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

Fitch Ratings - Austin - 23 Aug 2024: Fitch Ratings has affirmed the rating on various outstanding Revenue Financing System (RFS) bonds issued by the prior Board of Regents (BOR) of Stephen F. Austin State University (SFA), TX at 'A+'. (SFA's BOR was dissolved when the university became a member institution of the University of Texas System (UTS) on Sept. 1, 2023, and is now governed by the UTS Board of Regents).

The Rating Outlook is Stable.

The 'A+' RFS bond rating reflects Fitch's assumption SFA can feasibly return to thin but adequate cash flow margins over the near-term, despite a weakly moderate demand profile and budgetary structural imbalance anticipated thru fiscal 2025. Pledged UTS resources, sufficient cost management, and some revenue-raising ability underpin this assumption.

The 'a' Operating Risk profile also broadly considers the future institutional restructuring expected as part of SFA's long-range strategic/financial plan, currently under development by its new President. SFA benefits from the wrap-around strategic and operating support provided by UTS to its various member institutions, and the UT System's very strong credit profile (IDR AAA/Stable).

The 'A+' rating also reflects UTS's treatment of outstanding SFA debt as "prior encumbered obligations," whereby outstanding SFA bonds will remain secured by SFA's pledged revenues, and not by the entire UT System.

SECURITY

The 'A+' bond rating on SFA's outstanding bonds 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 and System Support

At 10,888, fall 2023 (fiscal 2024) headcount was down about 4%, slightly below 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. Recent headcount declines, that began in fiscal 2020, have averaged just under -4% over the last five fiscal years (fiscal years 2019-2024).

This longer trend of headcount loss is viewed with some concern, which in combination with only modestly selective demand metrics reflects the strong competition from area community colleges and other public universities. However, Fitch also recognizes SFA's demand profile may continue to evolve somewhat in the near to intermediate term as a relatively new member of the UT System, and could be enhanced by added scholarship, operational, and capital investment pledged by UTS to SFA over the next few years.

The state's strong demographic profile may also 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.

Preliminary headcount for fall 2024 (fiscal 2025) is down by a lower -2.1%, which management attributes primarily to SFA's decision to eliminate some of its dual credit programs distant to campus. However, the year's application and enrollment trends for first-time undergraduates at SFA were strong, and the fall 2024 class of nearly 2,100 is anticipated to be the largest since 2017. Undergraduate retention rates have reportedly improved somewhat as well. Housing demand and occupancy levels are also strong per management.

The 'bbb' Revenue Defensibility assessment is also underpinned by modest revenue diversity. Tuition and auxiliary revenue contributed an above-average 47% of fiscal 2023 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 23%. Fitch expects further modest shifts in SFA's revenue trends may be realized over the next few years given its relatively new status as a UTS member institution.

Operating Risk - 'a'

Diminished Margins

The fiscal 2023 adjusted cash flow margin further weakened to just under 1%, down from approximately 7% in fiscal 2022. This was due in part to the years' continued enrollment loss, prior spend-down of one-time federal stimulus funding, and the subsequent fiscal impact of certain voluntary separation agreement pay-outs. Recent fiscal years have also benefitted from management's expense control actions.

Fiscal 2024 is the first fiscal year SFA's financials are to be incorporated in the UTS's audit. Initial projections of SFA operating performance at YE is a slightly larger than budgeted gap of about $21 million (roughly 8% of spending).

Management indicates this was due in large part to certain higher than budgeted UTS benefit costs and some delays in realizing key budget savings and revenue opportunities expected in joining UTS. For fiscal 2025, SFA's $235 million operating budget retains a similarly-sized structural imbalance of about

-$16 million or 6% of spending, despite certain revenue increases put in place primarily for auxiliary housing/dining services.

Nonetheless, in its forward look, Fitch expects SFA will be able to regain adequate cash flow margins of no less than 6%, and close these structural budget gaps given the budgetary tools and resources at its disposal.

Average age of plant has crept up over time, reaching an elevated 21 years in fiscal 2023, which indicates very high life-cycle investment needs and deferred maintenance. SFA, as part of the UT System, is now eligible for Permanent University Fund (PUF) capital funding, and no longer receives state constitutional HEF for that purpose. Fitch expects the additional one-time PUF funding provided by UTS in its initial agreement with SFA may, along with 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 roughly $134 million at FYE 2023, down slightly from about $136 million the prior year. SFA's ratio of AF to Fitch-adjusted debt (including pensions) totaled 56% in fiscal 2023.

While this falls slightly below Fitch's 'aa' Financial Profile, SFA's current and forward-looking debt leverage ratios additionally benefit from state debt service reimbursement. About 22% or $39 million of SFA's total outstanding RFS debt principal was authorized for Capital Construction Assistance Projects; (CCAP or previously Tuition Revenue Bonds (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.

Beginning in fiscal 2024, future SFA liabilities (pension, debt) will no longer be reported at the institution, but system level. 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. SFA management has 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.

RATING SENSITIVITIES

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

--Unplanned enrollment declines and/or budgetary structure imbalance that cause weaker cash-flow margins to be sustained at below 6%;

--Debt leverage ratios weakening to 40% or below, over time.

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

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

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

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

PROFILE

Established in 1923 as a teacher's college, SFA has operated as a stand-alone public university, but became a member institution of the University of Texas System (UTS) on Sept. 1, 2023, and is now governed by the UTS Board of Regents. 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. Dr. Neal Weaver became the 11th president of SFA on May 13, 2024.

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
Stephen F. Austin State University (TX)					
• Stephen F. Austin State University (TX) /General Revenues/ 1 LT	LT	A+	Affirmed		A+

RATINGS KEY	OUTLOOK	WATCH
POSITIVE		
NEGATIVE		
EVOLVING		
STABLE		

Applicable Criteria

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

U.S. Public Sector, Revenue-Supported Entities Rating Criteria (pub.12 Jan 2024) (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

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

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