



MONTANA UNIVERSITY SYSTEM
Office of the Commissioner of Higher Education

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TO: BOARD OF REGENTS
FROM: LAURIE NEILS
DATE: JUNE 28, 2002
RE: REPORT ON AUXILIARY ENTERPRISES AND BONDED
INDEBTEDNESS

Auxiliary enterprises are a significant component of the Montana University System. For fiscal year 2001, total expenditures for auxiliary operations were over \$66 million; over 11% of the total budget. Most of the auxiliary revenues are pledged to service campus bond indentures. In order to help you better understand what goes on within the category called "auxiliary enterprises" and how those auxiliaries are connected to our bonded indebtedness, we have provided the attached report.

Rosi Keller of The University of Montana and Tom Gibson of Montana State University have worked diligently with me to make this report informational, understandable, and accurate. Campus fiscal officers will be in Glendive to answer any specific questions you may have. If you have comments or questions you would like answered prior to the meeting, please do not hesitate in calling me.

MONTANA UNIVERSITY SYSTEM AUXILIARY ENTERPRISES

The College and University Business Administration definition of auxiliary enterprises is:

An auxiliary enterprise furnishes a service directly or indirectly to students, faculty, or staff, and charges a fee related to, but not necessarily equal to, the cost of services. Traditionally, these services have encompassed food services, student housing, and college stores. On many campuses, services have expanded to include faculty dining, confectionery shops, ice cream parlors, vending machines, day-care centers, bus service, skating rinks, guest houses, athletic concessions, golf course, ski lodges, bicycle shops, and others.

The distinguishing characteristic of most auxiliary enterprises is that they are managed essentially as self-supporting activities, although sometimes a portion of student fees or other support is allocated to assist these activities.

The Montana University System campuses engage in many of the typical services that are classified as auxiliary enterprises. There is only one auxiliary operation that is common to all of our campuses, dining services. All of our campuses have bookstores, but the bookstores at The UM Missoula (main campus) and MSU Bozeman are operated by separate non-profit corporations. The Great Falls and Helena Colleges of Technology do not own residence halls. The University of Montana Missoula has the only campus golf course.

The MUS auxiliary enterprise operations are self-supporting. In fact, the cumulative total fund balance for the eight educational units at FYE 2001 was over \$15 million. Although there were four auxiliary accounts on the negative fund balance report, their total deficit was \$233,722, or 1.5% of the fund balance. At each university and certainly as a system, the auxiliary enterprise is covering its operating costs and debt service requirements.

The University of Montana and Montana State University have provided schedules that summarize their auxiliary enterprise revenues and expenses for fiscal year 2001. Because the MUS auxiliary operations are closely linked to our bonded indebtedness, we have shown the pledged and non-pledged auxiliary revenues. From these schedules you will be able to determine, by campus:

- Which of our major auxiliary activities were self supporting in FY2001;
- Which of our major auxiliary operations are pledged to bond indentures;
- What are the non-auxiliary sources of pledged revenue;

The bond indentures for Montana State University and The University of Montana are structured differently. The University of Montana master indenture is cross-pledged across all campuses. The University of Montana structured their debt in this way in order to provide the maximum benefit to their smaller campuses. The debt service subsidization that the Missoula campus absorbs was a decision that was analyzed and planned for. Montana State University also has a legally cross-pledged master bond indenture, but each campus is responsible for their campus debt service. Montana State University intentionally structured their debt in this way in order to allow each campus the maximum flexibility in enterprise financial and program management, while providing an instrument to ensure a strong consolidated earnings ratio for the bond insurer and rating agencies.

You will notice that Montana State University and The University of Montana significantly differ in the amount and extent of bonded auxiliary activity. The University of Montana has pledged 17 of 19 auxiliary funds for total pledged auxiliary revenue in FY01 of over \$34.7 million. Montana State University has pledged 5 of 18 auxiliary funds for total pledged auxiliary revenue of \$25.5 million.

Master bond indentures require a prioritization of the application of pledged revenues. This means that after the operating costs have been paid (net revenues) the annual debt service and debt service reserves must be paid and required deposits to the repair and replacement reserves and deposits to arbitrage rebate funds made. Other legal requirements include reserves for operation and maintenance of facilities, redemption of outstanding debt, and other renovations, expansions, and capital repair of facilities. What remains, if any, is available for "other lawful purpose" (OLP) and may be spent "as the Board of Regents or University directs." The amount of OLP that has been declared by the universities differs significantly. These differences are, to a certain extent, a product of differing bond structures and philosophies. The University of Montana has not exercised the use of OLP in recent years. The UM's net revenues remain and are spent within the pledged activity. Montana State University has utilized OLP in recent years and has provided you their rationale for spending these dollars.

Each university has provided a summary of their auxiliary operations and debt service management philosophy. As an appendix to this report, we have provided pages from the campus bond audits. This will allow you to tie the summary dollars that are reported in this auxiliary report to audited schedules in the bond audit reports.

The University of Montana
Schedule I - Pledged Revenues
Fiscal Year 2001

<u>Auxiliary Revenues</u>	Missoula	Butte	Dillon	Helena	TOTAL
Bookstore	\$399,511	\$1,009,680	\$575,376	\$324,038	\$2,308,605
Residence Life	8,852,950	675,650	973,304		10,501,904
Dining Services	6,764,307	778,550	1,099,092	87,783	8,729,732
Health Services	3,634,825				3,634,825
Parking	1,100,760	74,335	32,103		1,207,198
Student Unions	2,244,737	209,967	92,241		2,546,945
Campus Recreation	1,138,314		45,133		1,183,447
Public Events Center(s)	1,134,027		149,076		1,283,103
Rental Facilities	1,471,933				1,471,933
Printing Services	1,681,985				1,681,985
Miscellaneous	187,422	27,253			214,675
Total Revenue	\$28,610,771	\$2,775,435	\$2,966,325	\$411,821	\$34,764,352
<u>Auxiliary Expenditures</u>					
Bookstore	\$385,124	\$984,983	\$569,052	\$295,358	\$2,234,517
Residence Life	5,491,068	586,743	736,618		6,814,429
Dining Services	6,001,535	763,043	1,113,792	106,137	7,984,507
Health Services	3,095,747				3,095,747
Parking	753,077	54,303	21,146		828,526
Student Unions	1,814,358	299,672	98,685		2,212,715
Campus Recreation	1,055,284		233,877		1,289,161
Public Events Center(s)	754,504		167,262		921,766
Rental Facilities	868,978				868,978
Printing Services	1,383,742				1,383,742
Miscellaneous	211,627	28,704			240,331
Total Expenditures	\$21,815,044	\$2,717,448	\$2,940,432	\$401,495	\$27,874,419
Net Auxiliary Revenues	\$6,795,727	\$57,987	\$25,893	\$10,326	\$6,889,933

The University of Montana
Schedule I - Pledged Revenues (continued)
Fiscal Year 2001

<u>Other Pledged Revenues</u>	Missoula	Butte	Dillon	Helena	TOTAL
Investment Income	\$1,323,671	\$25,691	\$20,269	\$365	\$1,369,996
Student Facilities Fees	2,076,624	360,408	222,519	155,595	2,815,146
Events Revenue ⁽¹⁾	2,397,186				2,397,186
Continuing Education	1,755,160				1,755,160
Land Grant/Debt Service	190,603	703,824	278,221		1,172,648
Other Pledged Revenues	\$7,743,244	\$1,089,923	\$521,009	\$155,960	\$9,510,136
PLEDGED REVENUES - All Campuses AVAILABLE FOR DEBT SERVICE	\$14,538,971	\$1,147,910	\$546,902	\$166,286	\$16,400,069
Scheduled Annual Debt Service					\$8,338,609

⁽¹⁾ Revenues derived from UM sponsored ticket sales for athletics and the University Center

The University of Montana
Schedule II - Auxiliary Activities - Non-Pledged Revenues
Fiscal Year 2001

<u>Auxiliary Revenues</u>	Missoula	Butte	Dillon	Helena	TOTAL
Prescription Pharmacy	\$179,891				\$179,891
Health Services		55,383	55,093		110,476
Total Revenue	\$179,891	\$55,383	\$55,093	\$0	\$290,367
 <u>Auxiliary Expenditures</u>					
Prescription Pharmacy	\$196,070				\$196,070
Health Services		88,993	60,070		149,063
Total Expenditures	\$196,070	\$88,993	\$60,070	\$0	\$345,133
NON-PLEDGED NET REVENUES - All Campuses	-\$16,179 *	-\$33,610 *	-\$4,977	\$0	-\$54,766

* Fund balance in this account was positive at both the beginning and end of the fiscal year.

Montana State University
Schedule I - Pledged Revenues & Fees
Fiscal Year 2001

<u>Auxiliary Revenues</u>	Bozeman	Billings	Havre	Great Falls	TOTAL
Bookstore		\$2,797,865	\$801,090		\$3,598,955
Residence Life & Family/Graduate Hsng *	9,407,779	2,496,832	403,558		12,308,169
Dining Services - Pledged	7,253,884		490,275		7,744,159
Parking	Unpledged	314,624			314,624
Student Unions & Conference Services			19,137		19,137
Rentals		324,990			324,990
Total Revenue	\$16,661,663	\$5,934,311	\$1,714,060	\$0	\$24,310,034
<u>Auxiliary Expenditures</u>					
Bookstore		\$2,693,044	\$664,455		\$3,357,499
Residence Life & Family/Graduate Hsng	5,362,181	2,761,258	533,769		8,657,208
Dining Services - Pledged	5,281,095		518,800		5,799,895
Parking	Unpledged	275,674			275,675
Student Union & Conference Services			171,605		171,605
Rentals		269,625			269,625
Total Expenditures	\$10,643,276	\$5,999,601	\$1,888,629	\$0	\$18,531,506
Net Auxiliary Revenues	\$6,018,387	-\$65,290	-\$174,569	\$0	\$5,778,528
<u>Other Pledged Revenues</u>					
Investment Income - all Funds	\$1,423,238	\$239,628	\$27,957	\$23,218	\$1,714,041
Student Facilities & IT Fees	2,272,378	1,429,796	512,784	51,889	4,266,846
Pledged Parking Revenues	1,137,196				1,137,196
Museum Lease Income	300,000				300,000
Sports, Events Revenue & Athletic Fees	1,298,100				1,298,100
Land Grant/Debt Service	1,182,293	273,663			1,455,956
Other Pledged Revenues	\$7,613,204	\$1,943,087	\$540,741	\$75,106	\$10,172,139
Less Audit & Trustee Fees	-74,200		-9,748		-83,948

Montana State University

Schedule I - Pledged Revenues & Fees (continued)

Fiscal Year 2001

PLEGGED REVENUES - All Campuses

AVAILABLE FOR DEBT SERVICE

Less University G&A Recharges

Unrealized Gain on Investments

Total Net Pledged Revenues

	Bozeman	Billings	Havre	Great Falls	TOTAL
	\$13,557,391	\$1,877,797	\$356,424	\$75,106	\$15,866,719
	-\$1,189,365	\$0	\$0	\$0	-\$1,189,365
	44,359	9,965	1,991	0	56,315
	\$12,412,385	\$1,887,762	\$358,415	\$75,106	\$14,733,669

Scheduled Annual Debt Service

\$6,587,296 \$1,433,990 \$321,903 \$37,235 \$8,380,424

***NOTE:** Includes \$31,414 HUD subsidy

Montana State University

Schedule II - Auxiliary Activities - Non-pledged

Fiscal Year 2001

<u>Auxiliary Revenues</u>	Bozeman	Billings	Havre	Great Falls	TOTAL
Bookstore		Pledged	Pledged	\$616,710	\$616,710
Dining Services	2,832,195	61,467	Pledged	59,889	2,953,551
Parking	912,343	Pledged	48,277		960,620
Health Services	2,958,675	347,932	51,734		3,358,341
Student Unions & Conference Services	1,419,316	Pledged	Pledged		1,419,316
Campus Recreation & Sports Complex	277,282	19,218	12,460		308,960
Day Care Center		38,344			38,344
University Card Operations	Pledged	44,127	Pledged		44,127
Miscellaneous - rentals		37,687			37,687
Total Revenue	\$8,399,811	\$548,775	\$112,471	\$676,599	\$9,737,656
<u>Auxiliary Expenditures</u>					
Bookstore		Pledged	Pledged	\$643,434	\$643,434
Dining Services	2,721,173	28,764	Pledged	91,018	2,840,955
Parking	779,353	Pledged	18,834		798,187
Health Services	2,964,320	353,248	46,755		3,364,323
Student Unions & Conference Services	1,348,838	Pledged	Pledged		1,348,838
Campus Recreation & Sports Complex	266,999	8,022	122,248		397,269
Day Care Center					0
University Card Operations	Pledged	31,925	Pledged		31,925
Miscellaneous - rentals		7,282			7,282
Total Expenditures	\$8,080,683	\$429,241	\$187,837	\$734,452	\$9,432,213
Other Non-pledged Fees			\$114,627		114,627
Net Non-pledged Auxiliary Revenues	\$319,128	\$119,534	\$39,261	-\$57,853	\$420,070

NOTE: MSU Bozeman Parking revenues are also shown in Schedule I since they are Pledged to the Indenture. The revenues shown in this schedule are net of the monies retained in the Indenture for annual debt service.

The University of Montana

In November of 1993, The University of Montana entered into an indenture for the issuance of revenue bonds. The purpose of the Series A1993 bonds was to defease previous outstanding, high interest bonds and to provide capital for the construction/renovation of facilities at the Missoula and Dillon campuses. This original series would serve as the Master Indenture under which five subsequent series (B through F) were issued to provide the resources for renovations/construction projects on all four campuses of The University of Montana. Recognizing that for our campuses to be positioned for the future, these improvements would be essential.

The indenture is designed to commit pledged revenues from each campus to the total debt of all four campuses, commonly referred to as cross-pledging. Absent this approach, the ability for the smaller campuses to cost-effectively issue debt, if at all, becomes limited.

Although cross-pledged, the intent is that each campus will be self-supporting of their independent campus debt load. However, it is acknowledged that it might be difficult for the smaller campuses, at least initially, to accomplish this. A multi-campus Debt Management Team monitors debt activity and makes recommendations for operational changes to enhance net revenues. Currently, the Butte and Dillon campuses require some subsidization of their bonded indebtedness.

The Master Indenture identifies the following prioritization for the application of NET revenues (revenue less operating costs):

- Deposit, to the Debt Service Fund, the annual debt service payment
- Deposit to the Repair and Replacement Fund, held by Trustee, an amount equal to the deficiency in the required and Repair Replacement Reserve
- Deposit to the Rebate Account amounts required for rebate to the United States Government for arbitrage.
- Reserve an amount equal to not more than 25% of the budgeted operation and maintenance expense for the next fiscal year.
- Maintenance, renovation, expansion, furnishings, capital repair and replacement of pledged facilities; or redemption of outstanding debt.
- Any lawful purpose as directed by the University.

The University of Montana has consistently applied the above prioritization of revenues, and rarely (not at all in recent years,) exercised the “any lawful purpose” application.

By definition, an auxiliary is to be self-supporting. However, the smaller campuses take a global view of all auxiliaries since it is recognized that some student support operations will perform better than others. Each campus reviews their fees/rates for the upcoming fiscal year and adjusts accordingly taking into consideration personnel and operational increases (i.e. utilities, supplies) as well as the impact on students. The fee/rate increases have involvement from the students and are reviewed by the administration on each campus. Through the annual Inventory of Fees submission to Commissioners Office, these proposed fees/rates are forwarded for approval via the Missoula campus.

Montana State University

In January 1994, the Board of Regents approved and adopted a proposal to administratively consolidate the various State higher education units into two systems, one of them being Montana State University. As a result of the administrative merger, MSU issued the first bonds under the Montana State University (continued)

consolidation, the Series 1994-C Issue, in June 1994, for use by the MSU-Billings and the MSU-Northern campuses. Subsequently, in August 1996, the Series 1996-D bonds were issued for MSU-Billings and MSU-Bozeman, and the Series 1998-F bonds were issued in June 1998 for the benefit of all four MSU campuses. The Series 1996-D Indenture was issued as the Master Indenture for all four campuses, and a legal and binding cross-pledge document was prepared by Bond Counsel and executed by all of the campuses to protect the interests of all four campuses, and to show strength to the bond insurers and the bond rating agencies.

Under the Master Indenture, MSU has taken the position that each campus will independently accept the responsibility for its respective revenue bond funds and associated debt service. Each campus is responsible for the creation of an independent revenue bond report, coordinated by the Bozeman campus, and a consolidated bond report is prepared for certain users, such as the rating and insuring agencies.

Local campus management is also responsible for reviewing and assessing the annual fees that are associated with both the Pledged Revenue and the non-pledged Funds. The Bozeman campus coordinates bond-related activities and works closely with the other campuses to take advantage of expertise and access to opportunities of scale, coordination of bond debt service payments, and to structure new bond funds. They are reviewed by the Bozeman campus, and approved by the Regents via the annual Fee Schedule submittal. In any given year, an Auxiliary unit may incur an operating surplus or deficit, but prudent management and fiscal policies dictate that the rates for services be adjusted as needed to ensure that all Auxiliary activities are self-supporting. The rates must also allow the operations to invest in the facilities to attract the students and maintain the revenue streams. Thus, suite-style student housing, fiber optic internet connections for each student, cable TV, and fire and life safety equipment needs like smoke alarms, fire sprinkler systems, and asbestos eradication costs must also be met.

While only five of the 18 Auxiliary Funds at MSU are Pledged activities, they generate significant revenues and expenditures, as shown in the attached Schedule I. As additional capital needs are identified and met with the issuance of bonds, additional funding sources for the associated debt service are also identified and pledged. The following Auxiliary & Fee revenues are legally pledged to the campus revenue bond indentures under the most recent Master Indenture:

- Net Housing System Revenues, to include:
Residence Halls & associated Food Services, Family & Graduate Housing revenues
- Gross Parking Revenues
- Land Grant Income (Bozeman, Billings)
- Museum of the Rockies Lease Revenues (Bozeman)
- Student Building Fee Revenues (Bozeman, Billings, Northern)
- Student Athletic Fee Revenues (Bozeman)
- Student Union Building Fee Revenues (Billings, Northern)
- Technology Fee Revenues (Bozeman, Billings, Northern, CoT)
- Events Revenues (Bozeman)
- Bookstore Revenues (Billings, Northern)
- Interest Earnings on Revenue, Construction, R&R, and Bond Funds

Much attention has been given to the use of Other Lawful Purpose funds in recent years. Under the MSU operating and management philosophy, best practices dictate that excess Auxiliary

Montana State University (continued)

revenues be reserved annually and that facilities be maintained and updated in order to best preserve and protect MSU's investments and to attract students to campus housing. The MSU Master Indenture includes the Net Pledged Revenues stream of funding, that being the pledge of operating revenues, minus operating and maintenance expenses. MSU has a management philosophy that the Pledged Revenue stream of funding must also be utilized to assist in funding capital projects for non-academic public buildings, such as the Fieldhouse and the Student Union. In recent years, funds were expended to re-roof a major portion of the Student Union and to repair the Fieldhouse roof. At that time, MSU was formally advised that there was a need for a complete roof replacement on the Fieldhouse by about 2002 or so, and that it would likely cost \$2M or more. As with other capital intensive projects, the decision was made to create a sub-account within the Indenture that would allow us to accumulate funding of about \$4 -500K/year over a period of years until such time as MSU actually contracted to have the roof replaced.

When the Series 1996-D Indenture projects were completed and the arbitrage was rebated to the U.S. Government, the remaining Construction Fund monies were directed to the Fieldhouse roof repair as an expansion of the Regents' approved \$12.8M Fieldhouse renovation. In moving the excess funds of \$1.8M to the roof replacement project, MSU then suddenly was in a position to dis-encumber the funds that had been accumulating annually in the Indenture. It was this release of this one-time accumulated reserve funding that aided MSU in addressing the Athletic deficit reduction activity of recent months.

The bond Master Indenture identifies the prioritization for the application of Net Pledged operating revenues and all other sources of Pledged Revenues, very similar to the UM Indenture. In accord with the Indenture, the revenues are first utilized for annual bond debt service (\$8,380,424), then for annual R&R (\$1,264,913), for arbitrage rebate and outstanding bond redemption, then for operations (\$2,186,345). The excess Pledged Revenues remain in the Bond Fund for the purposes defined, and include several internal reserves building for specific uses, such as:

- The Fund Balance of the Pledged Revenue and Fees in the Indenture reflects a commitment of \$400K/year as a set-aside reserve to operate and maintain the Fieldhouse and Stadium. The present balance in this set aside is approximately \$635K.
- The Fund Balance must also be large enough to carry the Pledged operating cash flow needs from the major fee payments in January until the Fall Semester payments in August. That cash flow runs about \$6 -700K/month, and includes the change funds and inventories for the Pledged Facilities.
- Other reserves exist within the Indenture to pay for known upcoming capital projects such as asbestos abatement, the construction of the third Hedges Pod, and for family & residence hall roof and infrastructure replacements.

Other Lawful Purpose funding releases for operations not associated with the Indenture revenue production are reviewed and approved by the President's Executive Council. Only if sufficient funding exists after all of the Indenture covenants in the application of funds have been met, does funding become available for Other Lawful Purposes. In FY01, there were four un-related releases for the following:

- \$14K to New Student Services for recruiting software
- \$15K to Facilities to assist with the biennial campus surplus property purge
- \$66,930 to the new Bioscience Complex for O&M support
- \$50K to assist in funding renovations to Culbertson Hall for Extension and the Western Watercourse program.