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University of Puerto Rico; Public Coll/Univ - Unlimited Student Fees

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Credit Profile

University of Puerto Rico

Long Term Rating

BBB-/Stable

Affirmed

Rationale

Standard & Poor's Ratings Services affirmed its 'BBB-' long-term rating on the University of Puerto Rico's (UPR) series P and Q university system revenue bonds. At the same time, Standard & Poor's affirmed its 'BBB-' underlying rating (SPUR) on UPR's series O university system revenue bonds. The outlook on all ratings is stable.

The rating reflects management's swift return to positive operations on a full accrual basis. Previously, management had reported that the structural deficit would continue until 2013 as they implemented their deficit-reduction plan. In one year they were able to produce a surplus on a full accrual-basis, which management attributes to higher-than-expected tuition revenues from the stabilization fee and better-than-projected results from cost-reduction measures. At the same time, management was able to weather the accreditation issues and return to growing enrollment. We believe that management's long term fiscal stabilization and Cooperation and Financial Reporting Agreement with the Government Development Bank of Puerto Rico provides more stability for the credit than previous administrations.

Risks from the economic climate of the Commonwealth of Puerto Rico (BBB/Negative) and the extremely low financial resources remain as negative factors. The rating on UPR has historically mirrored that of the Commonwealth of Puerto Rico, given UPR's significant dependence (about 60%) on it for total revenues. We still believe the one notch differentiation is appropriate given the economic uncertainty at the commonwealth, and we would also view positively a longer trend of positive operations.

In our opinion, credit risks include UPR's:

- Significant revenue concentration with 60% derived from Commonwealth-appropriated funds for the annual operating budget,
- History of structural imbalance though this is partially mitigated by a return to positive operations on a full-accrual basis,
- Weakened cash position, given the large line of credit for working capital and nonexistent financial resource ratios, and
- Lack of fundraising and a modest endowment of about \$90 million as of June 30, 2012.

Credit strengths, in our opinion, include UPR's:

- Continued financial support from the Commonwealth of Puerto Rico, including recent increases in 2012 and 2013;
- Role as the commonwealth's only comprehensive public university of higher education;

- Several additional sources of Commonwealth revenue and funding from a broader pool of revenues, of which UPR receives 9.6%; and
- Manageable debt burden of 4.5% of 2011 adjusted operating expenses.

The bonds are secured by a pledge of all revenues, excluding appropriations and any contributions. We view this broad pledge as equivalent to an unlimited student fee pledge. Total debt as of June 30, 2012 was \$700 million. Management reports that they may consider issuing additional debt beyond the two-year outlook period; however, the timing and total amount has not been finalized.

The University of Puerto Rico was founded in 1903 and is the only state-supported university system. It comprises 11 institutional units located throughout the commonwealth. The main campuses are: Río Piedras, Mayagüez, and Medical Sciences. UPR offers 452 degree-granting programs (associates, undergraduate, masters, graduate certificates, professional) in the arts, sciences, business, engineering and technology. The Río Piedras campus has a Carnegie classification of High Research Activity and is the largest campus based on enrollment, with a headcount of 15,626 for fall 2012.

In fiscal 2011, the UPR restored its good accreditation standing with the Middle States Commission on Higher Education, after the commission placed 10 of its programs on probation in 2010. The probationary status was a result of a student stoppage that interrupted operations in these programs for 62 days. The UPR was able to resolve these issues and return to good standing within 15 months and has recently completed the 24 month follow-up period without any further issues.

Outlook

The stable outlook on UPR's debt reflects our expectation that, during the next two years, UPR will maintain stable demand and positive operations on a full-accrual basis and progress toward improving unrestricted net assets.

We could consider a negative rating action during the outlook period if the Puerto Rico economy further weakens, debt service coverage declines, and if enrollment declines or UPR returns to negative operations.

Outside the outlook period, we could consider a positive rating action if the university is able to significantly improve unrestricted net assets and has a longer trend of positive operations on a full-accrual basis.

Enterprise Profile

Demand

Despite student protests in 2010 and 2011, UPR continues to exhibit strong demand and plays a very important role in Puerto Rico's higher education system, as it enrolls about 30% (about 58,700) of Puerto Rico's college students. Total enrollment for fall 2012 was 57,045 -- an increase from the previous year's enrollment of 56,748. Management reports that its enrollment management is part of its strategic plan, and it expects to gradually increase enrollment to 60,000 by 2014. In addition, we believe the university has some admissions flexibility, as about 76% of its applicants are admitted each year, of which a high level, 88%, enroll.

Tuition

Tuition rates have increased to \$55 and \$53 per credit hour per semester in fiscal 2013 and 2012, respectively from \$51 in fiscal 2011. In 2011, the university implemented the \$400 per semester stabilization fee, which continued for fiscal years 2012 and 2013. Total tuition and fees are about \$2,534 per year (assuming 30 credit hours per year), which in our opinion is still affordable and below other private colleges and universities in Puerto Rico.

About 70% of undergraduates are Pell eligible and about 65% are eligible for the maximum Pell grant of \$5,500, well above the total tuition and fees per year. In addition, as of November 2010, a law was passed that guaranteed 10% of lottery revenues with a guaranteed minimum of \$30 million per academic year for a special scholarship fund designated for only UPR students. About 62% of graduates and undergraduates benefit from this fund. We believe that both the Pell Grants and scholarship provides the university with some flexibility with regard to pricing. Student dependence (net tuition and fees), though, represents only 5.4% of total 2011 revenues, and has grown from historical levels of about 4%. The UPR three-year student loan cohort default rate is 8.8%, which is lower than other private institutions in the commonwealth and consistent with the national average, which we view positively.

Management

The university is governed by a 17 member board of trustees, 14 of whom are appointed by the governor to six year terms, and two are elected for one year terms. The trustees appoint the president of the university who is the CEO though the president has no term limit. Dr. Miguel A. Munoz was appointed president of UPR in 2011 after previously serving as interim president.

In addition, we view positively the coordination with the Government Development Bank of Puerto Rico (GDB), which holds the university's two lines of credit. In August 2011, UPR signed a Cooperation and Financial Reporting Agreement with the GDB to provide support toward UPR's fiscal stabilization. The agreement includes periodic reporting by the UPR on budgeting, cash flow reports, and interim financial statuses.

Government-related entity (GRE)

In accordance with our criteria for government-related entities, our view of a "high" likelihood of extraordinary government support reflects our assessment of UPR's "very important role" in Puerto Rico (BBB/Negative), given its status as the only public university in the Commonwealth. In addition, the assessment is based on UPR's "strong" link with the government of Puerto Rico, given the commonwealth's history of regular operating support through annual appropriations and periodic capital support for programs and facilities through the Puerto Rico Government Development Bank. Pursuant to the GRE criteria, a high likelihood of extraordinary support from Puerto Rico does not result in an upgrade or downgrade of UPR's standalone credit profile of 'bbb-'.

Financial Profile

Appropriations

Under the Commonwealth Act 2 of 1966, UPR is allocated an amount equal to 9.6% of the average total revenue collected by Puerto Rico during the prior two fiscal years. While this strong link to the Commonwealth has historically benefited UPR in terms of annual appropriations growth, its revenue stream is vulnerable to the Commonwealth's economic slowdowns. Appropriations as a percentage of total revenues continues to decline: to 59.7% in 2011 from a

high of 76% in 2008. Total appropriations in 2012 were \$704.5 million, up from \$691.5 million in 2011. For fiscal 2013, appropriations increased to \$756.8 million.

Operations

Since fiscal 2008, the university has had negative operations on a full-accrual basis, with a deficit of \$33.2 million for fiscal 2010. Management reports this was a result from a decrease in Commonwealth appropriations that did not have corresponding reduction in expenses. For fiscal 2011, however, the university had \$41.3 million surplus on a full-accrual basis. Management reports that the improvement in operations was due to better-than-expected projections of the stabilization fee, which provided \$41 million in 2011, and reductions in retiree and employee benefits and improved communication and planning with the GDB. Though fiscal 2012 audited financials are not available, a similar surplus on a full-accrual basis is expected. We view positively management's ability to quickly return to positive operations, and we expect this trend to continue.

Financial resources

In our view, financial resource ratios are extremely low for an investment-grade credit; as a result, previous deficit accruals have further reduced audited UNA in each year since 2008. Total net assets at June 30, 2011 were \$426.1 million, of which a negative \$64.3 million were unrestricted (down from \$12 million UNA in 2007). After adjustments for debt service reserves, our adjusted 2011 UNA totaled negative \$12.3 million, equal to negative 4.7% of operating expenses and negative 1.7% of total debt obligations. Management expects to improve UNA as the deficits subside. The UPR's endowment of over \$90 million as of June 30, 2012 is small in our opinion, though the endowment fund was just established in 1996 and fundraising is nascent.

Debt and contingent liabilities

UPR's long term obligations as of June 30, 2011 totaled \$700 million, \$540 million of which are revenue bonds.

Maximum annual debt service is still manageable in our opinion at 4.5% of 2011 operating expenses. All debt is fixed rate. Management reports that pledged revenues totaled \$180 million in 2011 and provided coverage of about 2.99x. The university also has a \$125 million line of credit with the GDB for working capital, which currently has \$65 million outstanding. In our opinion, the university's weakened cash position is a credit risk.

The university provides other postemployment health care benefits (OPEB) for its retired employees although it does not pre-fund the obligation and, thus, the benefits are paid from the university's general assets each year. The total unfunded accrued liability for fiscal 2011 is \$189.5 million.

Related Criteria And Research

- USPF Criteria: Higher Education, June 19, 2007
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, Dec. 9, 2010

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