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Texas State University System, TX

Update to credit analysis

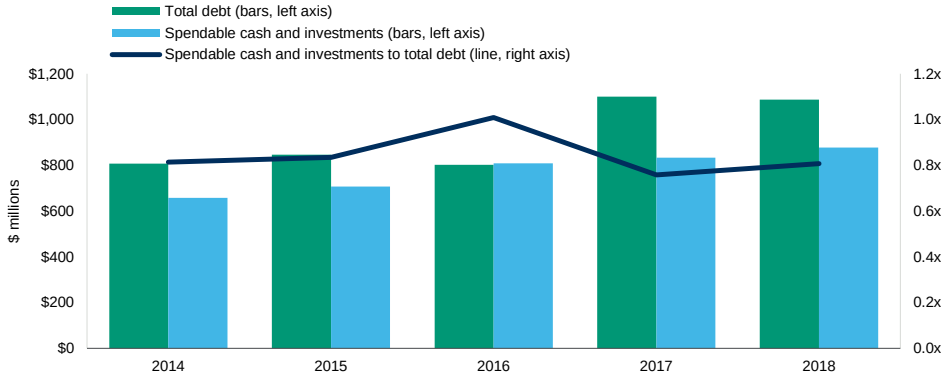
Summary

Texas State University System's (TSUS, Aa2 stable) very good strategic profile incorporates the system's large and growing enrollment, serving over 67,000 full-time equivalent (FTE) students across seven component institutions throughout central Texas (Austin, Houston and southwest regions), supported by robust operating and capital support from Aaa-rated State of Texas. Further supporting the Aa2 rating is the sizeable $1.3 billion scope of operations, $1 billion in cash and investments, and sound growth prospects in student demand. The rating is tempered by relatively high leverage, which is increasing with the Series 2019 financing, coupled with moderate financial resources and modest philanthropic support relative to Aa2-rated peers as well as a large net pension liability.

Exhibit 1

Growth in cash and investments is a mitigant to rising debt

Spendable cash and investments to debt



Source: Moody's Investors Service

Credit strengths

» Large, growing multi-institution public university system primarily serving Austin and Houston regions, with fiscal 2018 operating revenue of $1.3 billion and full-time equivalent (FTE) enrollment of over 67,000 students

» Strong and rising operating and capital support from Aaa-rated State of Texas, including debt service reimbursement for 22% of debt

» Systemwide $1 billion in cash and investments supports sound liquidity and solid cushion to expenses

» Consistently strong cash flow margins bolster financial resource growth and support rising debt service

Credit challenges

» High leverage with ongoing capital needs

» Modest philanthropic support and limited plans for substantial private gift funding

» Limited brand recognition outside of Texas and minimal research activity

» Large net pension liability may require higher system employer contributions

Rating outlook

The stable outlook reflects strong state operating and capital support and continued steady student market strength translating into sound revenue growth to support rising debt service requirements.

Factors that could lead to an upgrade

» Substantial growth in flexible financial reserves

» Consistently stronger operations and cash flow generation, and donor activity across all system institutions

» Stronger research activity presence at comprehensive universities

Factors that could lead to a downgrade

» Significant reductions in state financial support for operations or capital

» Sustained deterioration in operating performance

» Material increased in leverage without commensurate growth in financial reserves

» Reduction in liquidity

Key indicators

Exhibit 2
Texas State University System

	2014	2015	2016	2017	2018	Pro Forma	Median: Aa Rated Public Universities
Total FTE Enrollment	61,815	62,584	63,799	64,671	65,612	65,612	29,353
Operating Revenue ($000)	1,086,393	1,173,109	1,251,461	1,264,915	1,287,215	1,287,215	1,186,906
Annual Change in Operating Revenue (%)	5.0	8.0	6.7	1.1	1.8	1.8	3.2
Total Cash & Investments ($000)	808,824	832,565	933,756	961,985	1,016,072	1,016,072	1,363,489
Total Debt ($000)	807,795	846,110	801,435	1,100,183	1,086,555	1,169,355	643,972
Spendable Cash & Investments to Total Debt (x)	0.8	0.8	1.0	0.8	0.8	0.8	1.4
Spendable Cash & Investments to Operating Expenses (x)	0.6	0.6	0.7	0.7	0.7	0.7	0.7
Monthly Days Cash on Hand (x)	167	173	173	204	244	244	169
Operating Cash Flow Margin (%)	15.7	16.8	18.9	17.2	16.0	16.0	11.2
Total Debt to Cash Flow (x)	4.7	4.3	3.4	5.1	5.3	5.7	4.7
Annual Debt Service Coverage (x)	2.2	1.5	1.9	1.8	1.9	1.9	2.9

Pro Forma reflects a new money issuance, Series 2019A and 2019B bonds, during fiscal 2020.
Source: Moody's Investors Service

Profile

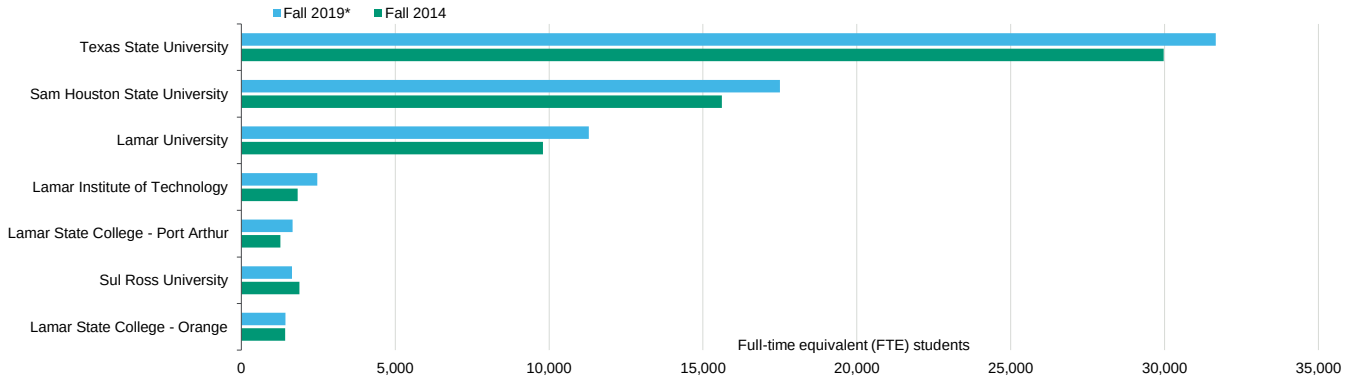
The Texas State University System is comprised of seven component institutions, both four-year and two-year, located throughout central, southeast and southwest Texas. The largest are Texas State University in San Marcos and Sam Houston State University in Huntsville. The system recorded fiscal 2018 Moody's adjusted operating revenue of $1.3 billion and served a headcount enrollment of over 86,000 students.

Detailed credit considerations

Market profile: multiple component institutions meeting Vision 2020 strategic targets

The system's broad composition of universities and colleges, with their programs and campuses located in economically strong regions of the state (Austin and Houston), lend enrollment stability. Favorably, the mix of two-year and four-year institutions offsets volatility in enrollment at one or more campuses, with growth in others. The largest system institutions by enrollment are the San Marcos-based Texas State University (preliminary fall 2019 FTE enrollment of 31,664) and Huntsville-based Sam Houston State University (17,498 FTE), comprising 47% and 26% of the system's preliminary fall 2019 total of 67,656 FTE, respectively. Over 95% of system-wide students are from Texas.

Exhibit 3
Nearly all of the TSUS institutions recorded strong enrollment growth over the fall 2014 to fall 2019 period



*Preliminary fall 2019 full-time equivalent enrollment.
Source: Moody's Investors Service

The system is nearing its targets for its Vision 2020 strategic plan. Major goals included enrollment growth and expanded access through online and dual enrollment programs, engaging a more diverse population and improving student outcomes. The preliminary fall 2019 enrollment of 86,299 is up 20% over fall 2010 and within 5% of its 90,750 headcount target. Several goals are near targets or have been exceeded, including the online credit hour growth, student diversity and degrees awarded.

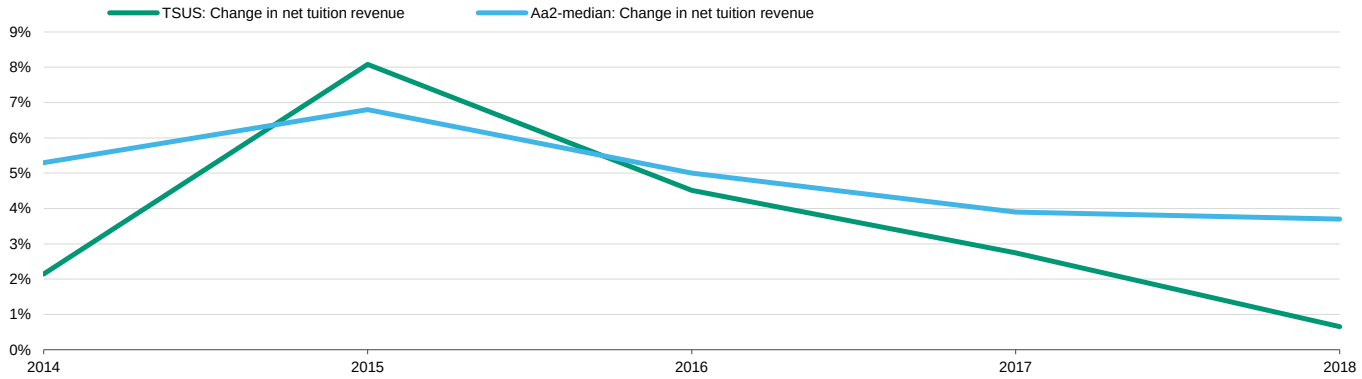
Operating performance: softer net tuition revenue growth reflects affordability mission; state support remains key revenue attribute

Strong state support coupled with very good fiscal oversight of the multiple system institutions will continue to produce positive operations. However, despite strong cash flow margins averaging 17% over the fiscal 2014-18 period, debt service coverage of just under 2.0x is below the Aa2-median of 3.0x demonstrating the system's relatively high leverage.

Current softening of the largest revenue source - student charges - will elevate attention for cost efficiencies across the system. Student charges, which include tuition and auxiliary revenue, comprise 55% of Moody's adjusted $1.3 billion in operating revenue. Students' heightened sensitivity to tuition affordability led to lower growth in net tuition revenue over the fiscal 2014-18 period, with fiscal 2017 to fiscal 2018 growth of just 0.7%, which is a significant turnaround from prior years.

Exhibit 4

TSUS net tuition revenue growth lags peers for the third consecutive year



Source: Moody's Investors Service

Robust funding from the State of Texas, for both operations and capital support, will continue to underpin the system's Aa2 rating. Operating appropriations, in addition to Higher Education Fund (HEF) monies used for operating expenses comprise an important 27% of operating revenue. The most recent biennium legislature, for fiscal years 2020-2021, increased system operating appropriations by 9%, and HEF allocations remain on track at $77.6 million. Favorably, the state is providing an additional $17.3 million over the 2020-21 biennium that allowed for an average 25% reduction in tuition and fees at the system's three Lamar State Colleges.

A credit weakness of the system is the ongoing absence of a central fiscal reporting platform to provide rapid financial roll ups on a combined basis. In addition, conservative budgets are based largely on flat enrollment plans. While the system does not have specific reserve policies, institutions do aim for at least four to five months of reserves.

Wealth and liquidity: ample reserves and unrestricted liquidity

The system's ample balance sheet reserves provide a very good cushion for debt and operations. Fiscal 2018 cash and investments totaled $1.0 billion, including the universities' affiliated foundations, up 26% over fiscal 2014. The system has good operating flexibility with $878 million of spendable cash and investments.

Philanthropic support is modest across the system's institution's. Each university is responsible for its fund raising efforts, with targeted campaigns for specific identified projects. Favorably, each four-year university is either in a campaign, recently completed or is in feasibility process, demonstrating a focus on gift support to supplemental operations and capital needs. The average annual fiscal fiscal 2016-18 system-wide gift revenue of $38 million, was below the fiscal 2018 Aa2-median of $85 million.

Liquidity

Unrestricted monthly liquidity of $752 million provides a strong 244 days cash, up from 167 days in fiscal 2014. With a conservative fixed rated debt structure and investment profile, there are few sources for unexpected liquidity calls.

Cash and investments are pooled and managed by each component unit as short-term working funds and long-term reserves, guided by the system's investment policy. The majority of funds are invested in TexPool, a local government investment pool operated by the State of Texas, from which funds are available on a same-day basis. Strong working capital is favorable in providing a sound financial cushion, if needed, for the Extendable Commercial Paper (ECP) notes program. The short-term rating on TSUS's ECP program is supported by our assessment of the system's ability to access the market combined with its ability to liquidate assets to repay bondholders.

Leverage: elevated leverage expected to continue, though mitigated in part by state support for debt service

Leverage will remain elevated relative to peers, though manageable in the near term. Debt outstanding at fiscal 2018 was $1.1 billion, including outstanding commercial paper. Fiscal 2018 spendable cash and investments to debt of 0.8x and debt to operating revenue of 1.3x are weaker than the Aa2-medians of 1.3x and 0.6x, respectively. State reimbursement for Texas legislatively approved Tuition Revenue Bonds (TRBs) for roughly 22% of debt service improves these measures to 1.0x and 0.7x.

The system will continue to have capital facility needs given growing enrollment and goals to improve student success. Near term, the system will be issuing Series 2019 bonds to finance capital facilities largely at Sam Houston State University, with an additional issuance of roughly $100 million planned for fiscal 2021. The 2020-25 capital budget is $1.4 billion, of which nearly half is attributable to development at Texas State University. Key funding sources would include tuition revenue bonds, if approved by the state legislature, as well as ongoing debt issuance, though on pace with annual amortizations. The system is also reviewing proposals for a public-private partnership (PPP) for housing development at the Texas State University San Marcos campus.

Debt structure

The system's debt structure is conservative, with fixed rate debt generally amortizing over 20 years.

Legal security

All of the system's RFS debt and CP notes are on parity and secured by a broad pledge of revenues, including tuition, fees, and auxiliary revenues, and certain unappropriated funds and reserve balances but excluding state appropriations and other restricted funds. Pledged Revenues in fiscal 2018 totaled $927 million, providing 8.1x coverage of pro forma maximum annual debt service ($115 million).

Debt-related derivatives

None.

Pensions and OPEB

Exposure to pension liabilities materially adds to the university's total adjusted leverage profile, though measures are on par with rated peers. The state's retirement system has an above average employee pension burden. As of June 30, 2018, the three-year average Moody's Adjusted Net Pension Liability (ANPL) was $580 million relative to debt outstanding of $1.1 billion. Total adjusted debt of 1.4x fiscal 2018 operating revenue and spendable cash and investments to total adjusted debt of 0.5x closely track the Moody's Aa2-medians of 1.5x and 0.5x, respectively. Certain employees may participate in the Teachers Retirement System (defined benefit plan, TRS) or an Optional Retirement Program (defined contribution plan, ORP).

TSUS participates in an OPEB program that is administered by the Employees Retirement System. The system's share of the net OPEB liability was reported at $126 million for fiscal 2018.

Environmental, social and governance considerations

Several of the TSUS institutions are located in areas of Texas that have been adversely impacted by hurricanes and heavy rains. These events can and have impacted institutions due to facility flooding, though often covered with insurance proceeds, and students who leave school to help families following the storms. Loss of students adversely impacts revenues, though these impacts have been modest.

The system benefits by its multiple university and college locations in Texas, which is recording stable to growing high school students and growing population, particularly in large city population centers. TSUS draws 96% of its students from the state of Texas. The

institution's multiple programs across 2-year and 4-year institutions also contribute graduates who transition into the workforce to benefit the state and local economies.

The system's business model is unique. While the system office provides efficiencies for debt management, legal and legislative oversight, and administrative functions, the component institutions maintain some autonomy for strategic endeavors. The system's very good strategic positioning reflects the state's strong financial support and the system leadership in managing the multiple diverse institutions. Additional governance strength stems from oversight from the State of Texas Higher Education Coordinating Board to align system planning with state goals.

Rating methodology and scorecard factors

The Higher Education Methodology includes a scorecard that summarizes the factors that are generally most important to higher education credit profiles. Because the scorecard is a summary and may not include every consideration in the credit analysis for a specific issuer, a scorecard-indicated outcome may or may not match an assigned rating. We assess strategic positioning on a qualitative basis, as described in the methodology.

Exhibit 5

Texas State University System

Rating Factors		Value	Score
Factor 1:	**Market Profile (30%)**		
	Scope of Operations (Operating Revenue) ($000)	1,287,215	Aa2
	Reputation and Pricing Power (Annual Change in Operating Revenue) (%)	1.8	Ba1
	Strategic Positioning	A	A
Factor 2:	**Operating Performance (25%)**		
	Operating Results (Operating Cash Flow Margin) (%)	16.0	Aa1
	Revenue Diversity (Maximum Single Contribution) (%)	54.8	A1
Factor 3:	**Wealth & Liquidity (25%)**		
	Total Wealth (Total Cash & Investments) ($000)	1,016,072	Aa2
	Operating Reserve (Spendable Cash & Investments to Operating Expenses) (x)	0.7	Aa2
	Liquidity (Monthly Days Cash on Hand)	244	Aa1
Factor 4:	**Leverage (20%)**		
	Financial Leverage (Spendable Cash & Investments to Total Debt) (x)	0.8	Aa3
	Debt Affordability (Total Debt to Cash Flow) (x)	5.7	Aa1
	Scorecard-Indicated Outcome		Aa3
	Assigned Rating		Aa2

Data is based on most recent fiscal year available. Debt may include pro forma data for new debt issued or proposed to be issued after the close of the fiscal year.

For non-US issuers, nominal figures are in US dollars consistent with the Higher Education Methodology.

Leverage measures reflect the addition of approximately $82 million in net new money debt to be issued in fall 2019.

Source: Moody's Investors Service

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