UTAH SYSTEM OF HIGHER EDUCATION
Building a Stronger State of Minds

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March 18, 2015

MEMORANDUM

TO: State Board of Regents

FROM: David L. Buhler

SUBJECT: Revision to Policy 588, Delegation of Debt Policy to Boards of Trustees, and the USHE Debt Ratio Analysis

Background

During the March 2014 Regents Finance & Facilities Committee review of R588, *Delegation of Debt Policy to Boards of Trustees*, several Regents recommended the Commissioner's office prepare a system-wide debt ratio analysis to be presented in a future meeting, and to consider including in policy a statement requiring institutions to annually provide an informational debt report to the Board of Regents. The analysis has been completed, vetted institutionally, and included in the accompanying agenda tab as well as referenced in relevant policy language added in section 3 of R588.

As additional background regarding the proposed policy revisions first reviewed in 2014, R588 was implemented in 2007 as a result of an accreditation visit to a USHE institution that suggested the Regents should adopt an umbrella debt policy for all institutions or delegate that policy making authority to institutional Boards of Trustees for implementation of institutional policies for those institutions that needed them. The Regents delegated the debt policy approval to the Trustees. Updated language now includes:

- Clarified the Purpose
- Expanded references to include the two major Regents policies on long-term debt that relate specifically to statutory authorization
- Moved section R588.4 to R588.3 and retitled it "General Policy"
- Added a new section, R588.4, Financing Structures to provide information about the kinds of financial instruments that need to be addressed in institutional policies
- Moved section 588.3, Definitions to 588.5. and retitled it to be General Considerations. It was erroneously titled "Definitions"
- Removed reference to "general obligation" debt since it is the sole purview of the State of Utah, not the Regents or USHE institutions

Issue

To respond to the Regents recommendation regarding a ratio analysis report, three common ratios were chosen from the publication "Ratio Analysis in Higher Education" 4th and 5th Edition. The three - viability, leverage, & debt burden - have historically proven to be useful basic measures. Each ratio is defined and presented, by institution, for the last five years using industry standardized formulas, and includes recommended industry standards. When ratios are viewed together they can provide the general health of debt practices with the USHE.

Viability Ratio: measures how many times an institution can cover their entire long-term debt obligation using their total expendable net assets. A ratio of 1:1 or greater indicates that an institution has sufficient expendable net assets to satisfy debt obligations. As the ratio falls below 1:1, the institution's ability to respond to adverse conditions from internal resources diminishes, as does its ability to attract capital from external sources and its flexibility to fund new objectives.

Leverage Ratio: measures the number of times that an institution's long-term debt can be covered using available net assets. A ratio of 2:1 or greater is recommended. Were this ratio to fall below 2:1, the concern would be that the institution might have difficulty maintaining its loan repayments should long-term economic conditions impacting the institution deteriorate.

Debt Burden Ratio: measures an institution's dependence on borrowed funds to finance its operation, by measuring the relative cost of borrowing to overall expenditures. Industry standards recommend 7% as the upper threshold for a healthy institution. The higher the ratio, the fewer resources are available for other operational needs. A level trend or a decreasing trend indicates that debt service has sufficient coverage, whereas a rising trend signifies an increasing demand on financial resources to pay back debt.

Institutional Controllers submitted all financial information from their audited annual financial statements, and have reviewed the results along with Chief Financial Officers, Budget Officers, and OCHE staff.

Commissioner's Recommendation

The Commissioner recommends that the Regents review the debt ratio analysis and if satisfied, approve revisions to policy R588, *Delegation of Debt Policy to Boards of Trustees*, effective immediately.

David L. Buhler
Commissioner of Higher Education

DLB/GLS/BLS/CRW/MWM
Attachment

R588, Delegation of Debt Policy to Boards of Trustees[1]

R588-1. Purpose: To authorize ~~an institution~~ USHE institutions to establish ~~a~~ debt ~~policy~~ policies approved by ~~its~~ their Boards of Trustees to provide a framework by which decisions are made concerning the use and management of debt and to provide guidelines for the establishment of such policies.

R588-2. References

2.1. 53B-1-102, Utah Code Annotated 1953 (State System of Higher Education)
2.2. 53B-1-103, Utah Code Annotated 1953 (Establishment of State Board of Regents – Powers and authority)
2.3. R590, Issuance of Revenue Bonds for Facilities Construction and Equipment
2.4. R587, Contract or Lease-purchase Financing

R588.~~4~~3. General Policy ~~An institution within the Utah System Of Higher Education may~~ USHE institutions are authorized to establish ~~its~~ their own institutional debt ~~policy~~ policies ~~in consultation with the Commissioner's Office and~~, as approved by ~~its~~ their Boards of Trustees, to meet the individual needs and objectives of the institutions ~~in regards to debt~~ regarding the use and management of debt. Such policies must adhere to the specific requirements pertaining to some financing structures as outlined below and should utilize the general considerations as guidelines. Institutions are required to annually provide an informational debt report to the Board of Regents.

R588-4. Financing Structures

4.1. Revenue Bonds – Revenue Bonds are long-term debt instruments that are repaid from an identified institutional revenue source. Upon recommendation by the Boards of Trustees, these bonds must be approved by the Utah State Board of Regents and authorized by the Utah State Legislature (see Board of Regents Policy R590, Issuance of Revenue Bonds for Facilities Construction and Equipment).

4.2. Leasehold Revenue Bonds – Financing of capital assets through the sale of bonds secured by lease payments ("lease revenue bonds"). This method requires that the property and/or equipment be purchased by a not-for-profit corporation or governmental agency. The not-for-profit corporation or governmental agency issues bonds secured by the lease and serves as lessor of the property. This form of financing is used by the State Building Ownership Authority (SBOA) – see Utah Code §63B-1-301 to 321.

4.3. Lease-purchase Financing of Facilities – A long-term financing method for construction or acquisition of buildings that amortizes the cost of the asset over a specified time period, at the conclusion of which the asset vests in the lessee. This is an alternative to revenue bond funding that requires Utah State Board of Regents approval upon the recommendation of the institutional Boards of Trustees (see Board of Regents Policy R587, Contract or Lease-purchase Financing).

4.4. Certificates of Participation - A lease-purchase financing arrangement through the public sale of certificates of participation (COPs) where the certificate holders own a pro rata share in a specific pledged revenue stream (usually lease payments by the issuer) and essentially become the lessors (see section 4.3 above).

[1] Adopted January 19, 2007, amended March 9, 2007.

4.5. Energy Service Agreement – A contractual agreement entered into whereby the institution implements energy efficiency measures using the stream of savings in utility costs resulting from implementation of the energy efficiency measures as the funding source for repayment. These arrangements are generally considered to be for facilities and are subject to the approval of the Utah State Board of Regents (see section 4.3 above).

4.6. Capital or Finance Lease Purchase of Equipment – A lease agreement in which the lessor agrees to transfer ownership rights of the asset to the lessee after the completion of the lease period

4.7. Operating Lease of Equipment – A contract that allows for the use of an asset, but does not convey rights of ownership unless a purchase option is available and exercised.

4.8. Other – Other debt instruments, such as off-balance sheet and third party debt may be considered in financing capital construction, renovation, or purchase of tangible assets (equipment) and intangible assets (computer software).

R588-5. General Considerations

~~3.1.~~5.1. A debt policy ~~may be helpful in forming~~ forms the foundation for a well-managed debt program~~. A debt policy can~~ by establishing parameters for issuing debt and managing the debt portfolio, ~~and by~~ as well as providing appropriate guidance to decision-makers, and identifying key objectives for institutional staff to implement. ~~If developed at the institutional level, a~~ Institutional debt ~~policy~~ policies should demonstrate a commitment to the institution's long-range financial plans, recognize a long-term commitment to full and timely repayment of all debt, and be compatible with the institution's goals for capital programs and budgets.

~~3.2.~~5.2. Institutional debt policies should give consideration to:

~~3.2.1.~~5.2.1. The purposes for which debt may be issued;

~~3.2.2.~~5.2.2. ~~Legal d~~Debt limitations~~, if any~~;

~~3.2.3.~~5.2.3. Types of debt permitted to be issued;

~~3.2.4.~~5.2.4. Criteria for issuance of short-term and long-term debt, ~~general obligation and~~ revenue debt, fixed and variable rate debt, lease-backed debt, tax-exempt and taxable debt, and special obligation debt;

~~3.2.5.~~5.2.5. Credit objectives, such as maintenance of specific credit ratings or adherence to benchmark debt ratios;

~~3.2.6.~~5.2.6. Authorized methods of sale, such as competitive sale, negotiated sale, and private placement;

~~3.2.7.~~5.2.7. Method of selecting and use of outside finance professionals; ~~and~~

~~3.2.8.~~5.2.8. Refunding of debt; and

5.2.9 Internal controls.

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R588, Delegation of Debt Policy to Boards of Trustees[1]

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R588-2. References

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2.3. R590, Issuance of Revenue Bonds for Facilities Construction and Equipment
2.4. R587, Contract or Lease-purchase Financing

R588.3. General Policy USHE institutions are authorized to establish their own institutional debt policies approved by their Boards of Trustees, to meet the individual needs and objectives of the institutions regarding the use and management of debt. Such policies must adhere to the specific requirements pertaining to some financing structures as outlined below and should utilize the general considerations as guidelines. Institutions are required to annually provide an informational debt report to the Board of Regents.

R588-4. Overview of Financing Structures

4.1. Revenue Bonds – Revenue Bonds are long-term debt instruments that are repaid from an identified institutional revenue source. Upon recommendation by the Boards of Trustees, these bonds must be approved by the Utah State Board of Regents and authorized by the Utah State Legislature (see Board of Regents Policy R590, Issuance of Revenue Bonds for Facilities Construction and Equipment).

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4.6. **Capital or Finance Lease Purchase of Equipment –** A lease agreement in which the lessor agrees to transfer ownership rights of the asset to the lessee after the completion of the lease period

4.7. **Operating Lease of Equipment –** A contract that allows for the use of an asset, but does not convey rights of ownership unless a purchase option is available and exercised.

4.8. **Other –** Other debt instruments, such as off-balance sheet and third party debt may be considered in financing capital construction, renovation, or purchase of tangible assets (equipment) and intangible assets (computer software).

R588-5. General Considerations

5.1. A debt policy forms the foundation for a well-managed debt program by establishing parameters for issuing debt and managing the debt portfolio, as well as providing appropriate guidance to decision-makers, and identifying key objectives for institutional staff to implement. Institutional debt policies should demonstrate a commitment to the institution's long-range financial plans, recognize a long-term commitment to full and timely repayment of all debt, and be compatible with the institution's goals for capital programs and budgets.

5.2. Institutional debt policies should give consideration to:

5.2.1. The purposes for which debt may be issued;

5.2.2. Debt limitations;

5.2.3. Types of debt permitted to be issued;

5.2.4. Criteria for issuance of short-term and long-term debt, revenue debt, fixed and variable rate debt, lease-backed debt, tax-exempt and taxable debt, and special obligation debt;

5.2.5. Credit objectives, such as maintenance of specific credit ratings or adherence to benchmark debt ratios;

5.2.6. Authorized methods of sale, such as competitive sale, negotiated sale, and private placement;

5.2.7. Method of selecting and use of outside finance professionals;

5.2.8. Refunding of debt; and

5.2.9 Internal controls.

Debt Ratio Analysis

Viability Ratio	FY10	FY11	FY12	FY13	FY14
University of Utah	3.18	2.78	2.41	2.79	2.22
Utah State University	1.82	2.12	2.57	2.94	2.58
Weber State University	3.43	3.05	2.20	2.27	2.50
Southern Utah University	1.37	1.50	1.73	2.51	3.97
Snow College	13.93	1.04	1.00	1.01	0.94
Dixie State University	3.57	2.37	2.18	2.32	3.16
Utah Valley University	3.43	4.47	1.12	1.25	1.18
Salt Lake Community College	12.79	16.16	9.82	11.54	13.73

Viability Ratio measures how many times an Institution can cover their entire long-term debt obligation using their total Expendable Net Assets. A ratio of 1:1 or greater indicates that an Institution has sufficient expendable net assets to satisfy debt obligations. This ratio should be considered along with the Leverage Ratio.

Leverage Ratio	FY10	FY11	FY12	FY13	FY14
University of Utah	5.92	5.06	5.27	4.55	4.05
Utah State University	5.23	5.53	7.74	8.27	6.35
Weber State University	8.42	6.48	5.00	5.72	6.14
Southern Utah University	5.46	6.36	6.46	8.18	9.42
Snow College	72.09	5.74	5.62	5.57	5.46
Dixie State University	16.87	10.56	13.60	14.82	21.99
Utah Valley University	12.99	16.05	4.60	4.84	4.80
Salt Lake Community College	34.97	40.85	21.72	36.62	49.22

Leverage Ratio measures the number of times that an Institution's Long-Term Debt can be covered using available Net Assets. Industry standard indicates the Institution should have a 2:1 ratio. Available Net Assets are defined as all Net Assets - Unexpendable Net Assets/Long-Term Debt. This ratio should be considered along with the Viability Ratio.

Debt Burden Ratio	FY10	FY11	FY12	FY13	FY14
University of Utah	3.0%	3.0%	2.0%	2.6%	2.7%
Utah State University	1.5%	1.5%	1.4%	4.3%	3.6%
Weber State University	1.8%	1.4%	1.4%	1.6%	2.2%
Southern Utah University	2.9%	2.9%	2.7%	1.7%	1.6%
Snow College	0.2%	0.3%	1.5%	3.2%	3.4%
Dixie State University	0.7%	1.2%	0.9%	1.5%	1.4%
Utah Valley University	1.4%	1.2%	1.0%	1.9%	2.4%
Salt Lake Community College	0.7%	0.7%	0.7%	0.8%	0.6%

Debt Burden Ratio measures an Institution's dependence on borrowed funds to finance it's operation, by measuring the relative cost of borrowing to overall expenditures. The industry has established 7.0% as the upper threshold for a healthy institution. Debt Service is defined as Interest Expense + Principal Payments. Total Expenditure is defined as Total Expenses - Depreciation Expense + Principal Payments.

Industry Standards & Formulas

1:1

$\frac{\text{Expendable Net Assets}}{\text{Long-Term Debt}}$

2:1

$\frac{\text{Available Net Assets}}{\text{Long-Term Debt}}$

< 7.0%

$\frac{\text{Debt Service}}{\text{Total Expenditure}}$

Sources: Ratio Analysis in Higher Education, 4th and 5th Editions (Prager & Co., LLC)