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Fitch Ratings: U.S. Higher Education Can Absorb Pension Liabilities

Fitch Ratings-Chicago-08 November 2018: Unfunded pension liabilities make up a large chunk of a U.S. public university's overall financial leverage, though a new Fitch Ratings report says pension debt in and of itself is not enough to drive rating changes in the sector. Fitch is also planning to release its higher education criteria exposure draft for comment early next week.

One notable reason unfunded pension liabilities alone do not drive ratings is the U.S. higher education sector's tolerance for higher leverage overall. Another is that, unlike other revenue supported sectors like not-for-profit healthcare, colleges and universities may receive direct state funding support for pension liability. Like other subsets of public finance, Fitch treats an institution's unfunded pension liability or net pension liability (NPL) like debt when calculating financial leverage. Fitch treats lease obligations like debt for similar reasons.

Fitch sees an institution's business model as the fundamental bedrock when considering its rating. Acceptable levels of leverage at a given rating level vary across sectors because the relative strength of the business model can be very different. Under Fitch's framework, public higher education institutions with a strong business model can have many multiples of leverage compared to other kinds of entities that have a midrange business model.

The revised framework does not represent a shift in Fitch's approach to considering leverage in public institutions differently from their not-for-profit counterparts. This is demonstrated in Fitch's historical median data. The median level of available funds to debt at the 'AA' rating level is 94.2% for public universities, while the same ratio for a 'AA' rated private institution is much higher at 202.5%.

'Pensions in Public Higher Education: Not Expected to Drive Rating Change' is available at 'www.fitchratings.com'

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