

MEMORANDUM



JOINT BUDGET COMMITTEE

TO Joint Budget Committee
FROM Amanda Bickel, JBC Staff
DATE September 20, 2018
SUBJECT Colorado State University Revenue Bond Intercept Request

REQUEST AND RECOMMENDATION: On September 5, 2018, the Capital Development Committee (CDC) considered and approved a request from Colorado State University to expand its debt under the Higher Education Revenue Bond Intercept Program (Section 23-5-139, C.R.S.) by \$44.3 million to finance five projects. Statutory provisions require approval from both the CDC and JBC. **JBC staff recommends that the JBC approve the request.**

BACKGROUND ON THE INTERCEPT PROGRAM: The Higher Education Revenue Bond Intercept Program, first authorized in 2008 and last modified in 2016, enables the governing boards of higher education institutions to issue debt under the state's credit rating rather than their own. This reduces the cost of debt for governing boards but also makes the State responsible for making timely payments on the debt if the governing board is not able to do so. If this occurs, the State is authorized to recoup its expenditures from the affected governing board.

Pursuant to Section 23-5-139, C.R.S., 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 (i.e., a rating in the A or higher category)
- 2 A debt service coverage ratio of at least 1.5x (net revenue available for debt service/annual debt service) applied to all debt.
- 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.
- 4 Debt service payments for intercept bonds that do not exceed 75 percent of the governing board's most recent fiscal year state General Fund appropriation (amounts reappropriated to the Board).
- 5 Pre-approval from the State Treasurer and approval from the CDC and JBC.

Senate Bill 16-206 (a JBC bill) modified Section 23-5-139, C.R.S., to tighten the program and ensure that the legislature and the Treasurer's Office have better oversight and information on use of the intercept program, given that the State serves as the financial backstop for this debt. An annual report from the Treasurer's Office, received September 1 each year, provides each governing board's debt profile and outlines whether, at the time of the report, the governing board is qualified to participate in the program. Total obligations for state institutions under the intercept program, including future year principal and interest payments, approach \$3.0 billion. All of the governing boards participate except the University of Colorado, which has a credit rating higher than the State's. Western State Colorado University holds debt under the program but may not expand this debt due to a low credit rating (Baa).

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COLORADO STATE UNIVERSITY REQUEST: The CDC supports CSU's expanded use of the intercept program for the following five projects.

Project Name	Location	Amount of Issuance*
Center for Vector-Borne Infectious Diseases	Foothills Campus	\$25,000,000
High Plains Campus Expansion	Rocky Ford	\$2,000,000
JBS Global Food Innovation Center Phase II	Main Campus	\$5,000,000
Richardson Design Center Tenant Finish	Main Campus	\$2,600,000
Western Campus Expansion	Orchard Mesa	\$9,650,000
Total		\$44,250,000

The additional information below is from project plans submitted to the Colorado Commission on Higher Education (CCHE) and additional information from CSU.

- Center for Vector-Borne Infectious Diseases (\$25.0 million):*** This project will construct an approximately 38,000 gsf facility on the Fort Collins Foothills Campus to house the faculty and research infrastructure that is currently located in both the Infectious Diseases Annex (IDA) and Anthropod-borne Infections Diseases Laboratory (AIDL). The institution reports that the current buildings were not designed for the type of research being conducted and are failing. Some research has already been temporarily relocated, and the poor condition of the current facilities is impacting critical research operations. This new facility is not an expansion, rather a consolidation of current space into a new building with functional research laboratory, insectary and office space. The existing AIDL and IDA buildings could be repurposed for office space with appropriate investment in renovations. The estimated budget range is \$18-\$26M, with a target budget of \$25M. The project will be funded through intercept bonds.

CSU reports that, if approved, it expects to issue the associated bonds in early October and to begin work on the project quickly. While bond documents for all of the projects will simply identify the funding source as CSU general fund, the institution anticipates that the source for bond repayment will be indirect cost collections and other revenue from research activities. Staff understands that this includes both federal research grant funding, which allows the institution to charge for operational costs and depreciation on facilities, as well as revenue from public-private partnerships, such as companies engaged in vaccine-development. The bonds will be taxable because the building will service public-private partnerships.

- High Plains (Rocky Ford) Campus Expansion (\$2.0 million) and Western (Orchard Mesa) Campus Expansion (\$9.65 million):*** With a goal of better serving constituents in western Colorado and along the eastern plains, CSU will create two Centers for Research, Extensions and Engagement. Both projects will be funded through intercept bonds. The centers are described below.

 - CSU High Plains Campus Expansion: This project will construct a new office and classroom facility at the Arkansas Valley Research Center at Rocky Ford, CO. It will house the CSU

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Extension Southeastern Regional Office, Otero County Extension Office and CSU Agricultural Experiment Station (AES) administration. The site currently houses CSU's Eastern Slope Diagnostics Lab and AES programs focused on specialty crops and water use. With the construction of this new 7,000 gsf facility, Rocky Ford will function as the CSU High Plains Campus. The project will cost \$2,000,000 funded by Intercept bonds.

- CSU Western Campus Expansion: This project will construct two new facilities at the Western Colorado Research Center at Orchard Mesa, CO. A classroom/office building will house the Colorado State Forest Service Grand Junction District Office, the CSU Extension Western Regional Office and AES administration. The other facility will be the relocated Western Slope Diagnostic Lab. The Orchard Mesa Site already houses AES programs focused on fruit and wine production, management of specialty crops and pest management. With the construction of the new facilities, Orchard Mesa will function as the CSU Western Campus. The project will add 20,500 gsf at a cost of \$9,650,000 funded by Intercept bonds.

CSU points to additional funding provided by the General Assembly in 2017 as the source for servicing the bonds for this project (although this will not be specified in bonding documents). In 2017, the Joint Budget Committee provided new base funding of \$875,000 per year to assist CSU in meeting its statewide research, extension and engagement mission on the western slope. CSU indicates that it is able to leverage these funds to help support the Rocky Ford campus, as well as the Western Campus expansion.

- ***JBS Global Food Innovation Center Phase II (\$5.0 million):*** JBS Global Food Innovation Center" will cost \$21,100,000. \$14,100,000 was funded using gifts and donations, and most of the remaining \$7,000,000 will be funded using intercept bonds. The project will construct a 38,000 gsf addition to the south of the existing Animal Sciences Building. This project will create an integrated facility to provide hands-on instruction for students, which is currently lacking. The project will include a livestock arena with Temple Grandin designed livestock handling, meat harvest and processing, classroom and laboratory spaces, culinary research and sensory analysis, and a retail store. It will replace the Stock Pavilion that was deconstructed for the new Chemistry Building. Phase II is slated to begin in September 2018 and commence January 2019.

CSU reports that, if approved, it expects to issue the associated bonds in early October and to begin work on the project quickly. Because the project included sale of naming rights, the bonds will not be tax exempt. As described above, the project has been financed with donations, as well as the naming rights, so the portion funded with bonds is expected to be only \$5.0 million.

- ***Richardson Design Center (\$2.6 million):*** The Richardson Design Center will cost \$19,100,000. \$16,500,000 was funded using gifts and donations, and the remaining \$2,600,000 will be funded using intercept bonds. The project will construct a 41,000 gsf building that includes a Maker's Lab (available to the entire campus community), as well as classroom and studio space for multidisciplinary courses. The 3rd floor was identified as core and shell space for the Interior Design Department, with tenant finish of the space included as an alternate. Funding is now available to proceed with tenant finish for the interior design department. The center will create opportunities for students from multiple disciplines to create, innovate and collaborate in an open and immersive design community. The initial incubator programs include Interior Design, Product

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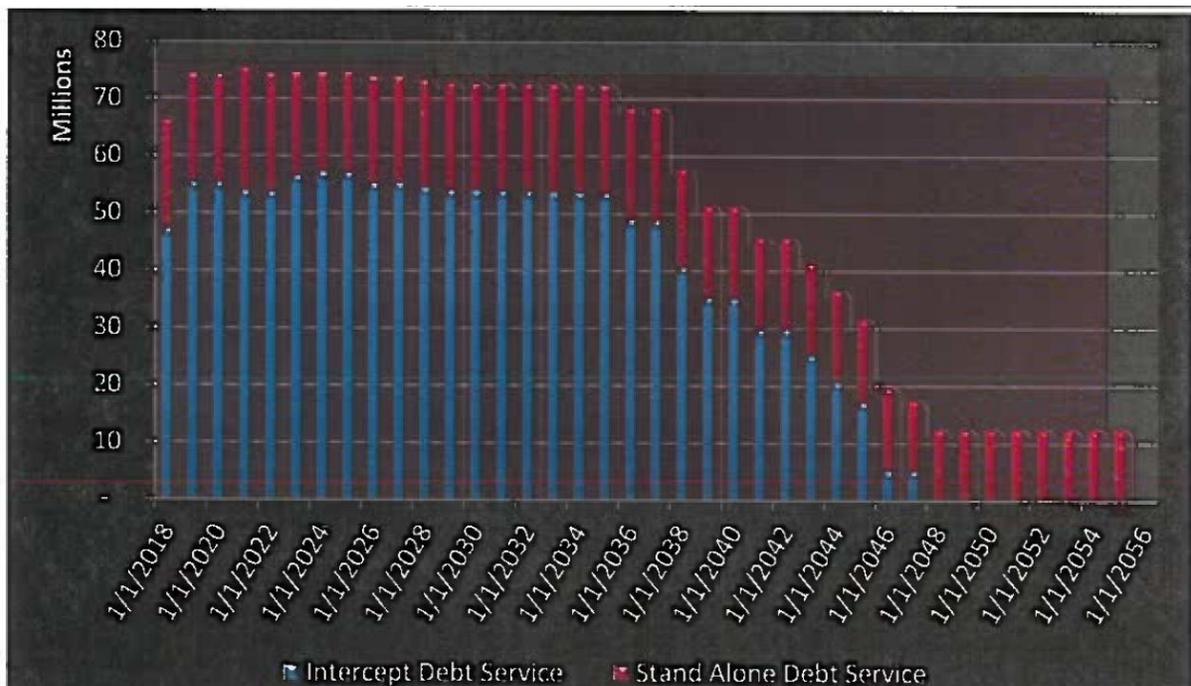
Development, Visual Arts, Landscape Architecture, and Construction Management. The finishes are slated to start in September 2018 and be completed in January of 2019.

CSU reports that it does not expect to issue bonds for this project yet, but will bundle this debt with other larger projects in the future. Because CSU now has access to short-term cash flow debt (commercial paper), staff assumes that it will proceed with this project when ready, even if bonds are not issued until later.

CSU ELIGIBILITY FOR THE INTERCEPT PROGRAM: The Treasurer's September 1, 2018 report on the Higher Education Revenue Bond Intercept program indicates that CSU is well within the parameters required for participation in the program:

- A governing board must have a credit rating in one of the three highest categories from a nationally recognized statistical rating organization (i.e., a rating in the A or higher category). *CSU's rating from Moody's (most recent) is Aa3, which is within this range.*
- A debt service coverage ratio of at least 1.5x (net revenue available for debt service/annual debt service) applied to all debt. *The Treasurer's Office calculates that CSU's overall debt service coverage ratio is 2.3, well above the 1.5 minimum required by the program.*
- 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. *The calculation above is based on existing pledged revenue. New bonds will presumably include similar provisions.*
- Total annual debt service payments for intercept bonds, including new and prior issuances, that do not exceed 75 percent of the governing board's most recent fiscal year state General Fund appropriation (amounts reappropriated to the Board). *CSU's anticipated intercept debt service represents 30.5 percent of its FY 2018-19 state appropriation.*

ADDITIONAL BACKGROUND ON CSU DEBT AND FINANCIAL PROFILE: The chart below, from the Treasurer's September 1, 2018 report on the program shows CSU's debt service obligations, including this additional request.



CSU’s proposal to increase its debt by an \$45.0 million is anticipated to increase its annual debt service by \$3.0 million (based on 30 year bonds at estimated 5.0 percent interest). Combined with escalators in previously issued debt, this increase would lead to total annual debt service payments of approximately \$76 million per year for the governing board.

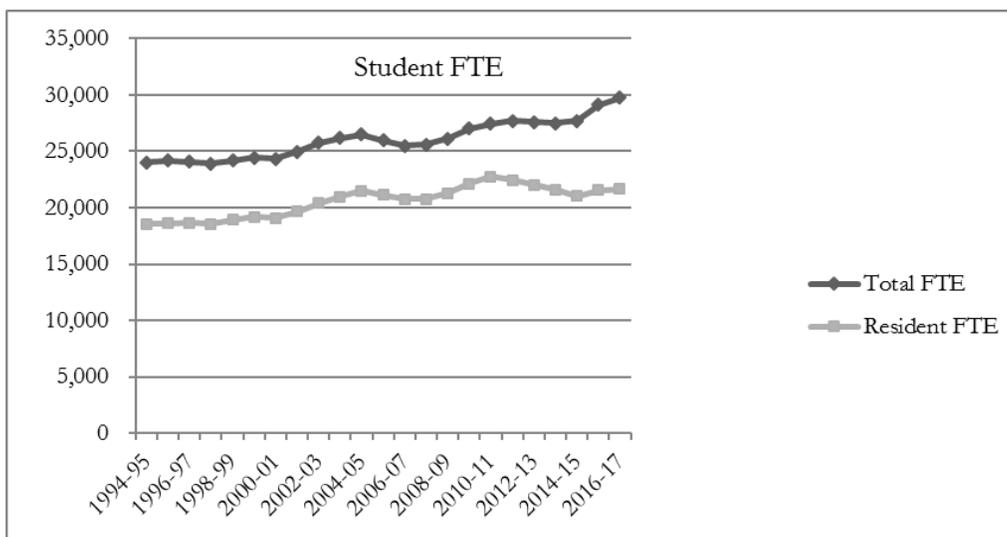
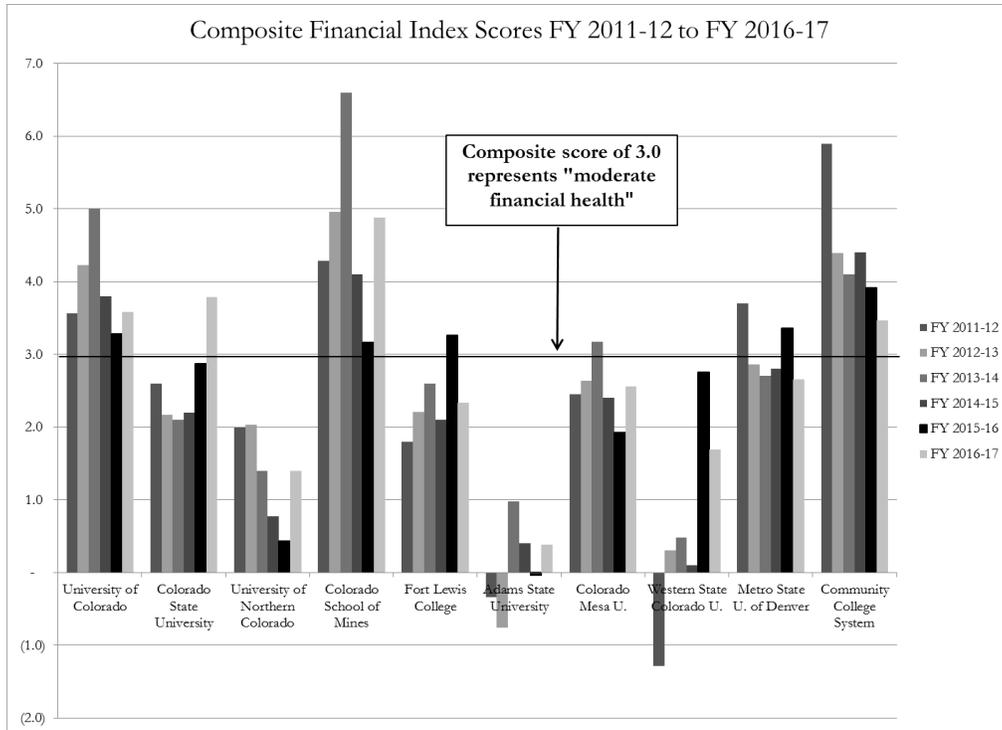
For context:

- CSU’s projected 2018 annual *debt service of \$76 million represents 5.5 percent of the governing board’s 2017 operating revenue* of \$1.4 billion. The additional \$45.0 million in debt represents an increase of 3.5 percent on the governing board’s \$1.3 billion in liabilities (2017 financial statements).
- The CSU system served 38,098 student FTE (including CSU Global) in 2016-17. The system’s total liabilities of \$1.3 billion divided by total student FTE enrolled--its *debt per student FTE--was \$33,306 in FY 2016-17.*

In December 2017, Moody’s assigned CSU an underlying **credit rating of Aa3**. This is lower than the State rating of Aa2 that CSU may use under the intercept program but is still relatively strong. (Moody’s scale from highest to lowest: Aa1, Aa2, Aa3, A1, A2, A3, Baa1, etc.) The credit report highlighted institutional strengths including its strategic positioning, revenue growth and philanthropic support but also emphasized credit challenges including “*Highly leveraged with spendable cash and investments to debt of 0.5 times and debt to operating revenue of 1.0 times, both weaker than Aa3 medians.*” The credit outlook at the time was stable, and CSU anticipates that its updated credit report will remain substantially the same.

STAFF RECOMMENDATION: Staff recommends the request.

- As highlighted by Moody's, CSU is quite leveraged, but **the ratings agencies appear convinced that the overall dynamic growth of the governing board mitigates the related risk.** In addition, staff notes that the governing board's composite financial index (CFI)--a measure of financial health--has strengthened in recent years, and it has been growing total non-resident enrollment at a rapid clip, which should further improve its financial position.



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- The projects proposed in the request are built around program and design plans approved by the Colorado Commission on Higher Education (CCHÉ) and the CDC. **The proposed projects support the institution's research and teaching mission and incorporate substantial philanthropic and industry support**, as well as anticipated revenue from federal research grants.
- **There are no student fee increases associated with these projects**, although overall debt service payments are covered in part by student tuition and fees. The largest share of new debt service payments will be covered by indirect cost collections from research activities (Center for Vector-Borne Infectious Diseases) or previously-approved state contributions (Western and High Plains campuses/agricultural extension).

Staff has attached a draft letter to the Treasurer's Office and the Colorado Commission on Higher Education for the Committee's consideration.

STATE OF COLORADO

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DRAFT

September 20, 2018

Walker Stapleton
Colorado State Treasurer

Lauren Larson
Director
Office of State Planning and Budgeting

Dan Baer
Executive Director
Colorado Department of Higher Education

Dr. Tony Frank
Chancellor
Colorado State University System

Dear Treasurer Stapleton, Director Larson, Director Baer, and Chancellor Frank:

Pursuant to the provisions of Sections 23-5-139 (1.5)(c), C.R.S., on September 20, 2018, the Joint Budget Committee reviewed a request from the Colorado State University System to expand its borrowing under the Higher Education Revenue Bond Intercept Program for the projects and amounts below.

Project Name	Location	Amount of Issuance*
Center for Vector-Borne Infectious Diseases	Foothills Campus	\$25,000,000
High Plains Campus Expansion	Rocky Ford	\$2,000,000
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The Joint Budget Committee voted to approve this request. As required by statute, the additional debt is within the amount specified in the State Treasurer's Office preapproval certificate (Treasurer's 3rd Annual Report on State Institutions of Higher Education, dated September 1, 2018), and the Capital Development Committee approved the request September 5, 2018. The Colorado Commission on Higher Education approved the program plans for these projects on August 18, 2018.

The Colorado State University System may therefore proceed with issuing this additional debt under the Higher Education Revenue Bond Intercept Program, so long as the final bond issue complies with Section 23-5-139 (1)(b)(I),(II), and (III), C.R.S., and any other relevant provisions of law.

Please contact Amanda Bickel on our staff ((303) 866-4960) should you have any questions about this matter.

Sincerely,

Millie Hamner
Chair

cc: Senator John Cooke, Capital Development Committee
Kori Donaldson, Capital Development Committee Staff
Luis Colon, Chair, Colorado Commission on Higher Education
Andrew Rauch, Department of Higher Education
Lauren Lopez, Department of Higher Education
Henry Sobanet, Colorado State University System
Lynn Johnson, Colorado State University
Jason Schrock, Office of State Planning and Budgeting
Rebecca Massey, Office of State Planning and Budgeting
Ryan Parsell, State Treasurer's Office
Bob Jaros, State Controller
John Ziegler, Staff Director, Joint Budget Committee