OHIO BOARD OF REGENTS

Agenda item 3.8 Consideration of a request by the Medical College of Ohio to pledge student fees in support of a bond issuance not to exceed $50,000,000.

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 Medical College of Ohio proposes to pledge student fees in support of general receipts obligation bonds and/or bond anticipation notes in an amount not to exceed $50,000,000 for the purpose of multiple capital projects on campus; and

WHEREAS, the Medical College of Ohio has determined that the proposed project is essential to fulfilling institutional goals; and

WHEREAS, the College's Board of Trustees adopted a resolution authorizing this bond issuance at its meeting of September 27, 2004; 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 Medical College of Ohio in support of general receipts obligation bonds and/or bond anticipation notes in an aggregate amount not to exceed $50,000,000 is hereby approved.

The Medical College of Ohio
November 2004 Fee Pledge Request - $50,000,000

A. Project Overview

The Medical College of Ohio requests authority to issue general receipts obligation bonds and/or bond anticipation notes, the proceeds of which will be used to renovate existing clinical space and make capital improvements to other existing campus infrastructure. The projects include:

- An outpatient surgery center
- Renovation of clinical research space
- Major information technology enhancements
- Cardiovascular center

All of the projects are planned within existing facilities that will allow for greater utilization and overhead absorption. MCO has deemed these projects as being essential in fulfilling the College's three missions of education, research and patient care.

Initial Submission to the Board: October 2004

Revised Submission:

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B. Project Financing and Costs

The Medical College of Ohio (MCO) requests authority to issue general receipts obligation bonds and/or bond anticipation notes to finance multiple capital projects on campus. The combined total estimated cost of these projects is $46.3 million.

Preliminary financing plans are based on a 25-year debt service schedule, with an estimated average debt service payment of $3.25 million per year. A pro-forma analysis provided by MCO forecasts revenues sufficient to cover annual debt service costs and related operating expenses. Revenue sources include outpatient center and clinical income, philanthropic gifts, investment revenues, and other strategic revenue enhancements. A projected growth in outpatient center revenues is in part due to the expanded capacity and services the bond-supported capital renovations will make possible.

A breakdown of the estimated project costs is presented below:

Project Costs:	Outpatient Center	Campus Infrastructure Improvements	Total
Construction	$8,660,000	$12,840,000	$21,500,000
Moveable Equipment	$2,500,000	$8,300,000	$10,800,000
Architects & Engineers	$840,000	$2,160,000	$3,000,000
IT Infrastructure	$0	$11,000,000	$11,000,000
Subtotal	$12,000,000	$34,300,000	$46,300,000
Financing Costs:			
Capitalized Interest	$777,538	$2,222,462	$3,000,000
Issuance Premium	$77,754	$222,246	$300,000
Underwriting Discount	$38,877	$111,123	$150,000
Cost of Issuance	$64,795	$185,205	$250,000
Subtotal	$958,963	$2,741,037	$3,700,000
Total	$12,958,963	$37,041,037	$50,000,000

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C. Project Description

Outpatient Surgery Center - $12 million

The 41,000 square feet Outpatient Surgery Center will be located on the first floor of Dowling Hall, which is connected to Medical College Hospital. The Center will include four operating/procedure suites with state-of-the-art equipment that will increase the Hospital's efficiency and capacity, and provide necessary clinical teaching opportunities for medical, allied health and nursing students and medical residents. Advancements in diagnostic and therapeutic technology enable significantly more surgical procedures to be performed in outpatient settings, improving patient care and reducing overall cost. Architectural work has begun and construction is expected to begin in spring 2005 with project completion scheduled for January 2006.

Campus Infrastructure Improvements - $34.3 million

One campus infrastructure project includes an significant investment in information technology to optimize clinical, financial and administrative processes. Planning is occurring to add, improve and integrate systems over the next few years, eventually becoming a mostly digital environment. This initiative will dramatically improve patient safety and quality as well as enhance the clinical learning environment of our students.

Additionally, significant enhancements to MCO's cardiovascular services will produce a greatly improved patient care environment, translational research opportunities and state of the art education.

Another project is the development of a Center for Clinical Research that will lead to more research funding like the $25 million grant MCO recently received from the National Heart, Lung & Blood Institute to lead a nationwide study. With dramatic advances in technology in the medical field, substantial investment will be made in technologically advanced medical and scientific equipment.

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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 Medical College of Ohio—including MCO's component unit hospital—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—and preliminary (unaudited) FY 2004 financial statements.

It is important to note that beginning in FY 2002, all campus's financial reports are 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 preliminary (unaudited - DRAFT) financial statements provided by the Medical College of Ohio. The FY 2004 data shown in *italics* reflect the ratios and composite score when $50 million in proposed new debt and $3.3 million in related debt service expenses are added to the calculations. Other factors not taken into account here include the impact of the new debt on MCO'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. Medical College of Ohio'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**
3800%	791.2%	686.9%	747.7%	*111.1%*

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 Medical College of Ohio'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**
19.3%	19.1%	22.6%	23.1%	*23.1%*

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 Medical College of Ohio'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**
+4.8%	-0.2%	+4.5%	+1.7%	+*0.5%*

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 Medical College of Ohio's composite scores for FY 2001, FY 2002, FY 2003 and FY 2004 (preliminary) have been above the minimum threshold:

			PRELIMINARY	
FY 2001	FY 2002	FY 2003	FY 2004*	*FY 2004**
3.80	4.50	4.50	3.60	*3.10*

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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 Medical College of Ohio has not previously issued long-term bonds and therefore has not received a bond rating. MCO's long-term debt has generally consisted of equipment lease purchase obligations and other capital leases. However, based on a preliminary analysis, MCO reports that its bond-rating would likely be in the range of an *A2* (Moody's).

For reference, 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.

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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.

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