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 $41,900,000, to be used to finance certain capital projects.

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 $41,900,000 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 January 25, 2005; 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 $41,900,000 is hereby approved.

The University of Cincinnati
April/May 2005 Fee Pledge Request - $41,900,000

I. Project Overview

The University of Cincinnati proposes to issue general receipts obligation bonds to finance the following projects:

- Additional costs for the MainStreet project, for which the Regents previously approved $218.7 million in debt issuances during various phases of the project financing plan;
- Non-permanent debt for early expenditures related to other future capital projects.

The University has provided a schedule of project costs and established a 25-year debt service schedule.

Initial Submission to the Board: April 2005

Revised Submission:

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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 $41.9 million, to provide financing for two separate capital projects. A breakdown of the estimated project costs is presented below:

	MainStreet Budget	Early Project Expenditures	Total
Estimated Project Costs	$25,600,000	$15,000,000	$40,600,000
Capitalized Interest	$884,000	$0	$884,000
Margin of Safety	$416,000	$0	$416,000
Total	$26,900,000	$15,000,000	$41,900,000

- MainStreet Budget: This project's annual debt service obligation is estimated to be $1.9 million per year, based on 5% interest for 25 years. The University will service this debt with revenues from campus auxiliary services.

- Early Project Expenditures: 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 3.0% will yield an estimated annual interest expense of $450,000. (Issuing non-permanent debt creates a significant savings, as the annual debt service would be $1.2 million if the University were to issue 20-year bonds.)

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III. Fee Impact

This proposed bond 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.

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IV. Project Description

MainStreet Budget

The MainStreet project is a complex, multi-phased project consisting of six separate components designed and constructed over a 7-year period in the University's Uptown Campus. Construction on the first phases of this project began in 2000, with the final phase expected to be completed in September 2005. The final total project cost is $250.2 million, for which the University has already issued $218.7 million in debt previously approved by the Board of Regents.

This latest request will provide an additional $26.9 million to support the additional costs for the MainStreet project, which include and/or are caused by:

- The complicated nature of a multi-phased project.
- The restricted and congested project site in the center of the Uptown Campus.
- Unforeseen field conditions (i.e., unmapped underground utilities).
- Contractor claim settlements due to the state-mandated multiple prime process that resulted in 53 prime contractors working on the project, some of whom defaulted on the contracts.
- The phased combination of projects, which resulted in numerous claims where contractors invoked settlement requirements for delays, inefficiencies, hindrances, and/or site condition.
- Extensions for construction management staff to coincide with contractor delays.

The attached exhibits 1 and 2 outline in greater detail the additional costs associated with MainStreet project.

The $26.9 million additional debt authority requested here is sufficient to fund the additional project costs, including the relocation of the Leather Institute and Armory, as well as related capitalized interest and issuance costs.

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 debt authority 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 $15 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 2001, FY 2002, FY 2003 and FY 2004 audited financial statements—the most up-to-date financial data available.

It is important to note that beginning in FY 2002, financial statements began being reported 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.

*NOTE: The FY 2004 data shown in *italics* reflect the ratios and composite score when $41.9 million in new debt and $2.35 million in new debt services expenses are 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

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, FY 2003 and FY 2004 are as follows:

FY 2001	FY 2002	FY 2003	FY 2004	*FY 2004**
51.0%	52.8%	39.6%	31.4%	*30.0%*

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, FY 2003, and FY 2004 are as follows:

FY 2001	FY 2002	FY 2003	FY 2004	*FY 2004**
42.5%	41.6%	34.0%	34.5%	*34.4%*

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, FY 2003 and FY 2004 are as follows:

FY 2001	FY 2002	FY 2003	FY 2004	*FY 2004**
0.40%	-4.6%	-3.2%	+13.0%	*+12.7%*

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, FY 2003 and FY 2004 have been stable and are above the minimum threshold:

FY 2001	FY 2002	FY 2003	FY 2004	*FY 2004**
3.00	2.80	2.80	3.60	*3.60*

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VI. Financial Outlook and Bond Rating

According to its FY 2004 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 $122 million in FY 2004 to $1.76 billion or 61% of total assets.

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 *AA-* and *AAA* by Standard & Poor's. Moody's Investors Services most recently assigned ratings of *A1* and *Aaa*. These ratings are based on the University's most recently issued bonds issued on March 16, 2005, which are insured by the American Municipal Bond Assurance Corporation.

These ratings indicate that 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).

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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 1998 and FY 2004, aggregate net plant debt increased by 206% or $2 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 162% or $552.3 million between FY 1998 and FY 2004. 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.

Institution	Long-Term Plant Debt						
	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004
UNIVERSITIES							
BOWLING GREEN	$41,050,000	$35,400,000	$32,035,000	$83,415,000	$79,255,000	$91,215,000	$84,410,000
CENTRAL STATE	$3,983,721	$3,780,127	$3,572,922	$3,346,920	$3,192,444	$2,703,429	NOT YET REPORTED
CLEVELAND STATE	$16,543,399	$16,420,347	$16,153,641	$12,393,540	$10,849,215	$55,977,422	$53,754,446
KENT STATE	$65,490,000	$63,143,000	$81,774,000	$234,407,000	$290,735,000	$285,773,000	$282,832,000
MCOT	$2,946,693	$2,883,387	$2,184,779	$1,229,464	$6,392,000	$8,837,000	$8,730,000
MIAMI UNIV.	$50,499,010	$44,949,785	$49,018,070	$45,061,353	$53,168,773	$47,994,898	$92,833,435
NEOUCOM	$0	$0	$0	$542,430	$1,583,286	$1,397,190	$1,237,841
OHIO STATE	$222,557,597	$315,216,350	$365,192,650	$378,145,912	$581,106,000	$586,233,000	$814,606,000
OHIO UNIVERSITY	$49,448,971	$79,696,363	$84,103,403	$132,049,339	$126,677,123	$133,002,202	$175,592,164
SHAWNEE STATE	$3,707,230	$3,672,175	$3,599,407	$3,406,398	$3,200,000	$2,910,000	$2,600,000
UNIV. AKRON	$29,591,298	$36,007,772	$59,014,572	$89,002,729	$191,864,557	$211,208,546	$226,729,516
UNIV. CINCINNATI	**$340,715,000**	**$365,895,000**	**$375,212,000**	**$577,365,000**	**$567,181,000**	**$647,688,000**	**$893,004,000**
UNIV. TOLEDO	$89,660,778	$93,722,220	$88,467,721	$121,691,439	$119,376,000	$172,577,000	$167,367,000
WRIGHT STATE	$14,191,357	$15,669,753	$14,438,988	$13,232,584	$11,575,625	$18,570,323	$29,584,121
YOUNGSTOWN ST.	$19,933,000	$19,096,590	$17,840,681	$16,368,157	$14,992,226	$14,263,619	$13,492,373
COMMUNITY COLLEGES							
CINCINNATI ST.	$1,254,220	$771,204	$592,494	$423,417	$0	$49,173,132	$47,580,000
CLARK STATE	$306,496	$0	$68,172	$47,234	$22,011	$0	$72,800
COLUMBUS ST.	$15,022,102	$14,263,821	$14,108,529	$13,221,412	$12,330,217	$11,434,658	$24,105,000
CUYAHOGA	$0	$0	$0	$4,083,210	$12,564,559	$59,095,229	$65,222,373
EDISON STATE	$220,000	$0	$800,000	$800,000	$738,589	$68,676	$604,972
JEFFERSON	$0	$0	$0	$0	$0	$0	$2,170,485
LAKELAND	$30,000	$6,493,734	$6,445,224	$2,900,237	$2,441,594	$1,976,978	$5,674,098
LORAIN	$77,449	$12,340,038	$9,806,212	$7,230,062	$5,426,817	$3,952,163	$9,560,074
NORTHWEST ST.	$991,860	$0	$0	$0	$123,260	$106,207	$73,705
OWENS STATE	$12,947,278	$136,892	$141,049	$206,317	$0	$0	$0
RIO GRANDE	$0	$0	$0	$0	$0	$0	$0
SINCLAIR	$0	$0	$0	$0	$0	$0	$0
SOUTHERN ST.	$371,229	$259,010	$138,968	$155,855	$122,950	$168,506	$3,245,886
TERRA STATE	$5,121	$0	$0	$49,805	$42,710	$35,171	$839,738
WASHINGTON ST.	$0	$0	$0	$0	$0	$0	$0
TECHNICAL COLLEGES							
BELMONT TECH	$0	$0	$0	$0	$126,878	$97,927	$66,728
COTC	$367,493	$337,831	$305,307	$270,726	$231,348	$186,826	$401,059
HOCKING	$1,862,829	$1,871,748	$1,873,504	$4,311,120	$5,213,938	$497,794	$516,117
JAMES RHODES ST	$0	$0	$0	$0		$0	$3,087,383
MARION TECH	$0	$0	$0	$0		$0	$0
ZANE STATE (MATC)	$0	$0	$0	$0	$0	$182,571	$341,385
NORTH CENTRAL	$920,656	$775,048	$703,213	$744,479		$375,474	$300,562
STARK STATE	$20,307	$143,311	$308,942	$259,870	$763,399	$620,993	$620,080
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	$3,011,255,341

(a) FY 2002 was first year of reporting under new GASB 34/35 requirements.

(b) FY 2003 figures are preliminary. The FY 2003 analysis is still under review and is subject to revision.