OHIO BOARD OF REGENTS

Agenda item 3.9 Consideration of a request by the University of Cincinnati to pledge student fees in support of a $94,500,000 bond issuance, to be used to finance certain capital projects on campus.

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 $94,500,000 for the purpose of financing certain 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 is expected to consider a resolution authorizing this bond issuance at its meeting of November 25, 2003; 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 $94,500,000 is hereby approved.

The University of Cincinnati
November 2003 Fee Pledge Request - $94.5 million

A. Project Overview

The University of Cincinnati proposes to issue general receipts obligation bonds and/or bond anticipation notes to finance three multi-faceted capital projects. A large portion of the requested debt issuance—$81.3 million—will supplement the $80 million bond issue previously approved by the Board of Regents in April 2003 for the Center for Academic Research Excellence (CARE) project. Also, a portion of the requested debt authority represents non-permanent debt that will provide bridge financing to be retired with future state capital appropriations and expected revenues from gifts to the University.

The total $94.5 million request is broken into three parts:

- Basic building renovations, $7.5 million
- Expansion of the varsity soccer field, $5.7 million
- Supplemental funding for the CARE project to include the Medical Science Building and Eden Quad projects, $81.3 million.

Initial Submission to the Board: October 16, 2003.

Revised Submission: November 13, 2003

The University of Cincinnati
November 2003 Fee Pledge Request - $94.5 million

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 $94.5 million, to support basic building renovations, the expansion of its soccer field and to provide supplemental funding for the Center for Academic Research Excellence (CARE) project. The financing aspect of each project is described below:

- Basic renovations: $7.5 million bond proceeds will provide interim short-term financing and cover capitalized interest and issuance costs. Future state capital appropriations will be used to retire the debt. The University forecasts state capital allocations of $2.5 million in the FY 2005-2006 biennium, and $5 million in the FY 2007-2008 biennium.

- Soccer field: Most of the $5.7 million cost of this project is comprised of $3.4 million of short-term debt that will be retired with anticipated gifts to the University’s athletic department. The remaining $2.3 million will be long-term debt that will be retired over 20 years with general student fee revenues and will have an estimated average annual net debt service requirement of $153,000 beginning in FY 2006.

- CARE project: This $81.3 million debt authority will supplement the $80 million debt previously approved by the Board of Regents in April 2003 for the CARE project, increasing the total debt authority to $161.3 million. Of this amended amount:

    - $18.7 million will provide non-permanent debt that will be retired with gifts to the University;
    - $32.6 million of short-term debt to be retired with state capital appropriations projected for the FY 2005-06, FY 2007-08 and FY 2009-10 biennia;
    - $18 million in non-permanent debt that will be financed with anticipated proceeds from the Third Frontier Program; and
    - $92 million in long-term debt to be retired over 30 years with an annual net debt service requirement of $6.4 million. This debt will be serviced with revenues from general student fees, general University receipts, and anticipated investment returns.

A breakdown of project costs can be found on the following page.

The University of Cincinnati
November 2003 Fee Pledge Request - $94.5 million

B. Project Financing and Costs (cont.)

	Basic Renovations	**Soccer Field**	**CARE**	**Total**
Project Costs				
Construction	$7,200,000	$5,100,000	$141,105,000	$153,405,000
Capitalized Interest	$300,000	$56,000	$12,737,000	$13,093,000
Issuance Costs	$0	$61,000	$854,000	$915,000
Margin of Safety	$0	$483,000	$6,604,000	$7,087,000
Subtotal	$7,500,000	$5,700,000	$161,300,000	$174,500,000
Available Resources				
Previously approved debt	$0	$0	$80,000,000	$80,000,000
Total request	**$7,500,000**	**$5,700,000**	**$81,300,000**	**$94,500,000**
Short-term debt commitments (estimated)				
Gift bridging	$0	$3,400,000	$18,700,000	$22,100,000
State Capital Approp.	$0	$0	$32,600,000	$32,600,000
Third Frontier	$0	$0	$18,000,000	$18,000,000
Total	$0	$3,400,000	$69,300,000	$72,700,000

The University of Cincinnati
November 2003 Fee Pledge Request - $94.5 million

C. Project Description

Basic Renovations, $7.5 million

The debt issue will provide short-term financing and allow the University Cincinnati to begin essential building renovations sooner than if the University were to wait for expected state capital appropriations over the course of the next three biennia. The issuance of short-term debt in this manner will allow the University to complete the work early and meet critical deadlines. The projects include but are not limited to: physical improvements to the Medical Science Building, various window replacement projects, security upgrades to Braunstein Center, electrical systems improvements, rehabilitation of certain elevator units, and various fire alarm system improvements.

Soccer Field, $5.7 million

The bond proceeds for this project will finance the costs of the design, acquisition, construction, and improvements for the new soccer field. The project includes an expanded soccer field and running track on site of the existing Meyers Field. These changes will allow the soccer field to conform to NCAA regulations. Additionally, the project includes synthetic field turf, seating for 1,400 spectators, restrooms, concession stands, a ticket office and first aid station, and a press box.

CARE/Medial Sciences Building/Eden Quad, $81.3 million

This is an addition to the $80 million debt issue approved by the Regents in April 2004 for the Center for Academic Research Excellence (CARE) project. The additional $81.3 million bond authority requested by the University will finance the design, acquisition, construction, improvements, and equipment for the CARE facility and Medical Sciences Building, as well as the rehabilitation of Eden Quad. All three projects are closely related and are part of the Millennium Plan, the University's ongoing effort to double its bio-medical research holdings every 7 to 10 years. The University intends for the Millennium Plan to tie directly to the Third Frontier Program and aims to attract federal grants from the National Institutes of Health and private grants through corporate partnerships.

The University of Cincinnati
November 2003 Fee Pledge Request - $94.5 million

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 and FY 2002 audited financial statements, and UC's preliminary unaudited FY 2003 financial statements—the most up-to-date financial data available. (UC's final FY 2003 audited financial statements will be available in December 2003.)

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 2003 data shown in *italics* reflect the ratios and composite score when $174.5 million ($80 million in previously approved debt and $94.5 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% would be a cause for concern. The University of Cincinnati's viability ratios for FY 2001, FY 2002, and FY 2003 (preliminary) are as follows:

FY 2001	FY 2001(B)	FY 2002	FY 2003	*FY 2003**
51.0%	52.8%	52.8%	39.6%	*31.2%*

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 (preliminary) are as follows:

FY 2001	FY 2001(B)	FY 2002	FY 2003	*FY 2003**
42.5%	44.7%	41.6%	33.6%	*33.6%*

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 (preliminary) are as follows:

FY 2001	FY 2001(B)	FY 2002	FY 2003	*FY 2003**
0.40%	(1.2%)	(4.6%)	(4.2%)	*(4.2%)*

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 (preliminary) 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.

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).