OHIO BOARD OF REGENTS

Agenda item 3.17 Consideration of a request by the University of Cincinnati to pledge student fees in support of a bond issuance not to exceed $15,000,000, to be used to finance certain capital projects.

RESOLUTION

WHEREAS, §209.64.69 of Am. Sub. H.B. 66 of the 126th 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 $15,000,000 for the purpose of financing capital projects at the University's main campus; 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 a resolution authorizing this bond issuance at its meeting of May 23, 2006; 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 & 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 $15,000,000 is hereby approved.

The University of Cincinnati
July 2006 Fee Pledge Request - $15,000,000

I. Project Overview

The University of Cincinnati proposes to issue general receipts obligation bonds to finance non-permanent debt for early expenditures related to future capital projects. The Board of Regents approved $15 million for this very same purpose in May 2005, and this request is for an additional $15 million to bring the total debt authority to $30 million.

Initial Submission to the Board: July 2006

Revised Submission:

The University of Cincinnati
July 2006 Fee Pledge Request - $15,000,000

II. 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 $30 million, of which $15 million was previously authorized by Board of Regents in May 2005. These bond proceeds will be used to finance early expenditures for various capital projects.

The University anticipates this issuance to be non-permanent, short-term debt that will be retired by proceeds from larger debt issuances that the University will seek in the future for various other projects. An annual interest of 4.0% will yield an estimated annual interest expense of $1.2 million on a $30 million issuance. (Issuing non-permanent debt creates a significant savings, as the annual debt service would be $2.3 million if the University were to issue 20-year bonds.)

The University of Cincinnati
July 2006 Fee Pledge Request - $15,000,000

III. Fee Impact

This proposed debt issuance will have no direct impact on student tuition and fees. While the University may use unrestricted student fee revenues to service the debt and pay for related operating costs, student fees are not expected to increase as a direct result of this fee pledge.

The University of Cincinnati
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IV. Project Description

Early Project Expenditures

The University has determined that it is fiscally prudent to issue non-permanent debt to reimburse itself for approved capital expenditures that are incurred prior to the issuance of local debt. The University reports that there is a time period during a debt-funded project's life when project approval is received to allow for the commitments and expenditures to occur before debt is actually issued. This approval is typically received via a specific recommendation from the Board of Trustees, within the approval of an annual capital budget. The debt funding is approved by the Board of Trustees later in the project's life. This delay between project approval, project expenditures and debt approval/issuance results in a reduction in cash.

The debt issuance requested here would authorize the issuance of general receipts obligations or other subordinate obligations to fund capital project expenditures, such as studies, design, acquisition, installation, and construction incurred prior to the issuance of the planned debt of an approved project. The requested $15 million in additional debt authority, combined with the $15 million debt authority approved by the Board of Regents in May 2005, is sufficient to cover early project expenditures indefinitely. Debt authority will be reduced as debt for early project expenditures is issued. Any outstanding debt issued will be retired as final project costs are determined and planned financing for the respective projects is obtained in the future. The debt authority associated with the retirement of the early project expenditure debt will replenish the debt authority only up to $30 million. This process will allow the authorization to remain effective in future years, subject to the approval of the Board of Trustees every three years.

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V. 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 2002, FY 2003, FY 2004 and FY 2005 audited financial statements—the most up-to-date financial data available.

*NOTE: The FY 2005 data shown in *italics* reflect the ratios and composite score when $79.6 million in new debt is added to the calculations. This amount equals the sum of the two prior debt authorizations approved by the Regents during FY 2006, plus the $30 million requested here. Also, $5.2 million in related debt service expenses have been added to the calculations. 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

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 2002, FY 2003, FY 2004 and FY 2005 are as follows:

FY 2002	FY 2003	FY 2004	FY 2005	*FY 2005**
52.8%	39.6%	31.4%	32.2%	*29.5%*

2. Primary Reserve Ratio

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 2002, FY 2003, FY 2004 and FY 2005 are as follows:

FY 2002	FY 2003	FY 2004	FY 2005	*FY 2005**
41.6%	34.0%	34.5%	32.2%	*32.0%*

3. Net Income Ratio

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 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 2002, FY 2003, FY 2004 and FY 2005 are as follows:

FY 2002	FY 2003	FY 2004	FY 2005	*FY 2005**
-4.6%	-3.2%	+13.0%	+6.4%	*+ 5.9 %*

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 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 at or below this level for two consecutive years. The highest possible score is a 5.0. The University of Cincinnati's composite scores have been above the minimum threshold:

FY 2002	FY 2003	FY 2004	FY 2005	*FY 2005**
2.8	2.8	3.6	3.6	*3.3*

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VI. Financial Outlook and Bond Rating

According to its FY 2005 audited financial report, the University of Cincinnati's financial position remains strong, having reported total assets of $2.9 billion and liabilities of $1.1 billion. Net assets, which represent the value of the University's assets after liabilities are deducted, increased by $61.4 million in FY 2005 to $1.8 billion or 62% of total assets. The retirement of outstanding debt in FY 2005 helped reduce the University's total liabilities by $2 million.

The University continues to implement its Master Plan through several major capital initiatives intended to provide facilities for advancing research, improve the quality of student life, improve infrastructure and enhance the ability of the University to be self-sustaining with respect to energy production.

The University's existing debt has received relatively high marks from independent bond-rating agencies. UC's long-term debt was most recently assigned ratings of *A+* and *AAA* (insured) by Standard & Poor's. Moody's Investors Services most recently assigned ratings of *A1* and *Aaa* (insured). These ratings are based on the University's most recently issued bonds issued in February 2006, which are insured by Financial Security Assurance, Inc.

These ratings indicate that the University's ability to meet its debt obligations is considered strong, as shown in Moody's and S&P's scale below.

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).

VII. 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 2000 and FY 2005, statewide plant debt increased by 170% or $2.1 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.

Although statewide institutional debt increased by $299 million or 10% in FY 2005, the University of Cincinnati reduced its debt last year by $15.6 million (2%). In response to a December 2003 survey, 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.

LONG-TERM PLANT DEBT, FY 1998 - FY 2005

Institution	Long-Term Plant Debt					
	FY 2000	**FY 2001**	**FY 2002**	**FY 2003**	**FY 2004**	**FY 2005**
UNIVERSITIES						
BOWLING GREEN	$32,035,000	$83,415,000	$79,255,000	$91,215,000	$84,410,000	$109,000,000
CENTRAL STATE	$3,572,922	$3,346,920	$3,192,444	$2,703,429	$2,535,821	$2,340,402
CLEVELAND STATE	$16,153,641	$12,393,540	$10,849,215	$55,977,422	$53,754,446	$115,923,075
KENT STATE	$81,774,000	$234,407,000	$290,735,000	$285,773,000	$282,832,000	$279,692,000
MCOT	$2,184,779	$1,229,464	$6,392,000	$8,837,000	$8,730,000	$56,299,000
MIAMI UNIV.	$49,018,070	$45,061,353	$53,168,773	$47,994,898	$92,833,435	$168,613,252
NEOUCOM	$0	$542,430	$1,583,286	$1,397,190	$1,237,841	$1,046,607
OHIO STATE	$365,192,650	$378,145,912	$581,106,000	$586,233,000	$814,606,000	$877,540,000
OHIO UNIVERSITY	$84,103,403	$132,049,339	$126,677,123	$133,002,202	$175,592,164	$167,529,147
SHAWNEE STATE	$3,599,407	$3,406,398	$3,200,000	$2,910,000	$2,600,000	$2,270,000
UNIV. AKRON	$59,014,572	$89,002,729	$191,864,557	$211,208,546	$226,729,516	$258,484,797
UNIV. CINCINNATI	$375,212,000	$577,365,000	$567,181,000	$647,688,000	$893,004,000	$877,453,000
UNIV. TOLEDO	$88,467,721	$121,691,439	$119,376,000	$172,577,000	$167,367,000	$176,779,000
WRIGHT STATE	$14,438,988	$13,232,584	$11,575,625	$18,570,323	$29,584,121	$46,189,820
YOUNGSTOWN ST.	$17,840,681	$16,368,157	$14,992,226	$14,263,619	$13,492,373	$13,268,653
COMMUNITY COLLEGES						
CINCINNATI ST.	$592,494	$423,417	$0	$49,173,132	$47,580,000	$47,530,000
CLARK STATE	$68,172	$47,234	$22,011	$0	$72,800	$46,400
COLUMBUS ST.	$14,108,529	$13,221,412	$12,330,217	$11,434,658	$24,105,000	$22,700,000
CUYAHOGA	$0	$4,083,210	$12,564,559	$59,095,229	$65,222,373	$64,840,147
EDISON STATE	$800,000	$800,000	$738,589	$68,676	$604,972	$532,347
JEFFERSON	$0	$0	$0	$0	$2,170,485	$2,023,978
LAKELAND	$6,445,224	$2,900,237	$2,441,594	$1,976,978	$5,674,098	$5,535,996
LORAIN	$9,806,212	$7,230,062	$5,426,817	$3,952,163	$9,560,074	$7,925,194
NORTHWEST ST.	$0	$0	$123,260	$106,207	$73,705	$82,001
OWENS STATE	$141,049	$206,317	$0	$0	$0	$749,152
RIO GRANDE	$0	$0	$0	$0	$0	$0
SINCLAIR	$0	$0	$0	$0	$0	$0
SOUTHERN ST.	$138,968	$155,855	$122,950	$168,506	$3,245,886	$3,022,204
TERRA STATE	$0	$49,805	$42,710	$35,171	$839,738	$655,721
WASHINGTON ST.	$0	$0	$0	$0	$0	$0
TECHNICAL COLLEGES						
BELMONT TECH	$0	$0	$126,878	$97,927	$66,728	$33,107
COTC	$305,307	$270,726	$231,348	$186,826	$401,059	$100,986
HOCKING	$1,873,504	$4,311,120	$5,213,938	$497,794	$516,117	$1,039,729
JAMES RHODES ST	$0	$0		$0	$3,087,383	$3,067,812
MARION TECH	$0	$0		$0	$0	$0
ZANE STATE (MATC)	$0	$0	$0	$182,571	$341,385	$285,586
NORTH CENTRAL	$703,213	$744,479		$375,474	$300,562	$220,160
STARK STATE	$308,942	$259,870	$763,399	$620,993	$620,080	$16,738
STATEWIDE TOTAL	**$1,227,899,448**	**$1,746,361,009**	**$2,101,296,519**	**$2,408,322,934**	**$3,013,791,162**	**$3,312,836,011**