UTAH SYSTEM OF HIGHER EDUCATION
Building a Stronger State of Minds

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MEMORANDUM

TO: State Board of Regents

FROM: David L. Buhler

SUBJECT: USHE – Debt Ratio Analysis

Issue

The Board of Regents has requested an annual report that includes a system-wide debt ratio analysis.

Background

During the March 2014 Regents Finance & Facilities Committee review of R588 *Delegation of Debt Policy to Boards of Trustees*, several members 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. This report addresses this request.

Three common ratios were chosen (viability, leverage, debt burden) that historically have proven good basic measures, from the publication "Ratio Analysis in Higher Education: New Insights for Leaders of Public Higher Education" 5th Edition. Each ratio is defined and presented by institution for the last five years using industry standards and formulas. When ratios are viewed together they can provide the general health of debt practices within 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.

Explanation of Unique Circumstances:

University of Utah

Beginning in FY 2016, the University of Utah began refunding older debt to take advantage of lower interest rates. This continued in FY 2017, with the Debt Burden Ratio showing the net effect of the refunding. During FY 2018, the total principal payment amount of $110,571,000 included $43,000,000 in payments on commercial paper, paid with university cash and refunding bonds GRB2017B. The $43,000,000 amount was not a scheduled payment and the adjusted ratio is net of this amount. The University of Utah is well within the standard for the Debt Burden Ratio.

Utah State University

The total principal payment amount includes $36,770,000 of refunded principal of Series 2013B Bonds, with the proceeds from the issuance of Series 2017 Bonds. The Debt Burden Ratio is net of this amount.

Utah Valley University (UVU)

The UVU Foundation reported as a blended component unit with the UVU's financial statements for FY 2017 and FY 2018. Recently, the UVU Foundation Board approved new bylaws that separated financial reporting according to GASB reporting standards; therefore, all ratios beginning in FY 2017 reflect this adjustment.

Salt Lake Community College

Salt Lake Community College had no debt at Fiscal Year End, June 30, 2016; therefore, there were no calculable ratios for Salt Lake Community College for FY 2016. During FY 2017, the only debt was a DFCM Energy Loan, which is an interest free vehicle. This has caused both the Viability and Leverage Ratios to calculate numbers that are not meaningful within the context of the ratios. The Debt Burden Ratio is still at zero because there was no debt service during FY 2017. During FY 2018, Salt Lake Community College acquired $13,131,802 of long-term debt, but made no debt service or principal payments during FY 2018, therefore the FY 2018 Debt Burden Ratio remains at zero.

Explanation of Ratios not meeting Standards:

Snow College

Snow College's Viability Ratio is below the standard of 1:1 and has been for the last five years, (though they are trending up). The components of the Viability Ratio are Expendable Net Assets/Long Term Debt. Snow College had an increase in Net Assets due to the transfer of the Science building from DFCM to the College. The full value transferred was not an increase to Net investment in capital assets as some of the

items transferred were for minor equipment. Therefore, the non-capital portion of the assets transferred reflects an increase in unrestricted net assets. A smaller portion of the increase was due to other DFCM transfers that were not capitalized.

Snow College has been paying off their long-term debt since FY 2013, decreasing each year (FY 2013 total was $17,815,052, while the total for FY 2018 was $14,887,044). This shows that the College's efforts are improving the Viability Ratio.

The Viability Ratio should properly be viewed together with the Leverage Ratio. Snow College has a very healthy Leverage Ratio of 7.44 (the standard for this Ratio is 2:1 or higher). Snow College has maintained a robust Leverage Ratio during all the years that their Viability Ratio has been below the standard.

Dixie State University (DSU)

Dixie State University recognizes that the Viability Ratio is under 1.0, however when looked at in conjunction with other ratios which are quite positive (specifically the Leverage Ratio), are in good standing. The Viability Ratio is under 1.0 because of bonding for new facilities. The reason the FY 2018 Viability Ratio is low is similar to the reason it was low in FY 2016. DSU had $14.6 million in "restricted" cash assets sitting in the trustee account as of fiscal year end. The trustee account was the cash account that held the 2017 bond proceeds, which will be used to build the Human Performance Center (still currently under construction). Because these restricted funds were not considered in the calculation of the Viability Ratio, it appears to be low. The ratio as presented includes these restricted assets.

Commissioner's Recommendation

This is an information item; no action is required.

David L. Buhler
Commissioner of Higher Education

DLB/KLH/BLS/MWM
Attachments

Debt Ratio Analysis

Viability Ratio	FY14	FY15	FY16	FY17	FY18
University of Utah	2.22	2.10	2.14	2.11	2.32
Utah State University	2.58	2.66	1.79	1.91	1.67
Weber State University	2.50	2.36	2.64	2.77	3.10
Southern Utah University	3.97	3.82	2.15	2.06	1.90
Snow College	0.94	0.88	0.97	0.97	0.98
Dixie State University	3.16	0.67	0.48	0.76	0.76
Utah Valley University	1.18	1.27	1.61	3.20	3.77
Salt Lake Community College	13.73	17.91	no debt	186.83	8.20

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	FY14	FY15	FY16	FY17	FY18
University of Utah	4.05	3.77	3.87	3.95	4.35
Utah State University	6.35	6.84	5.22	4.94	4.48
Weber State University	6.14	6.32	7.82	8.54	9.29
Southern Utah University	9.42	8.79	5.88	5.19	5.12
Snow College	5.46	5.51	5.57	5.80	7.44
Dixie State University	21.99	6.18	6.78	6.90	4.45
Utah Valley University	4.80	5.70	6.47	9.43	10.89
Salt Lake Community College	49.22	66.00	no debt	615.16	27.05

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	FY14	FY15	FY16	FY17	FY18
University of Utah	6.5%	6.0%	2.4%	2.4%	2.5%
Utah State University	3.6%	2.2%	5.0%	2.7%	2.5%
Weber State University	2.2%	2.0%	2.0%	1.9%	2.0%
Southern Utah University	1.6%	3.5%	1.0%	1.8%	2.3%
Snow College	3.2%	2.8%	2.7%	2.7%	2.5%
Dixie State University	1.4%	2.7%	2.0%	2.2%	2.5%
Utah Valley University	2.4%	1.7%	3.0%	1.7%	1.5%
Salt Lake Community College	0.6%	0.6%	no debt	0.0%	0.0%

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

Expendable Net Assets
Long-Term Debt

2:1

Available Net Assets
Long-Term Debt

< 7.0%

Debt Service
Total Expenditure

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

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Debt Ratio Analysis - Industry Standard Rationale

Utah System of Higher Education

<u>Viability Ratio (1:1)</u>

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.

<u>Leverage Ratio (2:1)*</u>

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.

<u>Debt Burden Ratio (< 7%)</u>

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.

Excerpts from Ratio Analysis in Higher Education, 4th Edition (Prager Co., LLC)
*Excerpt from Strategic Financial Analysis for Higher Education, 6th Edition (KPMG-Prager, Sealy Co., LLC)