FY2018 FINANCIAL STATEMENT ANALYSIS & FINANCIAL METRICS UPDATE

BACKGROUND

The baseline for the Ten-Year Business Forecast is the previous year's (FY2018) audited financial statement. The OSU Annual Financial Report, including the audited financial statements and management's discussion and analysis, has been completed and will be presented to the Executive & Audit and Finance & Administration Committees on January 18, 2019. To complement that report, this update provides information on the financial health of the university, including comparison of key financial metrics over time. These metrics are the starting point for the ten-year projections in the forecast.

OVERVIEW

Public universities operate in a challenging financial environment, as discussed briefly in Moody's current outlook for higher education.[1] Declining and volatile levels of state funding have required universities to reduce costs, gain efficiencies, and look to other sources of revenues through increasing philanthropy, developing additional intellectual property, growing their research base, and increasing tuition. The environment in Oregon is similar. Given OSU's Land Grant mission, wherein access and affordability are core, financial management of OSU is an exercise in balancing the goals of financial strength and security and access and affordability.

Over the past several years, the university has made investments in capital and human resources and in other operating expenditures needed to keep pace with enrollment growth and to address some of its deferred maintenance backlog. Consequently, the growth in net assets has not kept pace with the growth in the revenue and expenditure base. The university has begun to budget $5M a year beginning in FY2018, to a total of $45M annually by FY2026, to address capital renewal and deferred maintenance.

ANALYSIS OF SPECIFIC FINANCIAL METRICS

Table 1 provides a trend analysis of seven specific financial metrics to evaluate the university's financial health, including the five debt policy ratios used to evaluate debt capacity and affordability. The debt service amounts shown include only the university-paid debt; amounts exclude debt service on State Energy Loan Program (SELP) debt, where the legislature has committed to pay the debt service with a separate General Fund appropriation. (Since Fiscal Year 2015, state-paid debt is no longer reflected on the university's financial statement, therefore it has no impact on the financial ratios.)

The university implemented Governmental Accounting Standards Board (GASB) Statement No. 68[2], and GASB Statement No. 71 relating to pension accounting and reporting[3] effective for FY2015. In addition, GASB Statement No. 75 *Accounting and Financial Reporting for Post-employment Benefits Other Than Pensions* was implemented effective FY2018. These implementations impact six of the seven financial metrics with a varying degree of materiality. The changes in GASB 68 and 71 mainly require that the university show its share of the net

---

[1] Moody's Investors Service, December 5, 2018, "[Higher education – US: 2019 outlook remains negative with continued low net tuition revenue growth]"

[2] *Accounting and Financial Reporting for Pensions—an amendment of GASB Statement No. 27*

[3] *Pension Transition for Contributions Made Subsequent to the Measurement Date – an amendment of GASB Statement No. 68*

pension liability for employees in the state's retirement system. The move of these assets and liabilities onto OSU's statements has a substantial impact on some of the metrics. In Table 1, for FY2015, 2016, and 2017, the right-hand column shows the ratios without the cumulative impact of GASB 68 and 71 for comparison purposes. For FY2018 the right-hand column shows the ratios without the cumulative impact of GASB 68, 71 and 75.

While the trends in the financial metrics in Table 1 indicate balance sheet strength and relatively low leverage, the university is challenged to continue to show "income statement" improvements over the next several years in order to strengthen reserves and protect the university's net asset base. Specific financial metrics are summarized as follows:

Debt Burden Ratio – The debt burden ratio shows the magnitude of debt service expenditures for university-paid debt relative to total expenses, less depreciation and plus debt principal payments. This ratio measures the university's dependence on debt to finance its mission. The university's debt burden is 3.5% for FY2018, which is within the Board's established range and indicates that the university is not highly leveraged. Without the implementation of GASB statements 68, 71 and 75, this ratio is 3.6%, also within the Board's established range.

Debt Service Coverage Ratio – The debt service coverage, or debt affordability ratio, measures the sufficiency of net revenues to cover debt service. This ratio uses a three-year rolling average of net revenues to smooth out revenue volatility. The university's debt service coverage was 0.4 times debt service for FY2018 which is below the Board's established range. Without the implementation of GASB statements 68, 71 and 75, this ratio is 2.0 times debt service, within the Board established range.

Income Statement Leverage Ratio – The income statement leverage ratio measures the amount of debt relative to the size of operations as reflected in total revenues. This ratio considers only debt that will be repaid with university revenue. The university's income statement leverage stood at 42.3% for FY2018. This is within the Board's established range of 30.0% to 75.0% and shows that the university is not highly leveraged. This ratio is unaffected by implementation of GASB statements 68, 71 and 75.

The following four ratios are considered industry standard core measures of financial health. They combine amounts from the OSU Foundation's financial statements (where applicable), which is recommended by industry best practice, in order to portray the financial health of the university more comprehensively.

Viability Ratio – The viability ratio compares expendable net assets to total outstanding debt to be repaid with university revenues. This ratio measures the ability to repay debt with financial resources and the ability to use debt to strategically advance the university's mission. The university's viability ratio was 59.0% for FY2018, which is below the Board established range. Without the implementation of GASB 68, 71 and 75 this ratio is 96.4%, within the Board established range.

Primary Reserve Ratio – The primary reserve ratio measures the level of available reserves to meet the university's operating expenditures, indicating whether financial resources are sufficient and flexible enough to support the university's mission. The university's primary reserve, inclusive of the related foundations, was 25.5% as of FY2018, which is below the Board established range. Without the implementation of GASB 68, 71 and 75 this ratio is 42.8% and within the Board established range.

Return on Net Assets Ratio – The return on net assets ratio measures whether the university is financially better off than in previous years by measuring total economic return. The university's (inclusive of the related foundations) return on net assets was 3.5% for FY2018 and within the Board established range. Without the implementation of GASB 68, 71 and 75 this ratio is 5.3%, also within the Board established range.

Net Operating Revenues Ratio – The net operating revenues ratio explains how the results of operations affects the behavior of the other three core ratios: the viability ratio, the primary reserve ratio, and the return on net assets ratio. A large surplus or deficit directly impacts the amount of funds an institution adds to or subtracts from net assets, thereby affecting the other three core ratios. The university's net operating revenues ratio was −3.5% for FY2018, which is below the Board established range. Without the implementation of GASB 68, 71 and 75 this ratio is -0.8%, also below the Board established range.

CONCLUSION

In 2018, four of the seven key metrics were outside of the Board established range with GASB 68, 71, and 75 fully implemented. However, when considered without implementation of GASB and over the longer horizon of the last five years, five of the seven key financial metrics have generally been within the operating ranges set by the Board. These include the debt burden, income statement leverage, viability, primary reserve, and return on net assets ratios.

Over this same time period, the debt service coverage and net operating revenues ratios have primarily been below the lower level of the operating ranges. Being outside the range in these two ratios does not indicate an immediate concern about OSU's financial health or impact to our Aa3 credit rating. The debt service coverage ratio has been very slightly outside of the established range for four of the five years, and, in the most recent year, it is within the range. The net operating revenues ratio had been steadily improving over time, though the current year's calculation takes it barely outside the range. The university is addressing revenue generation through its budget and forecasting process. Staff discuss longer-term projected trends of these ratios in the Ten-Year Business Forecast.

Table 1: Key financial metrics based on the University's audited financial statements. For FY2015, 2016, and 2017, the right-hand column shows the ratios without the cumulative impact of GASB 68 and 71 for comparison purposes. For FY2018 the right-hand column shows the ratios without the cumulative impact of GASB 68, 71 and 75. Shading indicates metrics outside of the board's tolerances without GASB.

Oregon State University - Key Financial Metrics
(Dollar amounts in thousands)

	2014		2015		2015 (w/o GASB impact)		2016		2016 (w/o GASB impact)		2017		2017 (w/o GASB impact)		2018		2018 (w/o GASB impact)	
Debt Burden:																		
Debt Service[1]	28,570		28,570		28,570		33,053		33,053		34,260		34,260		40,610		40,610	
Total Adjusted Expenses[2]	888,185	3.2%	898,494	3.2%	951,765	3.0%	1,075,715	3.1%	982,474	3.4%	1,079,182	3.2%	1,039,061	3.3%	1,154,256	3.5%	1,118,919	3.6%
							range	2.5%-6.5%			range	2.5%-6.5%			range	2.5%-6.5%		
Debt Service Coverage:																		
3 yr. avg. Net Revenue available for Debt Service	48,409		61,859		48,409		36,580		49,926		39,966		66,682		17,534		80,976	
Debt Service[1]	28,570	1.7	28,570	2.2	28,570	1.7	33,053	1.1	33,053	1.5	34,260	1.2	34,260	1.9	40,610	0.4	40,610	2.0
							range	2-4.5 times			range	2-4.5 times			range	2-4.5 times		
Income Statement Leverage:																		
Debt[1]	395,834		452,559		452,559		406,392		406,392		437,560		437,560		540,214		540,214	
Revenues	965,880	41.0%	1,062,288	42.6%	1,062,288	42.6%	1,125,370	36.1%	1,125,370	36.1%	1,163,889	37.6%	1,163,889	37.6%	1,277,302	42.3%	1,277,302	42.3%
							range	30-75%			range	30-75%			range	30-75%		
Viability:																		
Expendable Net Assets[3]	426,431		409,657		430,939		309,478		423,960		324,676		479,279		318,959		520,506	
Debt[1]	395,834	107.7%	452,559	90.5%	452,559	95.2%	406,392	76.2%	406,392	104.3%	437,560	74.2%	437,560	109.5%	540,214	59.0%	540,214	96.4%
							range	75%-125%			range	75%-125%			range	75%-125%		
Primary Reserve:																		
Expendable Net Assets[3]	426,431		409,657		430,939		309,478		423,960		324,676		479,279		318,959		520,506	
Total Adjusted Expenses[2]	984,169	43.3%	976,306	42.0%	1,029,577	41.9%	1,154,282	26.8%	1,061,082	40.0%	1,166,407	27.8%	1,126,285	42.6%	1,250,850	25.5%	1,215,513	42.8%
							range	35%-65%			range	35%-65%			range	35%-65%		
Return on Net Assets:																		
Change in Net Assets[5]	64,163		105,795		52,524		(13,480)		79,720		58,610		98,731		49,745		85,082	
Total Net Assets	1,061,090	6.0%	1,050,699	10.1%	1,125,253	4.7%	1,381,161	-1.0%	1,402,444	5.7%	1,389,112	4.2%	1,503,595	6.6%	1,437,143	3.5%	1,602,325	5.3%
							range	0%-8%			range	0%-8%			range	0%-8%		
Net Operating Revenues:																		
Inc./(Loss) before Capital & Other	(29,715)		25,295		(27,977)		(101,233)		(8,033)		(21,657)		18,463		(45,250)		(9,913)	
Operating plus Nonoperating Revenues	1,005,933	-3.0%	1,084,460	2.3%	1,084,460	-2.6%	1,117,523	-9.1%	1,117,523	-0.7%	1,214,223	-1.8%	1,214,223	1.5%	1,288,416	-3.5%	1,288,416	-0.8%
							range	0%-6%			range	0%-6%			range	0%-6%		

[1] Debt service and debt excludes State paid debt.
[2] Total Expenses: Operating Expenses and Principal and Interest Paid less Depreciation Expense
[3] Expendable Net Assets: Unrestricted Net Assets and Expendable Restricted Net Assets, excluding Capital Projects
[4] Total Adjusted Expenses: Operating Expenses and Interest Expense
[5] Change in Net Assets: Adjusted for Special Item - Change in Entity and Change in Accounting Principle