

31 AUG 2023

## Fitch Affirms Stephen F. Austin State Univ., TX's IDR, RFS Bonds at 'A+'; Outlook Stable

Fitch Ratings - Austin - 31 Aug 2023: Fitch Ratings has affirmed at 'A+' the bond rating on various Revenue Financing System (RFS) bonds issued by the Board of Regents (BOR) of Stephen F. Austin State University (SFA), TX.

In addition, Fitch has affirmed SFA's Issuer Default Rating (IDR) at 'A+'.

The Rating Outlook is Stable.

Enabled by state legislation and effective Sept. 1, 2023 (fiscal 2024), SFA will formally join the University of Texas System (UTS; AAA/Stable) as its ninth academic institution, in addition to UTS' five healthcare institutions. Fitch expects to withdraw SFA's 'A+' IDR on or around Sept. 1 due to SFA's transfer into UTS, at which time the SFA Board of Regents will be dissolved and the university will become a member institution of UTS, governed by the UTS Board of Regents. Therefore, SFA's IDR will no longer be analytically relevant. Future debt issued by the UT System on behalf of its various universities and independent health science centers throughout the state, including SFA, is expected to be secured by the entire UT system, and carry the UTS rating at time of issuance.

However, the 'A+' / Stable bond rating on SFA's outstanding RFS bonds is affirmed to reflect UTS' treatment of outstanding SFA debt as "prior encumbered obligations," whereby outstanding SFA bonds will remain secured by SFA's pledged revenues, not by the entire UT System.

SFA and UTS both initiated and supported the plan for SFA to join UTS; the boards and senior management of both institutions expect positive academic alignment. SFA anticipates greater economies of scale, enhanced UT System name recognition (particularly in relation to its upcoming search for a new President) and financial, capital, and administrative system support. Respective sports teams, mascots and athletic conference affiliations are unchanged.

SFA's 'A+' RFS bond rating incorporates a weakly moderate demand profile, depressed by a steady, cumulative decline of roughly 16% in headcount since the pandemic (fiscals 2020-2024). Cash flow margins and debt leverage are projected to remain thin but adequate through a forward, Fitch-modeled stress scenario.

### SECURITY

The outstanding RFS bonds are secured by all legally available revenues and fund balances of SFA. The security pledge specifically excludes operating appropriations and state constitutional higher education funds (HEF).

## KEY RATING DRIVERS

### **Revenue Defensibility - 'bbb'**

Pressured Enrollment; Solid State Support

At 11,019, fall 2023 (fiscal 2024) headcount is favorably estimated to realize a slimmer decline of 3% as compared with the prior year's 5% loss. This performance was bolstered by a relatively large first-time undergraduate student class that did not fully offset the losses in dual credit, transfer, and graduate students. Fitch believes it is reasonable to assume future headcount loss may further soften, enhanced by added scholarship, operational, and capital investment pledged by UTS to SFA over the next few years.

The trend of headcount loss remains of concern to Fitch, in combination with only modestly selective demand metrics, strong competition from area community colleges and other public universities. However, Fitch also recognizes SFA's demand profile may evolve somewhat in the near to intermediate term given its decision to become part of the UT System.

Fitch expects the state's strong demographic profile will moderately benefit SFA, as current plans include SFA's participation in a coordinated academic partnership program with UT-Austin that is expected to bring roughly 100 students to enroll at SFA for one year, a portion of whom may be retained. Also, SFA is to receive additional funding over the next four years to strengthen its Regent's Promise Plus scholarship program, which will allow the university to expand its eligible pool of first-year students for free tuition/fees based on need-based eligibility from the current family income limit of \$30,000 up to \$80,000.

The 'bbb' Revenue Defensibility assessment is also underpinned by modest revenue diversity. Tuition and auxiliary revenue contributed an above-average 50% of fiscal 2022 adjusted total unrestricted operating revenues as compared with Fitch's public university medians, while the generally stable state appropriation comprised the next largest portion at 27%. Fitch expects modest shifts in SFA's revenue trends may be realized over the next few years given the transition to UTS.

### **Operating Risk - 'a'**

Adequate Cash Flow Margins, Limited Individual Debt Capacity

The fiscal 2022 adjusted cash flow margin shrunk to approximately 7% from 19% in fiscal 2021, in part due to the year's continued enrollment loss, prior spend-down of one-time federal stimulus funding, and the subsequent fiscal impact of certain voluntary separation agreement payouts. Recent fiscal years have also benefitted from management's expense control actions.

For fiscal 2023, SFA management currently expects to be at or near break-even operating results with no significant change anticipated to the unrestricted net position at year-end. Better than budgeted gains in investment and auxiliary revenues are projected to largely offset the gross tuition and auxiliary revenue coming in approximately \$7 million below budget due to the enrollment shortfall. Fiscal 2024 is the first fiscal year SFA's financials will be incorporated in the University of Texas System's audit.

The 'a' Operating Risk assessment includes Fitch's expectations of SFA preserving adequate cash flow margins in the forward look of no less than 6%, largely bolstered by the direct operational and capital funding to be provided by UTS. Fitch also expects this additional revenue will be met with continued and sufficient cost control by SFA management.

Average age of plant has crept up over time, reaching a weak 20 years in fiscal 2022, which indicates very high life-cycle investment needs and evidence of some deferred maintenance currently. Fitch expects the additional one-time Permanent University Fund (PUF) funding (\$45 million) to be provided by UTS in the near-term may, in addition to the likelihood of further investment, favorably help reduce a portion of SFA's long-standing capital needs.

### **Financial Profile - 'aa'**

#### **Adequate Leverage Ratios for Rating Category**

Available funds (AF; defined as unrestricted cash and investments) totaled \$136.1 million at FYE 2022, down from the approximately \$171 million the prior year. SFA's ratio of AF to Fitch-adjusted debt (including pensions) was 58%, down slightly from 62% in fiscal 2021, tempered in part by SFA's lack of new money debt issuance since 2019.

The adjusted debt leverage ratios are in line with a 'aa' Financial Profile, and further benefit from about 22% or \$39 million of SFA's total outstanding RFS debt principal that was authorized for CCAP (previously TRB) debt service reimbursement, which is not pledged to bondholders, and is subject to biennial approval of the Texas legislature. Texas has a long history of making these debt service funding payments on time and in full. Because of this support, SFA's leverage ratios are somewhat overstated.

Maintenance of the 'aa' financial profile through Fitch's modeled stress scenario considers UTS's pledged direct operational and capital support to SFA as an important element to the financial profile. SFA's leverage ratios, and thus its financial profile assessment, do however remain susceptible to pressure in a stress scenario, particularly in light of the enrollment decline trend. SFA management reports no new debt issuance plans, outside of utilizing its approximately \$42 million in state-supported CCAP bond authorization previously awarded, which will be issued by UTS within the year. SFA, as a member of the UT System, is now eligible for PUF capital funding, and will no longer receive state constitutional HEF for that purpose.

SFA holds its endowment at both the university level and at the separate SFA State University Foundation (SFASUF); management estimates total endowment was approximately \$109 million at FYE Aug. 31, 2022. AF related to just the SFASUF is not included in the university's AF calculations.

### **RATING SENSITIVITIES**

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

--Further enrollment declines, which pressure net tuition revenue and weaken cash-flow margins to 6%

or below consistently;

--Debt leverage ratios weakening to 40% or below, over time. SFA has limited new debt capacity for debt not supported by state CCAP debt service reimbursements.

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

--Consistent and sustained adjusted cash-flow margins in excess of 13%;

--Maintenance of adjusted debt leverage ratios in excess of 60%;

--An established trend of combined growth in SFA's enrollment base and selectivity metrics;

--Sustained benefit to SFA from its merger with UTS could support more favorable rating factors for the bond rating.

### **Best/Worst Case Rating Scenario**

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit <https://www.fitchratings.com/site/re/10111579>.

### **PROFILE**

Established in 1923 as a teacher's college, SFA has operated as a stand-alone public university. Its main campus is located in east Texas in Nacogdoches. SFA is largely residential and predominately undergraduate. Most SFA students come from Texas, with a mix of students primarily from east Texas, the Houston area and the Dallas-Fort Worth metroplex. SFA has six colleges offering 80 undergraduate degrees, 44 graduate degrees, and doctoral degrees in forestry, educational leadership and school psychology.

### **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

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
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## Rating Actions

ENTITY/DEBT	RATING	RECOVERY	PRIOR	
Stephen F. Austin State University (TX)	LT IDR	A+ 	Affirmed	A+ 
<ul style="list-style-type: none"><li>Stephen F. Austin State University</li></ul>	LT	A+ 	Affirmed	A+ 

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

## 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 \(pub.22 Sep 2022\) \(including rating assumption sensitivity\)](#)

### Applicable Models

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

Portfolio Analysis Model (PAM), v1.3.4 [\(1\)](#)

### Additional Disclosures

[Solicitation Status](#)

### Endorsement Status

Stephen F. Austin State University Board of Regents (TX) EU Endorsed, UK Endorsed

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