OHIO BOARD OF REGENTS

Agenda item 3.10 Consideration of a request by the University of Cincinnati to pledge student fees in support of a bond issuance not to exceed $7,460,267, to be used to finance multiple 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 $7,460,267 for the purpose of financing capital projects at the main, Clermont College and Raymond Walters campuses; 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 November 10, 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 $7,460,267 is hereby approved.

The University of Cincinnati
November 2004 Fee Pledge Request - $7,460,267

A. Project Overview

The University of Cincinnati proposes to issue general receipts obligation bonds to finance three capital projects:

- Student Life temporary structure removal and site restoration
- Clermont College building expansion
- Construction of a veterinary technology building at the Raymond Walters campus

The University intends for the general receipts obligation bond proceeds to be interim financing that will be retired with state capital appropriations that the University anticipates will be appropriated for the FY 2005-06, FY 2007-08 and FY 2009-10 capital biennia.

Initial Submission to the Board: October 2004

Revised Submission:

The University of Cincinnati
November 2004 Fee Pledge Request - $7,460,267

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 $7,460,267, to provide short-term financing for three separate capital projects. The combined estimated project cost is estimated to be $7,290,267. A breakdown of the estimated project costs is presented below:

Project:	Estimated Costs
Student Life Pavilions temporary structure	$3,430,000
Clermont College expansion	$2,407,892
Raymond Walters Vet Tech Building	$1,452,375
Subtotal	$7,290,267
Capitalized interested & other costs	$170,000
Total	**$7,460,267**

The University anticipates this bond issuance to be non-permanent, short-term debt that will be retired with state capital appropriations forecasted by the University. The bond proceeds would provide interim financing to allow the University to expedite the construction process and meet important deadlines.

In the absence of state capital appropriations, the University will continue to roll over the debt into short-term obligations to coincide with the passage of a state capital bill.

The University of Cincinnati
November 2004 Fee Pledge Request - $7,460,267

C. Project Description

Student Life Pavilions – Temporary Structure Removal & Site Restoration. This project entails the removal of pavilions located on the roof of Zimmer Hall, as well as the replacement of the roof on Zimmer Hall. Landscaping and access modifications are also included in this project. This project was approved in the FY 1999-00 capital budget (Zimmer Rehabilitation - Phase 1) and will be supported by a $3.6 million capital appropriation anticipated in the FY 2007-08 state capital cycle.

Clermont College Expansion. This project includes the construction of an addition to the Edith Peter Jones Building on at the University's Clermont College branch campus. This project will provide additional academic space and accommodate future enrollment growth. This project will be supported by anticipated future state capital appropriations of $767,870 in the FY 2005-06 biennium, $820,011 in the FY 2007-08 biennium, and $820,011 in the FY 2009-2010 biennium.

Raymond Walters College Veterinary Technology Building. This project includes the construction of a new building to accommodate the Vet Tech program offered at UC's Raymond Walters branch campus. (This program is currently taught in existing animal lab space at the Medical Sciences Building on the Uptown Campus.) This project will be supported by anticipated future state capital appropriations of $1,452,375 in the FY 2005-06 biennium.

The University of Cincinnati
November 2004 Fee Pledge Request - $7,460,267

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.

*NOTE: The FY 2004 data shown are based on <u>preliminary</u> (unaudited - DRAFT) financial statements provided by the University of Cincinnati. The FY 2004 data shown in *italics* reflect the ratios and composite score when $7.5 million in proposed additional debt is 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 (preliminary) are as follows:

			PRELIMINARY	
FY 2001	FY 2002	FY 2003	FY 2004*	*FY 2004**
51.0%	52.8%	39.6%	33.9%	*33.6%*

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 (preliminary) are as follows:

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

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 (preliminary) are as follows:

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

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 (preliminary) have been stable and are above the minimum threshold:

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

The University of Cincinnati
November 2004 Fee Pledge Request - $7,460,267

E. Financial Outlook and Bond Rating

Standard & Poor's recently reported that higher education institutions are likely to face more challenges in the future due to increased costs and physical plant needs. This uncertain outlook is also attributable to a change in students' educational needs and a changing demographic base. S&P believes this could affect the higher education sector's credit quality in the municipal market, which could cause institutional bond ratings to become more volatile. The S&P report also described the amount of investment needed to renew and upgrade technology in older higher education facilities as "staggering". [1]

The University of Cincinnati's existing debt has received relatively high marks from independent bond-rating agencies. UC's long-term debt was assigned a rating of *AA-* by S&P. Moody's Investors Services most recently assigned UC a bond rating to of *Aaa*.

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).

[1] *The Bond Buyer* (online edition): "S&P: Higher Education Institutions to Face Challenges in Future" by Adam Cataldo, August 19, 2004.

The University of Cincinnati
November 2004 Fee Pledge Request - $7,460,267

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.

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