Ohio | University System of Ohio
Board of Regents

John R. Kasich, Governor
Jim Petro, Chancellor

DIRECTIVE 2012 - 032

October 30, 2012

Re: CONSIDERATION OF A REQUEST BY THE UNIVERSITY OF CINCINNATI TO PLEDGE FEES IN SUPPORT OF A BOND ISSUANCE NOT TO EXCEED $51,600,000 TO BE USED TO FINANCE CAPITAL IMPROVEMENT PROJECTS.

Ohio Revised Code §3345.11 enables a state university or college to issue general receipts obligation bonds in the manner provided by and subject to the applicable provisions of Ohio Revised Code §3345.12.

§371.50.40 of Am. Sub. H.B. 153 of the 129th General Assembly requires that any new pledge of student fees to secure bonds or notes of a state college or university be approved by the Chancellor of the Ohio Board of Regents.

Pursuant to Ohio Revised Code, the University of Cincinnati has demonstrated the following:

- The proposed project is essential to fulfilling institutional goals.
- The University's Board of Trustees approved a resolution authorizing this bond issuance during its January 24, 2012 meeting.
- The institution's proposal complies with §3345.11 and §3345.12.

Agency staff reviewed the request and posted its recommendations to the Regents' web site for purposes of providing a period of public comment before final approval by the Chancellor. The materials posted for comment and the request to pledge student fees are attached to this document.

Based on my review of staff recommendations, I hereby approve the Request to Pledge Fees by the University of Cincinnati in support of general receipts obligation bonds in an aggregate amount not to exceed $51,600,000. Furthermore, any increase in student fees to support this issuance shall not be exempt from any future restraint to increases in undergraduate instructional and general fees imposed by the General Assembly

This directive will take effect immediately.

JimPetro

Jim Petro
Chancellor, Ohio Board of Regents

mlc

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End of Comment Period: October 16, 2012
No comments received, recommend approval

RECOMMENDATION

The Office of the Vice Chancellor for Finance has verified that the University of Cincinnati has demonstrated that their request to pledge student fees in support of general receipts obligation bonds, in an aggregate amount not to exceed $51,600,000, meets all the required guidelines for approval.

29 Oct 12

Signature **Date**

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I. Project Overview

The University of Cincinnati proposes to issue general receipts bonds in order to refinance existing Certificates of Participation (COPS) that were issued in 2005 in support of the University Center Project.

The University intends to refund these existing COPS through a permanent bond issuance that will be retired in 9 to 12 years. The term of the permanent financing is expected to match the amortization of the existing COPS.

Submission: October 2012

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II. Project Financing and Costs

The University of Cincinnati requests the authority to pledge fees in support of the issuance of general receipts obligation bonds in an aggregate amount not to exceed $51,600,000.

Estimated project costs funded through the proposed debt issuance are presented below:

University Center Project Certificates of Participation Refunding

Principal portion of Certificates of Participation currently outstanding	$49,970,000
Provision for Issue Costs	500,000
Margin of Safety	1,130,000
Total General Receipts Obligations Authorization Request	$51,600,000

The University Center Project Certificates of Participation currently outstanding cannot be refunded with tax-exempt debt until March 2015. The University estimates that the average annual debt service for a proposed tax exempt general receipts obligation debt issuance in 2015 will be $4,600,000 based on an average coupon of 2.77% over a period of 9 years. Authorization is being requested to refund the entire principal remaining on the Certificates of Participation at this time, should the University decide to refinance the 2013-2015 maturities utilizing taxable general receipt bonds or another financing instrument to comply with certain Internal Revenue Service rules. The University Center Project debt service is funded by General funds, the Parking auxiliary and the Kingsgate Conference Center auxiliary.

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III. Fee Impact

This proposed debt issuance will have no direct impact on student tuition and fees. While the University of Cincinnati may use unrestricted student fee revenues to support the debt service and operating costs relating to this request, student fees are not expected to increase as a direct result of this action.

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IV. Project Description

The primary purpose of this project is to refinance existing debt related to the University of Cincinnati University Center project, which was designed and constructed by a developer beginning in 1996; the project was completed in 1999. The project was financed in December 1996 through the issuance of Certificates of Participation (COPS). The COPS represent proportionate interests of the registered owners thereof in rental payments to be made by the University under a lease agreement between the developer and the University, as rental for a conference center with overnight lodging, a garage and an office building. The project is comprised of an eight-story Conference Center of approximately 208,000 gross square feet (gsf) with over 200 guest rooms and 30,000 gsf of conference facilities; a five level underground parking garage which holds approximately 550 vehicles and a six-story office building of approximately 172,000 gsf. While base rent is payable from the University's general receipts, the general receipts (including student fees) were never pledged to secure the payment of base rent; thus Ohio Board of Regents approval of this debt was not required prior to the original financing.

To date, $30,095,000 of principal on the COPS has been retired, leaving the principal balance of $49,970,000 with interest rates averaging 5%. The University anticipates refunding the COPS with General Receipts Obligations at rates between 1.37% and 3.47%, thus achieving a total net present value (NPV) savings of $3,301,000 over the remaining life of the debt. This is a conservative estimate of savings as current interest rates have been inflated to take into account the future issuance. The University would like to issue General Receipts Obligations to refund the COPS for the following reasons:

- Interest Rates: Current market spreads for COPS are 25-50 basis points greater than bonds, as of September, 2012;
- Ratings: Current debt ratings for General Receipts bonds would be Aa3/AA- verses A1/A+ for COPS;
- Market Demand: A larger market exists for General Receipts bonds
- Greater Savings: All of the above will result in the University being able to achieve greater debt service savings over the remaining life of the debt.

The University of Cincinnati estimates that $51,600,000 in total debt authority is sufficient to refunding the current Certificates of Participation relating to this project. Moreover, the institution estimates the maximum annual debt service to be $6,900,000 in 2016 and $4,300,000 per year beginning in 2017 through 2024. Debt service is supported by a combination of General funds, the Parking auxiliary and the Kingsgate Conference Center auxiliary.

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V. 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 2008, FY 2009, FY 2010 and FY 2011 audited financial statements—the most up-to-date financial data available.

*NOTE: The FY 2011 data shown in *italics* reflect the ratios and composite score when approximately $27,900,000 (the amount of debt authorized with the University's January 2012 Fee Pledge Request) in debt is added to the actual FY 2011 calculations. Also, $3,175,300 in related debt service expenses have been added to the calculations. The ratios do not take into account 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. No further adjustments to the FY 2011 calculations as a result of this request have been made as it is presumed the University's total debt outstanding and related debt service will either decrease or remain the same.

1. Viability Ratio

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 2008, FY 2009, FY 2010 and FY 2011 are as follows:

FY 2008	FY 2009	FY 2010	FY 2011	*FY 2011**
24.5%	24.3%	27.8%	34.1%	*33.3%*

2. Primary Reserve Ratio

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 2008, FY 2009, FY 2010 and FY 2011 are as follows:

FY 2008	FY 2009	FY 2010	FY 2011	*FY 2011**
27.4%	26.8%	31.6%	38.8%	*38.7%*

3. Net Income Ratio

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 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 2008, FY 2009, FY 2010 and FY 2011 are as follows:

FY 2008	FY 2009	FY 2010	FY 2011	*FY 2011**
-4.9%	-43.5%	+5.6%	+20.0%	*+19.7%*

As outlined in the Management's Discussion and Analysis section of the University's 2009 Financial Report, the net assets of the University declined in FY08 and FY09 as there are significant transactions included in the non-operating revenues (expenses) that are influenced significantly by the economy and investment markets. These items include: Fluctuations in the market value of investments; additions to permanent endowments and state capital appropriation revenue. A new strategic asset allocation policy was implemented on October 1, 2009 that will improve the ability of the endowment to sustain spending while maintaining its real, inflation-adjusted value. The University is committed to continuing its strategic vision while continuing to build upon its financial strength.

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 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 at or below this level for two consecutive years. The highest possible score is a 5.0. The University of Cincinnati's composite scores have been above the minimum threshold:

FY 2008	FY 2009	FY 2010	FY 2011	*FY 2011**
2.50	2.30	3.30	3.60	*3.60*

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VI. Financial Outlook and Bond Rating

According to its FY 2011 audited financial report, the University of Cincinnati's financial position remains strong, having reported total assets of $3,380,561,000 and liabilities of $1,447,092,000. Net assets, which represent the value of the University's assets after liabilities are deducted, increased by $249,219,000 in FY 2011 to $1,933,469,000 or 57.2% of total assets.

The University's existing debt has received relatively high marks from independent bond-rating agencies. Moody's Investors Services' rating for the University is *Aa3* with a stable outlook. Standard & Poor's rating of the University is an AA with a stable outlook.

These ratings indicate that the University's ability to meet its debt obligations is considered strong, as shown in Moody's and S&P's scale below.

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).

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VII. Institutional Plant Debt

The table on the following page depicts how long-term plant debt at Ohio's public colleges and universities has changed at the statewide level over the past five years. Between FY 2007 and FY 2011, statewide plant debt increased 40.5% or approximately $1.58 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 issue local debt.

While statewide institutional debt increased by $789.4 million or 16.8% in FY 2011, the University of Cincinnati's plant debt increased by $32,676,000 or 2.8%.

LONG-TERM PLANT DEBT, FY 2007 - 2011

Institution	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011
UNIVERSITIES					
BOWLING GREEN	$89,345,000	$80,290,000	$78,255,000	$141,265,000	$132,505,000
CENTRAL STATE	$2,003,952	$1,862,693	$1,743,287	$1,617,887	$1,513,758
CLEVELAND STATE	$161,098,196	$163,591,508	$207,067,009	$217,893,028	$217,354,270
KENT STATE	$273,153,000	$277,532,000	$276,019,000	$296,569,000	$326,014,000
MUO (b)	See UT	See UT	See UT	See UT	See UT
MIAMI UNIV.	$235,357,582	$228,484,393	$224,325,090	$213,566,272	$325,614,330
NEOMED	$700,300	$2,291,713	$1,992,413	$1,676,808	$16,454,983
OHIO STATE	$1,118,091,000	$1,076,097,000	$1,360,245,000	$1,354,259,000	$1,973,883,000
OHIO UNIVERSITY	$182,914,606	$167,403,027	$192,718,265	$177,027,086	$164,745,879
SHAWNEE STATE	$19,550,000	$17,765,000	$17,515,000	$17,015,000	$16,505,000
UNIV. AKRON	$247,378,185	$421,931,710	$418,195,077	$424,907,317	$398,884,080
UNIV. CINCINNATI	$1,074,333,000	$1,091,020,000	$1,090,644,000	$1,153,641,000	$1,186,317,000
UNIV. TOLEDO	$269,554,000	$265,409,000	$252,924,000	$295,561,000	$287,550,000
WRIGHT STATE	$38,738,096	$35,624,887	$31,564,022	$37,870,633	$32,690,128
YOUNGSTOWN STATE	$20,397,972	$18,603,592	$38,990,037	$62,083,924	$78,656,592
COMMUNITY COLLEGES					
BELMONT TECH	$0	$0	$0	$0	$0
CINCINNATI STATE	$47,701,975	$47,455,542	$46,774,109	$46,150,000	$45,085,000
CLARK STATE	$8,175,000	$8,175,000	$7,900,000	$7,615,000	$16,845,000
COLUMBUS STATE	$19,830,000	$18,255,000	$16,620,000	$14,910,000	$13,690,000
COTC	$3,875,762	$3,470,979	$2,394,382	$2,078,251	$1,477,666
CUYAHOGA	$57,393,209	$79,449,916	$178,119,296	$179,599,118	$173,508,483
EDISON STATE	$4,975,254	$4,704,730	$4,422,095	$4,126,979	$3,813,992
HOCKING	$5,235,058	$6,384,650	$6,089,638	$5,498,634	$3,191,976
JAMES RHODES	$2,968,669	$2,914,098	$2,859,527	$2,799,956	$2,740,385
JEFFERSON	$1,623,724	$1,422,593	$1,211,968	$957,506	$734,426
LAKELAND	$4,044,695	$3,308,426	$11,096,151	$9,590,647	$17,537,805
LORAIN	$7,010,546	$6,529,973	$6,035,000	$5,740,000	$5,440,000
MARION TECH	$0	$0	$0	$0	$0
NORTH CENTRAL	$727,540	$97,879	$51,308	$1,504	$0
NORTHWEST STATE	$25,249	$59,860	$40,300	$40,230	$5,063
OWENS STATE	$401,212	$536,241	$276,495	$6,417,348	$7,477,454
RIO GRANDE	$0	$2,411,421	$2,256,498	$2,114,858	$1,968,337
SINCLAIR	$0	$0	$0	$0	$0
SOUTHERN STATE	$2,710,583	$5,577,394	$5,371,694	$5,080,903	$4,771,667
STARK STATE	$0	$0	$0	$0	$19,443,994
TERRA STATE	$264,285	$66,409	$0	$0	$0
WASHINGTON STATE	$0	$0	$0	$0	$0
ZANE STATE (MATC)	$156,401	$309,075	$654,117	$460,366	$1,095,272
STATEWIDE TOTAL	**$3,899,734,051**	**$4,039,035,709**	**$4,484,369,778**	**$4,688,134,255**	**$5,477,514,540**