Adjustment of Financial Metrics and Operating Ranges

BACKGROUND

In March 2015, eight financial metrics were approved by the Board of Trustees Finance & Administration Committee. The purpose of these metrics is to assess key financial characteristics of OSU's operations and complement the strategic indicators of the university's strategic plan. In June 2016, the Finance & Administration Committee adopted recommended operating ranges for those eight financial metrics.

Ratio analysis is a key tool used to examine and measure the financial performance of the university and communicate financial and operational performance outcomes to stakeholders. The ratios are used in the Ten-Year Business Forecast, annual financial reporting analysis, and when the use of debt capacity is assessed or considered. OSU's Debt Policy, which guides the use and monitoring of debt capacity and debt affordability, incorporates five of the current eight financial metrics. The university's Liquidity Management Policy, which provides for the management of the institution's liquidity needs and utilization of short-term debt, references the eight financial metrics to compare historic and current results and model expected future performance.

FINANCIAL METRIC EVALUATION

The existing financial metrics, shown in Table 1, have become less useful as accounting changes have impacted the comparability and relevance of their results and, in some cases, the key components used to compute the existing ratios are no longer reported in audited financial statements. Staff and OSU's financial advisor, PFM, have reviewed the existing financial metrics in light of changes in accounting standards, peer analysis, and the updated Moody's Higher Education Methodology[1] used to evaluate the university's credit rating. The Fund Balance metric is reported in the quarterly management reports.

Table 1. Existing Financial Measures

Existing	Operating Ranges	Calculation
Operating Performance		
Net Income Ratio [Net Operating Revenues Ratio]	0% - 6%	Surplus or deficit to operating revenue
Return on Net Assets Ratio	0% - 8%	Change in net assets to total assets
Fund Balance	10% - 20%	Ending Education & General operating balance as a % of revenues
Reserve Levels and Debt Capacity		
Viability Ratio	75% - 125%	Expendable resources over debt
Debt / Revenues [Income Statement Leverage Ratio]	30% - 75%	Direct debt over revenues
Primary Reserve Ratio	35% - 65%	Expendable resources over total expenditures

[1] Published August 4, 2021.

Debt Affordability		
Debt Burden Ratio	2.5% - 6.5%	Debt service over total expenditures minus depreciation plus debt principal payments
Debt Service Coverage	2 – 4.5 times	Three-year average net operating income plus non-operating revenues plus interest and depreciation over debt service

Financial Peer Group Institutions

Moody's Investors Service maintains a financial database of all universities and colleges that carry a Moody's rating, known as Moody's Municipal Finance Data and Analytics (MFRA). Utilizing Moody's MFRA database, financial trends of peer institutions can be consistently evaluated. OSU staff selected a group of financial peers to monitor and compare with the university's financial metrics.

The defined peer group for OSU, shown in Table 2, is made up of universities that meet specific criteria:

- Moody's rated in Aa2 or Aa3 category
- Land Grant Institution
- Tier 1 Research Institution
- No patient-related revenue (no affiliated hospital)

Table 2. Peer Group List

Auburn University	Oklahoma State University
Clemson University	University of Arizona
Colorado State University	University of Florida
Iowa State University	University of Georgia
Kansas State University	University of Hawaii
Michigan State University	Washington State University
Montana State University	West Virginia University

Proposed Replacement Ratios

University staff propose to replace seven of the original ratios with those shown in Table 3 below, that will align with the new credit review standards adopted by Moody's rating agency. Performance of peer institutions and the Moody's rating category ranges were evaluated and compared to OSU's past performance to develop the recommended target operating ranges. In addition to comparing OSU trends to peer institutions, evaluating these metrics against the established ranges allows for an enhanced understanding of OSU's credit strength and financial position (Attachment 1, Figures 1 through 3).

Table 3. Recommended Replacement Financial Metrics

Recommended Ratio	Operating Ranges	Purpose
Operating Performance		
EBIDA (Earnings before Interest, Depreciation and Amortization) Margin	8.0% - 18.0%	Measures the ability to repay debt from operating revenue as well as invest in academic programs and facilities to advance its strategic objectives

Reserve Levels and Debt Capacity		
Total Cash and Investments to Operating Expenses	0.75 – 1.25 times	Measures level of available reserves to meet the university's operating expenditures
Total Cash and Investments to Adjusted Debt	0.5 – 2.0 times	Debt capacity ratio measuring ability to repay debt and pension obligation with available financial resources
Debt Affordability		
Debt Service Coverage	1.5 - 3.5 times	*EBIDA over Annual Debt Service* - Measures the sufficiency of operations on a cash flow basis to cover debt service

Reporting and Monitoring

The Fund Balance metric will continue to be reported in the quarterly management reports. Figures 1 to 3 illustrate how the existing ratios compare to the recommended replacement ratios. If approved by the Finance & Administration Committee, the replacement metrics in Table 3 will be reported in the Ten-Year Business Forecast, annual financial reporting analysis, and when the use of debt capacity is assessed or considered. OSU staff will continue to calculate, monitor and report the Net Income Ratio (also referred to as Net Operating Revenues Ratio), the Return on Net Assets Ratio, the Viability Ratio, and the Primary Reserve Ratio, as required by the HECC as a part of their evaluation of financial health.

Observations and Trends

Observing the four financial metrics together over time provides a comprehensive view of OSU's financial health. Currently, OSU is within the target ranges for each financial metric, except EBIDA margin, which indicates that OSU's operating performance has been weaker than its peer group and that the margin is weaker than OSU credit rating levels. A low EBIDA margin results in less financial flexibility to invest cash flows in strategic initiatives, capital projects or to build reserves. However, OSU's existing reserves are at healthy levels as indicated by the cash and investments to operating expenses, and to adjusted debt ratios. Moreover, debt service coverage is within the target range demonstrating the institution's ability to service its debt.

RECOMMENDATION

Staff recommend that the Finance & Administration Committee adopt the four new financial metrics and operating ranges, as shown in Table 3 to replace the current financial metrics.

Figure 1. Operating Performance Metrics

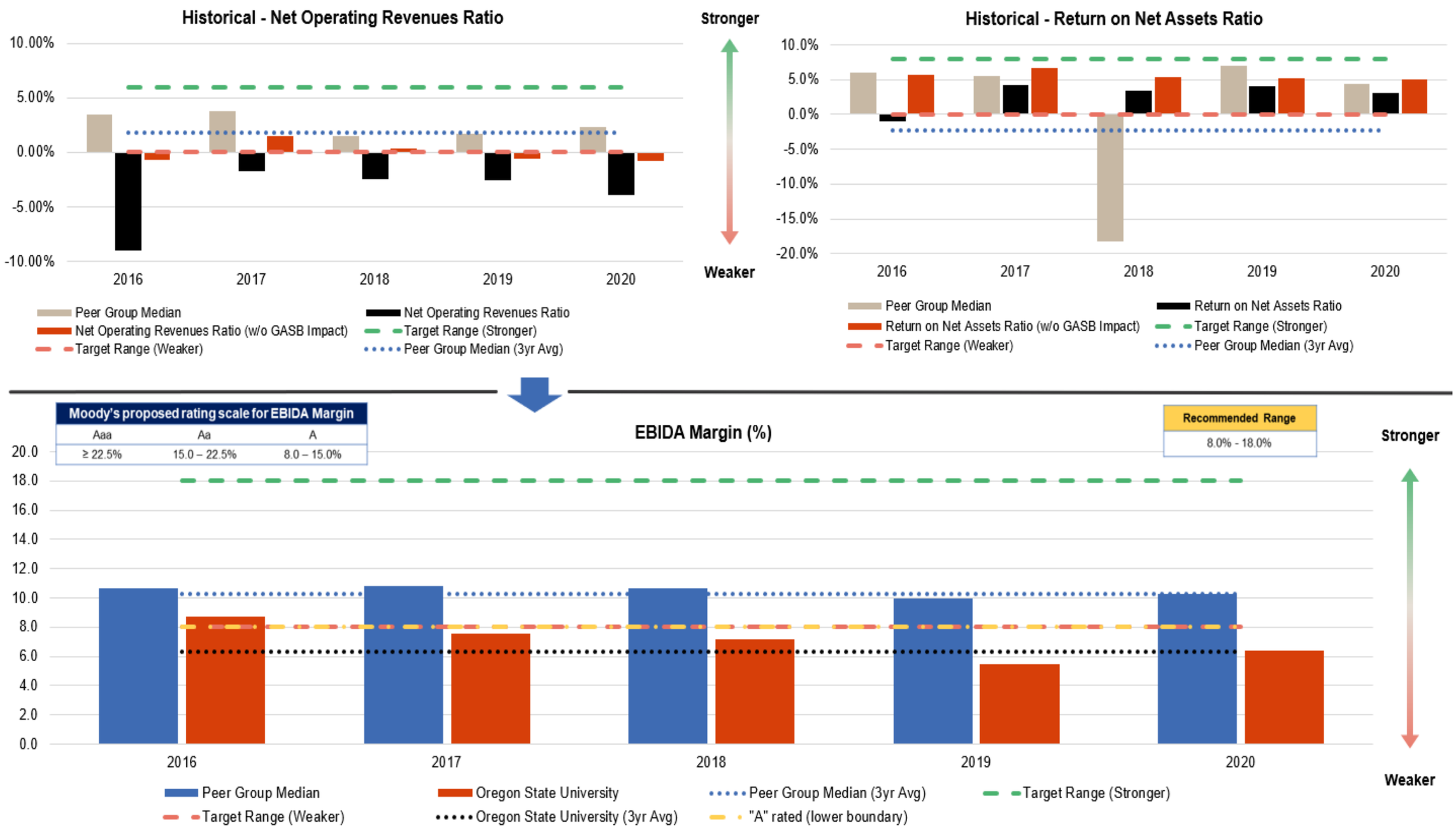
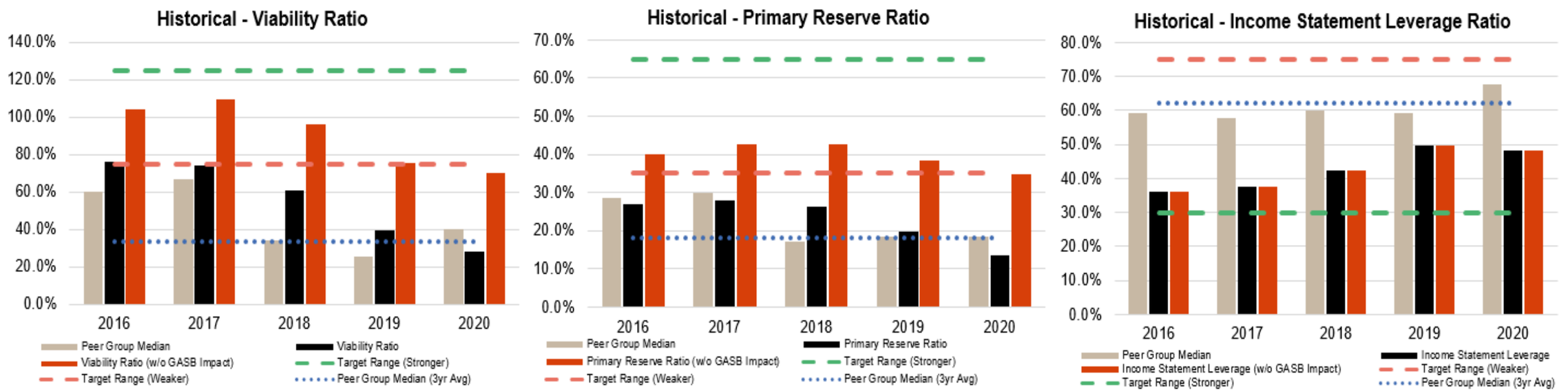


Figure 2. Reserve Levels and Debt Capacity Metrics



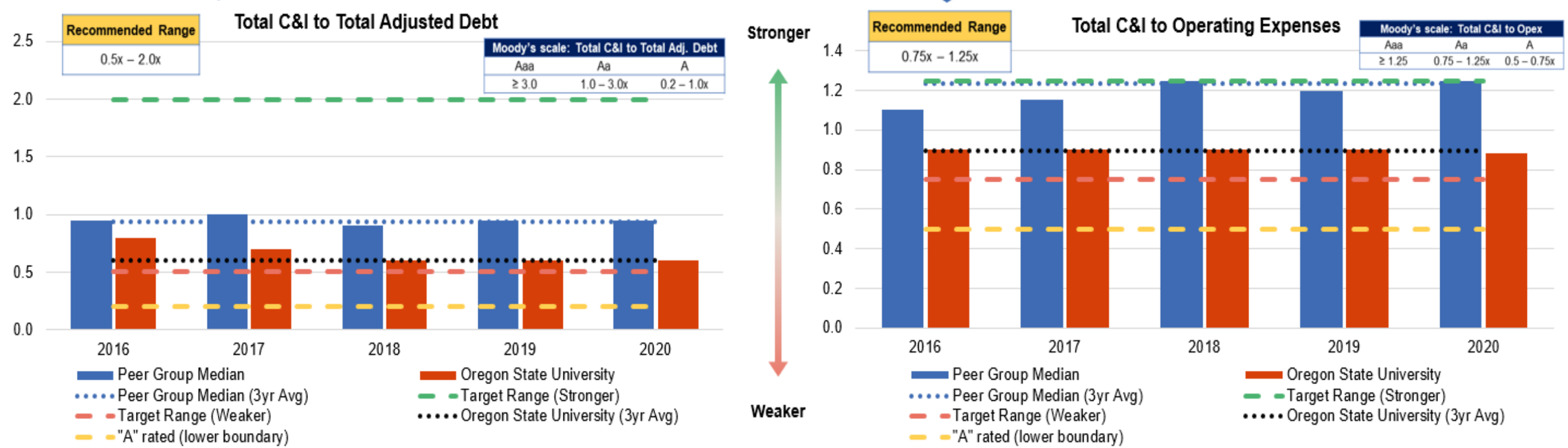


Figure 3. Debt Affordability Metrics: Annual Debt Service Coverage