AGENDA ITEM: 2 – C (2)

SOUTH DAKOTA BOARD OF REGENTS
PLANNING SESSION
AUGUST 3-4, 2016

SUBJECT: Higher Education Finance – Capital Investments

SDBOR Bonds and SDBA

The South Dakota Board of Regents has authority to issue bonds to finance and refinance capital projects within the auxiliary system. Facilities in the auxiliary system traditionally include student unions, wellness facilities, and residential facilities. The Board issues bonds pledging payment of debt from the revenues generated by the auxiliary system, agrees to maintain the facilities, must maintain property, casualty and liability insurance, and must sustain a coverage ratio of net revenues over annual debt of 120% or more. The debt pledge on the bonds is an institutional pledge of system revenues, repair and replacement reserve funds, and ultimately a cross-institutional pledge of the same sources. These bonds are rated based on the strength of the auxiliary system alone and are not backed by the credit and faith of the state of South Dakota.

The South Dakota Building Authority (SDBA) is a component unit of the state of South Dakota. The SDBA is empowered under SDCL to acquire, construct, complete, remodel, maintain and equip buildings and other facilities approved by the legislature. To finance projects, the Authority is empowered to issue and sell bonds pledging any and all income of the Authority and any revenues derived from such facilities to satisfy the debt. The Board utilizes SDBA to issue bonds to finance academic facilities and other facilities that fall outside the auxiliary system. SDBA takes ownership of the property until the debt is satisfied and charges the Board lease payments sufficient to cover the debt, provide insurance, and cover other administrative costs of the Authority. The Board pledges HEFF revenues or other sources to support the lease payments.

South Dakota Compared to Surrounding States

Many states utilize a similar revenue system structure to support housing, student unions and wellness centers. They may also utilize public-private-partnerships as part of their revenue portfolio. South Dakota is unique in the way it funds capital projects for academic facilities with most academic facilities funded with tuition proceeds rather than general obligation bonds.

The Higher Education Facilities Fund (HEFF) which represents 11.5% of tuition revenue, is used to support debt financing for capital projects as well as maintenance of facilities. This requires a premium on our tuition cost and leaves us with less money than other states to operate and fund programs. The following information was gathered from the surrounding states for the purpose of understanding if there is a way to compare the amount of debt being carried between the states. Given that much of the debt in other states is supported with state funding, it is impossible to make a state by state comparison.

How does your state fund new public higher education academic facilities that are not privately fund raised? How is the maintenance funded?

Nebraska: Most projects that are appropriated state general funds have also had either a private source of funding, an institutional source of funding such as fees, reallocation of funds by the institution, institutionally issued bonds, or some combination of these. During the last legislative session, the legislature appropriated general funds to the universities and state colleges for several capital construction projects. Each institution will issue bonds and pay them from the general fund dollars appropriated and a similar amount of institutional funding. The Commission has taken the position that if a portion of funding was provided for an academic facility, it would be appropriate for general funds to be appropriated for operating and maintenance (O&M) costs. However, with limited funding, the legislature has funded very few academic facilities' O&M costs over the past several years.

Montana: New academic buildings are funded by the state of Montana Long Range Building Program which is funded by cash appropriations from the legislature or general obligation bonds of the state of Montana - debt service paid by the state of Montana. When a new academic building is approved, the state of Montana appropriates new O&M for the additional square footage.

North Dakota: Academic facilities not funded with private dollars are typically paid for with state general fund cash appropriations. The state can also issue general obligation bonds for construction projects; however, the state has not issued new bonds since 2007. Generally, institutions are expected to pay for maintenance from their state general fund appropriations, or with any other appropriate funding source. Periodically, the legislature will approve one-time appropriations for deferred maintenance or other larger extraordinary repairs.

Minnesota: The state funds academic space for the Minnesota state colleges and universities with state issued GO bonds. The colleges and universities pay one-third of the debt service (using state funds, tuition and fee income) and the state pays the rest. The funding allotment makes no special provision for maintenance costs. All state funds are distributed to the campuses as a block grant. When a college or university gets new academic square footage, it is expected to finance maintenance within its base operating budget.

Wyoming: For the past 15 years, capital construction at the University of Wyoming has been almost exclusively paid for by the state's general fund. The state itself, for the last 15 years, has funded all capital construction with cash, no bonding. Given our current situation, that could well change. At the community colleges, it's a mixed bag. Generally, the state has paid for half of their building costs, the rest being paid through community college bonding and repayments via student fees and other local revenue sources (i.e. property tax mill levies in the respective community college districts).

Iowa: Academic buildings are generally funded by a mix of state support (either with capital appropriations from the legislature or permission to sell bonds), as well as other funds from private gifts, temporary treasure investments or departmental revenues. Funding for Operating costs must be included in the request; for academic buildings, this would most likely be from appropriations and tuition.

How does your state fund traditional auxiliary facilities that are revenue generating or traditionally student supported, such as residential facilities, Wellness Centers and Student Unions? How is the maintenance funded?

Nebraska: In most instances, revenue bonds have been issued for residential facilities and other non-academic facilities. In some instances, student fees have been increased and in one case, the students voted to increase fees in order to pay for a climbing wall. In projects where no state funds were used, the Commission does not recommend state funds for O&M costs and would expect institutional funding or private donations to pay for maintenance.

Montana: Campuses issue revenue bonds with the debt service being paid from revenue generated by the operation i.e. housing, food services. Other facilities (centers and unions) are financed with revenue bonds and the debt services supported by mandatory student fees implemented specifically for the support of the center or union. In both cases, the O&M comes from the revenue produced or fee collected, no state support.

North Dakota: Revenue generating facilities, such as residence facilities, student unions, wellness centers, are funded through the issuance of revenue bonds that are repaid by auxiliary service revenue.

Minnesota: For the MNSCU System, state revenue bonds are issued that are backed by the revenues of the auxiliary operation. The maintenance costs are a part of the activity's base budget responsibility.

Wyoming: The University of Wyoming has a limited amount of bonding authority which it can apply to certain types of campus construction, such as housing and student facilities. Those bonds are repaid generally through student fees of one form or another. In the last 15 years, the state has paid roughly 50% of the indebtedness cost through federal mineral royalties.

Iowa: All auxiliaries must be self-funded; no public funds may be used. Bonds are generally the funding source. Debt service is paid by reserves accumulated over time. Maintenance must be covered by revenue generated by the auxiliary.

<u>Enrollment Trends to Consider</u>

More and more on-campus students are taking credits via distance. While these students are on campus utilizing facilities and taking most of their credits face to face, it is a troubling trend. Students taking distance hours are not required to pay GAF on those credits, although some campuses now capture a GAF equivalent on these hours to generate revenue to support facilities. We know how many hours are taken from the public universities, but of course students are taking credits from other non-regental schools as well.

On-Campus FTE Generated Taking Distance Courses

University	BHSU	DSU	NSU	SDSM&T	SDSU	USD	Total
Fall 2010	226	113	128	149	516	304	1,436
Fall 2015	284	181	137	107	869	445	2,023
% Change	25.7%	60.2%	7.0%	-28.2%	68.4%	46.4%	40.9%
# Change	58	68	9	-42	353	141	587

The trends for on-campus enrollments since fall 2010 through fall 2015 show losses at three institutions (BHSU, NSU, and SDSU), growth at two institutions (SDSM&T and USD) and essentially flat at the sixth (DSU). The total on-campus enrollments has fallen by 911 students since fall 2010.

University FTE, On-Campus (Including distance credits taken by on-campus students)

University	BHSU	DSU	NSU	SDSM&T	SDSU	USD	System
Fall 2010	2,467	1,189	1,821	2,102	9,453	5,649	22,681
Fall 2011	2,354	1,172	1,866	2,075	9,279	5,649	22,395
Fall 2012	2,209	1,182	1,736	2,140	8,986	5,638	21,891
Fall 2013	2,147	1,172	1,744	2,292	9,049	5,640	22,044
Fall 2014	1,963	1,135	1,608	2,427	9,047	5,692	21,872
Fall 2015	1,927	1,176	1,495	2,436	8,979	5,757	21,770
Δ Since 2010 (Percent)	-21.9%	-0.1%	-17.9%	+13.7%	-5.0%	+1.9%	-4.0%
Δ Since 2010 (Number)	-540	-13	-326	+334	-474	+108	-911

We have become more dependent on non-resident students to fill our residence halls and to pay the fees to support student unions and wellness centers. The campuses have done an excellent job in replacing a declining number of residents with non-resident students. This trend also makes us more vulnerable when other states lower cost, add incentives to keep their students in state or grow their scholarship base. The following table shows the changes in total resident and non-resident FTE's from 2010 to 2015.

Resident and Nonresident FTE Changes
Self and State Support FTE

University	BHSU	DSU	NSU	SDSM&T	SDSU	USD	Total
Resident FTE							
Fall 2010	2,477	1,295	1,425	1,104	6,809	4,870	17,980
Fall 2015	2,069	1,207	1,356	1,107	5,747	4,657	16,143
% Change	-16.5%	-6.8%	-4.8%	0.3%	-15.6%	-4.4%	-10.2%
# Change	-408	-88	-69	3	-1,062	-213	-1,837

University	BHSU	DSU	NSU	SDSM&T	SDSU	USD	Total
Nonresident FTE							
Fall 2010	765	413	672	892	3,704	2,199	8,645
Fall 2015	814	652	639	1,298	4,394	2,744	10,541
% Change	6.4%	57.9%	-4.9%	45.5%	18.6%	24.8%	21.9%
# Change	49	239	-33	406	690	545	1,896

Auxiliary System Debt

The debt carried by the universities for their auxiliary revenue system is supported by the operating revenues from the residential facilities, wellness centers, parking systems (if included) and dedicated general activity fee revenue. We have looked at total debt over the years based on who is paying the bill. On-campus students are used as the denominator as it represents who might use the auxiliary system facilities and who would be paying for them through room and board plans and payment of the general activity fee. On-campus enrollments should also be a strong indicator for the need for additional space. Using the above enrollment information we can look at the total auxiliary system debt for each campus on a per student basis.

South Dakota Board of Regents
Auxiliary System Outstanding Long-Term Debt
As of June 30, 2016 Plus Approved Projects

Campus	Total Debt	On-Campus Student FTE*	Total/FTE
BHSU	$25,226,402	1,927	$13,091
DSU	$25,241,667	1,176	$21,464
NSU (1)	$26,427,938	1,495	$17,678
SDSM&T (2)	$70,828,447	2,436	$29,076
SDSU (3)	$181,736,193	8,979	$20,240
USD	$94,050,209	5,757	$16,337

* On-Campus Enrollment Report - December 2015
(1) Includes new residence hall debt assuming $7.0M principal and 3.75% interest for a total of $10,908,046.
(2) Includes Placer Hall lease estimated total lease payments for 30 years for a total of $33,074,183.
(3) Includes Wellness Addition debt assuming a $14.0M principal and 3.75% interest for a total of $21,816,091.

The greatest impact to the auxiliary revenue stream is a loss of students living in campus housing that are also on campus meal plans. Any shortfall in revenues necessary to meet bond obligations would first come from the campus Renewals, Replacements and Reserve (RRR) accounts and then would have to come from other campus revenues. This means that the campuses would stop maintenance of facilities as a stopgap measure. If enrollments are down, other revenues on campuses will also be suffering. There really is no easy way to address revenue shortfalls because the auxiliary system, like the rest of our operation, is student dependent.

Looking at the annual debt obligation, the debt on residential life can be looked at by bed capacity and the debt on other facilities can be broken down by students that pay the General Activity Fee. The following table shows what amount of debt is paid by each bed if all beds are rented, and the amount of debt paid by on-campus student FTEs for the other facilities (student unions, wellness and other).

South Dakota Board of Regents
Auxiliary Debt Service
Fiscal Year 2016

Campus	Residential Debt Service Per Bed	Student Union, Wellness and Other Debt Service Per On-Campus FTE	Total Debt Service Per Housed Student
BHSU	$1,095	$456	$1,551
DSU	$1,355	$400	$1,755
NSU	$484	$369	$853
SDSMT	$1,968	$464	$2,432
SDSU	$1,804	$367	$2,171
USD	$1,707	$297	$2,004

Note: FY16 debt service for USD, SDSU, and DSU have been adjusted to reflect what the estimated payments will be when including the Series 2015 bond debt for a full year. NSU debt was increased by $436,322 for the new residence hall (net 50 beds). SDSU debt was adjusted by $872,644 for the new Wellness Center addition approved but not yet bonded. The average 30 year mortgage payment of $1,102,472 for SDSM&T Placer Hall was added to the debt given the 30 year lease (202 beds).

Other Debt

The other debt category includes projects that the universities have funded using a student fee, M&R funds, operating revenues, or corporate sponsors and pledges to support. Most of the debt for SDSU is related to the stadium which will rely on operating revenues and corporate sponsors to satisfy. The majority of the debt for USD is related to its arena project which is to be funded with corporate sponsorships and pledges. The per student debt amount is provided to give a comparative perspective of the total debt, even though the major source of repayment is not from students.

South Dakota Board of Regents
Other Outstanding Long-Term Debt
As of June 30, 2016

Campus	Total Debt	On-Campus Student FTE	Total/FTE
BHSU	$530,142	1,927	$275
DSU	$310,880	1,176	$264
NSU	$0	1,495	$0
SDSM&T	$327,248	2,436	$134
SDSU	$66,608,763	8,979	$7,418
USD	$37,256,481	5,757	$6,472

HEFF Debt

HEFF funds are managed at the system level but are subject to some of the same risks associated with the auxiliary system debt – enrollment fluctuations are the main concern. The movement of hours to distance is less of a concern because we capture HEFF on all credits, however, the need for additional space is certainly impacted.

A full-time on-campus resident student currently contributes $916.00 per year to support HEFF debt and maintenance and repair of facilities. An off-campus student contributes $38.33 per credit hour to HEFF or about $115.00 for each course taken.

Our current HEFF projections assume stable enrollments, in other words, no loss in credit hours, and a 3% annual increase in our tuition rate. Each time we ask for a freeze in tuition, we must also request the funds needed to keep HEFF whole so we do not lose ground in maintenance and repair. With virtually no growth in credit hours, we are depending solely on rate increases to generate additional income to fund HEFF; this conflicts with the need to hold down cost so more students can access postsecondary education. Because most of our debt is less than 10 years old and without increases to tuition, we would not be able to build any new buildings until FY29.

For FY17, the maintenance and repair commitment from HEFF is $15,770,016 and our lease payment obligation is $12,572,157. A 1% loss in credit hours would mean an annual loss in revenue of about $272,000. While that amount does not seem significant, that loss would accumulate into a loss of $4,648,968 by 2030, pushing our ability to fund new buildings beyond FY30. A significant loss in credit hours would require us to reduce our annual investment in maintenance and repair to meet our lease obligations.

Decisions to invest in new or remodeled facilities and grow long-term debt is a twenty-five year commitment. Understanding the changing demographics and demand for distance education must weigh into those decisions. Given the current trends, a traditional campus will look very different in twenty-five years.