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Northern Arizona University; Appropriations; Lease; Public Coll/Univ - Limited Student Fees; Public Coll/Univ - Unlimited Student Fees

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Northern Arizona University; Appropriations; Lease; Public Coll/Univ - Limited Student Fees; Public Coll/Univ - Unlimited Student Fees

Credit Profile

Arizona Brd of Regents, Arizona

Northern Arizona Univ, Arizona

Arizona Brd of Regents (Northern Arizona Univ) APPROP

<i>Long Term Rating</i>	A/Stable	Affirmed
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Arizona Brd of Regents (Northern Arizona Univ) PCU_USF

<i>Long Term Rating</i>	A+/Stable	Affirmed
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Credit Highlights

- S&P Global Ratings affirmed its 'A+' long-term rating and underlying rating (SPUR) on the Arizona Board of Regents' system revenue bonds issued for Northern Arizona University (NAU).
- At the same time, S&P Global Ratings affirmed its 'A' long-term rating and SPUR on NAU's Stimulus Plan for Economic and Educational Development (SPEED) revenue refunding bonds, certificates of participation (COPs), and lease revenue bonds.
- The outlook is stable.

Security

As of June 30, 2022, total debt outstanding was about \$558.0 million, including \$301.1 million of system revenue bonds, \$106.8 million in SPEED revenue bonds, \$36.2 million in COPs, \$108.4 million in lease bonds, and \$5.5 million in financed purchases. All of the university's debt outstanding is fixed rate. The university continues to issue debt through three security structures. We base the rating on the system revenue bonds on NAU's unlimited student-fee pledge. The ratings on the SPEED bonds are different from those on the system revenue bonds because the SPEED bonds have a subordinate pledge of university system revenues. The ratings on the COPs and lease revenue bonds are different from those on the system revenue bonds because the lease structure is subject to annual appropriations.

Credit overview

We assess NAU's enterprise profile as very strong, characterized by increasing first-year student applications and improved graduation rates in fall 2022, offset by modest enrollment declines, with weaker matriculation and retention rates compared with those of its peers. We assess NAU's financial profile as strong, with positive operating performance the past two years with another anticipated in fiscal 2023, and sufficient financial resources relative to operations and debt, offset by the relatively high maximum annual debt service (MADS) burden of 7.2% of fiscal 2022 total adjusted operating expense. However, the debt burden is cushioned to some degree by state support for more than 25% of total debt. We believe that, combined, these credit factors lead to an indicative stand-alone credit profile of 'a+' and a final rating of 'A+'.

The 'A' long-term rating and SPUR on the COPs and the lease revenue bonds reflect the underlying credit quality of the unlimited student-fee pledge, adequate lease security provisions, and the lease-financing structure, with lease rental payments subject to annual budgeting and appropriation, which we rate as one notch below that of the system revenue bonds.

The 'A+' long-term rating and SPUR on the system revenue bonds reflect our view of NAU's:

- Unlimited student fee-equivalent pledge;
- Good student quality, which has led to improvement in student retention and higher graduation rates; and
- Operating surpluses in fiscal years 2021 and 2022 of 2.1% and 3.0%, respectively, with an additional operating surplus budgeted in fiscal 2023.

Partially offsetting these strengths, in our opinion, are NAU's:

- Weak available resources ratios for the rating category,
- Modest declines in full-time-equivalents (FTEs) since fall 2018, and
- High MADS burden of 7.2% when compared with medians.

The 'A' rating on the SPEED bonds reflects our view of:

- A subordinate pledge of the university's system revenues;
- A pledge of lottery revenues placed into the SPEED bond fund, which are designed by law to cover no more than 80% of annual debt service, and required to be used solely for that purpose; and
- The risk that NAU will have to pay the full amount, or a substantial portion, of SPEED debt service from university funds if lottery ticket sales decline significantly.

Located in Flagstaff, NAU lies approximately 130 miles north of Phoenix and serves 28,090 students as of fall 2022. Approximately 70% attend classes at the Flagstaff campus; the remainder participate in NAU's distance learning initiative at statewide and worldwide campuses, which offer a mix of certificate and degree courses through nontraditional media. Although the university offers both master's and doctorate-level degree programs in select professional disciplines such as nursing and physical therapy, it continues to focus on its mission as an undergraduate institution. Therefore, management expects undergraduates to remain the largest component of NAU's total headcount.

Environmental, social, and governance

We analyzed the university's environmental, social, and governance credit factors pertaining to its market position, management and governance, and financial performance. Health and safety risks, which we consider a social risk factor, have largely abated and are neutral in our credit rating analysis. All other environmental and governance credit factors are also neutral in our credit rating analysis,

Outlook

The stable outlook reflects our opinion of the continued full-accrual operating surpluses budgeted for fiscal 2023, significant increase in state appropriations in fiscal 2023, and NAU's improved liquidity, with cash and investments rising to a recent high of \$328.3 million at fiscal year-end 2022, or 58.8% of total debt outstanding. Although the university continues to experience enrollment pressure, we expect state support and management's cost containment measures will offset the revenue reduction. We believe the continued positive operating performance could translate into an improvement in NAU's available resources, lending stability to the ratings during the outlook period.

Downside scenario

A negative rating action could occur if the university's enrollment and demand metrics weaken and pressure the operating performance, available resource ratios decrease from current levels, or the university issues additional debt without commensurate growth in resources.

Upside scenario

We could consider a positive rating action if NAU stabilizes enrollment, strengthens demand metrics, sustains positive operations, and grows available resources ratios materially to levels commensurate with those of higher-rated universities.

Credit Opinion

Enterprise Profile

Market position and demand

Enrollment at NAU has experienced modest pressure during the past four years, with declines ranging from 1% to 4%. In fall 2022, FTE enrollment totaled 26,918, a 0.8% decline from 27,123 in fall 2021, but a 9.7% drop from the high of 29,524 in fall 2017. The decrease was driven by a 2.4% drop in undergraduate enrollment to 22,646 in fall 2022 from 23,193 in fall 2021. Undergraduate enrollment represented 84% of total FTE enrollment in fall 2022. The decline in undergrad FTE enrollment was partially offset by significant growth in graduate enrollment during the past six years, most recently in fall 2022. In fall 2022, graduate FTE enrollment totaled 4,272 students, an 8.7% increase compared with 3,930 in fall 2021.

In fall 2022, freshman applications totaled 44,855 a 4.6% increase over 42,872 in fall 2021, and a 20.0% increase compared with 37,386 in fall 2020. We consider NAU's demand metrics acceptable, with selectivity at or near 80.0% for the past three years. The university continues to focus on student retention, and the retention rate increased slightly to 75.9% in fall 2022 from 74.5% in fall 2021. NAU continues to attract regional recruits and has made a significant effort to expand both in Arizona and in states like California, Texas, and Illinois. The university draws approximately 34.1% of students from out of state, which we view as higher than at some similarly rated peers. It also competes heavily with the two other Arizona schools, University of Arizona and Arizona State University.

Management and governance

NAU welcomed its new president, Dr. José Luis Cruz Rivera, in June 2021 as the 17th president, after Dr. Rita Cheng decided to return to faculty. More recently, the university appointed Laurie Dickson as the vice president of university strategy and Nick Lobejko as the vice president of advancement and foundation in 2022. In addition, the university appointed John Holmes as the vice president of capital planning and campus operations in January 2023.

Management reports that the appointees' transitions have been smooth, and we view the overall management team as stable.

The board consists of 11 voting members as well as two student regents, appointed by the governor, who vote in the second year of their two-year term.

NAU has a strategic plan that is linked with the Enterprise 2025 goals set forth by the board of regents. With the adoption of the goals, each of the three Arizona public universities set annual metric targets through 2025 in 13 key areas related to enrollment, degrees, retention, graduation rates, research expenditures, etc. We believe that NAU has made progress on the key areas and will continue to do so. The university budgets for depreciation expense, which we view positively. In our view, NAU has adequate financial practices. We view management as stable, with a good understanding of NAU's market.

NAU has a comprehensive security program that is audited at least annually. In response to increased phishing attacks, the university now requires all employees and faculty to use multifactor authentication when accessing university information systems, which management believes reflects a targeted and more comprehensive extension beyond individuals in departments with access to personally protected information.

Financial Profile

Financial performance

Operations have been stronger in the past two years than historically, with full-accrual surpluses in fiscal years 2022 and 2021 of \$24.3 million and \$15.1 million, respectively, compared with a deficit of \$31.5 million in fiscal 2020. The surplus in fiscal 2022 was in part due to a significant increase in state appropriations of \$31.3 million (29.2%) and a one-time \$20.0 million investment from the state Technology and Research Initiative fund (TRIF) to support academic attainment. For fiscal 2023, the university has budgeted that TRIF funding will return to historical levels; however, state appropriations are anticipated to increase by approximately \$28.3 million. As a result of cost control measures as well as the increase in state appropriations, the university has budgeted an operating surplus of about \$7.9 million, but management reports that NAU is outperforming the budget and anticipates more positive operating results. We view the expected improvements in operations favorably.

The university's operating revenues are relatively diversified, in our opinion, and in fiscal 2022 included state appropriations (16.5%), grants and gifts (7.3%), net tuition and fees (43.7%), and auxiliary services (8.2%). The undergraduate tuition rate for the Flagstaff campus increased nominally in fiscal 2022 by 3.5%. The overall tuition discount rate, at 45.4%, is high compared with those of similarly rated peers, and we believe that it will likely remain high.

Available resources

Available resources for fiscal 2022 remained relatively weak for the rating category, in our view, despite the significant increase the past two years. Available resources (as measured by adjusted unrestricted net assets [UNA]) increased by 19.2% and 28.7% in fiscal 2021 and 2022, respectively. For fiscal 2022, UNA totaled \$235.6 million, which equated to 28.8% of total adjusted operating expense and 42.2% of total debt outstanding. Similarly, cash and investments have increased the past two years although to a lesser degree. For fiscal 2022, the university's cash and investments totaled \$328.3 million, a 1.8% increase compared with \$322.7 million in fiscal 2021, equating 40.2% of total adjusted operating expense and 58.8% of total debt outstanding.

Debt

In fiscal 2021, the university issued series 2021A and series 2021B direct purchase revenue refunding bonds, totaling \$21.4 million. Although we don't rate these bonds, we did review the documents associated with this issuance over the course of our analysis. The bonds were issued to refund the series 2010 and a portion of the series 2013 SPEED bonds. The series 2021A and 2021B bonds are on parity with other general revenue debt and are fixed rate.

System revenue bonds. Total system revenue bonds as of fiscal 2022 year-end equaled \$301.1 million. A variety of pledged revenue sources that we view as equivalent to a general obligation secure the system revenue bonds. These sources include tuition and some auxiliary revenue.

COPs. Total COPs as of fiscal 2022 year-end equaled \$36.2 million. The certificates are payable from NAU's lease payments, reflecting a lease-financing structure with lease-rental payments subject to annual budgeting and appropriation, as well as good university credit quality. Although no source is specifically pledged by NAU to make lease payments, the university uses a broad range of sources, including research indirect cost recovery revenue, state appropriations, gifts, general fund money, and auxiliary receipts. NAU is in compliance with all bond resolution covenants and has been in all cases since the date of their issuance.

Lease bonds. Total lease bonds as of fiscal 2022 year-end equaled \$108.4 million. Similar to the COPs, payments also reflect a lease-financing structure. The university's two housing projects originally funded by the lease revenue bonds have consistently demonstrated approximately 95% or better occupancy. The revenues from the projects, while not directly pledged, are used to pay debt service on the lease revenue bonds.

SPEED bonds. Total SPEED bonds as of fiscal 2022 year-end equaled \$106.8 million. As mentioned, security for the SPEED revenue bonds is a first-lien pledge of revenues deposited into the bond fund from state lottery revenues and university funds. If pledged revenues are insufficient, there is a subordinate lien on the university's system revenues. Lottery revenues have been sufficient to meet the statutory maximum allowable 80% of debt service on the SPEED bonds in every year since their issuance, including fiscal 2022 (with the remaining 20% provided by the university).

NAU contributes to the Arizona State Retirement System, a cost sharing, multiple-employer plan and the Public Safety Personnel Retirement System (PSPRS), an agent, multiple-employer plan. The contribution to PSPRS is very insignificant. We understand that the overall pension funded status is 78.6%. NAU's pension and other postemployment benefits expense relative to adjusted operating expense is 1.73%, which we view as manageable.

Northern Arizona University--Enterprise And Financial Statistics

--Fiscal year ended June 30--

	2023	2022	2021	2020	2019
Enrollment and demand					
Headcount	28,090	28,718	29,569	30,736	31,073
Full-time equivalent	26,918	27,123	28,078	29,175	29,384
Freshman acceptance rate (%)	80.0	78.4	81.6	85.0	82.6
Freshman matriculation rate (%)	15.7	15.8	17.1	17.4	19.7
Undergraduates as a % of total enrollment (%)	82.6	84.2	85.3	86.3	87.1
Freshman retention (%)	75.9	74.5	76.3	77.5	73.5
Graduation rates (six years) (%)	59.1	59.0	56.9	56.6	52.4
Income statement					
Adjusted operating revenue (\$000s)	N.A.	841,342	751,246	742,498	719,147
Adjusted operating expense (\$000s)	N.A.	817,013	736,103	774,037	746,243
Net adjusted operating income (\$000s)	N.A.	24,329	15,143	(31,539)	(27,096)
Net adjusted operating margin (%)	N.A.	2.98	2.06	(4.07)	(3.63)
Estimated operating gain/loss before depreciation (\$000s)	N.A.	75,682	57,198	13,700	15,726
Change in unrestricted net assets (UNA; \$000s)	N.A.	67,287	30,008	(10,187)	(1,226)
State operating appropriations (\$000s)	N.A.	138,737	107,396	113,523	103,200
State appropriations to revenue (%)	N.A.	16.5	14.3	15.3	14.4
Student dependence (%)	N.A.	51.9	57.6	60.3	62.3
Research dependence (%)	N.A.	5.6	6.2	5.8	5.5
Debt					
Outstanding debt (\$000s)	N.A.	557,970	608,961	599,735	594,632
Current debt service burden (%)	N.A.	6.57	6.00	6.59	6.99
Current MADS burden (%)	N.A.	7.21	7.00	6.28	7.30
Financial resource ratios					
Endowment market value (\$000s)	N.A.	154,220	178,641	127,324	125,025
Related foundation market value (\$000s)	N.A.	213,554	238,168	194,960	180,611
Cash and investments (\$000s)	N.A.	328,331	322,669	302,361	253,465
UNA (\$000s)	N.A.	26,352	(40,935)	(70,943)	(60,756)
Adjusted UNA (\$000s)	N.A.	235,646	183,066	153,639	166,929
Cash and investments to operations (%)	N.A.	40.2	43.8	39.1	34.0
Cash and investments to debt (%)	N.A.	58.8	53.0	50.4	42.6
Adjusted UNA to operations (%)	N.A.	28.8	24.9	19.8	22.4
Adjusted UNA plus debt service reserve to debt (%)	N.A.	42.2	30.1	25.6	28.1
Average age of plant (years)	N.A.	13.7	15.8	13.8	13.6

Northern Arizona University--Enterprise And Financial Statistics (cont.)

--Fiscal year ended June 30--

	2023	2022	2021	2020	2019
OPEB liability to total liabilities (%)	N.A.	0.5	0.6	0.5	0.9

N.A.--Not available. MADS--Maximum annual debt service. Total adjusted operating revenue = unrestricted revenue less realized and unrealized gains/losses and financial aid. Total adjusted operating expense = unrestricted expense plus financial aid expense. Net operating margin = 100*(net adjusted operating income/adjusted operating expense). Student dependence = 100*(gross tuition revenue + auxiliary revenue) / adjusted operating revenue. Current debt service burden = 100*(current debt service expense/adjusted operating expenses). Current MADS burden = 100*(maximum annual debt service expense/adjusted operating expenses). Cash and investments = cash + short-term and long-term investments. Adjusted UNA = Unrestricted net assets + unrestricted net assets of the foundation. Average age of plant = accumulated depreciation/depreciation and amortization expense.

Related Research

Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022

Ratings Detail (As Of March 14, 2023)

Arizona Brd of Regents, Arizona

Northern Arizona Univ, Arizona

Arizona Brd of Regents (Northern Arizona Univ) APPROP

Unenhanced Rating A(SPUR)/Stable Affirmed

Arizona Brd of Regents (Northern Arizona Univ) PCU_USF

Long Term Rating A/Stable Affirmed

Arizona Brd of Regents (Northern Arizona Univ) PCU_USF

Long Term Rating A+/Stable Affirmed

Arizona Brd of Regents (Northern Arizona Univ) PCU_USF (AGM)

Unenhanced Rating A+(SPUR)/Stable Affirmed

Arizona Brd of Regents (Northern Arizona Univ) PCU_USF (AGM)

Unenhanced Rating A(SPUR)/Stable Affirmed

Arizona Brd of Regents (Northern Arizona Univ) PCU_USF (BAM)

Unenhanced Rating A+(SPUR)/Stable Affirmed

Arizona Brd of Regents (Northern Arizona Univ) PCU_USF (BAM)

Unenhanced Rating A+(SPUR)/Stable Affirmed

Pine Ridge Village Campus Heights LLC, Arizona

Northern Arizona Univ, Arizona

Pine Ridge Village Campus Heights LLC (Northern Arizona Univ) PCU_USF (ASSURED GTY)

Unenhanced Rating A(SPUR)/Stable Affirmed

Stud and Academic Services L.L.C., Arizona

Northern Arizona Univ, Arizona

Stud and Academic Services L.L.C. (Northern Arizona Univ) LSE (BAM)

Unenhanced Rating A(SPUR)/Stable Affirmed

Many issues are enhanced by bond insurance.

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