The Board of Trustees of Oregon State University

Regular Meeting of the Finance & Administration Committee
June 1, 2017
Horizon Room, Memorial Union
Corvallis, Oregon

MINUTES

Committee Members Present: Mark Baldwin, Patty Bedient, Julia Brim-Edwards, Darry Callahan, Mike Green (*ex officio*), Brett Morgan, Pat Reser (*ex officio*), and Mike Thorne (*vice chair*)

Other Trustees Present: Mike Bailey, Rani Borkar, Michele Longo Eder, and Ed Ray

University Staff Present: Jennifer Almquist, Anita Azarenko, Sherm Bloomer, Debbie Colbert, Becca Gose, Heather Hesano, Cindy Sagers, Patti Snopkowski, and Marcia Stuart

Guests: Stacey Lewis (*partner, Pacifica Law Group*), Susan Musselman (*director, Financial Advisory, Public Financial Management*) and Thomas Toepfer (*senior managing consultant, PFM*)

1. Call to Order/Roll/Declaration of a Quorum

Committee Vice Chair Mike Thorne called the meeting to order at 11:01 a.m., asked the assistant board secretary to call the roll, and noted a quorum.

2. Interim Vice President for Finance and Administration Report

Interim Vice President for Finance and Administration and Chief Financial Officer Mike Green reported that Oregon State's Corvallis campus has experienced frequent power outages affecting teaching, research, and other important university operations. He said between January 2010 and May 2017, the Corvallis campus experienced 111 power outages: 43 were due to events occurring on campus; 52 outages resulted from off-campus events that affected electrical service to campus; and the remaining 16 outages were planned events for maintenance purposes involving the campus power grid. Green reported that staff have been working with Pacific Power to identify ways to improve the overall reliability of Oregon State's power grid through both short-term improvements and long-range investments. He stated that in the short-term, Pacific Power has committed to investing in capital improvements during 2017 in order to immediately improve the reliability of the power supply to campus and has also committed to assigning response personnel dedicated to the OSU campus. Longer range investments include implementing a long-term reliability plan, replacing outdated infrastructure, and examining a modernization program to improve the sustainability and energy storage of the campus grid. In addition to these efforts, Green said that the university has engaged with third-party consultants to identify on-campus power grid improvements necessary to meet the university's existing and future needs. In response to a question by Trustee Patty Bedient about the nature of the investments needed, Green reported that it was not presently clear; however, he noted that an Electrical Energy Sustainability Plan was expected to be completed by the end of June. He said the university will aim to make improvements in the most cost-effective way and to maintain existing infrastructure where possible, noting that any investments needed will be part of an updated ten-year business strategy. President Ray added that he has spoken directly with the CEO, and he believes Pacific Power is committed to making the necessary improvements.

3. Consent Agenda

a. <u>Minutes of the April 24, 2017 Finance & Administration Committee Meeting</u>

b. <u>FY2017 Q3 Investment Reports</u>

c. <u>FY2017 Q3 Operating Management Report</u>

A motion was made and seconded to approve the items on the consent agenda. The motion carried.

4. Action Items

a. <u>FY2018 Operating Budget</u>

Vice Chair Thorne asked Green to present this item. Green said the FY2018 Operating Budget proposal reflected projections about the state budget outlook and enrollment trends, noting that greater certainty was anticipated following the conclusion of the legislative session in July and verification of enrollment numbers in September. Green said the budget included strategic investments to continue advancing areas important to the university's mission; however, he added that the budget also reflected approximately $20M in reductions.

Following Green's summary, Director of Budgets and Fiscal Planning Sherm Bloomer made a presentation on the university's proposed FY2018 operating budget, summarizing the proposal and providing additional context. Bloomer noted that the proposed budget, totaling $1.217B in projected revenues and $1.220B in projected expenditures and net transfers, provides a plan to develop and distribute resources that will support pursuit of the goals outlined in Strategic Plan 3.0. Bloomer also emphasized that the proposed operating budget was an estimate, given the uncertainties mentioned by Green. He reported that enrollment is generally on track for projections, noting a modest decline in enrollment by resident undergraduates in Corvallis but growth in Ecampus and non-resident undergraduate enrollment as well as growth at OSU-Cascades. Bloomer said that one source of uncertainty was the lack of clarity about the Oregon Promise Program, which will likely have an impact on OSU's enrollments. President Ray asked about the impact of the university's move away from the undergraduate tuition "plateau" on time to graduation. Bloomer replied that there was a modest decrease in average credit hours during the 2015-16 academic year, but it has not had a significant impact on time to graduation, and the credit hour average has since somewhat rebounded.

With regard to state funding, Bloomer reported that the budget assumed a flat appropriation for the next biennium, adding that the impact would be different across each of the major operating parts of the Education & General Funds budget. Vice Chair Thorne noted the particular effect on the Statewide Public Services, adding that fault for reductions in staffing and services to stakeholders may be erroneously attributed to OSU rather than to the state's funding decisions. Ray added that the OSU Extension Service and the Forest Research Laboratory, in particular, have learned to be good stewards of resources, having navigated fluctuations in funding on a number of occasions.

Next, Bloomer discussed areas of strategic growth, which include programs and faculty at OSU-Cascades, the Marine Studies Initiative, and the Student Success Initiative. He also noted plans to bring Athletics to a balanced operating budget and to address deferred maintenance needs. Bloomer then discussed links between investments and the strategic plan. He also discussed the Corvallis Education & General Fund budget reduction of approximately $20M, which would be achieved by the reduction or deferral of some new and existing central commitments and targeted spending reductions. Ray noted that differential reductions would occur across academic and administrative units, with reductions averaging about 2.1% in colleges and 3.6% in administration. Bloomer added that there would also be differential reductions within academic and administrative units. Allocations reflect a new budget model being phased in for the Education & General Fund budget in Corvallis. For academic units, decisions will be based on strategic need and student impact. Bloomer said that allocation decisions for administrative units were based on a more qualitative assessment of the connection between activities and student success. Green added that some administrative units may see cuts greater than 5% in order to maintain critical services in other areas. Bloomer said that while implementation will be challenging, everyone is being thoughtful and remaining committed to protect the most essential functions.

Bloomer then provided an overview of Tables 1, 2, and 3 included in TAB K, which include projected revenues and expenditures for the Education and General, Self-Support, and Restricted Funds. Overall, he said that operating revenues across all funds were projected at $1.182B and expenses, net transfers, and deductions were projected at $1.22B for an overall ending net working capital reserve of $124.6M, or 10.2% of revenues. With regard to Education & General Fund, Bloomer noted that challenges in addition to what had already been mentioned included uncertainties about the state and federal funding environments. He said that strategic commitments included support for student success initiatives, capital renewal, support for the OSU Foundation and Alumni Association, and mid-year salary increases for unclassified faculty.

Next, Bloomer discussed Self-Support Funds, noting a projected 2.1% increase in revenue for a total of $235M with expenses, net transfers, and deductions projected at $239M. He added net working capital was projected to be $31.5M, which is down approximately $4.4M from the current year. Bloomer said most of the decrease is due to the operating deficit in Athletics, which offsets growth in other self-support operations; however, he said the projected deficit in Athletics is better this year by about $1.4M than what was initially projected. The deficit projected for next year is consistent with the sustainability plan. Bloomer said this is the first year of the increased investment in Athletics from Education & General Fund as part of that plan. Trustees Baldwin and Bedient posed questions about the sustainability plan, and Bloomer added that one component of the plan involves moving the university's allocation from approximately $4M to $8M per year over three years, noting that the rationale behind the $8M is that it approximates the amount student athletes pay to the university in tuition and fees. Without the funds transfer, the operating deficit in Athletics would grow. Bloomer also reported that many self-support operations are impacted by construction cost escalation and that University Housing and Dining Services, in particular, is effected by enrollment trends.

Lastly, Bloomer reported that Restricted Funds revenues are projected at $338M and expenditures are projected to be approximately $339M. He discussed challenges and uncertainties, such as a lack of clarity on the future of federal funding for many programs, including Pell Grants, research funding, and federal loan programs. Bloomer also highlighted the Capital Renewal Fund, noting the challenge of repairing and renewing research lab space. Thorne asked about whether there was hesitation in the legislature to approve capital requests because of the potential future costs universities may incur to maintain facilities. Green said that there were questions at the state level about requests by universities to fund deferred maintenance, suggesting universities consider the need to focus on taking care of existing buildings before submitting requests to fund new buildings. Bloomer added that efforts were underway to develop a plan for taking care of deferred maintenance without always having to rely on the state. Trustee Pat Reser asked whether any protocols were in place to allocate a percentage of money raised by the OSU Foundation for capital projects to a deferred maintenance fund. Bloomer stated that strategies to address future deferred maintenance were in development, including establishing a policy that would direct 10% of money for all new projects, regardless of how they're funded, to deferred maintenance and projecting the availability of state allocations. Green also stressed the importance of developing a comprehensive plan to address deferred maintenance.

Following the presentation, Thorne commended staff on the development and presentation of the operating budget. Bedient also acknowledged the work of staff and asked Bloomer to describe how they would characterize the budget. Bloomer described the budget as conservative, adding that he considered the university to be working from a strong foundation and with a realistic projection of revenues, particularly given the areas of uncertainty described in his presentation.

Following discussion, a motion was made and seconded to recommend to the Board that it approve the proposed operating budget for FY2018 as presented in TAB K, Tables 1 though 4. The motion carried.

b. <u>FY2018 Capital Budget and Bond Resolution</u>

Thorne reminded the committee that at their March 16, 2017 meeting they considered and recommended to the Board the FY2018 Capital Budget; however, disruptions at the Board meeting precluded consideration of the action. He said that since then new projects had been added, he asked Green and Anita Azarenko, associate vice president for capital planning and facilities services, to provide an update. Green said that the revised FY2018 Capital Budget included two new projects and a new bond sale resolution.

Azarenko started her presentation with the College of Veterinary Medicine's expansion of Magruder Hall to expand clinical space for increased caseload and specialty offerings. She said the project was originally approved by the Board in October 2016; however, construction costs have risen significantly since that time. The rising costs as well as a refinement in the scope of the project prompted the request to increase the funding from the Internal Bank by an additional $3.0M. Azarenko said this incremental addition has no impact on the funding for strategic investments in the capital forecast, adding that the *pro forma* shows a positive accumulated cash flow in year 5. Thorne asked about the impact of the expansion on the number of students admitted to the college. Azarenko said that 72 students had been admitted to the Class of 2021, and the expansion project includes a large classroom that can accommodate up to 100 students, to allow for future growth.

Next, Azarenko spoke about the project that will expand programming and address an on-campus housing need for underserved populations of graduate, transfer, and nontraditional students. Azarenko said that the upper division and graduate student housing project was planned for a sector of the Corvallis campus that was identified in the 2005 Campus Master Plan as a potential development site for housing, adding that the project moved forward in response to a documented need for additional on-campus housing. Azarenko shared that the project is now drawing attention because of interest in a house, known as the Sunflower House, which is currently located on the parcel identified for the new student housing. The Corvallis Multicultural Literacy Center (CMLC) has leased the Sunflower House since 2005 at a rate of $1 per month; however, that lease expires March 1, 2018. Azarenko said that although the CMLC is a non-profit organization with no formal affiliation with OSU, OSU staff have been in discussion with CMLC staff over the past year about options to help support the continuation of the center's services, including possible alternate university-owned locations that might be available to lease. Azarenko said OSU staff were trying to balance multiple considerations, including responding to an urgent need for additional on-campus housing as well as helping to preserve an important community resource. Reser asked whether the university was still receiving community pressure to increase on-campus housing, and Azarenko confirmed that was the case. She added that if the university tried to build the student housing around the Sunflower House, it could have a negative impact on the number of additional beds that are added to the housing inventory.

Azarenko then introduced the Newport Housing project, which is needed as the Marine Studies Initiative grows. Azarenko said OSU had made the commitment that housing to accommodate our students will be located near Oregon Coast Community College, built out of the tsunami zone, and built to the LEED Silver standard. She said this project is not anticipated to be as immediately self-sustaining as other OSU housing projects, due in part to the shorter-duration student housing demand, and it is anticipated that the project will have a positive accumulated cash flow in year 18. Green added that, while the project presents a challenging *pro forma*, it is a strategic opportunity and priority for the university. Trustee Michele Longo Eder also highlighted the value of the partnership between OSU and the City of Newport, noting that the housing project would help address the affordable housing shortage within the community.

Next, Green said that one component of the action before the committee was a revenue bond funding request. He reported that there are five projects proposed to be funded with proceeds from OSU revenue bonds. Green then provided a summary of the $74.675M funding request and the 2017/2018 General Revenue Bond Resolution provided in Attachment 1. Ray asked about current rates, and Green noted that, while they are still relatively low, it may be in the university's best interest to move quickly to issue the bonds because it is anticipated that the rates will go up later in the year. Ray also asked about the university's bond rating and the status of institutional borrowing versus borrowing capacity needed to maintain that rating. Green confirmed that Moody's Investors Service had awarded Oregon State a bond rating of Aa3, adding that the university had constrained itself to the current level of bond issuance on an annual basis so that it will not reach a capacity issue that might impact the rating. He then reviewed the five debt policy ratios used to evaluate debt capacity and affordability.

Following the presentation, Bedient asked about how financing energy infrastructure needs fit within the existing 10-year Capital Forecast. Green reported that energy infrastructure will be considered and prioritized by the Infrastructure Work Group and then incorporated into the Capital Forecast, which will be updated in January. He noted that reprioritization might be required, but that future consideration did not impact thinking about the proposed projects as strategic priorities for the university at this time. Thorne then asked about the university's positioning to address future potential risks to operations. Green stated that the university was presently well positioned having informed the Capital Forecast with anticipated long-term needs.

Following discussion, a motion was made and seconded to recommend to the Board that it adopt the FY2018 Capital Budget and the Bond Resolution provided in TAB L, Attachment 1. In the conversation about the proposal, Green clarified that the table on page 1 of TAB L would be corrected to note that the gift funds column, Magruder expansion line should include $5M, bringing the subtotal for Education & General Fund to $14M, which runs down to the total OSU capital budget request. He also clarified that the OSU funds column, Magruder line should include $8M, bringing the total project to $13M and changing the total for OSU funds to $8M. With these adjustments noted, the motion carried.

c. <u>Liquidity Management Policy</u>

Thorne asked Green to present this item. Green then introduced Directory of Treasury Heather Hesano and representatives from Public Financial Management, Inc. (PFM), Susan Musselman and Thomas Toepfer. Green said that the purpose of the proposed policy was to outline the university's philosophy for optimal liquidity management, to define the university's primary objective for liquidity management, and to provide a framework for utilization of short-term debt. He said the Liquidity Management Policy would link to other financial policies such as the Internal Bank, Debt, and Investment Policies allowing the university to optimize its financial structure, maximize investment earnings, and minimize debt costs.

Next, Hesano stated that the Liquidity Management Policy was intended to support transparency in decision-making relative to the use of cash and external borrowing. She said that using a variety of liquidity approaches limits dependence on an individual type or source of credit and also allows for exposure to different types of investors. Hesano stated that the policy provides a framework for consideration of the interrelationship of key questions outlined within the policy to align financial decisions with the university's mission, adding that, under the proposed policy, liquidity management would be guided by the consideration of liquidity sources and uses of funds. She stated that the university must balance the liquidity requirements with its investment objectives and its cost and renewal risk of third-party liquidity providers. She then described key liquidity risk measures, noting that the proposed Liquidity Management Policy requires that short-term debt proceeds be limited to interim financing of capital projects, pending issuance of long-term debt and/or receipt of philanthropic gifts or grants for university projects. Hesano then described the Internal Bank's management of available cash and investments to ensure that the university has sufficient cash to provide for routine and emergency operating expenses.

Following the presentation, Trustee Mike Bailey asked about the potential opportunity costs that arise from having excess cash, and Hesano noted the importance of making the best use of available cash. She described, for example, weighing the strategy of utilizing cash within the Public University Fund and receiving investment earnings versus articulating a strategic plan to spend available cash to have a recovery on investment in order to realize the best total return. Next, Thorne asked whether the university was trying to set policies to allow for development of the tools needed to optimize management of returns on investment in the university's future. Green noted that one aim of the interrelated policies was to establish the parameter within which the university operates and articulate a philosophy that allows for optimization of the university's financial position. In addition to tying together other financial policies, the Liquidity Management Policy provides a framework for thinking about liquidity and the subsequent presentation on short-term financing would provide the parameters for use of a line of credit as a tool to improve financial stability. Musselman added that implementation of these policies was intended to help identify cost effective sources of capital, whether that be the university's own money or borrowed money, and then determine the best use of that money, whether that be investment return or returns from strategic investments. She added that the Liquidity Management Policy ties together the policies that speak to how the university borrows, invests, and lends. Hesano also noted that while each individual financial policy addresses one specific topic, no single existing policy looks at the whole to consider the relationship between individual policies and the university's mission and strategic goals. Thus, the Liquidity Management Policy provides alignment across policies by establishing the framework for how the university obtains and manages funds.

Following the discussion, a motion was made and seconded to recommend to the Board that it adopt the Resolution establishing the Liquidity Management Policy as provided in TAB M, Attachment 1. The motion carried.

d. <u>Short-term Financing</u>

Thorne asked Green to present this item. In addition to Hesano, Musselman, and Toepfer, Green welcomed Stacey Lewis, a partner with Pacifica Law Group and the university's bond counsel. Green then reminded the committee that they had heard a presentation on and engaged in a discussion about the benefits of short-term financing at the April 2017 meeting. He said the university is seeking approval to issue a $50M Revolving Line of Credit (LOC) to provide liquidity for interim financing of capital projects, including financing pledges to the Oregon State University Foundation that come in over multiple years and to finance projects that will be bond-financed at some point in the future. Presently, the university is using its own liquidity to meet these needs, and the short-term financing resolution would allow for the use of external capital.

Next, Hesano provided a summary of the April 24, 2017 meeting, which included a discussion of the available short-term financing options for the Internal Bank and the recommendation of a LOC in order to maximize the benefits to the university. She reminded the committee that staff were asked to return with a recommendation for the maximum amount and term of the LOC, reiterating, as Green noted, that the resolution provided in Attachment 1 would grant the university authority to enter into one or more revolving line of credit agreements for a maximum aggregate amount of $50M. Hesano said this amount was based on expected construction spending and reimbursement for existing and future gift-funded projects for a term of five years. She added that staff have worked closely with PFM, both on the debt advisory and investment advisory side, and with Pacifica Law Group, who drafted the proposed resolution. Toepfer then discussed the sizing approach and impact of the LOC on debt policy ratios. He stated that the LOC is additional debt that does impact these Board approved ratios; however, there is no anticipated substantial impact on the trends of the debt policy ratios. Rather, the LOC helps to make available cash that would otherwise be used to make advances on gift-funded projects, which improves the university's liquidity ratios. Bailey asked about the impact on the university's bond rating, and Toepfer stated that the LOC was not anticipated to negatively impact the university's rating and may be a beneficial factor because it offers another tool for advancing the university's projects. Toepfer also provided examples of the types of projects that would for which use of a LOC might be beneficial, such as the Forest Science Complex and the Oregon Quality Food and Beverage Center. Ray asked what rate the university pays to the OSU Foundation on advances on projects, and Green stated that the university pays prime plus several points, which he estimated to be approximately 5%. Green added that the LOC would serve as a substitute to that practice. Hesano then reported that the university has issued a request for proposals seeking terms for a Revolving LOC to be provided by a financial institution and, if the Board approves the resolution, the university expects to enter into a LOC, with a targeted closing date prior to June 30, 2017.

Following the presentation and discussion, a motion was made and seconded to recommend to the Board that it adopt the Resolution authorizing the issuance of one or more lines of credit to the university in the aggregate principal amount not to exceed $50M for the purpose of providing interim financing for capital funding consistent with the Liquidity Management Policy. The motion carried.

5. Education/Discussion Item

a. <u>Risk Management Report – Research Space Needs</u>

In introducing this item, Thorne reminded the committee that they had reviewed an initial risk action plan for Research Space needs in August 2016. He then asked Green to provide a progress report on efforts to mitigate this risk. Green welcomed back Azarenko and also introduced Vice President for Research Cindy Sagers. He said the purpose of this education item was to discuss efforts to-date, adding that Sagers would also discuss specific examples of partnerships with external parties to help achieve the university's strategic goals. Green noted that progress reports would be made to the Board on an annual basis to keep trustees informed on progress to mitigate this risk.

Next, Azarenko discussed Cordley Hall as an example of the university's research space needs. She stated that, in the previous year, faculty residing in Cordley Hall generated a total of $20M in research awards. One of the chairs of a department housed in the building recently testified before the legislature about the university's diminished ability to attract and retain world-class faculty because of the poor quality of the research facilities. Azarenko added there were other examples that demonstrated the need to improve the university's research space. She then referenced TAB O, Attachment 1, and she provided a summary of the action items listed in the mitigation plan.

Sagers then provided additional information about the mitigation strategy of leveraging relationships with federal agencies and industry as a way to manage research space needs. She introduced two approaches, beginning with partnerships with federal agencies, including national laboratories and science agencies. Sagers said that partnerships with these agencies provide opportunities to quickly place Oregon State students and postdocs into state-of-the-art research facilities without significant investments by the university, adding that the university has five national laboratories within close driving distance. She described the vision of working with these national laboratories to establish a seamless relationship between the lab and the university, including providing joint oversight for doctoral students, providing the ability to move between coursework and lab work, and connecting students with a professional network.

Next, Sagers described the possibility of partnering with industry and other private entities. She noted, for example, efforts to develop Building 11 on the HP campus, which presently houses nine companies and seven research faculty. Sagers added that the nine companies all have touched on OSU technology and have connections to the university. Two, in particular, are in need of additional space, and if the university can meet that need, it will present an opportunity to anchor these companies in Corvallis and strengthen their connection with OSU. Sagers also stated that supporting these two growing business helps the university to further expand research space through use of the lease revenue.

Additionally, Azarenko reported that one challenge in renovating large buildings is the lack of surge space, which requires that the university identify alternate spaces to house individuals who are dislocated. Leasing research space may offer one option. Azarenko also noted that the university had contracted with a facility asset analysis consulting firm, Sightlines, as part of an effort to develop short- and long-term plans for space maximization.

In the discussion that followed, Ray noted the importance of balancing short-term investments to meet immediate research space needs with longer-term research enterprise plans. Reser also commended staff for their creative thinking in addressing this topic, which she noted was consistent with the Board’s core values.

6. Adjournment

With no further business proposed, Vice Chair Thorne adjourned the meeting at 2:26 p.m.

Respectfully submitted,

Jennifer M. Almquist
Assistant Board Secretary