OHIO BOARD OF REGENTS

Agenda item 3.15 Consideration of a request by the University of Akron to pledge student fees in support of a bond issuance not to exceed $36,000,000, to be used to finance construction of a new student residence hall.

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 Akron proposes to pledge student fees in support of general receipts obligation bonds and/or bond anticipation notes in an amount not to exceed $36,000,000 for the purpose of financing the construction of a new student residence hall; 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 September 2004 meeting; 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 Akron 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 Akron in support of general receipts obligation bonds and/or bond anticipation notes in an aggregate amount not to exceed $36,000,000 is hereby approved.

The University of Akron
October 2004 Fee Pledge Request - $36 million

A. Project Overview

The University of Akron proposes to issue general receipts obligation bonds to support the construction of a 189,500 square-foot, 460-student residence hall on campus. The new apartment-style facility will replace an existing 400-student residence hall, which was built in 1966 and will be demolished upon completion of the new facility.

The University plans to use income from its residence hall operations to retire the debt in 30 years, as well as to support the operating costs for the new facility.

Initial Submission to the Board: September 23, 2004.

Revised Submission:

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B. Project Financing and Costs

The University of Akron requests authority to issue general receipts obligation bonds and/or bond anticipation notes in an amount not to exceed $36 million, to support the construction of a new student residence hall on campus. The total estimated project cost is $35,829,250.

Based on a fixed annual interest rate of 5%, the University estimates the average debt service payment to be about $2.3 million per year. Debt service payments would begin in 2005 and would continue for 30 years until the debt is retired in 2035. Based on an assumed 95% occupancy rate and 4% annual increases in residence hall fees, the University anticipates that student rental income generated by the new facility will be sufficient to cover the annual debt service payment and operating costs by FY 2010.

The University also anticipates that rental income from private vendors (that will rent retail space in the new facility) will be available to help cover debt service and operating costs. However, these estimated revenues are not included in the University's pro-forma, which the University considers to be conservative.

A breakdown of the project costs is presented below:

Cost Category:	Total Costs	Cost per Gross Square Foot
Construction	$29,850,000	$157.52
Bank Acquisition	$125,000	$0.66
Moveable Equipment	$2,250,000	$11.87
Achitectural and Engieering	$2,244,250	$11.84
Adverstising and Marketing	$12,500	$0.07
Financing Transaction	$1,172,500	$6.19
Legal and Other	$175,000	$0.92
Total	$35,829,250	$189.07

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C. Project Description

The University of Akron plans to construct a 189,500 square-foot student residence facility on the west end of campus. The new structure will be built on what is presently a surface parking lot. It will feature apartment-style living, complete with full kitchens, in one wing of the facility and more traditional residence hall living in the other wing. The frontage of the U-shaped structure is currently designed to house retail space, as it will be situated on a main thoroughfare (West Exchange Street) in Akron.

This new facility is scheduled to open for autumn term 2006. The facility will be located in front of the University's largest existing residence hall, Gallucci Hall, which will be demolished when the new facility opens. (Accumulated residence hall reserves will be used to cover the demolition costs.) The replacement of Gallucci Hall with the new 460-student facility will create a net increase of 60 beds.

Gallucci Hall was built in 1966 and was originally a Holiday Inn hotel. The University explored the possibility of renovating the current structure but found that to be a nonviable option because:

1. Renovation would require taking the facility offline for at least one year and finding/leasing a substitute facility within close proximity to the campus for the relocation of approximately 400 resident students. Even if a nearby adequate facility were available, the lease costs would be prohibitive.

2. The age of the facility is not conducive to renovation, and it would be less expensive to build than to renovate the existing facility. Renovation estimates total nearly $19 million, with a reduction in occupancy to 200.

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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 University of Akron performed when these measures are applied to its FY 2001, FY 2002 and FY 2003 audited financial statements—the most up-to-date financial information presently available.

It is important to note that beginning in FY 2002, all institutions' 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 2003 data shown in *italics* reflect the ratios and composite score when $36 million in long-term debt and $2.3 million in debt service expenses are added to the calculations. All other factors being equal, each of the University's ratios is reduced slightly by the additional debt and related expenses, but its composite score is not affected. 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 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 Akron's viability ratios for FY 2001, FY 2002, and FY 2003 are as follows:

FY 2001	FY 2002	FY 2003	*FY 2003**
42.6%	20.3%	22.1%	*18.9%*

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 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 Akron's primary reserve ratios for FY 2001, FY 2002, and FY 2003 are as follows:

FY 2001	FY 2002	FY 2003	*FY 2003**
13.0%	13.1%	14.7%	*14.6%*

3. Net Income Ratio

For FY 2001, the net income ratio represents net total revenues divided by total current revenues. For 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 Akron's net income ratios for FY 2001, FY 2002, and FY 2003 are as follows:

FY 2001	FY 2002	FY 2003	*FY 2003**
0.80%	2.8%	1.9%	*1.2%*

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 Akron's composite scores for FY 2001, FY 2002 and FY 2003 are above the minimum threshold:

FY 2001	FY 2002	FY 2003	*FY 2003**
2.5	2.4	2.4	*2.4*

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 Akron's existing debt has received relatively high marks from two leading independent bond-rating agencies. The University's most-recently issued Series 2004 bonds received an *A2* rating from Moody's Investors Services and an *A* rating from Standard & Poor's.

These ratings indicate that UA'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).

[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 below 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