# FINAL REPORT

## Commission to Study Higher Education Debt Service

June 28, 1994

**Ohio Senate**
Senate Building
Columbus, Ohio 43215
614/466-8082

**Committees:**
Chairman, Education
Retirement & Aging
Economic Development
Science & Technology
Highways & Transportation
Rules

**Cooper Snyder**
14th District

June 28, 1994

The Honorable Stanley J. Aronoff
President
Ohio Senate
Statehouse
Columbus, Ohio 43266-0603

The Honorable Vern Riffe
Speaker
Ohio House of Representatives
Riffe Center, 14th Floor
Columbus, Ohio 43266-0603

Dear President Aronoff and Speaker Riffe:

Last October, pursuant to a provision in House Bill 152, you appointed members to a Commission to Study Higher Education Debt Service. Representative Ronald Gerberry chaired the Commission in 1993, while I have had the privilege to serve as chairman in 1994.

The Commission has now completed its work and recommends some significant reforms in the way we plan capital improvements for our colleges and universities.

The purpose of the Commission was to make recommendations on two policies proposed by the Ohio Board of Regents in 1992 and incorporated by Governor Voinovich in his executive budget for the current biennium. Because of the far-reaching consequences of the proposals, the General Assembly chose not to implement them without a special review by this Commission.

Both proposals were intended to hold campuses accountable for the costs of construction projects.

## Plant Operation and Maintenance

The first would change the allocation of funds for plant operation and maintenance costs within the instructional subsidy formula. Prior to 1980, those funds were allocated according to the same logic as funds for other elements of higher education costs: on the basis of enrollments, with the amount per student varying by the particular program and by the level of instruction being provided. In 1980, the formula was changed so that the fixed costs of plant operation and maintenance would be funded even if a campus experienced substantial enrollment decline, a prospect that seemed likely because of significant demographic changes. Funding for plant operating costs would no longer be related to enrollments. Instead, funding would be allocated on the basis of square footage. That is the system now in place. In that system, when a campus opens a new facility, its subsidy from the state is automatically increased to cover the additional costs of operating another building. In the last budget cycle, the Board of Regents and Governor Voinovich had recommended going back to an enrollment basis for distributing these funds, so that campuses would be forced to consider whether their need for additional facilities was great enough to justify the costs of operating those facilities.

DEBT SERVICE

The Board of Regents also proposed a system that would require campuses to consider the costs of financing the construction of facilities. Its second recommendation was to reduce a campus's instructional subsidy by an amount equal to the amount of debt service being incurred by the state to finance the cost of that campus's future capital appropriations. The total amount deducted from all campuses would then be redistributed through the instructional subsidy, but on a formula basis, with enrollments again being the principal variable of the formula. The state would continue to make capital appropriations as it has for many years. It would continue to sell bonds to finance those appropriations and to make debt service appropriations to retire those bonds. However, under the proposed system, campuses would have reason to be more conservative in their requests for capital appropriations, since the more capital appropriations they received, the more would be subtracted from their instructional subsidy.

In the policy statements we have approved, the Commission recommends that Ohio adopt both of these reforms, but with some significant modifications designed to meet the objections of the campuses.

The Plant Operation and Maintenance policy statement recommends a shift from a square footage basis to an enrollment basis, but calls upon the Board of Regents to include other variables besides enrollment in the new formula. At a minimum, the formula should consider the volume of sponsored research and of noncredit job training being provided by a campus. The policy statement requires the Board of Regents, in consultation with campuses, to devise a formula that includes credit enrollment, sponsored research, and noncredit job training, and possibly other important activities, and to weight the various elements so as to minimize the amount of redistribution that occurs. The policy statement also calls for a continuation of funding on a square footage basis for space already in use or authorized by the end of this year, with the rate of funding to be determined by a consultation. This provision assures campuses that they will have the funding required to operate facilities to which the state is already committed.

The Debt Service policy statement also calls upon the Board of Regents to develop, in consultation with campuses, a formula for the redistribution of debt service charges within the instructional subsidy. That formula could include subsidy-eligible enrollments; ineligible enrollments on a full or partial basis; a factor that recognizes the additional costs of serving part time students, if such costs can be demonstrated; other mission-essential activities such as sponsored research and noncredit job training; the age of facilities; and other factors that might be identified by the consultation by the consultation. The policy statement also indicates a willingness to exempt a portion of the cost of certain projects from the charge-back procedure if a campus needs unusually large investments relative to its instructional subsidy.

We also recommend that community projects funded through the higher education budget be subject to the same discipline that we propose for higher education projects. Legislation should be enacted that would reduce a county's share of Local Government Fund distributions by the amount of calculated debt service attributable to community projects received by the county in future capital bills.

These recommendations would become effective for the capital planning cycle that would begin next year, leading to the capital appropriations bill to be adopted in 1996. In order to monitor the effects of these policies on campuses in future years, the Commission also recommends that the Board of Regents report, in its biennial capital plan, a schedule of the amounts to be deducted from campus instructional subsidies as a result of the implementation of this policy as well as a schedule of campus indebtedness as a result of its own borrowing.

As our Commission was finishing its work, the Cleveland Plain Dealer published an editorial endorsing the reforms that we were recommending. Enclosed is a copy of that editorial as well as copies of the approved policy statements.

Sincerely,

Cooper Snyder

Cooper Snyder
State Senator

Enclosure

cc: Governor Voinovich
Members of the Commission
Office of Budget and Management
Legislative Budget Office
Legislative Service Commission
Legislative Office of Education Oversight

## APPROVED POLICY STATEMENT ON PLANT OPERATION AND MAINTENANCE

State funding for higher education ought to be designed to be supportive of the various activities that comprise the missions of our campuses, missions that are jointly defined by the campuses themselves and by state government. Support for plant operation and maintenance costs is ultimately justified by the fact that these activities cannot be conducted without facilities appropriate to the task. Consequently, it is reasonable to shift the basis of support for plant operating costs from a square footage to more direct measures of the activities being supported on our campuses. These activities would surely include credit instruction, sponsored research, and noncredit job training. This list may expand as the state works with campuses to define campus missions more precisely and to fashion a funding process that reflects these missions.

As the state moves to change the basis for plant operation and maintenance funding, it must remember that until such time that campuses can change their building inventories to the magnitudes needed to accomplish those missions (if in fact any change is required), campus plant operation and maintenance costs will be driven primarily by the building inventories now in place and as they will be increased by state appropriations already made or to be made later this year. Consequently, plant operation and maintenance allowances should be at least the amount generated by current square footage (augmented by square footage authorized by construction appropriations made in 1994 or earlier), multiplied by HB 152 FY 1995 rates per square foot. Whether these floors should be increased for inflation is a question that will be resolved by the budget consultation.

Over time, further increases in plant funding would be provided only on the basis of activity levels for functions identified by the 1994 or later budget consultations. This would discourage requests for additional space unless that space was designed to replace existing, obsolete space or was needed to accommodate an increase in the volume of activity that the state wished to support. In identifying the functions to be funded and the relative weights to be assigned those functions, the consultations shall consider the importance of the functions to the missions of our campuses and the degree to which any proposed approach would produce a redistribution of funds among campuses. No major redistribution of plant operation and maintenance funds is desired, although it is understood that some redistribution is inevitable with any formula change.

## APPROVED POLICY STATEMENT ON DEBT SERVICE

State appropriations for higher education debt service now approximate $300 million per year, even as real operating support per student has been in decline. It is not clear that campuses would choose the current distribution of operating versus capital support by the state if the decision rested with them. Consequently, the commission recommends that campuses be given more control of state capital investments on their campuses and that they be held financially accountable for their decisions.

Accountability will be achieved by charging campuses for the state debt service attributable to their future (1996 and later) capital appropriations. Campuses would not be charged for basic renovations appropriations, since the state desires that these funds continue to be expended to preserve the existing state investment. Campuses would also not be charged for distributions from statewide line items, such as Instructional Equipment.

Since campuses will be held accountable for these expenditures, they should have the ability to administer them as they choose, so long as their administration is consistent with state law. Consequently, campuses would have the right to administer locally any project, regardless of size, which they had the responsibility to finance through the procedure described in this policy statement. However, campuses would be free to employ Public Works for any services that were mutually agreeable.

The Commission recommends that alternative funding sources be found for "community" projects, or that the debt service for such projects that continue to be funded in the higher education budget be provided from other sources than the state appropriation for higher education debt service. However, even if neither of these solutions is implemented, under no circumstances should individual campuses be charged for the debt service attributable to any community projects, since that would create a conflict between town and gown that would serve no one's purposes. If some community projects continue to be included in the higher education capital budget, the General Assembly should establish a process whereby the Board of Regents shall calculate the debt service attributable to those projects and the Department of Taxation will reduce the Local Government Fund allocations to the counties benefitting from those projects by the amounts calculated by the Board of

Regents. These amounts will be transferred to the Higher Education Improvements Fund.

The Commission does not wish to prejudge the outcome of campus decisions in this new system. It is quite possible that aggregate higher education capital spending would not change substantially as a result of the proposed policy. While the new local accountability provisions would almost surely lead to the cancellation, delay, or reduction of some capital investments, the new local control might very well lead to larger capital investments on other campuses, which might decide to address facilities needs at a more rapid pace than the state had been willing to do. However, if the result of the proposed policy is an overall reduction in higher education capital spending, it is the intent of this Commission that any savings in debt service costs be reinvested in higher education operating appropriations. The purpose of the policy is not to reduce state support for higher education, but to ensure that state support for higher education is spent as wisely as possible by placing control of it in the hands of campuses.

If campuses are to be held accountable for a major cost, they will need a major revenue stream to fund that cost. The Board of Regents will convene a special consultation to develop a formula for the distribution of these funds. In constructing a formula, the consultation will consider such matters as:

- FTE enrollments, by model;
- the inclusion of ineligible enrollments in those counts, on either a full or partial basis;
- the additional capital needs that might be driven by headcount enrollments;
- other mission-essential activities such as sponsored research, noncredit job training, etc.;
- the age of existing facilities; and
- other variables that the consultation deems relevant.

Money distributed pursuant to this formula would be restricted to capital-related purposes, such as debt service on state and/or institutional debt, or for cash expenditures for such purposes as equipment acquisition, major maintenance or renovation projects, property acquisition, construction, etc.

The consultation may also recommend that the state continue to have responsibility for a portion of the debt service on certain campus projects, where unusually large capital investments are required, and the consultation believes that its distribution formula would not provide sufficient funding to support the debt service required to fund those capital expenditures.

The Board of Regents shall include schedules of data in future capital plans. These schedules shall show the bonded indebtedness of each campus and the accumulated amounts to be deducted from future instructional subsidy appropriations as a result of this policy.

April 11, 1994

3/14/94

THE PLAIN DEALER
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# Responsible university funding

Inefficient. That's probably the best way to describe the process that Ohio has used for a generation to fund capital improvements on college campuses, a process that has encouraged pork-barrel spending across the state and helped drive up tuitions.

Responsible. That's probably the best way to describe reforms the Ohio Board of Regents is urging lawmakers to include in capital spending plans for 1996 and beyond.

The problem is that while enrollment has stagnated or declined at many of the state's universities, the construction boom has continued largely unabated.

The reason is simple. Ohio's method of funding capital improvements — brick and mortar — has provided no incentives for schools to build wisely.

The system works like this: Every two years, the schools provide the regents with a building wish list. Once it's approved by the governor and the General Assembly, the schools get money from the state to help build and operate the structures. And the kicker: The bigger the building, the more the subsidy. A bonanza, one might say.

Regents Chairman Paul Dutton calls it "Christmas every two years."

That could soon change, however, and it should. A committee of legislators, educators and regents has come up with a capital funding idea that makes so much sense, it should become law.

The idea is to give capital funds to the schools each year as part of their general operating subsidy — not every two years in a separate budget. The schools would be given greater discretion on how to use the money, but — and this is the key — the schools will for the first time be forced to be responsible in their requests and spending.

This would happen because they would be required to pay the annual debt service on the funds they receive. That means schools would be able to build their buildings. But they will also be responsible for paying the interest on the debt the state incurs from bond sales to finance the construction.

This kind of formula would force expansion-happy schools to think twice before overbuilding, while rewarding a thrifty school that decides to save its share of capital funds, or use the funding to leverage additional dollars from private sources.

The legislature and universities will probably clash over the proposal for maintenance subsidies. Currently, such subsidies are based on building size. But that archaic formula helps contribute to overbuilding. The number of students using the building or, perhaps, the age of the building would be more realistic gauges to use when deciding maintenance funding.

Some legislators will probably oppose the commission's suggestion that higher education bonds no longer be used to finance community projects. The Cleveland Rock and Roll Hall of Fame and Museum received $7 million in higher education capital dollars over the last several budgets, for example.

Some commission members, including its chairman, State Sen. Cooper Snyder of Hillsboro, label the practice of using education appropriations to finance community projects like the Rock Hall as a "promiscuous use" of the public money. His concerns are valid and should be debated.

Finally, there is no denying that many Ohio schools have urgent needs for capital funds. Cleveland State University, for example, badly needs a home for its business school. And CSU's law school could lose its accreditation if its library expansion project isn't completed. Cuyahoga Community College also has pressing needs. These are concerns that the state capital budget should promptly address.

But there is no reason why a funding formula cannot be created that has built-in fiscal responsibility. If funding for the physical plants of universities were done more like capital improvements in the private sector, taxpayers would save money, and eventually responsible schools would come out ahead.

# Results of Debt Service Commission Vote

| Member | When Voted | POM Statement | Debt Service Amendment | Debt Service Statement |
|---|---|---|---|---|
| Snyder | Meeting | Y | N | Y |
| Boyd | Mail | Y | N | N |
| Creamer | Meeting | Y | N | Y |
| Espy | Mail | Y | Y | N (BECAUSE OF THE RESTRICTION) |
| Fekete | Mail | Y | Y | Y |
| Filipic | Meeting | Y | N | Y |
| Finan | Meeting | Y | Y | Y |
| Gerberry | Meeting | Y | N | Y |
| Miller | Meeting | Y | Y | Y |
| Nettle | Meeting | Y | Y | Y |
| Pearson | Mail | Y | N | Y (BECAUSE OF THE RESTRICTION) |
| Penning | Mail | Y | N | Y (BECAUSE OF THE RESTRICTION) |
| Stinziano | Mail | N | N | N |
| Total Y | | 12 | 5 | 10 |
| N | | 1 | 8 | 3 |

March 28, 1994