OHIO BOARD OF REGENTS

Agenda 3.10 Consideration of a request by the University of Cincinnati to pledge student fees in support of a $119,000,000 bond issuance, to be used to finance capital projects 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 in an amount not to exceed $119,000,000 for the purpose of financing the Varsity Village capital project on campus; and

WHEREAS, the University has established a 20-year debt service schedule and will retire the debt using auxiliary service revenues, gifts to the University, student fee revenues, and undesignated general funds available to the University; and

WHEREAS, the University has determined that the proposed project is essential to meeting the needs of students and 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 obligations not to exceed $119,000,000 is hereby approved.

The University of Cincinnati
November 2002/January 2003 Fee Pledge Request - $119,000,000

A. Project Overview

The University of Cincinnati proposes to issue general receipts obligation bonds to finance the construction for the capital project known as the Varsity Village. The total projected cost of this proposal is $113.76 million, which includes construction and acquisition costs, capitalized interested, financing costs, and other related costs. The University has established a $5.24 million margin of safety, bringing the total requested debt authorization to $119 million. The University has established a 20-year debt service schedule for the project, and anticipates future revenues sufficient to retire the associated debt.

Some of the components of this project include the construction and renovation of the following:

- A new 150,000 square-foot multi-purpose athletic center
- A new baseball stadium
- Outdoor athletic fields and courts
- A 150-space parking garage
- A student health service center

Initial Submission to the Board: November 14, 2002.

Revised Submission: January 16, 2003

The University of Cincinnati
November 2002/January 2003 Fee Pledge Request - $119,000,000

B. Project Financing

The University of Cincinnati proposes to issue $119 million of general receipts obligation bonds to fund the $113.76 million estimated project cost of the Varsity Village capital project. This amount includes construction costs, capitalized interest, and the cost of issuance with principal amortized over twenty years.

A portion of the project is expected to be funded by $41 million in gifts to the University. Roughly $4 million of gift funds will be available during construction. Bridge financing for the remaining $37 million would be provided through the proposed debt issuance. These gift funds are the result of a specific campaign led by the University's athletic director and vice president for finance.

The University has established a 20-year debt service schedule with an estimated interest rate of 5%. The University estimates the annual net debt service payment to be $6.16 million, which will be financed with revenues from associated auxiliary services, as well as general funds and gifts to the University. Additionally, the revenues from a new special $10 per quarter student fee will be used to help finance the debt. Debt service payments will begin in FY 2006.

A breakdown of the total costs associated with the University's proposed bond issue is presented in Table B-1 below.

Table B - 1	
Estimated project costs	$109,000,000
Capitalized interest	$7,800,000
Bond discount & issue costs	$960,000
Margin of safety	$5,240,000
Less available resources, gifts in hand	($4,000,000)
Total Bond Authorization Requested	**$119,000,000**
Less future available gift resources	($37,000,000)
Net long-term debt	**$82,000,000**
Estimated annual debt service (on long-term debt)	$6,158,000
Debt service schedule	20 Years
Estimated interest rate	5.0%

The University of Cincinnati
November 2002/January 2003 Fee Pledge Request - $119,000,000

C. Project Description

The central location of the Varsity Village will integrate the University's Athletic Department with the rest of the University community, and will provide shared use of modern facilities that will be readily accessible. The new athletic center will house a new student health service facility and a new multi-purpose club, which will serve both students and faculty. The total scope of the athletic center will be approximately 150,000 square feet, of which 144,000 square feet is existing space scheduled for renovation.

Other components of this project include a new baseball stadium, a new multi-purpose outdoor practice field, an indoor gymnasium with one full-size basketball court, two auxiliary basketball courts, three volleyball courts, and six tennis courts. A parking facility will also be constructed that will provide 150 new parking spaces.

The University of Cincinnati
November 2002/January 2003 Fee Pledge Request - $119,000,000

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:

FY 2000	FY 2001	FY 2001(B)*	FY 2002
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:

FY 2000	FY 2001	FY 2001(B)*	FY 2002
47.0%	42.5%	39.5%	36.0%

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:

FY 2000	FY 2001	FY 2001(B)*	FY 2002
(0.80%)	0.40%	(1.1%)	(4.0%)

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:

FY 2000	FY 2001	FY 2001(B)*	FY 2002
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.

The University of Cincinnati
November 2002/January 2003 Fee Pledge Request - $119,000,000

E. Bond Rating

The University of Cincinnati's existing bond-related debt has generally received 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 most recently issued Series 2002F general receipts obligation bonds on July 2, 2002, which have been assigned ratings of *Aa3* and *AA* from Moody's and S&P, respectively.

These ratings indicate that UC's long-term bonds are of high quality with low investment risk. Table E-1 below illustrates Moody's and S&P's rating scale. Both companies generally use the same principals, criteria, and rating system. However, Moody's sometimes applies numerical modifiers to augment each rating category, 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.

Table E-1

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).

N:\NM\Fee Pledges\FY2003\UC_11_2002.doc