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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\$125.0 mil GO bnds (University of Minnesota) ser 2016A dtd 04/13/2016 due 04/01/2041

Long Term Rating AA/Stable New

Regents of the University of Minnesota, Minnesota

University of Minnesota, Minnesota

Univ of Minnesota ser 2004A, 1996A

Long Term Rating AA/Stable Outlook Revised

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 Outlook Revised

Rationale

Standard & Poor's Ratings Services has revised its outlook to stable from negative and affirmed its 'AA' long-term rating on the Regents of the University of Minnesota's existing debt, issued for the University of Minnesota (UM). At the same time, Standard & Poor's assigned its 'AA' long-term rating to UM's series 2016A 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 outlook revision and rating affirmation are based on the application of our revised criteria published on Jan. 6, 2016.

We have assessed the university's enterprise profile as very strong, reflecting stable enrollment and robust demand, with very good selectivity and student quality. We have assessed the university's financial profile as very strong, reflecting our view of the university's positive operations on a cash basis, financial resources to debt that are 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. When we combine the enterprise profile and the financial profile, this leads to an indicative stand-alone credit rating of 'aa' and a final long-term rating of 'AA'.

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, 2015, the university held cash and high-quality, short-term fixed-income assets of approximately \$900 million, which provides ample liquidity at 4x coverage of the approximately \$233 million in CP outstanding.

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 negative on an adjusted full-accrual basis in fiscal 2014 and fiscal 2015;
- Manageable pro forma MADS burden of about 3.7% of adjusted operating expenses in fiscal 2015; and
- History of very strong fundraising.

Offsetting factors include our view of UM's:

- Increase in debt during the past few years, with plans to issue approximately \$200 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 (UNA) of \$1.2 billion equal to 35% of 2015 adjusted operating expenses and about 84% of postissuance debt (\$1.4 billion, including state-supported debt).

The university plans to use the net proceeds from the series 2016A bonds to finance 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. At this time, management reports additional debt plans totaling approximately \$200 million through fiscal 2018, including an additional \$50 million for the combined heat and power plant, and approximately \$120 million for the athletic village. We note that the university is scheduled to amortize about \$150 million in principal repayment during the same time period. When we include the university's anticipated \$50 million in net debt plans during our two-year outlook period, total pro forma debt equals approximately \$1.45 billion. 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.

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, with \$872.4 million in grants and contracts revenue received in fiscal 2015, up from \$836.8 million in fiscal 2014.

The university has co-signed a letter of intent 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. This agreement, which will include a new chief executive officer of the integrated system and a 50-50 competency-based board membership, is being negotiated and implementation is expected in 2016. UMP is currently a component unit of the university, and it is our understanding that the new M Health will be a separate legal entity, which will have limited impact on the university's audited financial results. We will evaluate any material impact that M Health has on the university's credit when the structure is determined.

Outlook

The stable outlook reflects our view that UM will continue to experience favorable demand trends and steady enrollment, steady state financial support, improve its operating performance on a full-accrual basis, and maintain a manageable debt burden in the next two years. We would view growth in available resources relative to debt positively.

Downside Scenario

Credit factors that could lead to a negative rating action during the outlook period include a significant drop in enrollment, significant operating deficits on a full-accrual adjusted basis, a substantial decline in financial resource to debt ratios relative to peer institutions, or significant debt issuances beyond the current capital program.

Upside Scenario

While we believe positive rating actions are unlikely during the outlook period, they could be possible beyond two years if the university's financial operations improve consistently on a full-accrual basis and financial resources relative to debt increase.

Enterprise Profile

Industry risk

Industry risk addresses the higher education sector's overall cyclicity 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 29% 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 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 66,651 for fall 2015, down just 1% from fall 2014. About 65% of students are undergraduates, approximately 70% of which come from Minnesota. With about 51,000 students in fall 2015, the Twin Cities campus is the largest in the UM system. Management expects that total enrollment in fall 2016 will be similar to fall 2015, although the university plans to increase the Twin Cities undergraduate population modestly over the next few years.

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. Its freshmen applicants are better qualified, as indicated by an average ACT score of about 27 for fall 2015 (the national average is about 21) across all campuses. At the Twin Cities campus, the average ACT

scores are even higher at 28. 2. Freshman demand continues to grow, and management reports that applications are up for fall 2016.

The university also has a strong fundraising record and continues to raise funds on a project-by-project basis. Management reports that fiscal 2014 and 2015 were solid fundraising years.

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 elected members. The management team is very stable and has a history of conservative budgeting and finance practices. Capital plans are considered and made a couple of years in advance, and management is frequently able to provide detailed financial forecasts of capital projects.

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 negatively affect 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 impact 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 operations and revenue diversity

State operating appropriations remain an important source of university revenue. For the fiscal 2014 and fiscal 2015 biennium, state funding levels were up. 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 fiscal 2014 and 2015. State operating appropriations for fiscals 2016 and 2017 are expected to rise.

UM's financial results have been consistently positive on a cash basis during the past few years, although operations fluctuate modestly on a full-accrual basis, after we make adjustments for investment gains and losses. In fiscal 2014 and fiscal 2015, the university posted small operating losses on a full-accrual adjusted basis, demonstrating some financial weakness and inconsistency compared to historical results. After we adjusted UM's fiscal 2015 operations for realized and unrealized gains and losses for the year, as well as for approximately \$50 million in endowment draws,

and \$39.9 million in recurring capital appropriations for operating expenses, we estimate that the university produced a \$24.1 million deficit for the year on a full-accrual basis or an operating margin of negative 0.7%. However, when we include about \$219 million of depreciation expense in fiscal 2015, the university's results are very positive on a cash basis. After we make the same adjustments to 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, \$42.4 million in recurring capital appropriations for operating expenses, and \$42 million in one-time nonrecurring expenses, we estimate that the university produced a \$49.3 million deficit for the year on a full-accrual basis or an operating margin of negative 1.7%. 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.

Management reports that fiscal 2016 operating results are expected to be better than our adjusted "normalized" fiscal 2015 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.

Available resources

Financial resources remain adequate, in our view, for a public flagship university, although low compared with other 'AA' rated institutions. However, we note that this is partly due to approximately \$300 million in debt on the university's balance sheet that is supported by state funds. At June 30, 2015, the university had only about \$290 million of unrestricted net assets, due to the implementation of GASB 68. Adjusted unrestricted net assets (which include \$218 million of unrestricted net assets of all component units, as well as an adjustment for GASB 68) totaled about \$1.2 billion, equal to 35% of 2015 adjusted operating expenses, and 84% of pro forma post-issuance debt (\$1.4 billion). When we include the expected \$50 million in net future debt, this ratio weakens to 81%. 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%. However, 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 June 30, 2015 (unaudited), it had \$1.3 billion in the university-held endowment and an additional \$2 billion in the University of Minnesota Foundation. In addition, the university had an additional \$900 million 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

Pro forma for this transaction, the university has approximately \$1.4 billion in total debt, and its pro forma MADS burden remains modest, in our opinion, at about 3.7% of fiscal 2015 expenses. This MADS percentage is further enhanced by the allocation of state funding to pay a significant portion of the university's debt service; the university receives approximately \$24 million annually in support of debt service.

University of Minnesota	--Fiscal year ended June 30--					Medians
	2016	2015	2014	2013	2012	Public Colleges & Universities 'AA' 2014
Enrollment and demand						
Headcount	66,651	67,477	68,047	68,418	69,221	34,431
Full-time equivalent	60,620	60,950	61,481	61,794	61,739	32,265
Freshman acceptance rate (%)	50.2	51.1	50.0	54.5	52.3	68.6
Freshman matriculation rate (%)	28.9	29.5	31.3	31.2	31.4	MNR
Undergraduates as a % of total enrollment (%)	65.2	64.3	64.1	64.0	63.7	77.7
Freshman retention (%)	88.0	88.2	86.9	86.8	87.3	85.0
Income statement						
Adjusted operating revenue (\$000s)	N.A.	3,529,837	3,462,363	3,361,735	3,256,164	MNR
Adjusted operating expense (\$000s)	N.A.	3,553,938	3,511,617	3,347,317	3,225,995	MNR
Net adjusted operating income (\$000s)	N.A.	(24,101)	(49,254)	14,418	30,169	MNR
Net adjusted operating margin (%)	N.A.	-0.68	-1.40	0.43	0.94	MNR
Estimated operating gain/loss before depreciation (\$000s)	N.A.	194,464	143,451	207,557	214,044	MNR
Change in unrestricted net assets (UNA; \$000s)	N.A.	(521,810)	(7,790)	92,798	119,984	MNR
State operating appropriations (\$000s)	N.A.	642,069	614,791	575,491	572,075	MNR
State appropriations to revenue (%)	N.A.	18.2	17.8	17.1	17.6	21.4
Student dependence (%)	N.A.	39.5	39.2	39.4	39.3	MNR
Research dependence (%)	N.A.	24.7	24.2	24.9	26.4	MNR
Endowment and investment income dependence (%)	N.A.	1.4	1.3	1.4	1.5	2.4
Debt						
Outstanding debt (\$000s)	N.A.	1,389,652	1,209,982	1,300,730	1,226,388	689,891
Proposed debt (\$000s)	N.A.	223,350	N.A.	N.A.	N.A.	MNR
Total pro forma debt (\$000s)	N.A.	1,475,002	N.A.	N.A.	N.A.	MNR
Pro forma MADS	N.A.	130,682	N.A.	N.A.	N.A.	MNR
Current debt service burden (%)	N.A.	3.49	3.35	3.43	3.28	3.30
Current MADS burden (%)	N.A.	3.44	N.A.	N.A.	N.A.	3.50
Pro forma MADS burden (%)	N.A.	3.68	N.A.	N.A.	N.A.	MNR
Financial resource ratios						
Endowment market value (\$000s)	N.A.	1,293,232	1,276,888	1,075,466	970,593	631,508
Related foundation market value (\$000s)	N.A.	2,557,373	2,404,742	2,155,332	2,080,030	646,108
Cash and investments (\$000s)	N.A.	2,575,530	2,402,331	2,259,701	2,214,776	MNR
UNA (\$000s)	N.A.	290,546	812,356	820,146	727,348	MNR
Adjusted UNA (\$000s)	N.A.	1,238,914	1,100,696	1,033,639	972,133	MNR
Cash and investments to operations (%)	N.A.	72.5	68.4	67.5	68.7	63.5

University of Minnesota (cont.)						
Cash and investments to debt (%)	N.A.	185.3	198.5	173.7	180.6	163.0
Cash and investments to pro forma debt (%)	N.A.	174.6	N.A.	N.A.	N.A.	MNR
Adjusted UNA to operations (%)	N.A.	34.9	31.3	30.9	30.1	36.1
Adjusted UNA plus debt service reserve to debt (%)	N.A.	89.2	91.0	79.5	79.3	102.1
Adjusted UNA plus debt service reserve to pro forma debt (%)	N.A.	84.0	N.A.	N.A.	N.A.	MNR
Average age of plant (years)	N.A.	13.1	13.8	13.1	12.9	12.2
OPEB liability to total liabilities (%)	N.A.	4.3	5.2	4.3	3.4	5.4

N.A.--Not available. MNR--Median not reported. MADS maximum annual debt service 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 + UNA of component units + GASB 68 adjustment. Average age of plant = accumulated depreciation/depreciation & amortization expense.

Related Criteria And Research

Related Criteria

- General Criteria: Methodology: Not-For-Profit Public And Private Colleges And Universities, Jan. 6, 2016
- 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 March 16, 2016)

Univ of Minnesota Crookston Dorm bonds ser AB

Long Term Rating AA/Stable *Outlook Revised*

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 *Outlook Revised*

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 *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*

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