Texas State University System, TX
Update to credit analysis

Summary
Texas State University System’s (TSUS, Aa2 stable) very good strategic positioning incorporates the system’s sizable and stable student base, serving around 65,000 full-time equivalent (FTE) students across seven component institutions throughout central Texas (Austin, Houston and southwest regions). Its strong and stable operating performance is supported by robust operating and capital support from the Aaa-rated State of Texas. Despite adequate levels of wealth and strong liquidity, the system’s modest philanthropic support and relatively high leverage, coupled with a large net pension liability, limit its financial flexibility.

Credit strengths
» Large, growing multi-institution public university system primarily serving the Austin and Houston regions, with fiscal 2020 operating revenue of $1.3 billion and full-time equivalent (FTE) enrollment of over 65,000 students
» Strong and stable operating and capital support from Aaa-rated State of Texas, including debt service reimbursement for 21% of debt
» Consistently strong cash flow margins bolster financial resource growth and support rising debt service
» Systemwide $1.1 billion in cash and investments supports sound liquidity and provides a solid cushion to expenses
Credit challenges

» High leverage with ongoing capital needs limits financial flexibility
» 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 expectations that strong state operating and capital support and continued steady student demand will drive modest revenue growth and improving debt service coverage.

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 beyond what is currently planned

Key indicators

Exhibit 2

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<tbody>
<tr>
<td>Total FTE Enrollment</td>
<td>63,799</td>
<td>64,671</td>
<td>65,612</td>
<td>65,511</td>
<td>64,990</td>
<td>30,062</td>
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<tr>
<td>Operating Revenue ($Billion)</td>
<td>1.3</td>
<td>1.3</td>
<td>1.3</td>
<td>1.3</td>
<td>1.3</td>
<td>1.3</td>
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<tr>
<td>Annual Change in Operating Revenue (%)</td>
<td>6.7</td>
<td>1.1</td>
<td>1.8</td>
<td>1.0</td>
<td>2.1</td>
<td>4.2</td>
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<tr>
<td>Total Cash &amp; Investments ($Billion)</td>
<td>0.9</td>
<td>1.0</td>
<td>1.0</td>
<td>1.0</td>
<td>1.1</td>
<td>1.6</td>
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<tr>
<td>Total Debt ($Billion)</td>
<td>0.8</td>
<td>1.1</td>
<td>1.1</td>
<td>1.1</td>
<td>1.1</td>
<td>0.7</td>
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<tr>
<td>Spendable Cash &amp; Investments to Total Debt (x)</td>
<td>1.0</td>
<td>0.8</td>
<td>0.8</td>
<td>0.8</td>
<td>0.9</td>
<td>1.5</td>
</tr>
<tr>
<td>Spendable Cash &amp; Investments to Operating Expenses (x)</td>
<td>0.7</td>
<td>0.7</td>
<td>0.7</td>
<td>0.7</td>
<td>0.8</td>
<td>0.7</td>
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<tr>
<td>Monthly Days Cash on Hand (x)</td>
<td>173</td>
<td>204</td>
<td>244</td>
<td>243</td>
<td>268</td>
<td>157</td>
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<tr>
<td>Operating Cash Flow Margin (%)</td>
<td>18.9</td>
<td>17.2</td>
<td>16.0</td>
<td>15.8</td>
<td>17.1</td>
<td>11.8</td>
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<tr>
<td>Total Debt to Cash Flow (x)</td>
<td>3.4</td>
<td>5.1</td>
<td>5.3</td>
<td>5.4</td>
<td>4.9</td>
<td>4.1</td>
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<tr>
<td>Annual Debt Service Coverage (x)</td>
<td>1.9</td>
<td>1.8</td>
<td>1.9</td>
<td>1.9</td>
<td>2.1</td>
<td>2.8</td>
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Source: Moody’s Investors Service

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moodys.com for the most updated credit rating action information and rating history.
Profile
The Texas State University System is comprised of seven institutions, both four-year and two-year, located throughout central and southwest Texas. The largest are Texas State University in San Marcos and Sam Houston University in Huntsville. The system recorded fiscal 2020 Moody’s adjusted operating revenue of $1.3 billion and served a headcount enrollment of over 87,000 students in fall 2020.

Detailed credit considerations
Market profile: steady student demand across multiple component institutions
The system’s broad composition of universities and colleges, which are located in economically strong regions of the state (Austin and Houston), drive enrollment stability despite the economic impact from the coronavirus outbreak. The mix of two-year and four-year institutions contributes to demand diversity and lower overall volatility compared to more homogenous peers.

The largest system institutions by enrollment are the San Marcos-based Texas State University (preliminary fall 2020 FTE enrollment of around 30,831) and Huntsville-based Sam Houston State University (17,531 FTE), comprising 47% and 27% of the system’s preliminary fall FTE, respectively. Overall FTE enrollment declined by less than 1% in fall 2020, highlighting demand resilience. However, the higher education landscape in Texas is competitive, and the system draws a regional base of students, with over 95% of students from Texas, which limits growth potential.

Operating performance: state support remains a key revenue driver
Strong and stable state support, coupled with very good fiscal oversight, will continue to produce strong operating cash flow margins, which averaged 17% between fiscal 2016 and fiscal 2020. Stagnation of the largest revenue source, student charges, highlights the importance of efficiencies across the system. Student charges, which include auxiliary revenue that declined only slightly as a result of the coronavirus, comprise 58% of operating revenue for fiscal 2020. Students’ heightened sensitivity to tuition affordability will make it difficult to grow net tuition revenue. However, while housing occupancy remains compressed at around 89% occupancy in fall 2020, an expected improvement in fall 2021 will help drive a rebound in student charges.

As of December 31, 2020, the system has incurred over $100 million in costs and lost revenue associated with the virus. While federal support from the CARES Act only covered 60% of this deficit, growth in fall 2020 headcount enrollment and steady state support will drive stable revenue and wealth through fiscal 2021.

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 2020 cash and investments totaled $1.1 billion, including the universities’ affiliated foundations, up 19% over fiscal 2016. The system has good operating flexibility with $950 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 2018-20 system-wide gift revenue of $36 million, is well below the Aa2-median of $89 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 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 2020 was $1.1 billion, including outstanding commercial paper. Fiscal 2020 spendable cash and investments to debt of 0.9x and total debt to operating
revenue of 0.8x are weaker than the Aa2-medians of 1.4x and 0.6x, respectively. State reimbursement for Texas legislatively approved Tuition Revenue Bonds (TRBs) for roughly 22% of debt service improves these measures, but not to the level of the medians.

A capital improvement plan focused on renovations and new academic and student facilities will result in continued high capital expenditures, of around $1.3 billion over six years, but will remain in line with historical levels. The system does not plan to issue new debt through fiscal 2022.

**Legal security**

The system’s Revenue Financing System (RFS) debt and ECP notes are on parity and secured by a broad pledge of revenue, including tuition, fees, and auxiliary revenue and certain unappropriated funds and reserve balances but excluding state appropriations and other restricted funds. Pledged Revenues in fiscal 2020 totaled $764 million, providing 6.6x coverage of maximum annual debt service ($115 million).

**Debt structure**

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

**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 August 31, 2020, the three-year average Moody’s Adjusted Net Pension Liability (ANPL) was $834 million relative to debt outstanding of $1.1 billion.

Total adjusted debt to operating revenue of 1.5x and spendable cash and investments to total adjusted debt of 0.5x in fiscal 2020 closely track the Moody’s Aa2-medians. 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 $693 million for fiscal 2020.

**ESG considerations**

**Environmental**

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, and strong liquidity serves as a mitigate.

**Social**

The coronavirus outbreak will continue to impact operations in fiscal 2021 as the system incurs costs relating to the outbreak and housing occupancy remains lower than historical levels. We regard the coronavirus as a social risk under our ESG framework, given the substantial impact for public health and safety. While federal support from the CARES Act did not fully cover costs and lost revenue associated with the virus (as of December 2020), growth in fall 2020 headcount enrollment, coupled with steady state support, will drive stable revenue and wealth through fiscal 2021.

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. 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.

**Governance**

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.

<table>
<thead>
<tr>
<th>Scorecard Factors and Sub-factors</th>
<th>Value</th>
<th>Score</th>
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<tbody>
<tr>
<td><strong>Factor 1: Market Profile (30%)</strong></td>
<td></td>
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<tr>
<td>Scope of Operations (Operating Revenue) ($000)</td>
<td>1,327,781</td>
<td>Aa2</td>
</tr>
<tr>
<td>Reputation and Pricing Power (Annual Change in Operating Revenue) (%)</td>
<td>2.1</td>
<td>Baa3</td>
</tr>
<tr>
<td>Strategic Positioning</td>
<td>A</td>
<td>A</td>
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<tr>
<td><strong>Factor 2: Operating Performance (25%)</strong></td>
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<td></td>
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<tr>
<td>Operating Results (Operating Cash Flow Margin) (%)</td>
<td>17.1</td>
<td>Aa1</td>
</tr>
<tr>
<td>Revenue Diversity (Maximum Single Contribution) (%)</td>
<td>57.5</td>
<td>A1</td>
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<tr>
<td><strong>Factor 3: Wealth &amp; Liquidity (25%)</strong></td>
<td></td>
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<tr>
<td>Total Wealth (Total Cash &amp; Investments) ($000)</td>
<td>1,107,343</td>
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<td>Operating Reserve (Spendable Cash &amp; Investments to Operating Expenses) (x)</td>
<td>0.8</td>
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<tr>
<td>Liquidity (Monthly Days Cash on Hand)</td>
<td>268</td>
<td>Aaa</td>
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<tr>
<td><strong>Factor 4: Leverage (20%)</strong></td>
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<tr>
<td>Financial Leverage (Spendable Cash &amp; Investments to Total Debt) (x)</td>
<td>0.9</td>
<td>Aa3</td>
</tr>
<tr>
<td>Debt Affordability (Total Debt to Cash Flow) (x)</td>
<td>4.9</td>
<td>Aa1</td>
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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.

Source: Moody’s Investors Service
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