UTAH SYSTEM OF HIGHER EDUCATION
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MEMORANDUM

TO: State Board of Regents

FROM: David L. Buhler

SUBJECT: USHE – Debt Ratio Analysis

Issue

Regent Policy R588, *Delegation of Debt Policy to Boards of Trustees,* requires that USHE institutions provide an annual informational debt report to the State Board of Regents. This report is typically shared with Regents at the March Board meeting and is presented via debt ratio analysis. Using the most recent audited financial statements, the Commissioner's staff, in consultation with institutional controllers, budget officers, and chief financial officers, has prepared the annual report for Regent review.

Background

The debt ratio analysis report highlights, by institution, three common ratios - viability, leverage, and debt burden – for each of the last five years. These ratios were chosen using the publication "Ratio Analysis in Higher Education: New Insights for Leaders of Public Higher Education" 5th edition. Definitions and a summary of recommended industry standards for each ratio is shown below and included in the attachments. When viewed together, the ratios help demonstrate the general health of debt practices at USHE institutions.

Viability Ratio: measures how many times an institution can cover their entire long-term debt obligation using the 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.

Commissioner's staff is highlighting a couple items of note for Regent review in this year's report.

- Snow College's viability ratio is currently <1. This is due to the implementation accounting standard GASB 68 in the fiscal year 2015. The implementation of this standard required that Snow record a non-cash transaction (related to the Utah Retirement System (URS) liability), in its financial statements. This transaction resulted in an increase in long-term debt and a decrease in expendable (unrestricted) net assets for the college. Had the college not implemented the GASB 68 standard, the college would have seen a slight decrease in its long-term debt and an increase in its expendable (unrestricted) net assets and the resulting viability ratio would have been 1.06. Regents will want to monitor the viability ratio for the college in future years until it returns to a 1.0 or greater value.

- Dixie State University's (DSU) viability ratio is <1. This is due to timing of when certain transactions were recorded. In June 2015 at the end of the fiscal year, DSU issued a general revenue bond in the amount of $21,315,000, increasing the liability for long-term debt for the 2015 fiscal year. However, the bond revenue, which would have offset the debt, was held in an escrow account and was not included in the year end financials. This resulted in an effect of disproportional long-term debt to expendable (unrestricted) net assets and a viability ratio of <1. When calculating the ratio without the new bond debt, the viability ratio would have been 2.66, well above the recommended threshold. Regents should expect to see DSU's viability ratio increase in future year's reports.

Commissioner's Recommendation

This is an informational item and no action is required.

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David L. Buhler
Commissioner of Higher Education

DLB/KLH/BLS/MWM
Attachments

Debt Ratio Analysis

Utah System of Higher Education

Viability Ratio	FY11	FY12	FY13	FY14	FY15
University of Utah	2.78	2.41	2.79	2.22	2.10
Utah State University	2.12	2.57	2.94	2.58	2.66
Weber State University	3.05	2.20	2.27	2.50	2.36
Southern Utah University	1.50	1.73	2.51	3.97	3.82
Snow College	1.04	1.00	1.01	0.94	0.72
Dixie State University	2.37	2.18	2.32	3.16	0.67
Utah Valley University	4.47	1.12	1.25	1.18	1.27
Salt Lake Community College	16.16	9.82	11.54	13.73	17.91

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	FY11	FY12	FY13	FY14	FY15
University of Utah	5.06	5.27	4.55	4.05	3.77
Utah State University	5.53	7.74	8.27	6.35	6.84
Weber State University	6.48	5.00	5.72	6.14	6.32
Southern Utah University	6.36	6.46	8.18	9.42	8.79
Snow College	5.74	5.62	5.57	5.46	4.49
Dixie State University	10.56	13.60	14.82	21.99	6.18
Utah Valley University	16.05	4.60	4.84	4.80	5.70
Salt Lake Community College	40.85	21.72	36.62	49.22	66.00

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

Debt Burden Ratio	FY11	FY12	FY13	FY14	FY15
University of Utah	3.0%	2.0%	2.6%	6.5%	6.0%
Utah State University	1.5%	1.4%	4.3%	3.6%	2.2%
Weber State University	1.4%	1.4%	1.6%	2.2%	2.0%
Southern Utah University	2.9%	2.7%	1.7%	1.6%	3.5%
Snow College	0.3%	1.5%	3.2%	3.4%	2.8%
Dixie State University	1.2%	0.9%	1.5%	1.4%	2.7%
Utah Valley University	1.2%	1.0%	1.9%	2.4%	1.7%
Salt Lake Community College	0.7%	0.7%	0.8%	0.6%	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%

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

Source: Excerpts from "Ratio Analysis in Higher Education," 4th Edition (Prager & Co., LLC)

Debt Ratio Analysis - Industry Standard Rationale

Utah System of Higher Education

Viability Ratio (1:1)

Although a ratio of 1:1 or greater indicates that, as of the balance sheet date, an institution has sufficient expendable net assets to satisfy debt obligations, this value should not serve as an objective since most institutions would find this relationship unacceptable. However, the level that is "right" is institution-specific. The institution should develop a target for this ratio and other ratios that balances its financial, operating, and programmatic objectives.

There is no absolute threshold that will indicate whether the institution is no longer financially viable. However, the Viability Ratio can help define an institution's "margin for error." As the Viability Ratio's value 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 (2:1)*

This ratio is similar to a debt-to-equity ratio. It is different from the Viability Ratio because net investment in plant is included as part of the numerator. The numerator includes all net assets less nonexpendable net assets, plus the FASB component unit unrestricted and temporarily restricted net assets. The denominator includes all long-term debt of the institution and its component units.

Indications are that the threshold for this ratio should be above 1:1 for most institutions. How much above 1:1 is an institution-specific question. The lower this ratio becomes, concern increases that the institution might have difficulty maintaining its loan repayments should long-term economic conditions impacting the institution deteriorate. In fact, many financially sound public institutions operate effectively with a ratio less than 1:1.

Debt Burden Ratio (< 7%)

Investment bankers have identified an upper threshold for this ratio at 7 percent, meaning that current principal and interest expense should not be greater than 7 percent of total expenditures, a generally accepted threshold. Since debt service is a legal claim on resources, the higher the ratio the fewer the resources available for other operational needs. A level trend or a decreasing trend indicates that debt service has sufficient coverage without impinging further on financial resources required to support other functional areas. On the other hand, a rising trend in this ratio usually signifies an increasing demand on financial resources to pay back debt.