

MOODY'S

INVESTORS SERVICE

New Issue: Moody's assigns A1 to Missouri State University's Series 2014A Aux. Enterprise System Rev. Bonds; affirms ratings on outstanding bonds; outlook stable

Global Credit Research - 10 Feb 2014

\$110M rated debt

MISSOURI STATE UNIVERSITY
Public Colleges & Universities
MO

Moody's Rating

ISSUE	RATING
Auxiliary Enterprise System Revenue Bonds, Series 2014A	A1
Sale Amount \$39,405,000	
Expected Sale Date 02/27/14	
Rating Description Revenue: Public University Limited Pledge	

Moody's Outlook STA

Opinion

NEW YORK, February 10, 2014 --Moody's Investors Service has assigned an A1 rating to Missouri State University's (MSU) \$39.4 million Auxiliary Enterprise System Revenue Bonds, Series 2014A. At this time we have also affirmed the A1 rating on MSU's outstanding Auxiliary Enterprise System Bonds and the Aa3 issuer rating and Aa3 rating on the outstanding Educational Facilities Revenue Bonds (see RATED DEBT below). The university's rating reflects its established role as a public university in Missouri with three campuses and a variety of programs and very strong operations. The outlook is stable.

SUMMARY RATING RATIONALE

The Aa3 rating and stable outlook reflect MSU's position as a regional public university with a strong market position, stable operating margins, healthy balance sheet coverage of debt and operations, improving state funding environment, as well as the broader pledge for the Educational Facilities Revenue Bonds. The rating also incorporates limited flexibility to increase tuition and future borrowing plans. The A1 rating for the auxiliary enterprise system bonds reflects the narrower pledge and limited revenue stream supporting debt service.

STRENGTHS

*MSU holds a stable market position as a regional public university primarily serving southwest Missouri. Full-time equivalent (FTE) enrollment of 16,797 in fall 2013 represents a 2.2% increase over fall 2012 FTE enrollment of 16,435.

*Consistently healthy operating performance, even in the face of declining state support, is evidenced by FY 2013 operating and cash margins of 5.4% and 15.2% respectively. FY 2014 appropriations were increased by 3.2% and there is a proposed 5.2% increase in state support for FY 2015.

*The university has conservative fiscal management with prudent budgeting and capital planning.

*All debt is in fixed rate mode and monthly liquidity is strong at 203 days monthly cash on hand.

CHALLENGES

*Flat state appropriations for FY 2013 and nominal growth for FY 2014 continue to apply pressure to MSU's operating performance. State appropriations have declined 12.3% since 2009.

*MSU has limited flexibility to raise tuition if needed, further diminishing prospects for revenue growth. Missouri state law prohibits tuition increases that exceed CPI, which was 1.5% in 2013, and the university agreed to hold undergraduate resident tuition flat in FY 2015 in exchange for a modest increase in state appropriations.

*A limited student draw greatly exposes MSU to state-wide economic and demographic shifts.

*Expendable financial resources have recently declined (7.2% since FY 2011), and without replenishment further pressure could be added as MSU pursues future borrowing plans.

*The Auxiliary System Revenue bonds have a more limited security pledge, and the Series 2007A rely on a single donor's annual contribution to pay nearly half of annual debt service. This donor has consistently made debt service payments on time and has a history of support for the university; however there are multiple pending law suits against the donor's trust.

DETAILED CREDIT DISCUSSION

USE OF PROCEEDS: The Series 2014A bonds are being issued to: (1) acquire, construct, erect, equip and furnish certain additions, renovations, extensions and improvements to the facilities of the Auxiliary Enterprise System; (2) to pay the costs of issuance. There is no debt service reserve fund.

LEGAL SECURITY: The Auxiliary Enterprise System Revenue bonds constitute special obligations of the university payable solely from net income and revenues derived from the operation of the Auxiliary Enterprise System, including investment income and other funds available to the university for use within the Auxiliary Enterprise System. The owners of the bonds do not have the right to demand payment out of funds raised or to be raised by taxation. The Auxiliary Enterprise System consists of 11 residence halls (4,029 beds), four dining facilities including the Student Union Building, parking facilities (9,366 parking spaces), recreational facilities, health facilities, a university bookstore and certain auxiliary operations at the university's West Plains Campus.

The Series 2014A bonds are on parity with the Series 1998 Note, the Series 2005A Bonds, the Series 2007A Bonds, the Series 2010A Bonds, the Series 2010B Bonds and the Series 2010C Bonds. Under a rate covenant, the university agrees to establish and collect fees that will produce at least 1.1 times annual debt service coverage. Pro-forma maximum annual debt service (MADS) coverage of Auxiliary Enterprise System debt (including the Series 2014A bonds) in FY 2013 is 1.33 times. This excludes a new student fee dedicated to debt service coverage of the auxiliary system bonds. Pro-forma MADS coverage increases to 1.45 times with the addition of the new fee, which is being collected in FY 2014. Mandatory student approved fees can be assessed to provide support to debt service coverage.

Under the Support Agreement for the Series 2007A bonds a donor has agreed to make annual contributions to the foundation in the amount equal to 47.54%, or \$1.9 million per year, of annual debt service payments on \$29 million of the principal amount. This gift is to be received at least 15 days in advance of the semi-annual payments. The university then has a Support Agreement with the foundation whereby the donor's contribution is transferred to make debt service payments. Since issuance, the donor has consistently made debt service payments on time and has a history of support for the university; however there are currently three pending lawsuits against the donor's trust alleging overstated assets. The financial ramifications of the lawsuit are uncertain at this point. Excluding the donor's gifts completely from the auxiliary system revenue stream, pro-forma MADS coverage on the auxiliary system revenue bonds would be a sufficient, but thin 1.17 times in FY 2013. Under a rate covenant, the university agrees to establish and collect fees that will produce at least 1.1 times annual debt service coverage. The series 2007A bonds are further secured with a debt service reserve which is funded with a surety bond provided by Syncora Guarantee, Inc.

The Educational Facilities Revenue Bonds are an unsecured general obligation of the university, excluding state appropriated funds and funds pledged to the payment of the auxiliary enterprise system revenue bonds. Educational Facilities Revenue Bonds are secured with a sum sufficient rate covenant and a negative mortgage pledge.

DEBT STRUCTURE: All of the university's debt consists of amortizing, fixed-rate bonds with final maturity in 2036.

DEBT RELATED DERIVATIVES: None.

MARKET POSITION: REGIONAL PUBLIC UNIVERSITY WITH SOLID MARKET POSITION

Enrollment growth is expected at Missouri State University due to their affordability, expansion of programmatic offerings and its strong foothold in Southwest Missouri. FTE enrollment was 16,797 in fall 2013, a 2.2% increase over fall 2012. Matriculation over the past five years fall between 42% and 45%, reflecting stability in student demand. MSU is highly exposed to state-wide economic and demographic shifts; in fall 2013, 90% of enrolled students were from the state of Missouri. Management expects enrollment growth to continue at 1% per year, with online growth being the primary driver. The university has three campuses; the main campus in Springfield; the West Plains Campus, a community college serving a seven-county rural area of south central Missouri; and the research campus in Mountain Grove. In 2000, the university established the MSU Branch Campus on the campus of Liaoning Normal University (LNU) through an agreement with LNU. This is a joint venture between the two campuses and MSU receives a percentage of tuition. There are no expectations for growth in revenue from this venture.

Over the past five years, despite weak demographic trends in Missouri, FTE enrollment has grown 3.5% and we expect enrollment to remain stable. Only 10% of MSU's students come from outside of the state, mostly from the neighboring state of Illinois. Illinois students enjoy in-state tuition pricing at MSU. Despite projections of improved demographics in the state over the next couple of years, the university is currently developing more aggressive out-of-state and international recruiting strategies with hopes of capturing more out-of-state tuition. In addition, the university continues to pursue articulation agreements with community colleges in the state. Out of 13 public universities in the state, MSU ranks 5th on this list in terms of the lowest tuition charged for in-state students. This has been and will continue to be a source of strength for the university as in-state and out-of-state competitors continue to increase tuition. Tuition charges for FY14 remained flat in exchange for more modest cuts in state appropriations.

OPERATING PERFORMANCE: HEALTHY OPERATING PERFORMANCE EXPECTED TO CONTINUE WITH IMPROVEMENTS IN STATE FUNDING

Despite appropriation cuts by the state of Missouri (Aaa stable) over the last five years, MSU has been able to achieve strong operating performance and we expect this trend to continue. Cash flow margins in FY 2012 and FY 2013 were strong at 15.1% and 15.2% respectively, well above the median of 11.3% for Aa-rated public universities in FY 2012. Management was able to maintain healthy operating performance due to expense containment measures such as cost center cuts, an incentivized retirement program in 2011 and having new employees hired after 2010 share the cost of the university's pension liability by contributing 4% of their pay to the program.

We expect FY 2014 operating performance to be comparable to FY 2013. Other than a 2.0% budget increase for salaries, there were no material changes to the budget. State appropriations for FY 2014 have increased by 3.2%, or \$2.5 million, and FTE enrollment grew by 2.2% in fall 2013. Applications for enrollment for fall 2014 are up over last year and there is an expectation of 1% growth in headcount, yet management is budgeting flat enrollment for FY 2015. MSU passed all five measures used in the new state performance funding model and is expecting a 5.2% increase in the base amount of appropriations for FY 2015. The university also received \$1.3 million in FY 2014 for health initiatives within the state and the university expects this to be an annual recurring contribution from the state.

The university is legally restricted from increasing tuition more than CPI, 1.5% in 2013, which means headcount and tuition discounting remain important drivers of future revenue growth. In FY 2009, tuition represented 44.4% of revenue, compared to 51.9% in FY 2013, and continues to become a more significant source of revenue for the university as management offsets declines in state funding. Pressure on tuition revenue will continue as expense containment measures wear thin and state funding begins to increase.

BALANCE SHEET AND CAPITAL INVESTMENT: FINANCIAL RESOURCES PROVIDE SUFFICIENT COVERAGE OF DEBT AND OPERATIONS, WITH SOME EROSION EXPECTED DUE TO CAPITAL PLANS

The financial resources of the university and affiliated foundation provide a solid cushion for debt and operations, and we expect continued strong support due to well-managed capital planning strategies and the success of the recently completed fundraising campaign. In FY 2013, expendable financial resources of \$194 million covered pro-forma debt 1.30 times and operations 0.73 times. However, total cash and investments of \$135 million in FY 2013 represents a 7.5% decrease over FY 2012 due to a decision by management and the Board to begin to draw on financial resources for capital investment. Management has indicated that it will continue to make strategic draws as warranted. In December 2012, MSU purchased a 120-bed off campus apartment for \$7 million as part of this strategy. The university has a relatively fast principal pay down schedule, with 25% of pro-forma principal paid by

2019.

MSU has a history of steady philanthropic support. The university recently completed its Our Promise campaign in December 2012, meeting its \$125 million goal. Proceeds of the campaign are being allocated towards endowment growth, scholarships, and capital projects.

MSU's endowment is invested entirely with its affiliated foundation. The endowment is managed by the foundation with the help of an investment consultant. Endowment returns have been slightly beneath its peers with a FY 2013 annual return of 9.7% and a five-year return of 3.42%. Asset allocation is well diversified with no one fund containing more than 8%. As of June 30, 2013, the endowment's asset allocation consisted of domestic and international equities (53.6%), fixed income (24.4%), hedge funds (12.4%), private equity (1.8%), real estate (4.4%), and cash (3.4%). As of December 31, 2013, the foundation's investments had a market value of \$72.4 million and 9.3% FYTD returns.

GOVERNANCE AND MANAGEMENT: STRONG MANAGEMENT TEAM SUPPORTS HEALTHY OPERATIONS THROUGH FISCAL PRUDENCE

MSU's prudent budgeting, especially in light of recent state budget cuts, is a credit positive. The university has adopted a strategic plan and measures performance regularly with use of key performance indicators. Although there has been a fair amount of turnover with senior management in recent years, all of the positions were filled by individuals who were already employed by the college in different roles providing strong continuity. A new president was appointed in 2012. Prior to that he served as interim president since 2011 and prior to that he served as general counsel for MSU from 2007-2011; 5 VPs and a CFO report in to the president. The CFO, Provost and General Counsel have all been hired within the last two years.

Outlook

The stable outlook reflects our expectation that the university will maintain stable enrollment and that capital plans will be balanced with resource growth and continued strong operating cash flow.

WHAT COULD CHANGE THE RATING UP

An upgrade could result from a substantial increase in financial resources, coupled with strong enrollment and net tuition revenue.

WHAT COULD CHANGE THE RATING DOWN

Erosion of financial resource coverage of debt and operations could result in a downgrade, as would sustained enrollment declines.

KEY INDICATORS (FY 2013 financial data and 2013 fall enrollment)

Operating Revenue: \$290.4 million

Full Time Equivalent (FTE) Enrollment: 16,797 students

Net tuition per student: \$6,733

Average Gifts per Student: \$751

Total Cash and Investments: \$136 million

Total Pro-Forma Direct Debt: \$149.6 million

Expendable Financial Resources to Pro-Forma Direct Debt: 1.30 times

Expendable Financial Resources to Operations: 0.73 times

Monthly Days Cash on Hand: 203 days

Operating Margin: 5.4%

Operating Cash Flow Margin: 15.2%

Three-Year Average Debt Service Coverage: 3.97 times

Operating Reliance on Student Charges Revenue (% of Moody's Adjusted Operating Revenue): 51.9%

Reliance on Government Appropriations (% of Moody's Adjusted Operating Revenue): 27.4%

State of Missouri rating: Aaa stable

Missouri State University Issuer rating: Aa3 stable

RATED DEBT:

Educational Facilities Revenue Bonds, Series 2010A and 2010B: Aa3

Auxiliary Enterprise System Revenue Bonds, Series 2007A: A1; insured by Syncora Guarantee Inc.

Auxiliary Enterprise System Revenue Bonds, Series 2010A, 2010B, and 2010C: A1

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.

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