OHIO BOARD OF REGENTS

Agenda Item 3.19 Consideration of a request by the University of Cincinnati to pledge student fees in support of a bond issuance not to exceed $25,900,000, to be used to finance the Financial System Replacement Project.

RESOLUTION

WHEREAS, §89.11 of Am. Sub. H.B. 95 of the 125th 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 $25,900,000 for the purpose of financing the Financial System Replacement Project; and

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

WHEREAS, the University's Board of Trustees is expected to consider a resolution authorizing this bond issuance at its meeting of June 22, 2004; and

WHEREAS, this proposal complies with the requirements of Ohio Revised Code §3345.11 and §3345.12;

NOW THEREFORE,

BE IT RESOLVED: Contingent upon the approval of the University of Cincinnati Board of Trustees, and upon the recommendation of the Chancellor and with the concurrence of the Resources & System Efficiency 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 $25,900,000 is hereby approved.

The University of Cincinnati
July 2004 Fee Pledge Request - $25.9 million

A. Project Overview

The University of Cincinnati proposes to issue general receipts obligation bonds to finance the Financial System Replacement Project. This project will replace the University's existing 18-year old financial system with a mySAP Business Solution that uses the latest technology.

The University has secured local funding to help pay for the project, and plans to use general funds to retire the debt in 15 years.

Initial Submission to the Board: June 10, 2004.

Revised Submission:

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B. Project Financing and Costs

The University of Cincinnati requests the authority to issue general receipts obligation bonds and/or bond anticipation notes in an aggregate amount not to exceed $25.9 million, to support the design, acquisition, project resources, installation and equipment for the Financial System Replacement Project. The estimated project cost, including capitalized interest and other issuance costs is $24.58 million. In addition, the University has available $1.2 million in local resources to support project costs. A breakdown of project costs is presented below.

Project costs	$22,800,000
Capitalized interest	$1,472,000
Bond discount & issue costs	$308,000
Margin of safety	$1,320,000
	$25,900,000

The University estimates that the average annual interest rate will be 5% and the average debt service payment to be $2,368,000 per year. Debt service payments would begin in FY 2007 and would continue for 15 years until the debt is retired in FY 2021. The University anticipates that general funds will be sufficient to cover this debt service requirement. Additionally, the University intends to deposit these bond proceeds into an interest-earning account, from which funds will be disbursed for the project as needed. This will allow the University to earn interest that can be applied toward the project, thereby cutting costs and reducing the amount of debt issued.

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C. Project Description

The Financial System Replacement Project will replace the University of Cincinnati's existing financial system with a more up-to-date mySAP Business Solution system that applies the latest technology. The University's existing financial system is 18 years old and has been deemed obsolete. The University has determined that the new system will have a useful life of 15 years and will greatly improve the ability to capture and access financial information and enhance the overall financial management of the University.

The University undertook a complete analysis of all applicable financial systems before choosing the mySAP Business Solution system. This system is employed by several other universities, including Duke University, the Massachusetts Institute of Technology, the University of Tennessee, the University of Kentucky, the University of Mississippi and Johns Hopkins University.

Some of the other benefits of this new system identified by the University include: increased flexibility and responsiveness; improved quality, quantity and timely processing of data; elimination of duplicate data entries; improved customer service; reduced inefficiencies through streamlined business processes; and a more user-friendly system that allows for better information sharing and access.

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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 2001, FY 2002 and FY 2003 audited financial statements—the most up-to-date financial data available.

It is important to note that the University's FY 2002 and FY 2003 financial reports 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. 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 2003 data shown in *italics* reflect the ratios and composite score when $200.4 million ($174.5 million in previously approved debt and $25.9-million of proposed new debt) is added to the calculations. All other factors being equal, only the University's viability ratio would be reduced 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 2001, the viability ratio is defined as expendable fund balances divided by plant debt. For FY 2001(B)*, FY 2002, and FY 2003 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% might be a cause for concern. The University of Cincinnati's viability ratios for FY 2001, FY 2002, and FY 2003 are as follows:

FY 2001	FY 2001(B)	FY 2002	FY 2003	*FY 2003**
51.0%	52.8%	52.8%	39.6%	*30.2%*

2. Primary Reserve Ratio

For FY 2001, the primary reserve ratio is defined as expendable fund balances divided by total expenditures and mandatory transfers. For FY 2001(B)*, FY 2002, and FY 2003 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 2001, FY 2002, and FY 2003 are as follows:

FY 2001	FY 2001(B)	FY 2002	FY 2003	*FY 2003**
42.5%	44.7%	41.6%	34.0%	*34.0%*

3. Net Income Ratio

For FY 2001, the net income ratio represents net total revenues divided by total current revenues. For FY 2001(B)*, FY 2002, and FY 2003 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 2001, FY 2002, and FY 2003 are as follows:

FY 2001	FY 2001(B)	FY 2002	FY 2003	*FY 2003**
0.40%	-1.2%	-4.6%	-3.2%	*-3.2%*

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 2001, FY 2002, and FY 2003 have been stable and are above the minimum threshold:

FY 2001	FY 2001(B)	FY 2002	FY 2003	*FY 2003**
3.00	2.80	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 LLP for the fiscal year ending June 30, 2003. In the management discussion and analysis section of the University's FY 2003 audited financial report, it was noted that while Standard & Poors downgraded the University's long-term debt from *AA* to *AA-*, the University's outlook was upgraded from negative to stable by S&P. However, Moody's Investors Services maintained a negative outlook for the University. Both rating agencies emphasized the need for growth in the University's resources to correspond with new debt.

The University of Cincinnati's existing debt has received relatively high marks from independent bond-rating agencies. As noted above, UC's long-term debt was assigned a rating of *AA-* by S&P. Earlier this year, Moody's dropped UC's bond rating from *Aa3* to *A1*. However, Moody's increased its rating to *Aaa* after UC acquired bond insurance.

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 sometimes 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).

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F. Institutional Plant Debt

The table on the following page depicts how long-term plant debt at Ohio's public colleges and universities has consistently increased at the statewide level over the past five years. Between FY 1998 and FY 2003, aggregate net plant debt increased by 145% or $1.4 billion. A major contributing factor to this growing level of debt is the need for institutions to address critical capital and maintenance needs on campus. As the state's capital investment in Ohio's campuses has diminished in recent years, the need has grown for campuses to locally issue debt.

At the University of Cincinnati, net growth in long-term plant debt increased by 90% or $307 million between FY 1998 and FY 2003. In response to a December 2003 survey of campuses, the University of Cincinnati reported that 51% of its outstanding debt essentially pays for itself—that is, the debt and operating costs are supported by auxiliary revenues directly related to the capital projects for which debt was issued—and 49% is supported by general receipts.

By the end of the current fiscal year, the University of Cincinnati plans to have retired $15.9 million in principal for long-term debt. In addition to the proposed $25.9 million for the new Financial System Replacement Project, the University of Cincinnati may issue in FY 2005 approximately $9.9 million in short-term debt in anticipation of future capital appropriations for three capital projects on campus. Additionally, the University is considering issuing $21.7 million during FY 2005 for three other capital projects on campus.

Institution	Long-Term Plant Debt					
	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002	FY 2003
UNIVERSITIES						
BOWLING GREEN	$41,050,000	$35,400,000	$32,035,000	$83,415,000	$79,255,000	$91,215,000
CENTRAL STATE	$3,983,721	$3,780,127	$3,572,922	$3,346,920	$3,192,444	$2,703,429
CLEVELAND STATE	$16,543,399	$16,420,347	$16,153,641	$12,393,540	$10,849,215	$55,977,422
KENT STATE	$65,490,000	$63,143,000	$81,774,000	$234,407,000	$290,735,000	$285,773,000
MCOT	$2,946,693	$2,883,387	$2,184,779	$1,229,464	$6,392,000	$8,837,000
MIAMI UNIV.	$50,499,010	$44,949,785	$49,018,070	$45,061,353	$53,168,773	$47,994,898
NEOUCOM	$0	$0	$0	$542,430	$1,583,286	$1,397,190
OHIO STATE	$222,557,597	$315,216,350	$365,192,650	$378,145,912	$581,106,000	$586,233,000
OHIO UNIVERSITY	$49,448,971	$79,696,363	$84,103,403	$132,049,339	$126,677,123	$133,002,202
SHAWNEE STATE	$3,707,230	$3,672,175	$3,599,407	$3,406,398	$3,200,000	$2,910,000
UNIV. AKRON	$29,591,298	$36,007,772	$59,014,572	$89,002,729	$191,864,557	$211,208,546
UNIV. CINCINNATI	**$340,715,000**	**$365,895,000**	**$375,212,000**	**$577,365,000**	**$567,181,000**	**$647,688,000**
UNIV. TOLEDO	$89,660,778	$93,722,220	$88,467,721	$121,691,439	$119,376,000	$172,577,000
WRIGHT STATE	$14,191,357	$15,669,753	$14,438,988	$13,232,584	$11,575,625	$18,570,323
YOUNGSTOWN ST.	$19,933,000	$19,096,590	$17,840,681	$16,368,157	$14,992,226	$14,263,619
COMMUNITY COLLEGES						
CINCINNATI ST.	$1,254,220	$771,204	$592,494	$423,417	$0	$49,173,132
CLARK STATE	$306,496	$0	$68,172	$47,234	$22,011	$0
COLUMBUS ST.	$15,022,102	$14,263,821	$14,108,529	$13,221,412	$12,330,217	$11,434,658
CUYAHOGA	$0	$0	$0	$4,083,210	$12,564,559	$59,095,229
EDISON STATE	$220,000	$0	$800,000	$800,000	$738,589	$68,676
JEFFERSON	$0	$0	$0	$0	$0	$0
LAKELAND	$30,000	$6,493,734	$6,445,224	$2,900,237	$2,441,594	$1,976,978
LORAIN	$77,449	$12,340,038	$9,806,212	$7,230,062	$5,426,817	$3,952,163
NORTHWEST ST.	$991,860	$0	$0	$0	$123,260	$106,207
OWENS STATE	$12,947,278	$136,892	$141,049	$206,317	$0	$0
RIO GRANDE	$0	$0	$0	$0	$0	$0
SINCLAIR	$0	$0	$0	$0	$0	$0
SOUTHERN ST.	$371,229	$259,010	$138,968	$155,855	$122,950	$168,506
TERRA STATE	$5,121	$0	$0	$49,805	$42,710	$35,171
WASHINGTON ST.	$0	$0	$0	$0	$0	$0
TECHNICAL COLLEGES						
BELMONT TECH	$0	$0	$0	$0	$126,878	$97,927
COTC	$367,493	$337,831	$305,307	$270,726	$231,348	$186,826
HOCKING	$1,862,829	$1,871,748	$1,873,504	$4,311,120	$5,213,938	$497,794
JAMES RHODES ST	$0	$0	$0	$0		$0
MARION TECH	$0	$0	$0	$0		$0
ZANE STATE (MATC)	$0	$0	$0	$0	$0	$182,571
NORTH CENTRAL	$920,656	$775,048	$703,213	$744,479		$375,474
STARK STATE	$20,307	$143,311	$308,942	$259,870	$763,399	$620,993
STATEWIDE TOTAL	$984,715,094	$1,132,945,506	$1,227,899,448	$1,746,361,009	$2,101,296,519	$2,408,322,934