

**Research Update:**

# Southern Methodist University, TX Revenue Bond Rating Affirmed At 'AA-'

February 14, 2025

## Credit Highlights

- S&P Global Ratings affirmed its 'AA-' rating on Southwest Higher Education Authority Inc., Texas' revenue bonds, issued for Southern Methodist University (SMU).
- The outlook is stable.

## Security

SMU's general obligation pledge secures the debt. As of May 31, 2024 (the latest audited year), SMU's total debt outstanding was approximately \$613.6 million, with 41.8% composed of privately placed debt. SMU also holds escrowed assets to defease an additional \$1.6 million in debt. Excluding the bullet maturity of the 2023 bank loan, maximum annual debt service (MADS) equals \$53.7 million, or 5.7% of total adjusted operating expenses in fiscal 2024, which we consider somewhat high. Management does not have additional debt plans during the two-year outlook period.

## Credit overview

We assessed SMU's enterprise risk profile as very strong, characterized by growing undergraduate enrollment, solid retention, and a substantial graduate student base, somewhat offset by slightly worsening matriculation and selectivity. We assessed SMU's financial risk profile as strong, characterized by consistently positive operating margins and high cash and investments ratios, somewhat offset by a high MADS burden. We believe these credit factors, combined, lead to an anchor of 'a+'. As our criteria indicate, the final rating can be within one notch of the anchor. Due to SMU's very high cash and investments relative to operating expenses and debt outstanding, we believe its credit profile is in line with the final rating of 'AA-'.

The rating also reflects our opinion of SMU's:

- Sustained enrollment growth and increasing applications over the past several years;
- Consistent full-accrual operating surpluses supported by a long trend of net tuition revenue growth;

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- Extremely strong cash and investments relative to debt; and
- Substantial demonstrated fundraising ability, given \$1.4 billion raised so far toward the ongoing \$1.5 billion campaign.

Somewhat offsetting factors, in our opinion, are SMU's:

- Somewhat weak demand metrics compared with those of similarly rated peers; and
- Fairly high MADS burden of 5.7% in fiscal 2024.

Founded in 1911 by the Methodist Episcopal Church, SMU is in University Park, a residential area five miles north of the Dallas business district. SMU offers a variety of undergraduate, graduate, and professional degree programs through its eight schools, including law, business, theology, and engineering. Approximately 65% of students are undergraduates, and the majority (52%) come from within Texas, with increasing enrollment from California, Florida, and the northeast U.S.

## **Environmental, social, and governance**

We have analyzed the university's environmental, social, and governance factors related to its market position and financial performance and view them as neutral in our credit rating analysis.

## **Outlook**

The stable outlook reflects S&P Global Ratings' expectation that SMU will likely maintain modest enrollment growth, steady demand metrics, consistent full-accrual operating surpluses, and balance-sheet ratios consistent with the current rating.

### **Downside scenario**

We could lower the rating or revise the outlook to negative if demand metrics materially weaken or full-accrual operating margins deteriorate below breakeven. We would also view negatively the issuance of significant additional debt to an extent that pressures financial resource ratios below levels commensurate with the current rating.

### **Upside scenario**

We could raise the rating or revise the outlook to positive if enrollment growth is sustained, demand metrics improve, and financial resource ratios increase substantially to levels we consider more in line with those of higher-rated peers.

## **Credit Opinion**

## **Enterprise Risk Profile--Very Strong**

### **Market position and demand**

SMU's full-time equivalent (FTE) enrollment increased by 3.8% to 13,924 in fall 2024 from 13,414 in fall 2023, offsetting two years of slight declines from the previous high of 13,841 in fall 2021. Over the past five years, FTE enrollment has grown modestly by a total of 4.5% from 13,316 in fall

2019, supported by consistent increases in undergraduate enrollment (up 10% since fall 2019). Management targets further modest growth in undergraduate enrollment, bolstered by increasing retention rates and additional transfer students. First-year retention rates have remained very stable at around 90% (increasing slightly to 90.5% in fall 2024), which we consider strong but still low compared with those of similarly rated peers.

Graduate enrollment increased by 5.3% in fall 2024 over the previous year, although this growth did not fully offset the previous three years of decreases. Over five years, graduate FTE enrollment fell by 4.2% since fall 2019, although management attributes the recent rebound to the addition of industry-specific programs within the school of business. Management expects to implement further new programs in that school, as well as enhancing international recruiting efforts in the school of engineering, although it will monitor the potential impact of federal policy on international students.

Applications steadily rose in recent years (barring a change in reporting guidance in fall 2023), with significant further increases in applications anticipated based on current data for fall 2025, as a result of focused marketing around the move to the Atlantic Coast Conference (ACC) and SMU's football success in the past year. In addition to the athletic focus, management attributes the increased draw to the steady increase in sponsored research activity, focus on the student experience and academic quality, and career opportunities in the Dallas area, which has not experienced the same demographic pressures as many other regions. Given SMU's targeted enrollment increases, selectivity worsened slightly to 63.4% in fall 2024 despite the increase in applications. Matriculation rates remained below 20% for the fourth year, which we consider indicative of the competitive environment and weak compared with those of similarly rated peers, although the university still saw a large freshman class of 1,716 students in fall 2024.

## **Management and governance**

The board of trustees governs the university and establishes all policies and guidelines for its operation. There are 48 trustees, including representatives from the United Methodist Church. The president and representatives of the faculty senate, student body, and alumni association serve as ex-officio members.

The management team has generally maintained a long tenure and has strong experience within higher education. Since our last review, the current university president, Dr. R. Gerald Turner, announced his retirement would take effect at the end of fiscal 2025, although he intends to provide continuity and assistance as needed in an emeritus role. The next president, Dr. Jay Hartzell, will join SMU on June 1, 2025, following his tenure as the president of the University of Texas at Austin (UT Austin). Dr. Hartzell oversaw growth in applications, enrollment, graduation rates, and research expenditures at UT Austin, bringing leadership experience in line with SMU's current strategic goals.

Management continues to work under its current strategic plan, which runs through 2025, with the expectation of developing the next plan under Dr. Hartzell's guidance. Management reports making significant strides toward its sponsored research and graduation rate goals under the current strategic plan, and it has sustained consistent full-accrual operating surpluses and increased financial resources, in line with the strategic target of effective financial stewardship. Management does not include depreciation in the annual budget, although it does operate on a conservative basis and generally outperforms targets, which we view positively.

## Financial Risk Profile--Strong

### Financial performance

SMU has consistently generated full-accrual operating surpluses, including a \$18.1 million surplus in fiscal 2024, or 1.9% of total adjusted operating expenses. The surplus in fiscal 2024 was supported by consistent growth in net tuition revenue (although graduate tuition and fees fell slightly), as well as sustained strong auxiliary revenue. The steady net tuition revenue increases reflect enrollment growth, modest decreases in tuition discounting to 36.5% in fiscal 2024, and consistent increases in total cost of attendance (tuition, fees, and room and board). The consistent auxiliary revenue reflects the very high 99.3% occupancy rates on campus, sustained by SMU's freshman and sophomore residency requirement for its recent large classes of undergraduates.

SMU also recognized a substantial increase in restricted donor contributions (to \$233.5 million in fiscal 2024 from \$141.1 million in fiscal 2023); while this revenue is not reflected in unrestricted operating margins, it does support SMU's ongoing fundraising targets to offset ACC transfer expenses, among other goals. SMU's revenue remains somewhat diverse, providing some budget flexibility and insulation from enrollment fluctuations. The university's student-dependent revenues comprised 69.3% of total adjusted operating revenues in fiscal 2024, followed by 9.5% from endowment and investment income, and 3.5% from grants and contracts.

Total adjusted operating revenues in fiscal 2024 increased by 6.7%, more than offsetting the 5.3% increase in total adjusted operating expenses compared with fiscal 2023. Higher expenses related primarily to increased compensation, particularly among staff to remain competitive with the local market rates, inflationary impacts on service contracts, and one-time professional services fees related to the searches for the new university president and deans of three schools. Management expects financial performance in fiscal 2025 will be similar to fiscal 2024 based on current projections, supported by ongoing anticipated increases in net tuition revenue and otherwise generally stable operations.

### Financial resources

Cash and investments increased by 2.6% to \$2.56 billion in fiscal 2024 from \$2.5 billion in fiscal 2023. The cash and investments to operating expenses ratio fell slightly to 272.8%, which we consider strong. Given the decrease in debt outstanding, the cash and investments ratio relative to debt outstanding improved to 417.8%, which we consider extremely strong. Both ratios remain high compared with those of similarly rated peers, although still somewhat low compared with rating category medians. As of May 31, 2024, the university allocated approximately 27% of its investments in short-term paper, stocks, and bonds; 29% in private equity; 19% in hedged strategies; 18% in equity funds; 3% in mineral rights; and the remainder across fixed income funds, notes receivable, and funds held in trust.

The endowment's market value increased by 6.3% to \$2.1 billion in fiscal 2024 from \$2.0 billion in fiscal 2023. SMU's endowment spending policy is based 30% on a four-quarter average market value of the endowment pool times a factor of 4.5%, and 70% on the previous year's transfer, increased by an inflation factor of 3.0%. Although the policy allows for a maximum 7% transfer, the spending formula results in an actual transfer usually being 4.0%-5.0%, which we consider average. Overall, the university does not overly rely on the transfer for operations; for fiscal

2024, the endowment transfer was \$88.2 million, or a low 3.7% draw, providing 9.2% of total adjusted operating revenues.

As of May 31, 2024, approximately 35% of the university's investments were liquid within 30 days, which we consider sufficient for its regular operations and potential contingent liabilities. The university also reported \$534.4 million of resources available within one year for general expenditures, as well as \$100 million of undrawn line-of-credit availability. As of May 31, 2024, the university had approximately \$260.9 million of unfunded investment commitments, which we believe is manageable, given the size of the endowment.

## **Fundraising**

SMU has historically been a strong fundraiser, completing campaigns of over \$1 billion in the past. In September 2021, it launched its current campaign, SMU Ignited, with a goal of raising \$1.5 billion by 2028. To date, SMU has raised almost \$1.4 billion for a combination of capital projects, endowment funds, and current operations and scholarships.

Significant capital projects include the renovation and expansion of the Cox School of Business and construction of the Weber End Zone Complex within the Ford football stadium, both completed at the time of this review. Other upcoming capital projects include construction of the new president's home, the creation of the Library of the American West, and renovations of certain residence halls. Given the considerable investment SMU has made in campus infrastructure over the years, we consider the university's age of plant low compared with that of similarly rated peers.

## **Debt and contingent liabilities**

As of May 31, 2024, SMU's total debt outstanding was approximately \$613.6 million, including \$355 million of publicly placed debt, \$256.2 million of privately placed debt, and \$2.4 million of operating lease liability. SMU also holds escrowed assets to defease an additional \$1.6 million in debt.

On March 31, 2023, SMU entered into a \$150 million bank loan with Bank of America N.A., used as financing to fund residence hall renovations, library expansion, and bridge funding for other capital projects supported by the current fundraising campaign. The bank loan matures in 2030 with a bullet payment, which management expects to pay through a combination of fundraising pledges receivable and refinancing. Given management's substantial fundraising for these capital projects (approximately \$443 million as of the last campaign report in December 2024) and \$353.7 million of donor contributions receivable within the next five years, we exclude the bullet maturity of this loan from our MADS calculation in order to reflect SMU's regular debt service requirements. Excluding the bullet maturity of the series 2023 bridge loan, MADS equals \$53.7 million, or 5.7% of total adjusted operating expenses in fiscal 2024, which we consider somewhat high.

The university provides a defined contribution retiree medical plan and a defined contribution retirement plan for eligible employees. The university's contributions under these plans equaled 2.6% of total adjusted operating expenses in fiscal 2024, which we consider manageable.

## Southern Methodist University, Texas--Enterprise and financial statistics

	--Fiscal year ended May 31--					Medians for 'AA' category rated private colleges & universities
	2025	2024	2023	2022	2021	2023
<b>Enrollment and demand</b>						
Full-time-equivalent enrollment	13,926	13,414	13,511	13,841	13,832	7,994
Undergraduates as a % of total enrollment	65.0	65.5	64.4	61.6	61.0	70.5
First-year acceptance rate (%)	63.3	61.3	52.3	52.5	52.7	14.4
First-year matriculation rate (%)	17.8	17.2	19.4	18.9	20.7	38.4
First-year retention rate (%)	90.5	89.5	90.0	91.0	90.0	95.0
Six-year graduation rate (%)	84.2	83.1	82.0	82.0	81.0	91.1
<b>Financial performance</b>						
Adjusted operating revenue (\$000s)	N.A.	957,901	897,906	873,358	858,046	MNR
Adjusted operating expense (\$000s)	N.A.	939,754	892,871	832,327	801,753	MNR
Net operating margin (%)	N.A.	1.9	0.6	4.9	7.0	2.4
Change in unrestricted net assets (\$000s)	N.A.	56,368	52,934	47,690	95,794	MNR
Tuition discount (%)	N.A.	36.5	36.5	37.9	38.9	39.3
Student dependence (%)	N.A.	69.3	71.4	72.8	73.6	60.8
Health care operations dependence (%)	N.A.	N.A.	N.A.	N.A.	N.A.	MNR
Research dependence (%)	N.A.	3.5	3.5	5.0	5.6	3.3
<b>Financial resources</b>						
Endowment market value (\$000s)	N.A.	2,114,890	1,989,586	2,012,766	2,037,182	2,219,768
Cash and investments (\$000s)	N.A.	2,563,788	2,497,774	2,372,681	2,387,299	2,821,640
Cash and investments to operations (%)	N.A.	272.8	279.7	285.1	297.8	373.7
Cash and investments to debt (%)	N.A.	417.8	389.5	463.1	447.5	472.3
<b>Debt</b>						
Outstanding debt (\$000s)	N.A.	613,597	641,340	512,350	533,424	612,704
Current MADS burden (%)	N.A.	5.7	6.0	5.4	5.6	4.9
Average age of plant (years)	N.A.	12.7	13.1	12.2	12.4	14.7

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 =  $100 \times (\text{net adjusted operating income} / \text{adjusted operating expense})$ . Student dependence =  $100 \times (\text{gross tuition revenue} + \text{auxiliary revenue}) / \text{adjusted operating revenue}$ . Current MADS burden =  $100 \times (\text{maximum annual debt service expense} / \text{adjusted operating expenses})$ . Cash and investments = cash + short-term and long-term investments. Average age of plant = accumulated depreciation/depreciation and amortization expense. N.A.--Not available. MNR--Median not reported. MADS--Maximum annual debt service.

## Ratings List

## Ratings Affirmed

## Education

Southern Methodist Univ, TX General Obligation AA-/Stable

The ratings appearing below the new issues represent an aggregation of debt issues (ASID) associated with related maturities. The maturities similarly reflect our opinion about the creditworthiness of the U.S. Public Finance obligor's legal pledge for payment of the financial obligation. Nevertheless, these maturities may have

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different credit ratings than the rating presented next to the ASID depending on whether or not additional legal pledge(s) support the specific maturity's payment obligation, such as credit enhancement, as a result of defeasance, or other factors.

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