MEMORANDUM

TO: Joint Budget Committee

FROM: Amanda Bickel, JBC Staff

SUBJECT: Metropolitan State University of Denver Intercept Program Request and Recommendation for Statutory Change to the Intercept Program

DATE: March 16, 2016

INTERCEPT BONDS AUTHORIZATION – METROPOLITAN STATE UNIVERSITY

	Request	Recommendation
Total – Cash Funds Intercept Bonding Authorization	**$40,000,000**	**$27,450,000**

Request: Metropolitan State University of Denver (MSU) has requested, and the Capital Development Committee has approved, intercept bond authorization for its Aerospace Engineering Science Building project. The overall project cost is $60.0 million, including $20.0 million requested in state Capital Construction Funds and $40.0 million from cash funds. MSU anticipates that the remainder will be supported by bonds and donations. In its original submission, MSU reported that it expected to raise $20.0 million in donations, leaving $20.0 million that would need to be financed with bonds. **The CDC authorized bonding under the intercept program of up to $40.0 million, and the final amount financed was $27,450,000. MSU proceeded with the bond issuance on February 26, 2016, prior to JBC review. It now seeks retroactive approval for issuing the bonds under the intercept program.**

PRIOR APPROPRIATION AND REQUEST INFORMATION

Fund Source	Prior Approp.	FY 2016-17	FY 2017-18	Future Requests	Total Cost
CCF	$20,000,000	$0	$0	$0	$20,000,000
CF	$16,404,160	$23,595,840	$0	$0	$40,000,000
Total	$36,404,160	**$23,595,840**	$0	$0	$60,000,000

Project Title	Summary of Request	Amount
Aerospace Engineering Science Building	Final phase of a project to construct a 118,000 GSF facility to support the development of an advanced manufacturing degree program by creating an interdisciplinary learning space combining aerospace science, industrial design, computer science, engineering technology, and a new advanced manufacturing program.	Up to $40,000,000

Recommendation: Staff recommends:

- **The Committee provide retroactive approval** of MSU's issuance under the intercept program for the amount issued; and
- **The Committee sponsor a bill to modify portions of the intercept program to ensure that no bonds are issued under the program in the future without proper authorization.** If the Committee wishes to proceed with this bill, staff would also recommend several other statutory changes to the intercept program.

Each of these issues is discussed below.

MSU Intercept Project: The General Assembly previously approved state support to cover one-third of the cost of this new facility. The University anticipates that the project will be completed and the new building occupied by July 2017.

The average annual payment on the new debt is $1,639,819 for 30 years starting in FY 2016-17 for $27.45 million in new debt. Prior to this new issuance, in FY 2014-15, MSU carried $124.4 million in debt, about half of which was issued under the intercept program.

MSU has indicated that the source of the cash funds for bond repayment is an existing student facility fee that yielded $6.6 million in FY 2014-15. The student capital fee was $502 for 30 credit hours in FY 2015-16. MSU's annual debt service of $7.42 million will rise to $9.0 million with the new issuance. *MSU indicates that it will not need to increase its student facility fee to accommodate the additional debt service payment.*

Staff Recommendation on MSU Project: S***taff recommends that the Committee approve the request.*** Pursuant to Section 23-1-106 (10) (b), C.R.S., any higher education cash funded project costing $2.0 million or more which is subject to the Higher Education Revenue Bond Intercept Program must be reviewed and approved by the Colorado Commission on Higher Education (CCHE) and the Capital Development Committee (CDC). The CDC is then required to make a recommendation regarding the project to the JBC, which is required to refer its recommendations, with written comments to the CCHE. The CDC has already approved the requested projects. Had proper procedures been followed, a letter from the JBC to the CCHE, if approved, would have enabled MSU to proceed with the project. As the related bonds have already been issued, such a letter will instead provide retroactive legal authority for action that has already been taken.

Staff Analysis on MSU Project: The CDC has approved these cash funded projects, and MSU's bond rating and available revenues are sufficient to comply with the statutory limits and guidelines for use of the intercept program. On this basis, staff recommends the requests.

Statutory Guidance:
Pursuant to Section 23-11-106 (10) (b), C.R.S. (most recently modified in S.B. 13-099), to qualify for the Revenue Bond Intercept Program, an institution must have:

(1) A credit rating in one of the three highest categories from a nationally recognized statistical rating organization
(2) A debt service coverage ratio of at least 1.5x (net revenue available for debt service/annual debt service subject to this article)
(3) Pledged revenues for the issue of not less than the net revenues of auxiliaries; 10% of tuition if an enterprise; indirect cost recovery revenues; facility construction fees designated for bond repayment; and student fees and revenues pledged to bondholders.

If it meets these requirements and participates in the Program, and if the institution indicates that it will fail to meet the required payment, the State Treasurer makes the payment, and the amount owed is then withheld from the institution's fee-for-service contract, from any other state support for the institution, and from any unpledged tuition moneys collected by the institution.

When analyzing requests under the intercept program, staff considers:

- The Treasurer's analysis of the proposed issue and compliance with Section 23-5-139, C.R.S. (Revenue Bond Intercept Program)
- The institution's Composite Financial Index
- The projected impact of the new bond and the associated payment on the CFI analysis.
- A comparison between the institution's most recent General Fund appropriation (FY 2015-16) and the existing and proposed annual payment obligations under the revenue bond intercept program.

Treasurer's Statutory Analysis:
The Treasurer's analysis indicates that the MSU request will comply with the statutory limitations on the intercept program.

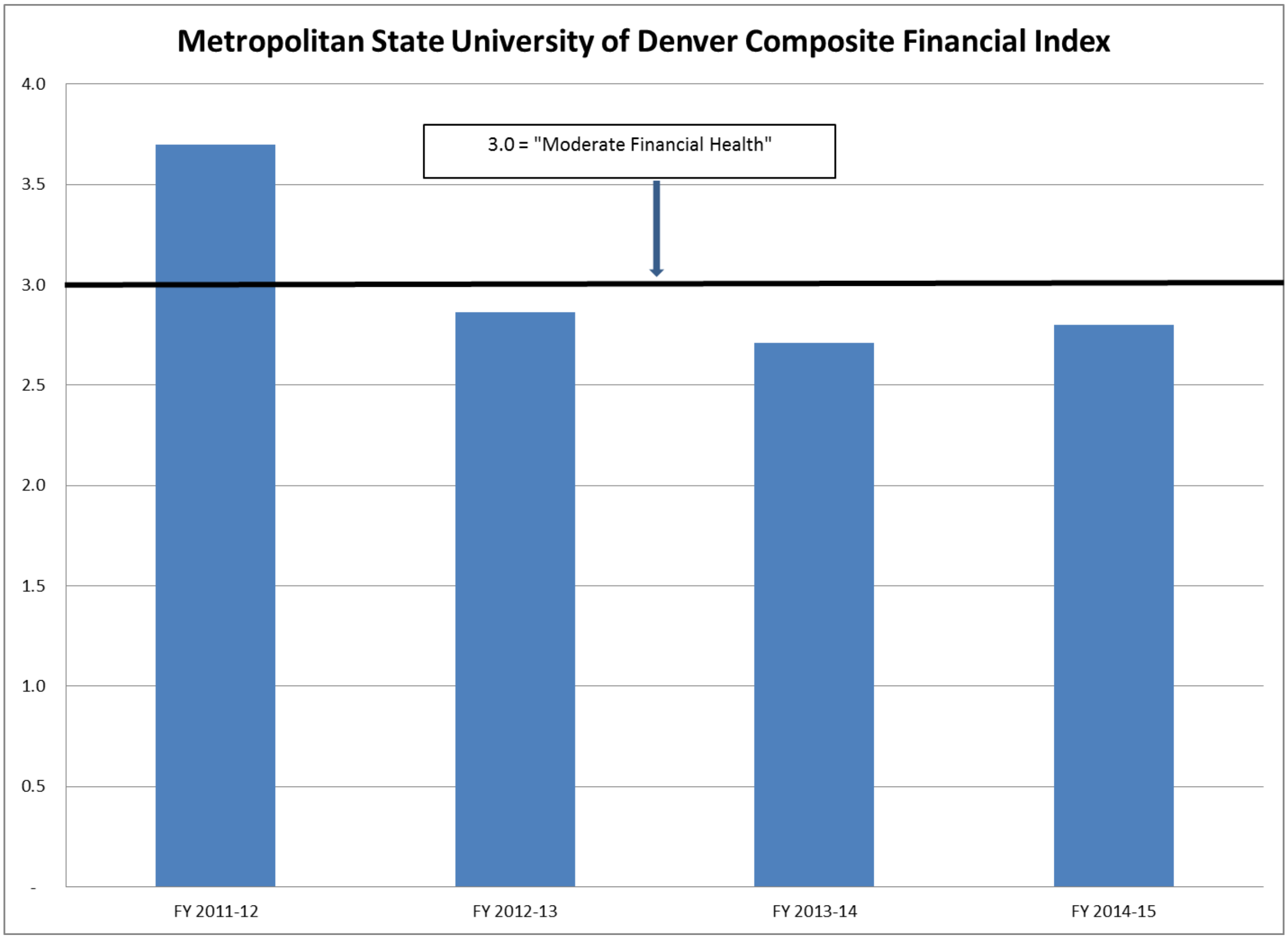
Current ratings:
Moody's has assigned the following ratings:
Non-intercept: Moody's: A1
Intercept (state-backed/ "enhanced"): Moody: Aa2

According to the Treasurer, MSU has a current debt service coverage ratio greater than 2.0 based on overall debt service payments of $7.42 million ($3.5 million of this for the intercept program). Bond disclosure documents report an overall debt service coverage ratio of 2.91 in FY 2014-15.

The Treasurer indicated that even with the new issuance, MSU will still maintain more than adequate coverage to meet the 1.5x test for the intercept program.

Composite Financial Index (CFI)/Institutional Health:
In FY 2014-15, MSU had revenue of $199.9 million and institutional debt of $124.4 million for a student population of 16,111 or debt of about $7,724 per student. With the new $27.5 million issuance and a projected reduction in the student population to about 15,000 in FY 2016-17, this will increase to over $10,000 per student. Yet even with the new debt, annual debt service will represent only 4.5 percent of MSU's annual revenue.

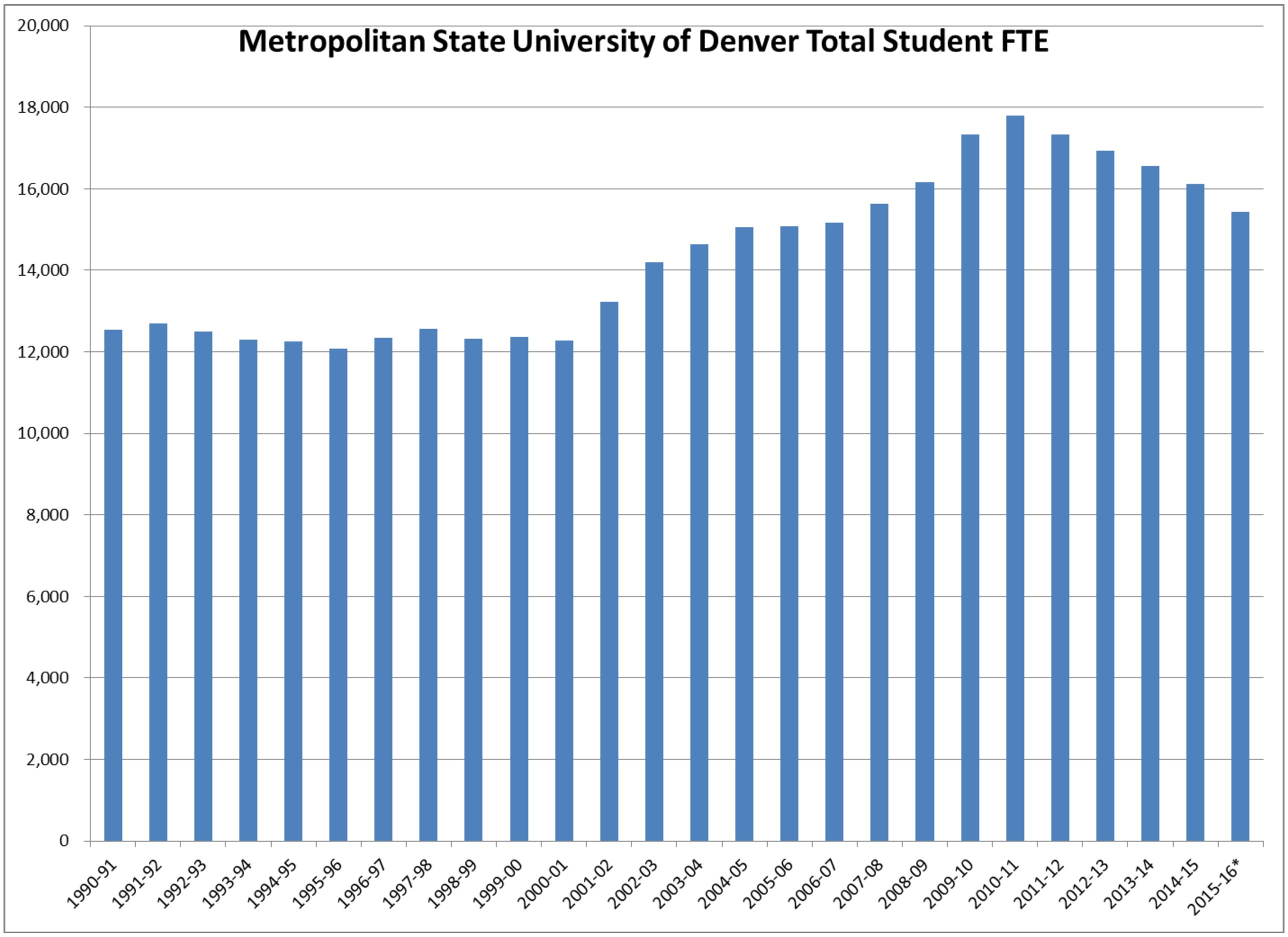
MSU's financial health as reflected by the Composite Financial Index (CFI) has been stable at 2.7 to 2.9 for the last three actual years.



*FY 2014-15 excludes GASB 68 pension liabilities

The additional liabilities associated with the proposed new issuance are expected to have a minimal impact on the CMU Composite Financial Index, based on staff's analysis. The FY 2014-15 CFI of 2.8 might fall to 2.7 assuming no changes other than increased debt.

While MSU currently appears in reasonably strong financial health, MSU's enrollment has been falling for the last six years, since peaking during the recession, and it is projected to continue to decline in FY 2016-17. This could affect its financial health in the future.



Annual General Fund Appropriation versus Intercept Obligations:

The table shows the 2017 projected payment under the intercept program and compares it to the FY 2016-17 General Fund appropriation College Opportunity Fund Program to be reappropriated to MSU based on JBC action to-date. As shown, **with this addition, total annual intercept payment obligations are anticipated to be just 10.0 percent of the 2016-17 state funding anticipated for MSU.** The *anticipated General Fund appropriation still appears adequate to cover any potential bond-payment shortfall in a worst-case scenario in which the intercept would be applied*.

Intercept bond payment for 2017 before new	$3,505,407
Avg. additional projected payment for this bond as of 2017	1,639,819
Estimated intercept bond payment beginning 2017	5,145,226
Reappropriated state GF support for MSU FY 2016-17 (JBC action 9/9/16)	51,415,001
Projected 2017 payment as percentage FY 2016-17 state funds request	10.0%

INTERCEPT BILL RECOMMENDED

When researching this request, staff discovered that MSU had already issued $27.45 million in bonds for this project at the end of February 2016, although the JBC had not yet reviewed the project. This is not consistent with the process outlined in statute at Section 23-1-106 (10) (b), C.R.S.

Staff believes this reflects an unintentional oversight on the part of MSU, the Treasurer's Office, and presumably bond counsel and others involved in the issuance. Nonetheless, s**taff is deeply concerned that the State has been obligated to back $27.45 million in debt through the intercept program without proper legislative authorization.**

This is not a lone example. CDC staff report that this has occurred in the past when a project that was partially supported with capital construction funds also wished to use intercept authority. It appears that on this occasion and occasions in the past, the Treasurer's Office has provided authority to use intercept for such projects without specific authorization for use of the intercept program.

JBC staff has identified a number of other recent bond announcements that indicate use of the intercept program but that the JBC was never informed about. For example, it appears that the Colorado School of Mines and Adams State University, among others, may have issued new debt or have announced issuances under the intercept program that have not been discussed or reviewed by the CDC and JBC. Staff is currently researching these issues.

In light of this, staff recommends that the Committee sponsor a bill to clearly specify that no bonds may be issued under the intercept program unless the Treasurer receives a letter from the JBC authorizing the use of the intercept program. This letter should specify the maximum amount to be authorized. If the Committee wishes to sponsor such a bill, staff would also recommend some other adjustments to the program. Based on information currently available, staff would recommend the following changes. (Staff has a meeting scheduled after this document is printed but before it is presented. Staff may recommend refinements based on that meeting.)

Provisions to improve intercept process:

- Neither the Treasurer nor any governing board of an institution of higher education shall authorize bonds to be issued under the state's revenue bond intercept program unless the Treasurer has received a letter from the Joint Budget Committee indicating that both the CDC and the JBC have reviewed and approved the issuance. This letter must specify the maximum amount of new debt that is authorized for the governing board under the intercept program.

- Prior to legislative review of any intercept request, the State Treasurer shall provide an analysis of whether the project qualifies under the intercept program based on the governing board's credit rating and debt coverage ratio. This year, the CDC added this step to its review process, and staff suggests formalizing this in statute.

Provisions to modify limits on the intercept program*:*

- The 1.5x minimum coverage ratio specified in statute should apply to all bonded debt and not solely debt issued under the intercept program.

- No new debt should be issued under the intercept program if the resulting annual debt service paid under the intercept program, including for both new and previously-authorized debt, exceeds 75 percent of the most recent state-support appropriation for the governing board. State support is defined as General Fund appropriated for stipends and fee-for-service contracts that are reappropriated to the governing board. (This figure could be increased to 100 percent if the Committee desires, but staff does not believe the intercept commitment should exceed 100 percent of operating support.)

Additional Background/Analysis on Provisions to Modify Intercept Program

General Background: All state governing boards other than the University of Colorado have issued debt under the intercept program created in Section 23-5-139, C.R.S. The benefit of the program from an institutional perspective is that it allows debt to be issued under a higher "enhanced" credit rating rather than an institution's underlying credit rating. It thus **reduces the cost of debt**. The University of Colorado does not use the program because of the strength of its own underlying credit rating.

The State and students benefit from lowering the cost of institutional debt: lower cost debt ultimately helps keep the cost of higher education more affordable. However, there are also risks to the State inherent in the intercept program. Specifically, for debt issued under the program—which is typically issued for 30 years and in some cases more—the State has committed to make the necessary intercept payment if the governing board is not able to do so. The State would then collect the debt from the governing board. **This is a long-term obligation**.

The Capital Development Committee sponsored legislation during the 2013 session (S.B. 13-199) that changed the test for institutions to qualify for bonding authority under the Higher Education Revenue Bond Intercept Program. Previously, institutions' ability to use the program was capped, so that annual debt service payments could not exceed 100 percent of their year's fee-for-service contract appropriation. Senate Bill 13-199 eliminated this restriction and replaced it with a requirement that the institution have no lower than an "A" credit rating and demonstrate that debt service coverage ratio was at least 1.5x.

Coverage Ratio: Based on advice from the Treasurer's Office, staff recommends that current statutory language regarding the minimum "coverage ratio" for intercept debt be amended. Currently, statute establishes a 1.5x minimum coverage ratio (amounts pledged for repayment versus debt) but applies this solely to amounts issued under the intercept program. However, staff assumes the "coverage ratio" requirement was deigned to help ensure that the odds of repayment by the institution are high and thus the odds intercept will be invoked are low. From this perspective, limiting the calculation to debt payments due under the intercept program does not make sense. Staff notes that both institutional financial statements and official statements related to bond issues provide data on "coverage ratios" but not on the narrower question of coverage ratios for debt issued under the intercept program.

Scale of Intercept Obligation versus General Fund appropriation: In general, staff assumes the intercept program <u>will only be invoked in a serious, unanticipated situation</u>, e.g., a disaster or other emergency which significantly compromises ongoing operations at a state institution. In such a situation, staff is not confident that the State will be able to collect the payments due from the governing board. **For this reason, staff does not want annual intercept payment obligations to come too close to annual operating appropriations for a governing board.** If a governing board could not make a payment and the payment exceeded the State's annual appropriation for the governing board, where would the State find the funds to make the intercept payment? Would it take those funds from other programs?

The prior fee-for-service contract restriction was problematic because the portion of an institution's overall appropriation that was allocated as fee-for-service was relatively high for some institutions (e.g., Adams and Western) and very low for others (e.g., the community colleges), but this was not related to institutions' financial health. While JBC staff agrees that intercept authority should not be limited by fee-for-service contract amounts, staff believes intercept authority should be limited by total General Fund appropriations to a governing board. Under the intercept program, an institution is borrowing on the state's credit rating, and the State is agreeing to advance bond-payment amounts, if an institution cannot cover them. Staff is concerned that, under current law, institutions could expand their bonding under the intercept program over time, and State might ultimately be agreeing, in the event of a shortfall at the institution, to advance a larger amount than the institution's entire General Fund appropriation.

Most governing boards are currently well below the suggested 75 percent threshold (debt payment/ annual General Fund appropriation).

The table below compares General Fund appropriations in FY 2015-16 and in FY 2012-13 (before General Fund was restored) with FY 2014-15 debt service obligations reflected in governing board financial statements. Note that this includes all debt and not only debt issued under the intercept program, which for some institutions is a subset of this. As shown:

- Based on FY 2015-16 appropriations, and assuming all debt shown was issued under the intercept program, all governing boards would be below the recommended threshold.

- Based on the far lower FY 2012-13 appropriations, all governing boards would still be below the threshold, but some, such as CMU and the Colorado School of Mines would be approaching the limit.

Staff notes that the JBC previously agreed in January 2014 to sponsor a bill that would have limited new issuances under the intercept program to 100 percent of annual General Fund appropriations. It subsequently withdrew that bill at the request of the then-deputy treasurer. The Committee should be aware that there may be opposition to proposals to cap growth in the intercept program because the program reduces institutions' cost of debt.

Information Currently Available on Relationship Between Intercept Obligations and GF Appropriations*		
	Annual Intercept Debt Service FY 2014-15 as Percentage FY 2015-16 GF Appropriation	Annual Intercept Debt Service FY 2014-15 as Percentage FY 2012-13 Appropriation
University of Colorado	n/a	n/a
Colorado State University	36.5%	46.5%
University of Northern Colorado	22.3%	28.4%
Colorado School of Mines	45.6%	58.3%
Fort Lewis College**	36.3%	46.7%
Adams State University**	36.4%	46.5%
Colorado Mesa U.	50.6%	65.5%
Western State Colorado U.	41.1%	51.9%
Metro State U. of Denver	7.0%	9.4%
Community College System**	5.1%	6.6%

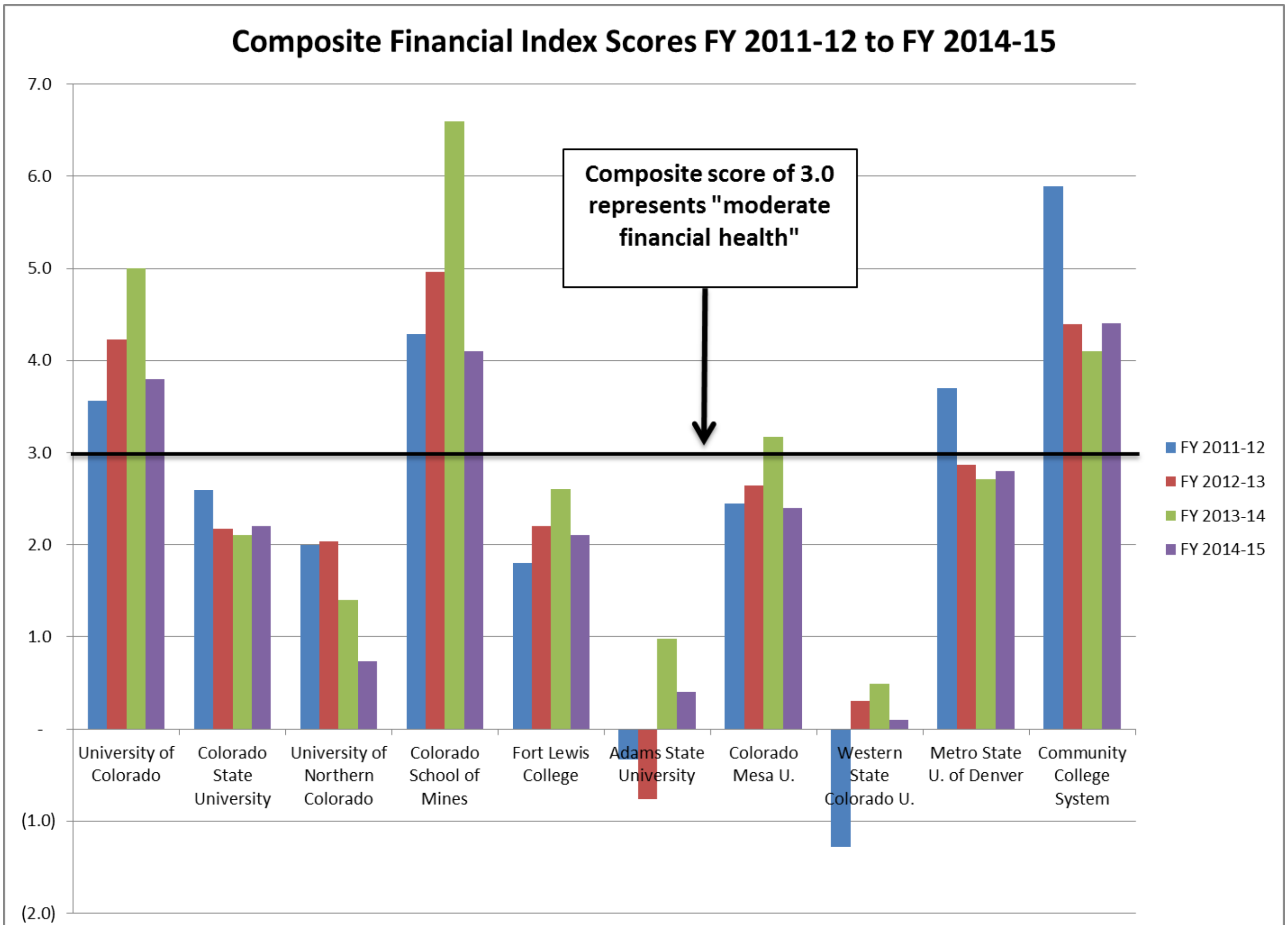
*Staff now believes that more debt may have been issued under the intercept program than reflected in current staff records. Staff will update this table as additional information is available.

*Based on total debt service, rather than intercept only.

General Background on Institutional Debt, Financial Health, and Credit Ratings: As shown below, for many institutions, the ratio of liabilities to revenues is very high, as is the debt per student FTE. However the scale of an institution's overall debt does not always correspond to its overall financial health or its bond rating, as an institution with a high level of debt that has strong revenue and good growth prospects may be deemed in better financial health and a better credit risk than an institution with low debt but a less reliable revenue stream.

	FY 2014-15 Governing Board Liabilities (thousand $s)	FY 2014-15 Governing Board Revenue (thousand $s)	Ratio Total Liabilities to Total Revenue	FY 2014-15 Governing Board Student FTE	Liabilities per Student FTE
University of Colorado	1,707,629	3,367,680	**50.7%**	50,765	**$33,638**
Colorado State University	1,096,761	1,185,829	**92.5%**	27,730	**$39,551**
University of Northern Colorado	143,805	213,437	**67.4%**	8,953	**$16,062**
Colorado School of Mines	200,395	263,361	**76.1%**	5,529	**$36,244**
Fort Lewis College	51,715	68,531	**75.5%**	3,542	**$14,601**
Adams State University	73,045	51,485	**141.9%**	2,325	**$31,417**
Colorado Mesa U.	197,353	123,984	**159.2%**	7,399	**$26,673**
Western State Colorado U.	91,746	47,842	**191.8%**	1,991	**$46,080**
Metro State U. of Denver	124,445	199,855	**62.3%**	16,111	**$7,724**

	FY 2014-15 Governing Board Liabilities (thousand $s)	FY 2014-15 Governing Board Revenue (thousand $s)	Ratio Total Liabilities to Total Revenue	FY 2014-15 Governing Board Student FTE	Liabilities per Student FTE
Community College System	99,162	601,157	**16.5%**	53,015	**$1,870**



Moody's Credit Ratings as of March 2016									
CU	CSU	UNC	Mines	Fort Lewis	Adams	Mesa	Western	Metro	CCCS
Aa2	Aa3	A1	Aa3	A2	A3	A2	Baa1	A1	Aa3

Moody's scale, from highest to lowest credit rating: Aa1, **Aa2, Aa3, A1, A2, A3, Baa1**, Baa2