



Financial Policy

As Approved by the Board of Trustees

June 13, 2003

I. PREAMBLE

As Wright State University completes the fourth decade of its existence, the University has become a stable, highly regarded institution successfully accomplishing its missions of teaching, scholarship and service. The University now has greater authority and responsibility for managing its financial affairs, including capital spending and debt. State financial support is diminishing in importance, further increasing the University's financial independence and the need for prudent, enlightened financial management.

The Board of Trustees, after study and consultation with others, including Moody's Investors Service, has established the following policy and guidelines for the overall financial management and debt policy of the University. We are mindful of the fact that many financial matters have consequences of long duration, affecting the choices and strategies of the University for decades, long beyond our current vision. The financial policy and guidelines are tools to aid in financial decision making and establishing priorities. As such, they should be reviewed and updated periodically as fundamental credit factors and university needs change.

While the policy that follows is new in the sense that the university has not had a formal financial policy in the past, it does not call for a departure from recent practice. Instead, it simply makes that recent practice of maintaining positive operating margins, producing gradual growth in the university's reserves, a long term policy of the university.

II. POLICY

Wright State University is committed to serving a broad cross-section of the population, performing research that addresses societal needs, and engaging the community to improve the quality of life.

In order to accomplish its missions, now and in the future, Wright State University needs to be financially strong. Consistently positive operating margins and a steady accumulation of reserves will protect the university from the worst effects of state budget reductions and other unanticipated shocks. Strong finances will provide the university with gradually increasing investment income, the ability to make strategic investments, and access to capital markets at favorable interest rates. They provide the assurance that the University will be able to meet its future obligations not only to its bondholders, but also to its faculty, staff, and students. Wright State University's financial policy is designed to achieve these results by striking an appropriate balance between the current and future needs of the University.

The policy of Wright State University is to manage its financial affairs so as to maintain a minimum Moody's rating of A2. The minimum threshold of A2 was chosen because ratings inferior to A2 call for higher interest risk premiums and because comparable schools, with which we choose to be associated, are rated A1 and A2.

The financial strength and credit rating of the University are the result of the interplay among a number of factors. Some of these factors lie outside the scope of financial policy and are not addressed in this policy. Chief among the "non-financial" factors which influence our bond rating is enrollment, which in turn is determined by solid academic programs and services, competitive tuition levels, and effective admissions and marketing efforts. Similarly, the strength and durability of the University's research program and the institution's ability to attract and retain high quality faculty members is outside the scope of financial policy. The level and consistency of state support is also an important factor which influence judgments and financial policy.

Guidelines are intended to provide benchmarks to help achieve the overarching policy objective. The following guidelines attempt to frame fiscal policy issues as

they relate to the dichotomy between our relatively strong operating performance and our relatively weak¹ balance sheet. The objective of guidelines is to optimally manage our resources and deploy our cash reserves in the long-term interest of Wright State University and the community.

III. GUIDELINES²

- A. Operating Performance. Costs and revenues should be matched so that the average annual operating surplus runs between two to five percent of revenue. Consistency in generating a surplus is important and, while occasional downturns may occur, keeping any single year surplus above zero is highly desirable. It is especially important that the University avoid sliding into a situation in which ongoing annual expenses exceed ongoing annual revenues. This can result from reductions in state support, loss of enrollments, or similar factors. Such an imbalance would threaten the ability of the University to sustain current programs or to invest in needed improvements. The University must remain alert to threats to its revenue streams and make appropriate adjustments to avoid such disparities.
- B. Reserve Levels³. Current Wright State reserve levels (as defined by Moody's) of \$8,500/student are typical of Moody's A2 universities. Over time, Wright State University should raise its reserves per student to the midpoint between the medians for A1 and A2 institutions. Currently this midpoint would be about \$12,000/student. Over time,

¹ While our debt levels are quite low in 2003 and our reserve levels have been growing in recent years, we have much lower reserve levels and much smaller endowments than higher-rated universities, which are generally larger, older, and typically the "flagship" research institutions in their states.

² A more thorough discussion of considerations in the operating performance Guidelines including definitional issues and historical performance is included in Appendix A. Appendix B discusses the measures of operating performance that Ohio has used in its Senate Bill 6 analysis and provides historical data back to 1985 on Wright State University's performance.

³ Further discussion of Reserve Levels is provided in Appendix B and Appendix C.

this goal can be reached by maintaining positive operating margins, growing the Foundation's endowment, and avoiding spending down the reserves that are accumulated. By having reserve levels in excess of those typically held by other A2 rated universities, we will also have investment earnings in excess of those received by other A2 institutions that will be available to support the important work of the university. The availability of these funds becomes more important as the reliability of state support becomes more uncertain.

- C. Debt. Wright State University's direct and indirect debt (i.e., the amount attributed to the University as a result of its relationships with third parties) should not exceed the median debt capacity of a peer group of A2 and similar universities. In 2001, this figure was \$89 million.⁴

Appendix E calculates available debt capacity as of the spring of 2003.

This guideline limits our indebtedness to the median debt capacity of a peer group with similar bond ratings. It is deliberately conservative. By definition, fully half of this peer group has greater levels of debt. While the policy would permit substantial increases in our current debt levels, we must be careful not to exhaust the University's debt capacity in future years. Consequently, it is also our policy to be relatively aggressive in retiring the debt that we incur. An institution more comfortable with higher levels of debt might choose to extend the length of its debt so as to maximize amounts available for investment.

⁴ Since debt capacity is calculated using several ratios that consider not only the amount of outstanding debt, but also the size of the University's enrollments, reserves, and operating budget, it is likely that continued success in these measures would result in a further increase in our calculated debt capacity. See the discussion of Moody's calculation of debt capacity in Appendix D.

We will not do that, preferring instead to keep our outstanding indebtedness as low as possible.

D. Interest and debt service coverage. The University should not take on additional interest obligations unless it is achieving annual operating surpluses substantially in excess of those interest obligations. A minimum ratio of 2.5 : 1 (current annual operating margin to new annual interest obligation) should be maintained.⁵

E. Project Specific Financing. Debt incurred for certain projects will be retired from revenues generated by the project itself. Pro forma projections of the viability of such projects should be based on relatively conservative estimates, allowing for the possibility of modest declines in enrollment or other factors that drive the analysis.⁶

F. Fixed/Variable Interest Rates. Given the exceptionally low interest rates currently (March 2003) available in the market, there is little reason to consider alternatives to fixed rate debt. However, over the longer run, the university will want to have a debt portfolio that includes some amount of variable rate debt. Future revisions of the financial policy will include guidance on that topic.

G. Establishing Priorities. Projects that will consume any substantial fraction (\$5 million or more) of the University's debt capacity should be

⁵ Annual debt service as a fraction of our budget should be tracked against Moody's medians. (Moody's has calculated two measures: current year debt service and peak debt service as a fraction of current funds expenditures less scholarships and fellowships. The median for A2 institutions in 2001 was 3.4% for the first measure and 4.1% for the second. In contrast, because of our very low debt levels, our ratios were each about 1.0%)

⁶ This does not mean that the university may not take on debt to finance projects that do not generate their own revenue streams or do not generate sufficient revenues to retire the debt incurred to finance them. It simply means that the projections used to determine the financial viability of projects should be reasonably conservative.

assessed against the following standards, which are listed in priority order:

- Relationship to the University's Strategic Plan
- Required to maintain the condition of the campus and its facilities
- Relationship to increased enrollment
- Revenue generating capacity of the project. Projects that generate revenue create some debt capacity to help offset the capacity being used.
- Relationship to university research priorities

Special caution must be exercised with respect to projects that increase the university's building inventory and, consequently, its operating costs and future capital requirements, without generating a commensurate increase in operating revenues. This does not mean such projects should not be undertaken. It means that they should not be undertaken without a full appreciation for the costs that will be incurred as a result of the project and a conclusion that the benefits of the project outweigh those costs.

IV. MONITORING ADHERENCE TO THE POLICY.

At least annually, the Vice President for Business and Fiscal Affairs shall report to the Finance and Audit Committee of the Board of Trustees on the financial health of the University and its compliance with the guidelines established here. The focus of the report shall be the long-term trends governing the financial health of the University. The Board of Trustees recognizes that in any given year,

results may deviate from the norms established in this policy. Such deviations need to be understood within a longer-term context. Are they the result of institutional decisions or other factors specific to a given period that do not suggest an imbalance in ongoing revenues and expenses? Or do they represent a more permanent deflection from the long-term results that this policy calls for? The latter possibility would be of much greater concern than the former; it would require immediate action by the University to restore the balance in the operating budget that would be necessary to put it back on the path toward favorable annual operating results and the gradual accumulation of reserves.

V. FUTURE CHANGES TO THIS POLICY

This policy provides a series of guidelines directing the financial performance of the University. It is possible that in the future, the University may wish to consider decisions that would clearly violate these guidelines (e.g., by incurring debt beyond the median experience of a peer group or by deliberately spending down accumulated reserves.) It is not the purpose of this policy to forever foreclose such options. However, this policy would require that such decisions not be made until this policy is reviewed and amended to permit it. This should ensure that any such decision be considered not only from a programmatic perspective, but also from the perspective of the long term financial health of the University.

Even in the absence of pending decisions that would violate these guidelines, the Board of Trustees will want to consider possible changes to this policy from time to time. These changes might deal with issues that are not now addressed (such as guidelines for the use of variable rate debt or other financial mechanisms) or modify guidelines to reflect changes in the University's situation or in the broader financial environment. Recommended changes to the policy could be included in the Vice President's annual report.

Appendix A

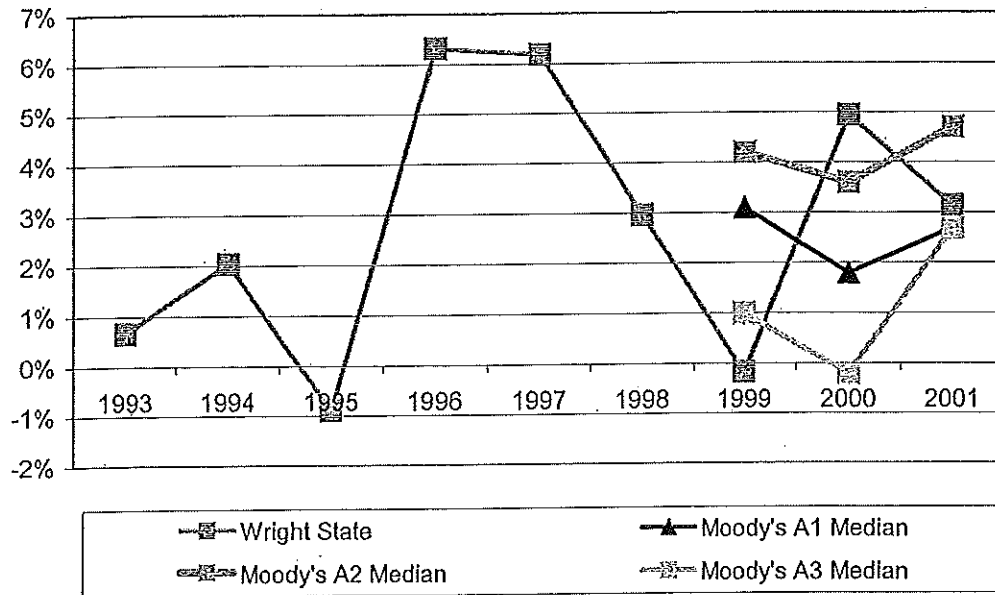
Operating Performance Guideline Discussion

Through 2001, Moody's has tracked operating performance through a ratio whose numerator was annual change in Current Funds fund balances, adjusted for non-mandatory transfers and other changes. The denominator was annual Current Funds revenues less Scholarships and Fellowships. With the implementation of new accounting standards in 2002, Moody's has refined how it will calculate ratios from financial statements prepared according to the new standards. We plan to track our annual operating performance using the measure that Moody's has developed, so that we can compare our performance to those of Moody's medians. The modified calculation determines operating revenues by taking operating revenues per the financial statements and adding to it state appropriations, gifts, and an assumed level of investment income (4.5% of the prior year cash and investment balance) and then subtracting from that amount scholarship and fellowship expense as reported on the financial statements. Operating expenses are defined as operating expenses per the financial statements, excluding scholarship and fellowship expense, and adding interest expense. The difference between these two calculated amounts is the operating margin.

The chart below displays the University's recent performance on this Moody's operating margin ratio⁷. It also displays for the three most recent years the median performance of A1, A2, and A3 rated public universities.

⁷There are some ambiguities in Moody's description of the calculation of this measure. We have chosen an option that most nearly replicates Moody's calculation of our operating margin in recent years.

**Wright State University Operating Margins as Fraction of Current
Fund Revenues Net of Scholarships and Fellowships**



Our recent operating performance has been strong, except for 1999. Interestingly, of the three medians reported here, the best performing is the A2 group. Institutions that are rated A1 or better receive that rating primarily because of their accumulated reserves. As in the old commercial, the A2 group is number two and must try harder.

Appendix B

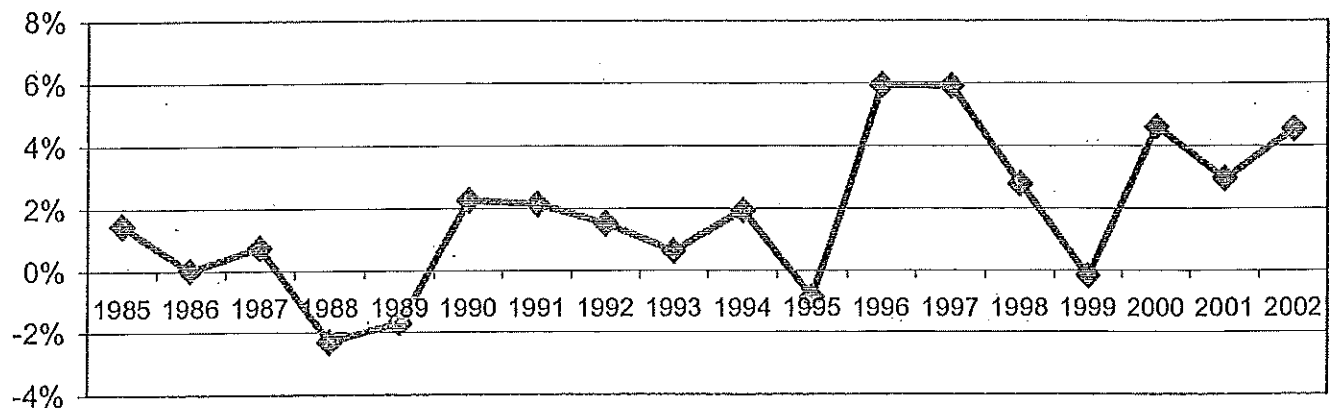
Ohio's Senate Bill 6 Ratios

In 1997, the Ohio General Assembly enacted Senate Bill 6, which mandated the creation of a set of objective standards for judging the financial health of public universities and colleges. A committee chaired by the Office of Budget and Management and including representatives of the Auditor of State, the Ohio Board of Regents, and several campuses, developed a system based on three key ratios. One of those ratios, the Net Income ratio, was a measure of annual operating performance.

The Net Income ratio was calculated by subtracting Current Funds expenditures and mandatory transfers (i.e., debt service payments) from total Current Funds revenues and dividing that result by total Current Funds revenues. Effective for the year ended June 30, 2002, higher education financial accounting statements no longer present information on a funds basis. Consequently, for 2002 and later years, the Net Income ratio will be calculated as the change in net assets divided by total revenues. Since this change in net assets may be the result of increased capital investment financed by state appropriations as well as favorable operating results, the ratio is no longer a true measure of operating performance.

The chart below depicts Wright State University's Net Income ratio since 1985:

WSU Net Income Ratio: 1985 - 2002

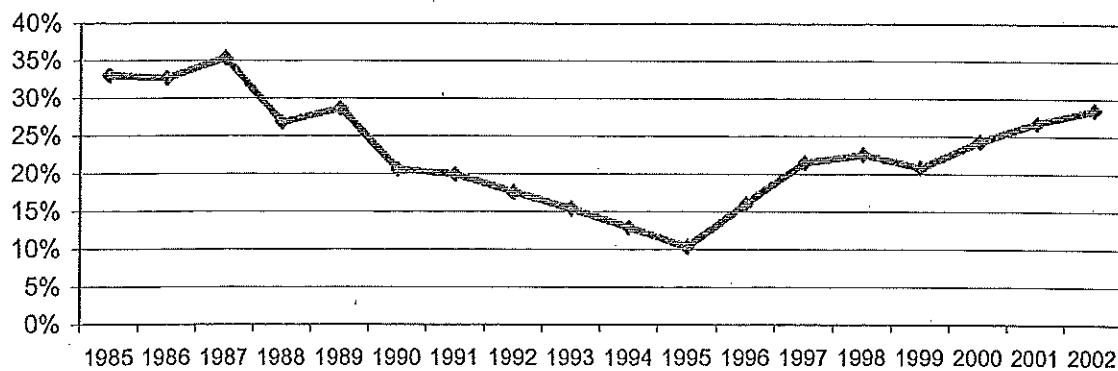


It is clear from this chart that our operating performance has been much stronger since 1995 than it had been earlier. Since 1995, the only year with poor results was 1999 and that was due to the one-time costs associated with an early retirement program.

Senate Bill 6 uses two different measures of the adequacy of reserves.

The Primary Reserve ratio divides a broad measure of expendable resources by total current funds expenditures and mandatory transfers. The ratio describes the fraction of a year's spending that a university has in reserve. Since the measure of reserves is a measure of expendable resources, it does not include endowments or physical plant assets. It does include Current Funds fund balances, quasi-endowments, and several categories of cash assets held in plant funds. The Senate Bill 6 system encourages campuses to have a ratio of at least ten percent. The following chart displays our performance on this measure since 1985.

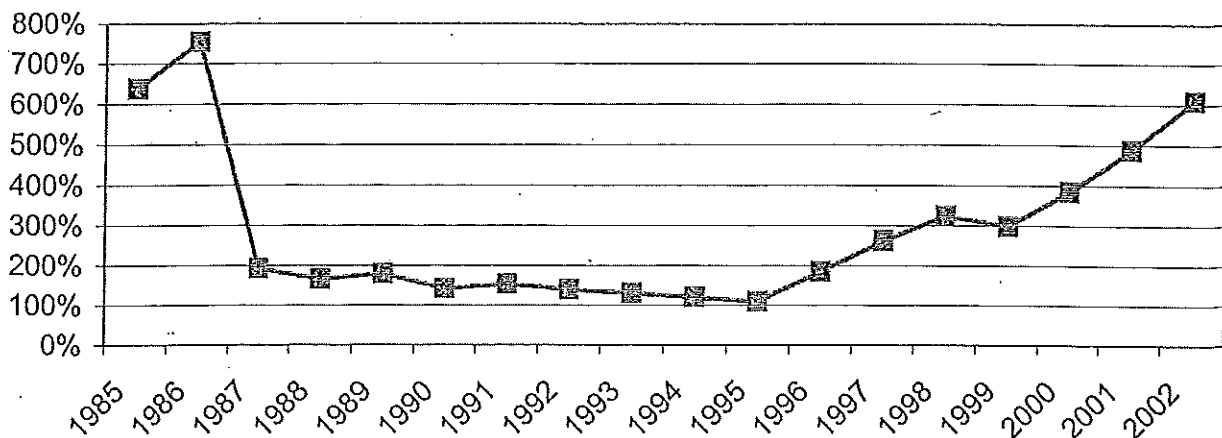
WSU Primary Reserve Ratio 1985 - 2002



Note that the University experienced a steady erosion of reserves through about FY 1995. Since then, we have enjoyed a steady recovery, but our expendable reserves as a fraction of our annual budget are still below those of the mid-1980's.

A second measure of the adequacy of our reserves is the Viability ratio. This measure divides expendable resources by outstanding plant debt. The state encourages campuses to have reserves equal to at least 60% of outstanding debt. Because of its traditionally low levels of indebtedness, Wright State University has been well above this standard, as the chart below describes.

WSU Viability Ratio: 1985 - 2002



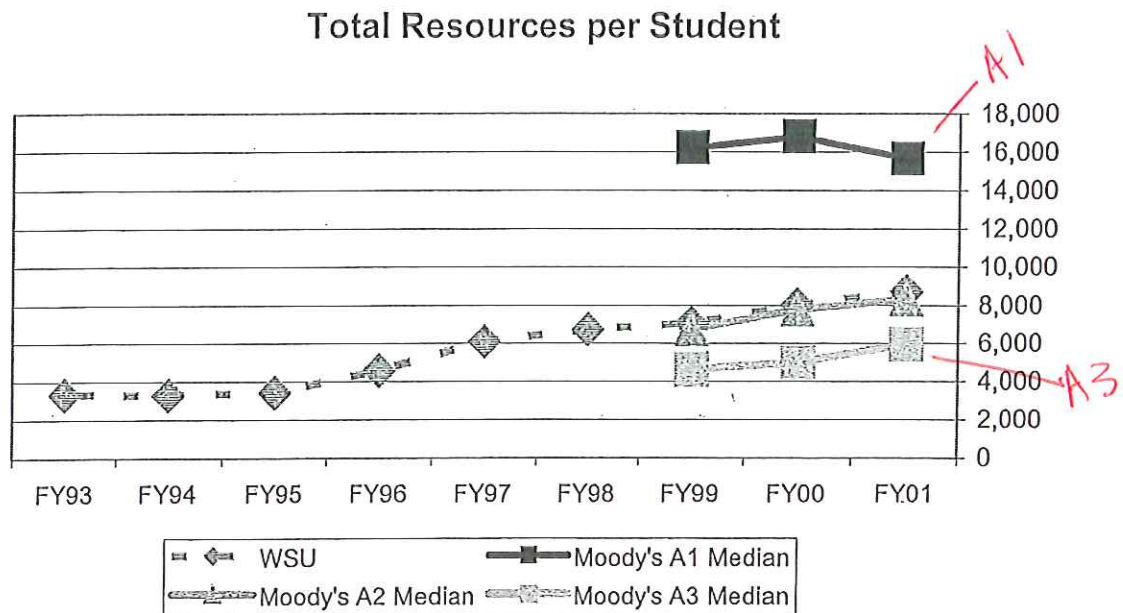
Even with the decline in its reserves in the late 1980's and early 1990's, Wright State University has remained comfortably above the desired level of 60 percent. As reserves have grown again and some debt has been retired, we have reached a ratio ten times the desired level. However, this is an especially volatile ratio. We should not be surprised to see it drop dramatically in the future, since even modest amounts of additional debt will substantially change the denominator. But even a dramatic drop could keep us well above the levels expected by the state or experienced by most of our peers.

Appendix C

Reserve Level Guideline Discussion

Moody's uses two ratios to measure reserve levels, one that compares reserves to the size of the institution (measured in student FTE's) and one that compares them to the amount of debt. Their measure of reserves includes endowments, including those held by affiliated foundations, as well as the expendable reserves that have historically been shown as fund balances in the current funds and certain plant funds.

The first ratio divides resources by FTE enrollments, as shown below.



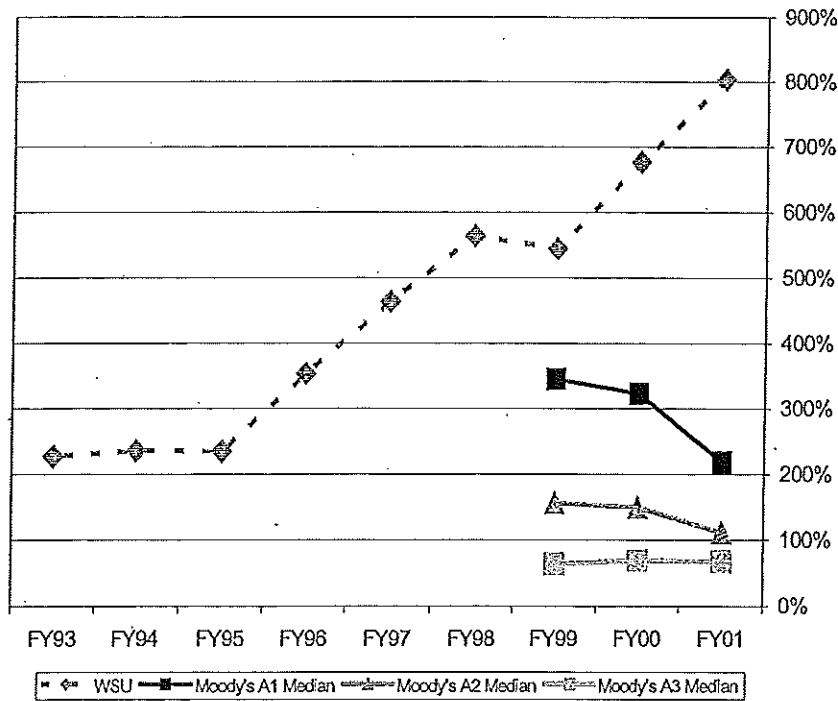
We can see that our performance in recent years has tracked the median performance of the A2 institutions. We are substantially below the A1 medians. Hence the goal to gradually move to a midpoint between the two.

The other Moody's ratio is a Resources to Debt ratio. Moody's measure of resources is the same as in the previous ratio – a broad measure that includes endowments.

The denominator is outstanding debt. The combined effect of growing reserves and reduced debt paints a very positive picture.

Appendix B presents the measures Ohio uses to gauge adequacy of reserve levels.

Total Resources to Debt Ratio



Appendix D

Moody's Calculation of Debt Capacity

This policy requires that the University keep its debt below the median for peer institutions as calculated by Moody's Investor Services. The purpose of this Appendix is to describe Moody's methodology for calculating that median.

Moody's Four Calculations

Moody's uses four calculations to determine debt capacity. The first is straightforward. It is simply the amount of debt outstanding at peer institutions. The median indebtedness of 30 peer institutions as of June 30, 2001 was \$88.8 million. This was one of the four numbers that Moody's used to calculate our capacity. Over time, this number will change, as our peer institutions issue new debt and retire existing debt.

The other three calculations used to determine our debt capacity are ratios. They introduce a more dynamic element into the calculation.

The first ratio is Median Debt per Student. Our peers had a median debt per student of \$6,200. Based on our Fall 2001 full time equivalent (FTE) enrollment, this would translate into a debt capacity of \$78.3 million for us. However, this calculation would not only be affected by changes in debt levels and enrollments at our peer institutions. It would also be affected by changes in our enrollment. Our enrollment increases of the past two years would increase our debt capacity as measured by this calculation. Similarly, future declines in our enrollment – if they occurred - would reduce our debt capacity as estimated by this calculation.

The second ratio is Total Resources to Debt. Total Resources, in Moody's calculation, include a broad measure of net assets, both restricted and unrestricted, expendable and nonexpendable (i.e., endowments – including those held by the Foundation), but excluding the depreciated value of capital assets. The median ratio for peer institutions was 1.19:1. That ratio, applied to our Total Resources as of June 30, 2001, produces a debt capacity calculation of \$89.3 million. If we increase our Total Resources over time, as required by this financial policy, through good operating results and from increases in our endowments, our debt capacity as measured by this calculation will also increase.

The third ratio that Moody's uses is Median Peak Debt Service to Operations. The median for our peers in 2001 was 3.7%. Moody's calculates that if our highest projected debt service was 3.7% of our operating budget, we would have a debt capacity of \$101.0 million. Moody's calculated this by dividing 3.7% of our operating budget, or \$8 million, by a capitalization rate of 8%. This particular calculation of debt capacity will grow as our budget grows. In particular, it would increase substantially if we were to acquire the university housing that is now held and managed privately. Such a change would create an immediate increase in our operating budget, since the room charges and associated expenses for these facilities would begin to flow through our accounts.

In summary, Moody's has used a sophisticated approach to measure our debt capacity. Their calculation is dynamic. It will change over time, reflecting changes here and in our peer group with respect to

enrollments, resources, and operating budgets as well as outstanding debt. As of 2001, Moody's four calculations of our debt capacity ranged from \$78.3 to \$101 million. The average of the four calculations was \$89.3 million, compared to an actual debt outstanding of \$13.2 million. Our unused debt capacity as of 2001 thus ranged from \$65.1 to \$87.8 million. If we use the average calculation, our unused capacity was \$76.1 million.

Indirect Debt

Moody's believes that certain relationships with private entities, for student housing or other purposes, may consume institutional debt capacity even if they are not direct obligations of the university or are "off balance sheet". In their analysis of our financial health and debt capacity in 2002, Moody's estimated the current depreciated value of the AM properties at \$50 million, with \$12 million of that value attributed to the Woods. Since it appears that our obligations to AM pursuant to our general agreement are contingent (triggered only if we decide to change our current exclusive relationship with AM with respect to additional housing) and even in that event only applicable to the Woods housing, Moody's decided to attribute \$12 million in indirect debt to that relationship. Had they concluded that we had a financial obligation with respect to all of AM's housing, the figure might have been as high as \$50 million.

Appendix E

Calculation of Available Debt Capacity

	<u>\$ In Millions</u>
Total Debt Capacity as of 2001	\$89.0
Current debt (bonds and capital leases)	(18.2)
Provision for indirect debt and future student housing	<u>(25.0)</u>
Available debt capacity	\$45.8

Appendix F:

Testing the Reasonableness of Our Financial Goals

Operating Revenues as Defined by
Moody's, FY 2002

As per financials	\$145,800,000
State appropriations	93,800,000
Gifts	4,300,000
Investment Income	3,800,000
Other	<u>(10,200,000)</u>
Total	\$237,500,000

05/15/03

Additional Resources Required to Reach \$12,000 per FTE

	FTE Enrollment	Resources	Resources/ FTE	Increase in Resources Required
2001 (per Moody's)	12,621	\$106,297,000	\$8,422	
Goal, assuming 1% annual increase in enrollment				
2013	13,941	\$167,297,230	\$12,000	\$61,000,230
Goal, assuming 2% annual increase in enrollment				
2013	15,385	\$184,619,143	\$12,000	\$78,322,143

15-Mar-03

Projections of Operating Revenues and Surplus in 2002 Dollars
2003 to 2013

Assuming Average Enrollment Growth of 1% or 2%
Assuming Average Operating Surplus of 3% or 4% of Operating Revenues

	Revenue/Enrollment Growth Rate of One Percent				Revenue/Enrollment Growth Rate of Two Percent		
	Operating Revenues	Operating Surplus @ 3%	Operating Surplus @ 4%		Operating Revenues	Operating Surplus @ 3%	Operating Surplus @ 4%
2002	\$237,500,000				\$237,500,000		
2003	239,875,000	\$7,196,250	\$9,595,000		242,250,000	\$7,267,500	\$9,690,000
2004	242,273,750	7,268,213	9,690,950		247,095,000	7,412,850	9,883,800
2005	244,696,488	7,340,895	9,787,860		252,036,900	7,561,107	10,081,476
2006	247,143,452	7,414,304	9,885,738		257,077,638	7,712,329	10,283,106
2007	249,614,887	7,488,447	9,984,595		262,219,191	7,866,576	10,488,768
2008	252,111,036	7,563,331	10,084,441		267,463,575	8,023,907	10,698,543
2009	254,632,146	7,638,964	10,185,286		272,812,846	8,184,385	10,912,5
2010	257,178,468	7,715,354	10,287,139		278,269,103	8,348,073	11,130,764
2011	259,750,252	7,792,508	10,390,010		283,834,485	8,515,035	11,353,379
2012	262,347,755	7,870,433	10,493,910		289,511,175	8,685,335	11,580,447
2013	264,971,232	<u>7,949,137</u>	<u>10,598,849</u>		295,301,398	<u>8,859,042</u>	<u>11,812,056</u>
Totals		\$83,237,834	\$110,983,779			\$88,436,139	\$117,914,852

Increased Resources
Goal

\$61,000,000

\$61,000,000

\$78,000,000

\$78,000,000

Percent of Surplus
Required to be
Retained to Achieve
Goal

73.3%

55.0%

69.0%

51.7%

Percent of Surplus
Required to be
Retained to Achieve
Goal if Endowments
Also Grow by \$2 Million

46.9%

35.1%

63.3%

47.5%

WSU Net Income Ratio: 1985-2002

