

OHIO BOARD OF REGENTS

Agenda Item 3.8 Consideration of a request by the University of Cincinnati to pledge student fees in support of an \$11,532,250 bond issuance, to be used to finance two 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 and/or bond anticipation notes in an amount not to exceed \$11,532,250 for the purpose of financing two capital projects; and

WHEREAS, the University has determined that the proposed projects are essential to fulfilling institutional goals; and

WHEREAS, the University's Board of Trustees approved the resolution authorizing this bond issuance at its meeting of April 1, 2003; and

WHEREAS, this proposal 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 \$11,532,250 is hereby approved.

The University of Cincinnati
June/July 2003 Fee Pledge Request - \$11,532,250

A. Project Overview

The University of Cincinnati proposes to issue general receipts obligation bonds and/or bond anticipation notes to finance two capital projects on campus. The University proposes to use state capital appropriations and related operational revenues to meet the debt service requirements for this issuance. The projects include the rehabilitation of the Van Wormer Administrative Building and the acquisition of property known as Bellevue Gardens near campus.

Initial Submission to the Board: June 19, 2003.

Revised Submission:

The University of Cincinnati
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B. Project Financing and Costs

The University of Cincinnati proposes to issue \$11.5 million of general receipts obligation bonds and/or bond anticipation notes to help finance the rehabilitation of the Van Wormer Building and to reimburse the University's Endowment for the acquisition of Bellevue Gardens.

- The total cost of the Van Wormer Building project is approximately \$8.5 million, for which the University has almost \$2.3 million in available funds from prior state capital appropriations and local college/departmental funding. The remaining portion will be supported by proceeds from this proposed debt issuance, which will be retired with future state capital appropriations. Issuing debt prior to receiving future capital appropriations enables the University to commence work locally, complete the project much sooner, and subsequently replace the interim local financing with state capital dollars during the regular capital cycle. The state capital appropriations the University expects to receive for this project equal \$2,632,250 in the FY 2005-2006 biennium and \$3.6 million in the FY 2007-2008 biennium.
- The debt associated with the Bellevue Gardens acquisition will be supported by general receipts obligations, which will provide bridge financing for the property which the University intends to sell within five to seven years. The purpose of the acquisition is to minimize carrying costs through tax-exempt financing and property tax exemptions. The University predicts market conditions to improve within five to seven years, allowing for the sale of the property to a private buyer. The University estimates the annual operating costs to be \$90,000 and annual net debt service payment to be \$145,000, which is based 2.75% interest rate with principal retirement in 2010. The University anticipates that approximately \$230,000 in annual operating revenues will be available to cover the debt service requirement and interest costs associated with Bellevue Gardens.

Estimated Project Costs:

| | |
|---|------------------------------------|
| Van Wormer construction | \$8,026,800 |
| Bellevue Gardens purchase | \$5,158,000 |
| Issuance costs & capitalized interest | \$535,500 |
| Margin of safety | \$62,500 |
| Total Estimated Project Costs | <u><u>\$13,782,800</u></u> |
| | |
| Available resources - Van Wormer Bldg. | <u><u>(\$2,250,550)</u></u> |
| | |
| Total Debt Authority Requested | <u><u>\$11,532,250</u></u> |

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C. Project Description

- The 18,500 square-foot Van Wormer Building was built in 1899 and has been used primarily for administrative purposes by the University. Upon completion of the rehabilitation project, the facility will continue to house administrative offices, including the offices of the University provost and vice president for Research & Advanced Studies. The University has already received more than \$1.9 million in state capital appropriations to support the building's rehabilitation, and also expects to support the project with \$322,800 in locally-raised funds from University colleges and academic departments.

- Prior to being purchased by the University Endowment, the 48,720 square-foot Bellevue Gardens was a privately-held, 40-unit rental housing facility. The University intends to use the facility as temporary, stand-alone housing primarily for medical center students and faculty members. The University expects that a combination of rising rents and improving neighborhood conditions will make this property attractive for sale on the private market within five to seven years.

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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.

*NOTE: The FY 2002 data shown in *italics* reflect the ratios and composite score when \$6.4 million of proposed new debt is added to the calculations. (This \$6.4 million is net of the \$5.8 million already on the UC Endowment's books for Bellevue Gardens.) All other factors being equal, only the University's viability ratio would be reduced slightly by the additional debt. Other factors not taken into account here include the impact of the new debt on the University's expendable net assets, the future retirement of existing debt obligations, and future changes in revenues and expenses.

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> | <u>FY 2002*</u> |
|----------------|----------------|-------------------|----------------|-----------------|
| 82.0% | 51.0% | 52.8% | 52.8% | 52.2% |

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> | <u>FY 2002*</u> |
| 47.0% | 42.5% | 44.7% | 41.6% | 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> | <u>FY 2002*</u> |
| (0.80%) | 0.40% | (1.2%) | (4.6%) | (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> | <u>FY 2002*</u> |
| 3.10 | 3.00 | 2.80 | 2.80 | 2.80 |

(B): 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 most recently issued bonds (issued in March 2003) have been assigned ratings of *Aa3* and *AA-* from Moody's and S&P, respectively.

These ratings indicate that UC's ability to meet its debt obligations is considered strong. The table below illustrates Moody's and S&P's rating scale. Both companies generally use the same principals, criteria, and rating system. Moody's applies numerical modifiers to 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. Similarly, S&P's ratings may be augmented by a plus or minus sign to show the relative standing within these categories.

| 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). |