ATHLETICS FINANCIAL SUSTAINABILITY PLAN

BACKGROUND

Intercollegiate athletics adds significant value to the overall student experience and culture of Oregon State University and meaningfully contributes to the university's engagement with alumni, donors and the broader community. National media attention showcasing the performance and contributions of Oregon State student athletes, both on the field of competition and in the community, positively advances public awareness of the university and its mission. The intercollegiate athletics program at Oregon State, however, has operated at a deficit for the last three fiscal years, and projections show that significant changes in the operating model are required to run a competitive and financially sustainable Pac-12 Conference athletics program.

The Interim Vice President for Finance and Administration and the Interim Provost convened a work group to review the current operations of Athletics and to make recommendations to President Ray on strategies to develop a sustainable operating model. The President received that report on December 15, 2016, and has endorsed the recommendations.

CONTEXT

Athletics has been a part of OSU for most of the university's history. An effective Division I athletics program must advance the mission of the university through the academic success of student athletes and engagement with the larger campus community, be financially sound and clearly accountable to the university, and reflect the values of the university.

Membership in the Pac-12 Conference enhances OSU's academic reputation (e.g., eight of the Pac-12 schools are members of the Association of American Universities, four are ranked in the top 20 universities in the world, and nine are ranked in the top 100 universities in the world), has a positive impact on recruiting undergraduates, and affords national visibility the institution would not otherwise have. Athletics provides opportunities for student athletes and other students (e.g., band members, trainers, student workers) to develop as individuals and also provides many students a common point of engagement outside of the classroom.

Athletics is also an important contributor to OSU's relationship with the City of Corvallis. Annual spending by visitors to Corvallis for athletics events has a large positive impact on the local economy, estimated at $31-36M.

There are some common misperceptions about athletics at OSU. Football, while the most expensive program to deliver, generated direct net revenues of over $15M in FY16, which helped support general athletics operations and the costs of other sports. The support provided by the university is for programs other than football and men's basketball. While the university does provide that support to Athletics, the university receives tuition and fee revenue for the more than 500 student athletes who would otherwise likely not be at OSU.

While maintaining participation in the Pac-12 does require some university funding, participation at other NCAA levels does not necessarily become less expensive. Division I schools outside the five largest conferences like Colorado State, University of California, Davis, and University of California, Santa Barbara spend significantly more institution funds on athletics than OSU does. Division II programs consistently spend 5-7% of institutional revenues on their athletic programs, while OSU spends about 1%. The larger institutional expenditures reflect the lack of

major revenue sources for athletics at that level.

OSU's level and types of spending for athletics are consistent with peers in the Pac-12 and nationwide; OSU's level of spending is in the lower third of the Pac-12. OSU is unusual in that total revenues declined somewhat from 2013 to 2015, and gifts as a proportion of operating revenues have declined in recent years. OSU's proportion of expenditures for coaches and staff is at the low end of peers but spending in "other expenses" is higher than the average for peers (this category of spending includes a variety of costs including depreciation, institutional assessments, medical costs, and other categories which can be treated differently at different institutions; details of OSU's expenditures in this area are in Table 9 later in the report). Ticket and gift revenues as a portion of total revenues are low at OSU compared to peers.

The operating deficit in Athletics came about for a variety of reasons including lower ticket sales (affected by later kickoff times, win-loss success, coaching changes); significantly reduced unrestricted gift revenues (linked to lower season ticket sales); and continued cost escalation to remain competitive in the market and the conference. The size of our stadium, our geographic location, and variation in attendance impact the revenue generated from ticket sales and related donations.

Projections show that significant changes in the operating model are required to run a competitive and financially sustainable Pac-12 athletics program.

PARTICIPATION AND PROCESS

The work group convened by the Interim Vice President for Finance and Administration and the Interim Provost was charged with reviewing the current operations of Athletics and making recommendations on action to develop a sustainable operating model. The group met six times in July through October and prepared a report summarizing their observations and recommendations that was delivered to President Ray in December.

Work group members were:

Ron Adams ..... Interim Provost and Executive Vice-President
Mike Green ..... Interim Vice President for Finance and Administration
Todd Stansbury ..... Vice President and Director of Intercollegiate Athletics (succeeded by Marianne Vydra, Interim Vice President and Director of Intercollegiate Athletics, for the last two meetings and subsequent discussions)
Mike Goodwin ..... Chief Executive Officer, OSU Foundation
Kate Halischak ..... Director, Student Athlete Academic Services, and President, Faculty Senate (for first two meetings Janine Trempy, Professor in Microbiology, represented the Faculty Senate)
Susie Brubaker-Cole ..... Vice Provost for Student Affairs
Rachel Grisham ..... President, Associated Students of Oregon State University
Jim Patterson ..... Senior Associate Director of Athletics Development, OSU Foundation
Joey Spatafora ..... Professor, Botany and Plant Pathology, and Faculty Athletics Representative

Staff supporting the work group were:

Sherm Bloomer ..... Director, Budget and Fiscal Planning
Jacque Bruns ..... Associate Athletic Director for Business Operations
Nicole Real..... Director of Capital Budgeting & Self-Support Fund Budget & Resource Planning
Kay White..... Special Assistant to the Division of Finance and Administration

The group convened for six meetings and spent those meetings discussing the recent history and trends in Athletics operations, the net cash flows between the Education & General (E&G) fund and Athletics budgets, operating forecasts for the next several years, comparisons to programs at peer institutions, strategies to develop a balanced operating budget and defray the accumulated negative working capital, and preparation of this report.

In November and early December, the draft report was discussed with the Faculty Senate Executive Committee, Provost's Council, Faculty Senate's Budget and Fiscal Planning Committee, the ASOSU Senate, the ASOSU House of Representatives, the University Budget Committee, and the Student Budget Advisory Council. The recommendations in the draft report were presented at the December 8 meeting of the Faculty Senate.

These discussions produced a variety of comments and concerns. There were concerns about the additional commitment of E&G funds to Athletics, but also a recognition in many of the conversations that athletics did have an important role at OSU. Several of the student representatives noted that Pac-12 athletics was an important part of the OSU experience for many students and is a factor in some students choosing to enroll here. Questions were raised as to whether the potential of unrestricted fundraising, business partnerships, and media revenue has been fully realized. Questions were asked about the appropriateness of the high salaries for coaches in some sports, the potential for dramatic cost escalations from legal or NCAA decisions, and the possibility of changing our athletic affiliation sometime in the future. In most of the discussions the value of athletics to the community and to student athletes was acknowledged as was the role of athletics in some students' decisions to attend OSU. The need for ongoing oversight and accountability was also raised. The comments and discussions helped clarify some of the points in the report, but the major recommendations in the final report did not change significantly.

RECOMMENDED ACTIONS

The most important outcome that guided the work group's recommended actions is to establish an operating budget for Athletics that allows for an appropriate mix of sports, that can be consistently balanced (excluding depreciation), and that is predictable from year to year. Membership in the Pac-12 is strategically important for OSU's academic goals, student experience goals, and goals for the success of student athletes.

Based on discussions in the work group, the following are the principal actions that will be implemented:

- Develop a balanced operating budget based on recurring, annual revenue streams that match the cost of fielding competitive sports programs, and allocate one-time or non-recurring revenues (e.g., Pac-12 equity, projects, one-time distributions, etc.) to a reserve and investment fund and to addressing the accrued deficit.
- Implement changes on a timeline such that the FY19 operating budget is balanced and the accrued negative net working capital does not exceed $46M.

- Assess the need to budget for cost increases mandated by external requirements, in particular costs of NCAA rules changes, regulatory compliance obligations and litigation decisions, or investments necessary to remain competitive including meals for athletes, full cost of attendance, and other pending issues.
- Implement changes in the sources of revenues and in overall expenditures to develop a recurring, balanced operating budget by FY19. These include:
    - Changes by Athletics (including $6.5M in new net revenues and expense reductions):
        - Effect operating efficiencies and cost reductions in Athletics to reduce projected expenditures by $1.1M by FY20 ($1.1M).
        - Fund construction of future new facilities by gifts or new incremental revenues dedicated to the project, rather than by university-paid debt
        - Complete renegotiation of local media rights with an increase in annual operating revenues (at least $3.0M).
        - Increase annual ticket revenues through revised pricing and sales strategies (at least $1.0M).
        - Identify and implement innovative business partnerships that result in incremental revenue to the department; this could also include strategic naming and licensing agreements. ($0.7M).
        - As debt service payments decrease beginning in FY18, redirect savings to operations ($1.78M)
        - Plan for increased assessments in support of university business operations, some facilities charges, and media contract obligations and for reduced charges for negative interest by restructuring negative working capital balance (net added cost of $0.69M in FY20).
        - Assume that there will be additional costs annually by FY20 to meet revised NCAA rules for support of student athletes (on the order of $0.40M annually).
    - Changes by University and Foundation ($5.33M annually):
        - Increase annual unrestricted giving through the existing Our Beaver Nation program and through programs focused on scholarships for student athletes to about $10.6M annually (at least $1.33M).
        - Increase institutional support in steps from the current $4M annually to about $8M annually by FY20. The specific amount will be structured to cover the debt service and utilities costs of Athletics facilities operations and will provide some access to Athletics facilities for E&G events, recreational sports, and other institutional events. The debt service portion will decline with time. The total commitment by FY20 would be about $8M annually. ($4M increment).

No change should be requested by the university in the current agreements on the student incidental fees that support Athletics and that provide free admission for students to all athletic events. Those fees are determined in discussion between ASOSU's Student Incidental Fee Committee and Athletics.

These changes, in combination, can reasonably yield positive operating balances in FY19 and FY20 with reasonable assumptions about inflation in current costs and other revenues.

While the projections for operating balances are conservative, the work group identified a strategy to address shortfalls in any of the revenue projections or significantly increased expenses that are outside the control of the program. The current facilities debt in Athletics could be restructured to a new 30-year loan, saving an additional $2.0M in debt service annually in FY20 over what the current debt schedules provide. This approach would cost an additional $28M in interest costs over the 30-year term but would provide significant short-term operating savings.

The work group has also considered strategies to defray the accrued negative net working capital balance. The budget projections are conservative, and the group recommends that any additional operating surplus be directed half to E&G operations to defray the accumulated operating deficit (up to $2.4M annually[1]) and the balance to Athletics operations to increase the competitive success of OSU's teams. The Vice President for Finance and Administration may also designate any one-time funds that come to Athletics (e.g., buy-outs from other institutions, unanticipated distributions from the Pac-12, etc.) to be used to defray the deficit.

NEXT STEPS

President Ray has charged the Interim Vice President of Finance and Administration with drafting a memorandum of understanding, based on the recommendations of the work group, between leadership of the University, Athletics, and the OSU Foundation. That memorandum of understanding defining the budget plans and various commitments and responsibilities will be in place before the end of the current academic year.

Progress towards the recommendations of the work group will be reviewed quarterly by the Vice President for Finance and Administration to confirm that changes are on track and to make any necessary adjustments in a timely manner.

[1] This assumes the accumulated deficit is about $44.7M at the end of FY19 and is managed as 30-year debt at 3.25% annual interest through the internal bank.