

OHIO BOARD OF REGENTS

Agenda #3.11

Consideration of a request by the University of Cincinnati to pledge student fees in support of an 80,000,000 bond issuance, to be used to finance one capital project on campus.

RESOLUTION

WHEREAS, Section 94.06 of Am. Sub. H.B. 94 of the 124th General Assembly requires that any new pledge of student fees to secure bonds or notes of a state college or university must be approved by the Ohio Board of Regents; and

WHEREAS, the University of Cincinnati proposes to pledge student fees in support of general receipts obligation bonds and/or bond anticipation notes in an amount not to exceed \$80,000,000 for the purpose of financing the Center for Academic Research Excellence; and

WHEREAS, the University has determined that the proposed project is essential to fulfilling institutional goals; and

WHEREAS, the University's Board of Trustees approved the resolution authorizing this bond issuance at its meeting of November 26, 2002; and

WHEREAS, the proposed bond issuance complies with the requirements of Ohio Revised Code §3345.11 and §3345.12;

NOW THEREFORE,

BE IT RESOLVED, upon the recommendation of the Chancellor and with the concurrence of the Resources Committee of the Ohio Board of Regents, that the pledge of fees by the University of Cincinnati in support of general receipts obligation bonds and/or bond anticipation notes in an aggregate amount not to exceed \$80,000,000 is hereby approved.

The University of Cincinnati
March/April 2003 Fee Pledge Request - \$80,000,000

A. Project Overview

The University of Cincinnati proposes to issue general receipts obligation bonds and/or bond anticipation notes to finance the construction for the Center for Academic Research Excellence (CARE) project. The CARE project is one of the centerpieces of the *Millennium Plan*, the University's ongoing effort to double its bio-medical research holdings every 7 to 10 years. The University intends for the Millennium Plan to tie directly to the Third Frontier Program and aims to attract federal grants from the National Institutes of Health and private grants through corporate partnerships.

The CARE project will expand the University's Medical Science Building in two phases by providing approximately 212,875 net square-feet of new academic and research space, including teaching laboratories, administrative offices, and student support facilities.

Initial Submission to the Board: March 20, 2003.

Revised Submission:

The University of Cincinnati
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B. Project Financing and Costs

The University of Cincinnati proposes to issue \$80 million of general receipts obligation bonds and/or bond anticipation notes to help finance the \$97.3 million estimated project cost of the Center for Academic Research Excellence (CARE) project. The University anticipates future grant revenues will be received on a periodic basis, which would offset the required debt obligation.

A portion of the bonds would be short-term and flexible so that the debt can be retired as funding sources permit. The remaining portion would be full-term debt, which would be supported by anticipated new revenues from related research activities. Any fixed debt associated with the CARE project would consist of principal payments for 20 years and would have an estimated interest rate of 4%. A breakdown of the project costs are provided below.

Estimated Project Costs:

Construction Costs	\$73,000,000
Movable Furnishings & Equipment	\$1,908,000
Architect/Engineer Design Fees	\$9,993,000
Testing/studies/surveys/commissioning fees	\$1,223,000
Construction management	\$2,819,000
Bid advertising/permits/misc.	\$1,266,000
Contingency	\$7,091,000
Total Estimated Project Costs	<u><u>\$97,300,000</u></u>

Available Resources	<u><u>\$17,300,000</u></u>
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Total Debt Authority Requested	<u><u>\$80,000,000</u></u>
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C. Project Description

The CARE project will expand the University's Medical Science Building complex in two phases:

- **Phase I:** Design of the proposed facility and related site work will provide about 212,875 net square feet of new academic space, including teaching laboratories, administrative areas, and student support and research facilities. This first phase will include major components for the expansion, including site preparation, utility relocation, construction of the building's core shell, the completion of all public spaces and of all tenant fit-up and finishes in levels R through 2, and installation of all safety and mechanical systems. The scope will include surveying, preparation of an environmental site assessment study, and soil/concrete testing.
- **Phase II:** Design and construction will include completion of laboratories, research facilities, and administrative and support space for levels 3 through 5. This will include lab casework finishes and the completion of all safety, mechanical and electrical systems for support of the laboratory benches, research facilities, and lab support spaces.

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D. Financial Ratio Analysis

Through the 1997 enactment of Senate Bill 6, the 122nd General Assembly established a standardized method for monitoring the financial health of Ohio's state-assisted colleges and universities. Subsequently, the administrative rules used to guide the implementation of S.B. 6 identified three financial ratios to evaluate an institution's fiscal health. The rules also established threshold factors for ranges of ratios, and created a weighted score of the threshold factors, termed the *composite score*, which provides a summary statistic to evaluate an institution's financial stability. The ratios and composite score are described in greater detail below, including how the University of Cincinnati performed when these measures are applied to its FY 2000, FY 2001 and FY 2002 audited financial statements—the most up-to-date financial data available.

It is important to note that the University's FY 2002 financial report was prepared in a modified format as required by the Government Accounting Standards Board (GASB) statements 34 and 35 for public colleges and universities. The most significant change resulting from the new GASB 34/35 format is the inclusion of depreciated assets in the annual audited financial statements reported by public campuses. Accordingly, the procedures for calculating the S.B. 6 ratio analysis were adjusted to permit a comparable, consistent and effective methodology for measuring fiscal stability. In preparing its FY 2002 financial statements, the University of Cincinnati also restated its FY 2001 financial statements in the new GASB 34/35 format, thereby providing an additional degree of comparability.

1. Viability Ratio

For FY 2000 and FY 2001, the viability ratio is defined as expendable fund balances divided by plant debt. For FY 2001(B)* and FY 2002, the viability ratio is defined as expendable net assets divided by plant debt. This ratio is a measure of an institution's ability to retire its long-term debt using available current resources. A viability ratio in excess of 100% indicates that the institution has expendable fund balances in excess of its plant debt. Pursuant to this analysis, a viability ratio of 60% or greater is considered good, while a ratio below 30% would be a cause for concern. The University of Cincinnati's viability ratios for FY 2000, FY 2001 and FY 2002 are as follows:

<u>FY 2000</u>	<u>FY 2001</u>	<u>FY 2001(B)*</u>	<u>FY 2002</u>
82.0%	51.0%	52.8%	52.8%

2. Primary Reserve Ratio

For FY 2000 and FY 2001, the primary reserve ratio is defined as expendable fund balances divided by total expenditures and mandatory transfers. For FY 2001(B)* and FY 2002, the primary reserve ratio is defined as expendable net assets divided by total operating expenses. This ratio is one measure of an institution's ability to continue operating at current levels without future

revenues. Pursuant to the S.B. 6 analysis, a ratio of 10% or greater is considered good, while a ratio below 5% would be a cause for concern. The University of Cincinnati's primary reserve ratios for FY 2000, FY 2001 and FY 2002 are as follows:

<u>FY 2000</u>	<u>FY 2001</u>	<u>FY 2001(B)*</u>	<u>FY 2002</u>
47.0%	42.5%	44.7%	41.6%

3. Net Income Ratio

For FY 2000 and FY 2001, the net income ratio represents net total revenues divided by total current revenues. For FY 2001(B)* and FY 2002, the net income ratio represents the change in total net assets divided by total revenues. This ratio is an important measure of an institution's financial status in terms of current year operations. A negative net income ratio results when an institution's current year expenditures/expenses exceed its current year revenues. A positive net income ratio indicates that the institution experienced a net increase in current year fund balances. The University of Cincinnati's net income ratios for FY 2000, FY 2001 and FY 2002 are as follows:

<u>FY 2000</u>	<u>FY 2001</u>	<u>FY 2001(B)*</u>	<u>FY 2002</u>
(0.80%)	0.40%	(1.2%)	(4.6%)

4. Composite Score

The ratios are translated into a single composite score by assigning individual scores to ranges of ratios, weighting the individual scores, and summing the weighted scores. The primary reserve score is generally weighted more heavily than is the viability ratio, which in turn is weighted more heavily than the net income ratio. This scoring process effectively emphasizes the need for campuses to have strong expendable fund balances, manageable plant debt, and a positive operating balance.

The minimum acceptable composite score is any score above 1.75. Institutions with composite scores at or below this level merit special monitoring, and would be placed on fiscal watch if the ratio analysis yielded a composite score below this level for two consecutive years. The highest possible score is a 5.00. The University of Cincinnati's composite scores for FY 2000, FY 2001 and FY 2002 are above the minimum threshold:

<u>FY 2000</u>	<u>FY 2001</u>	<u>FY 2001(B)*</u>	<u>FY 2002</u>
3.10	3.00	2.80	2.80

* FY 2001(B) reflects ratios as applied to UC's FY 2001 audited financial statements restated in new GASB 34/35 format.

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E. Financial Outlook and Bond Rating

An independent audit of the University of Cincinnati's finances has been conducted by the accounting firm Deloitte & Touche. In the management discussion and analysis section of the University's FY 2002 audited financial report, the following concern was noted:

“Recently Moody's [Investors Services] revised downward, from stable to negative, their outlook for the University. Moody's has also indicated concern about weakening student demand. Both agencies [Moody's and Standard & Poor's] have emphasized the need for growth in University resources commensurate with new debt in order for rating outlooks to improve. The \$60 million gift received in 2002, which was used to increase the endowment, will temporarily address some of these concerns; however, further growth in financial resources must be sought.”

Nevertheless, the University of Cincinnati's existing debt continues to receive relatively high marks from independent bond-rating agencies. Both Moody's Investors Services and Standard & Poor's Rating Services have reviewed and rated the University's debt obligations. The University's bonds have been assigned ratings of *Aa3* and *AA* from Moody's and S&P, respectively. And notes issued by the University were assigned ratings of *MIG1* and *SP-1+* by Moody's and S&P, respectively.

These ratings indicate that UC's long-term bonds are of high quality with low investment risk, and that the University's notes are of the best quality. For reference, the two tables on the following page illustrate Moody's and S&P's rating scales for bonds and notes. Both companies generally use the same principals, criteria, and rating system. However, Moody's applies numerical modifiers to augment each category for rating bonds, with a modifier of 1 indicating the higher end of the category; a modifier of 2 indicating a mid-range ranking; and a modifier of 3 indicating the lower end of the category.

Long-Term Bonds				
Moody's			S & P	Description
Aaa1	Aaa2	Aaa3	AAA	Best quality with little or no investment risk.
Aa1	Aa2	Aa3	AA	High quality with low investment risk.
A1	A2	A3	A	High quality with moderate investment risk.
Baa1	Baa2	Baa3	BBB	Good quality with some investment risk.
Ba1	Ba2	Ba3	BB	Medium quality with some investment risk.
B1	B2	B3	B	Medium quality with higher investment risk.
Caa1	Caa2	Caa3	CCC	Low quality and susceptible to default.
Ca1	Ca2	Ca3	CC	Low quality and highly vulnerable to default.
C1	C2	C3	C	Lowest quality and extremely vulnerable to default.
-	-	-	D	In payment default (S&P rating only).

Short-Term Notes		
Moody's	S & P	Description
MIG 1	SP-1+	Best quality with very strong debt service capacity.
MIG 2	SP-1	High quality with strong debt service capacity.
MIG 3	-	Good quality but may have narrow protection.
MIG 4	SP-2	Adequate quality with some risk of vulnerability.
SG	SP-3	Speculative quality and capacity for debt service.

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