FitchRatings

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Fitch Affirms Texas State Univ System's IDR, RFS Bonds at 'AA'; Extend CP at 'F1+'; Outlook Stable

Fitch Ratings - Austin - 08 Dec 2023: Fitch Ratings has affirmed the Texas State University System's (TSUS) Issuer Default Rating (IDR) at 'AA' and various outstanding system revenue bonds issued by the TSUS Board of Regents at 'AA'.

In addition, Fitch has affirmed at 'F1+' TSUS authorized RFS extendible commercial paper program (consisting of RFS commercial paper notes, series A and RFS commercial paper notes, taxable series B) that is to increase to $350 million from the previous $240 million.

The Rating Outlook is Stable.

The 'AA' IDR and revenue bond ratings reflect Fitch's expectation that TSUS will maintain its historically strong 'aa' Financial Profile, underpinned by a solid resource base and very strong state support. These credit strengths, in the context of a stronger operating profile that has generated adjusted cash flow margins of no less than 12% historically, largely offset TSUS' relatively high debt burden that will be increasing with its sizable near-term capital and debt plans. TSUS has good student demand and continued enrollment growth prospects are supported by solid demographic trends and the system's reach throughout the state.

The 'F1+' Short-Term rating on TSUS' ECP program corresponds to the system's 'AA' IDR, which implies strong market access and financial flexibility to take out notes inside the extended maturity window, if necessary.

SECURITY

TSUS' outstanding RFS bonds are secured by all legally available revenues, funds, and balances of the system. Pledged revenues specifically exclude state appropriations and restricted funds. RFS commercial paper notes are on parity with the outstanding RFS bonds.

KEY RATING DRIVERS

Revenue Defensibility - 'aa'

Sound Growth Prospects for System; Strong State Funding Support

TSUS is a public higher education system that serves students across seven campuses in several regions of the state of Texas (AAA/Stable). Its student base has generally tracked flat to modest growth in recent years, although full time enrollment (FTE) rose by a robust 7% yoy to 71,505 in fall 2023 (fiscal

2024) or 91,318 in headcount. Management reports student housing occupancy remains strong at nearly all of TSUS' four-year institutions, bolstered in part by limitations inherent in a low inventory of student housing. Fitch expects sound demand fundamentals will generate similar trends over the intermediate term.

TSUS' revenue base is strong and fairly diverse, with additional pricing power, if needed. The system also benefits from the state's strong funding framework for operations and capital. Net tuition/fees and auxiliary revenue contributed a more usual 45% of fiscal 2023 adjusted total operating revenues, followed by 28% from state funding. Fitch expects the state will maintain TSUS' historically strong funding levels over time, most recently exemplified by TSUS' mix of both new one-time operational and/or capital dollars as well as increased ongoing, general operational state funding support for the current fiscal 2024-2025 biennium. A certain portion of this new biennial state funding is being provided as a result of mutual agreement to maintain affordability between the state and all public Texas university systems, which largely precludes any TSUS increases to basic tuition and fees in this time period.

TSUS will also soon be able to further capitalize on its current research trajectory as one of four currently eligible Texas university systems in the Texas University Fund (TUF), a newly established $3.95 billion endowment fund designed to promote "emerging" research university systems. New research-directed revenue from the TUF is meaningful at an estimated $22 million/year against research spending that totaled $125 million in fiscal 2022.

Operating Risk - 'a'

Strong Cost Management; Capital Plans Incorporate State Support

The current 'a' midrange Operating Risk assessment considers TSUS' strong operating cost flexibility and significant, recurring state support for capital, counterbalanced against its fairly large stated capital and near-term debt plans. The 'a' Operating Risk assessment also reflects Fitch's view that, despite potential inflationary increases to projected capital costs, TSUS' capital spending requirements and further debt leverage will remain in line with the 'a' assessment over time. The midrange (13.6) aggregate average age of plant suggests to Fitch TSUS retains some capital flexibility if needed.

TSUS expects to utilize a portion of its $424 million, state supported CCAP/TRB authorization, in its prospective $475 million 2024 bond issuance. Certain planned debt-funded capital projects, such as auxiliary student housing, could feasibly self-support the associated debt, and other projects anticipate a mix of funding that includes grants or gifts. Fundraising largely occurs at TSUS' four-year institutions, although it remains relatively modest in size, as compared with recurring and one-time state capital funding levels.

TSUS has a track record of strong expense management and financial performance, with Fitch-adjusted cash flow margins consistently around 12% or better when including state HEF capital appropriations. While fiscal 2023 operations generated a slightly slimmer, roughly 11% adjusted cash flow margin, Fitch believes the system has the financial resilience to address revenue fluctuations and will maintain robust cash flow margins similar to historical performance over time.

Financial Profile - 'aa'

Resource Base and State Support Offset Debt Load

TSUS has a solid resource base that largely offsets the relatively high absolute debt levels, including pensions. The system has grown its available funds (AF or cash and investments less certain restricted net assets) since fiscal 2019 to balance against total debt. AF in fiscal 2023 increased moderately yoy to $1.15 billion. TSUS' financial profile remains resilient at 'aa' over a period of moderate investment and operating pressure in Fitch's modeled stress scenario.

Available funds-to-adjusted debt equaled a higher than usual 83% as of FYE Aug. 31, 2023, which Fitch believes is due in large part to the impact of one-time federal stimulus funds that year. Strong state capital support and a conservative, front-loaded aggregate debt service structure, help mitigate risk from the system's elevated total adjusted debt. The system's bonded debt is all fixed-rate, with no derivative instruments. About 16% of TSUS' outstanding debt is approved for CCAP debt service reimbursement, which is not pledged to bondholders, and is subject to biennial approval by the Texas legislature. Still, Texas has a long history of making CCAP (previously TRB) debt service funding payments on time and in full. Because of this support, TSUS' leverage ratios are somewhat overstated.

At FYE Aug. 31, 2023, TSUS had approximately $1.16 billion in long-term obligations, largely due to its outstanding RFS bonds. State-funded employees at TSUS usually participate in the state's cost-sharing Texas Teacher's Retirement System (TRS) pension plan, and in calculating TSUS' total adjusted debt of about $1.4 billion, Fitch utilized the Fitch-adjusted net pension liability (using the 6% discount rate assumption). TSUS' liquidity and coverage are neutral considerations. Available funds totaled 69% of fiscal 2023 operating expenses.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/ Downgrade

--Trend of declining enrollment and/or fundamentally weaker demand indicators systemwide;

--Sustained Fitch-adjusted cash flow margins below approximately 8%;

--Significant and sustained declines in state operating and capital support, including unexpected loss of annual state appropriations for capital construction assistance projects/tuition revenue bond (CCAP/ TRBs) debt service;

--Material and unexpectedly higher debt leverage, such that available funds-to-adjusted debt is diminished to roughly 30%.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

--Significantly stronger and sustained Fitch-adjusted cash flow margins exceeding 18%;

--Improved leverage position with cash-to-adjusted debt increasing toward 80%-100%.

PROFILE

Created in 1911, TSUS is the oldest university system in Texas. Seven component institutions with campuses located across the state offer either two- or four-year degree programs, in addition to comprehensive research programs that provide doctoral and/or master's degrees at the four-year institutions. The system's two largest enrollment bases are at Texas State University in San Marcos (32,678 FTE) and Sam Houston State University (16,762 FTE), with proximity to the expansive Austin-San Antonio or Houston MSAs. The diversity of member institutions by geography and programmatic focus benefits the system, which has achieved consistent enrollment and revenue growth even through periods of mild volatility at individual institutions.

Extendible Commercial Paper Program

The program will be authorized to an increased $350 million and has approximately $143.2 million outstanding. The ECP structure provides sufficient time for TSUS to access the long-term capital markets and provide takeout proceeds in the event of a failed remarketing. ECP notes are issued with a maximum original maturity of 90 days. However, TSUS may extend the maturity of any note to 270 days from issuance, and the extension is automatic for notes not redeemed on the original maturity date. TSUS may redeem extended mode notes with a minimum of one day's notice during the extension period.

Repayment of the ECP notes is largely dependent on TSUS's ability to refinance or fix out maturing notes. Fitch considers market access risk to be tied directly to the system's overall creditworthiness. Therefore, the 'F1+' Short-Term rating corresponds to the system's 'AA' IDR. TSUS' practice is to pass a resolution each year authorizing revenue refunding bonds to take out the maximum $350 million ECP balance, in order to speed market access in the event of a failed remarketing or maturity extension.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG Considerations

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

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Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
Texas State University System (TX)	LT IDR	AA ●	Affirmed		AA ●
• Texas State University System (TX) /General Revenues/ 1 LT	LT	AA ●	Affirmed		AA ●
• Texas State University	ST	F1+	Affirmed		F1+

ENTITY/DEBT	RATING	RECOVERY	PRIOR
System (TX) /General Revenues/ 1 ST			

RATINGS KEY OUTLOOK WATCH

RATINGS KEY	OUTLOOK	WATCH
POSITIVE	⊕	⬘
NEGATIVE	⊖	⬙
EVOLVING	⊙	◆
STABLE	⊡	

Applicable Criteria

Public Sector, Revenue-Supported Entities Rating Criteria (pub.27 Apr 2023) (including rating assumption sensitivity)

U.S. Public Finance College and University Rating Criteria (pub.19 Sep 2023) (including rating assumption sensitivity)

Applicable Models

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Portfolio Analysis Model (PAM), v2.0.0 (1)

Additional Disclosures

Solicitation Status

Endorsement Status

Texas State University System Board of Regents (TX) EU Endorsed, UK Endorsed

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The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Fitch also provides information on best-case rating upgrade scenarios and worst-case rating downgrade scenarios (defined as the 99th percentile of rating transitions, measured in each direction) for international credit ratings, based on historical performance. A simple average across asset classes presents best-case upgrades of 4 notches and worst-case downgrades of 8 notches at the 99th percentile. Sector-specific best- and worst-case scenario credit ratings are listed in more detail at https://www.fitchratings.com/site/re/10238496

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