June 30 --					**-- Medians --**
Enrollment and demand	**2015**	**2014**	**2013**	**2012**	**2011**	**Public Colleges & Universities Rated 'AA' In 2014**
Headcount	67,477	68,047	68,418	69,221	67,932	34,431
Full-time equivalent	60,950	61,481	61,794	61,739	61,146	32,265
Freshman acceptance rate (%)	51.1	50.0	54.5	52.3	54.0	68.6
Freshman matriculation rate (%)	29.5	31.3	31.2	31.4	32.7	MNR

Table 1

University of Minnesota, Minn. (cont.)						
Undergraduates as a % of total enrollment (%)	64.3	64.1	64.0	63.7	64.0	77.7
Freshman retention (%)	88.2	86.9	86.8	87.3	89.2	85.0
Graduation rates (five years) (%)	N.A.	N.A.	N.A.	N.A.	N.A.	55.4
Income statement						
Adjusted operating revenue ($000s)	N.A.	3,171,943	3,078,472	3,023,863	2,983,297	MNR
Adjusted operating expense ($000s)	N.A.	3,263,587	3,108,251	2,993,694	2,922,616	MNR
Net adjusted operating income ($000s)	N.A.	(91,644)	(29,779)	30,169	60,681	MNR
Estimated operating gain/loss before depreciation ($000s)	N.A.	101,061	163,360	214,044	224,370	MNR
Change in unrestricted net assets (UNA; $000s)	N.A.	(7,790)	92,798	119,984	(18,943)	MNR
State operating appropriations ($000s)	N.A.	614,791	575,491	572,075	623,300	MNR
State appropriations to revenue (%)	N.A.	19.4	18.7	18.9	20.9	21.4
Student dependence (%)	N.A.	42.8	43.0	42.3	40.9	MNR
Research dependence (%)	N.A.	26.4	27.2	28.4	27.4	MNR
Endowment and investment income dependence (%)	N.A.	7.4	4.0	1.2	N.A.	2.4
Debt						
Outstanding debt ($000s)	N.A.	1,209,982	1,300,730	1,226,388	1,145,419	689,891
Total pro forma debt ($000s)	N.A.	1,409,982	N.A.	N.A.	N.A.	MNR
Pro forma MADS	N.A.	122,854	N.A.	N.A.	N.A.	MNR
Current debt service burden (%)	N.A.	3.6	3.7	3.5	13.0	3.3
Current MADS burden (%)	N.A.	N.A.	N.A.	N.A.	N.A.	3.5
Pro forma MADS burden (%)	N.A.	3.8	N.A.	N.A.	N.A.	MNR
Financial resource ratios						
Endowment market value ($000s)	N.A.	1,276,888	1,075,466	970,593	968,300	631,508
Related foundation market value ($000s)	N.A.	2,404,742	2,155,332	2,080,030	1,923,347	646,108
Cash and investments ($000s)	N.A.	2,402,331	2,259,701	2,214,776	2,067,152	MNR
UNA ($000s)	N.A.	812,356	820,146	727,348	607,364	MNR
Adjusted UNA ($000s)	N.A.	999,408	951,206	909,146	781,740	MNR
Cash and investments to operations (%)	N.A.	73.6	72.7	74.0	70.7	63.5
Cash and investments to debt (%)	N.A.	198.5	173.7	180.6	180.5	163.0
Cash and investments to pro forma debt (%)	N.A.	170.4	N.A.	N.A.	N.A.	MNR
Adjusted UNA to operations (%)	N.A.	30.6	30.6	30.4	26.7	36.1
Adjusted UNA plus debt service reserve to debt (%)	N.A.	82.6	73.1	74.1	68.2	102.1
Adjusted UNA plus debt service reserve to pro forma debt (%)	N.A.	70.9	N.A.	N.A.	N.A.	MNR
Average age of plant (years)	N.A.	13.8	13.1	12.9	13.7	12.2

Table 1

University of Minnesota, Minn. (cont.)						
OPEB liability to total liabilities (%)	N.A.	N.A.	4.3	3.4	2.6	5.4

N.A. -- not available. MNR -- median not reported. MADS -- maximum annual debt service. Adjusted operating performance= Adjusted for invetsment grains and losses, endowment draw, and non-recurring expenses. Net operating margin = 100*(net adjusted operating income/adjusted operating expense) Student dependence = 100*(gross tuition revenue + auxiliary revenue/adjusted operating revenue) Current debt service burden = 100*(current debt service expense/adjusted operating expenses) Current MADS burden = 100*(maximum annual debt service expense/adjusted operating expenses) Cash and investments = cash + short-term & long-term investments Adjusted UNA = Unrestricted net assets + unrestrticted net assets of the foundation Average age of plant = accumulated depreciation/depreciation & amortization expense Pro forma debt = Includes debt issued since fiscal 2014 audit and this issuance.

Related Criteria And Research

Related Criteria

- USPF Criteria: Higher Education, June 19, 2007
- USPF Criteria: Commercial Paper, VRDO, And Self-Liquidity, July 3, 2007
- USPF Criteria: Assigning Issue Credit Ratings Of Operating Entities, May 20, 2015
- Criteria: Use of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Standard & Poor's Reclassifies 157 U.S. Public Universities; They Are No Longer Government-Related Entities, Dec. 5, 2014

Ratings Detail (As Of August 5, 2015)		
University of Minnesota (Crookston Dorm)		
Long Term Rating	AA/Negative	Outlook Revised
Regents of the University of Minnesota, Minnesota		
University of Minnesota, Minnesota		
Regents of the University of Minnesota (University of Minnesota) taxable commercial paper nts (University of Minnesota) ser E due 12/17/2039		
Short Term Rating	A-1+	Affirmed
University of Minnesota Regents (University of Minnesota)		
Long Term Rating	AA/Negative	Outlook Revised
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
University of Minnesota at Morris, Minnesota		
University of Minnesota, Minnesota		
University of Minnesota at Morris (University of Minnesota)		
Long Term Rating	AA/Negative	Outlook Revised