

MEMORANDUM

To: Board of Regents
From: Board Office
Subject: Tuition Replacement Appropriations Requests for FY 2005
Date: September 8, 2003

Recommended Action:

Approve FY 2005 tuition replacement appropriations request of \$23,838,452, with the understanding that the amount may be modified after the proposed sale of Academic Building Revenue Bonds in October 2003.

Executive Summary:

Tuition replacement appropriations represent an ongoing commitment of the state to meet the debt service cost of Academic Building Revenue Bonds. The issuance of these bonds, primarily for academic facilities at the Regent universities, requires approval of the General Assembly and Governor.

The Board is asked to approve a tuition replacement appropriations request of \$23,838,452 for FY 2005; this request includes the debt service costs for previously issued bonds, as well as the estimated debt service costs for Academic Building Revenue Bonds scheduled to be sold in October 2003 to refund the project notes issued in 2002 for the Engineering Teaching and Research Complex, Phase II project at Iowa State University.

Should the results of the October 2003 bond sale be significantly different than has been estimated, the Board Office requests that it be permitted to revise the appropriations request to reflect the changes resulting from the sale.

Background:

State Funding of Regent Capital Projects

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| 1969 Act – Academic Building Revenue Bonds | <p>The 1969 General Assembly passed legislation (<u>Iowa Code §262A</u>) permitting the issuance of Academic Building Revenue Bonds to fund capital projects at the Regent universities. This funding mechanism is unique among state entities. The <u>Code</u>:</p> <ul style="list-style-type: none">• Requires legislative and gubernatorial authorization prior to the issuance of the bonds;• Defines the types of buildings and facilities eligible for bonding (universities only); and• Requires the pledging of revenue from tuition and fees to pay the debt service on the Bonds. |
| Tuition Replacement Appropriation | <p>The tuition replacement appropriation from the State replaces the tuition and fee revenue that is pledged for the debt service on the Academic Building Revenue Bonds.</p> |
| Bonds Issued | <p>The first Academic Building Revenue Bonds were issued in 1970 and provided the primary source of funds for construction of academic facilities at the Regent universities until 1995.</p> <ul style="list-style-type: none">• From 1970 until 1995, 47 new (as opposed to refunding) Academic Building Revenue Bond issues totaling more than \$385 million were sold. <p>No new Academic Building Revenue Bonds have been issued since 1995.</p> |
| Capital Appropriations | <p>Beginning with FY 1996, capital appropriations became the source of funds for State-constructed academic facilities at the Regent institutions. From FY 1996 – FY 2001 funds were appropriated from the Rebuild Iowa Infrastructure Fund; most appropriations from FY 2002 forward have been from the Tobacco Settlement Trust Fund Restricted Capital Funds Account. (Funding by the State of Iowa for Regent capital projects is discussed in more detail in G.D.5d – FY 2005 Capital Requests.)</p> |
| 2002 General Assembly Action | <p>The Second Extraordinary Session of the 2002 General Assembly, which met in late May 2002, transferred \$7 million of the capital appropriation for the Engineering Teaching and Research, Phase II project at Iowa State University from the Rebuild Iowa Infrastructure Fund to the FY 2002 State General Fund.</p> <p>The legislation of the 2002 General Assembly also authorized the Board to issue Academic Building Revenue Bonds to complete the project and appropriated for FY 2004 the sum of \$7 million from the Rebuild Iowa Infrastructure Fund to repay the bonding.</p> |

- Interim Financing In July 2002, the Board issued \$7 million in project notes to provide interim financing for the project as permitted under Iowa Code.
- The notes, which have a maturity of 18 months, may be called for redemption on any date after August 1, 2003.
- 2003 General The FY 2004 appropriation of the 2002 General Assembly from the
Assembly Action Rebuild Iowa Infrastructure Fund to replace the interim financing was deappropriated by the 2003 General Assembly.
- October 2003 Sale Bonds thus need to be issued to replace the interim financing and a sale of new Academic Building Revenue Bonds is scheduled for October 2003 (see B.C. 4).

Funding of Tuition Replacement Appropriations

- Prior to FY 2002 Until FY 2002, tuition replacement appropriations were made from the State's General Fund.
- FY 2002 A portion of the FY 2002 tuition replacement requirement was appropriated from the tax-exempt bond proceeds of the Restricted Capital Funds Account of the Tobacco Settlement Trust Fund based upon a schedule established by the State's Tobacco Settlement Authority.
- The remainder of the FY 2002 appropriation was from the State's General Fund.
- FY 2003 The FY 2003 appropriation included funds from the tobacco tax-exempt bond proceeds and from funds that were to have been deposited into the Endowment for Iowa's Health Account of the Tobacco Settlement Trust Fund.
- FY 2004 The FY 2004 appropriations include funds from the tobacco tax-exempt bond proceeds, Rebuild Iowa Infrastructure Fund, and the State's General Fund.
- Board Request The Board has historically requested a dollar amount for tuition replacement and the specific fund sources for the appropriations have been determined during the legislative process.
- The General Assembly and the Governor have a historic record of supporting the Board's request for tuition replacement appropriations to meet the on-going debt service costs of Academic Building Revenue Bonds.
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Analysis:

Calculation of Need Calculation of the tuition replacement need begins with the scheduled debt service payments (principal and interest) for the upcoming fiscal year.

The total debt service payment is decreased by investment earnings on the reserve and sinking funds, arbitrage rebate, and any reduction in the reserve fund to arrive at the tuition replacement appropriations request.

Investment
Earnings

- The reserve funds, which currently total more than \$25 million, are invested in United States Treasury Notes. As the Notes mature and the reserve funds are reinvested at different interest rates, interest earnings will change. Lower interest earnings would increase the amount needed for the tuition replacement appropriation, absent any refundings.
- For example, \$25 million in reserve funds earning 7% annual interest will generate \$1,750,000 annually in investment earnings; if the rate is only 3%, \$750,000 in annual interest income would be generated.
- Under the bond covenants, one-half of the principal due on July 1st of each year is deposited into the sinking fund on the previous January 1st. Interest earned on the sinking fund also reduces the amount needed for the tuition replacement appropriation.

Arbitrage Rebate

- Calculations also include the estimated amount of arbitrage rebate due to the United States Internal Revenue Service. The arbitrage rebate calculations are provided by the Berens-Tate Consulting Group.
- Arbitrage is the difference between the rate at which the bond proceeds were borrowed and the rate at which the proceeds are invested.

Reserve Fund
Reduction

- Under the bond covenants, as bonds are retired and annual debt service payments decline, reserve funds can be freed up. These freed up reserve funds can then be used to pay a portion of the principal and interest payments, thereby reducing the net tuition replacement requirement.

When new bonds are sold for construction, the investment earnings on the bond proceeds also reduce the needed tuition replacement appropriations request.

The Board's financial advisor, Springsted, Inc., projects tuition replacement needs for each university based on known debt service obligations and the universities' estimates of investment earnings and the other factors, as listed above.

While annual debt service payments are known for the life of the bonds, absent any refundings, the annual tuition replacement appropriations request may require modification from estimates previously provided due to changing interest rates, as reserve funds are reinvested or refundings are accomplished.

Refundings

To minimize the impact of lower interest earnings and to minimize interest payments on outstanding debt, the Board has actively pursued the refunding of Academic Building Revenue bonds.

As detailed in this month's report on Savings from Bond Refundings (see B.C. 6), the present value savings of Academic Building Revenue Bond Refundings undertaken since 2001 total \$5.7 million.

The last maturity of the outstanding Academic Building Revenue Bonds is July 1, 2020. While there is an on-going obligation to make the debt service payments each year, the Board submits an annual tuition replacement appropriation request of the net amount needed for debt service costs in the upcoming fiscal year.

FY 2005 Request

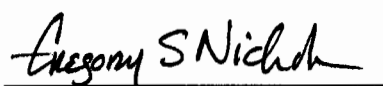
The FY 2005 tuition replacement appropriation request is \$23,838,452 which includes an estimate of the FY 2005 debt service payment for the Academic Building Revenue Bonds scheduled to be sold in October 2003.

This sale will be the first new issue (as opposed to a refunding issue) of Academic Building Revenue Bonds to be sold since 1995.

As the outstanding bonds mature, the amount needed for the tuition replacement appropriation will decline.

Since new bonds were not sold from 1995 until the proposed October 2003 sale, the amount needed for the tuition replacement appropriation has declined from a high of \$28.2 million in FY 2001 to the \$23.8 million requested for FY 2005. The amounts will continue to decline each year unless the General Assembly and Governor authorize additional issuances of Academic Building Revenue Bonds.


Joan Racki

Approved: 
Gregory S. Nichols