University System of New Hampshire

Approved 10-22-21

REPORT OF THE FINANCIAL AFFAIRS COMMITTEE
September 30, 2021

The Financial Affairs Committee met at Granite State College on September 30, 2021, at 9:00 am.

Committee members participating at the meeting location: Mike Pilot, Kass Ardinger, Frank Edelblut, George Hansel, and Alex Walker; Committee members participating by teleconference: Todd Black, Morgan Rutman, and Wally Stevens; Other trustees participating: Joe Morone (presiding); Trustees, Amy Begg, Jamie Burnett, Cathy Green, Senator James Gray; President Donald Birx, President James Dean, and President Melinda Treadwell

Staff: present at meeting location, (UNH) Marcel Vernon; (PSU) Tracy Claybaugh;(KSC) Nathalie Houder; (USNH) Catherine Provencher, Karen Benincasa, Tia Miller, and Lorna Jacobsen.

Additional attendees via video conference for portions of the meeting: USNH staff Jim Kulesza; Jeff Croteau, Ryan O'Quinn, and Kate Dumas from Prime Buchholz; June Matte, Joe DaBreo, and Andrew Estrada, from PFM.

I. Call to Order:

At 9:10 Chairman of the Board Joe Morone called the meeting to order. He set the stage for the meeting by describing the different set of circumstances under which higher education is operating today. He pointed out factors that impact USNH relative to other New England public institutions including high tuition and low state support, aggressive competition, and the proximity to other high-quality public and private institutions. He described the objectives of the meeting, explaining that proforma financial projections, debt capacity, demographics, balance sheet and endowment would be reviewed with the goal of reaching a common understanding of where resources may be available to make investments that would better position USNH to compete in this challenging market in both the short-term and the long-term.

Campus CFOs were introduced and Natalie Houder from KSC and Marcel Vernon from UNH, both new to USNH, were welcomed.

II. USNH Pro Forma

Vice Chancellor Provencher reviewed a pro forma for the five-year period FY22 to FY26. She described the assumptions in the model noting they were kept to a high level and continued current trends rather than trying to predict changes. Key operating revenue assumptions are flat state appropriations, no increases in resident tuition rates, essentially flat auxiliary revenue, nonresident tuition increase of 2.5%, flat mandatory fee rates, and an annual decline of 1.5% in undergraduate first year students.

Expense assumptions were assumed at inflation of 2.5% per year, no new debt, capital spending at FY22 budget, and 1 times depreciation for FY23-FY26. Cost savings initiatives are expected to be 90% of the $70 million target by FY 23.

The five-year pro forma projects that USNH would be operating at a loss in FY24 – FY26 with a $30 million gap by FY 26 to have a 1% operating margin under these assumptions.

A slide depicting historical trends and demographic changes in recent high school graduates in NH residents and other NE states was shared as well as projections through 2035. It was noted that USNH's market share has also been declining.

Vice Chancellor Provencher reviewed USNH reserves and defined "restricted" and "unrestricted" reserves. She reported that USNH has $330 million in unrestricted reserves as of June 30, 2021. Of that amount, $131 million is internally designated by individual campuses. Examples of the internally designated purposes of these funds were given. Trustee Walker asked how frequently these funds were reviewed to see if the purposes for which they have been restricted are still valid. Chairman Morone suggested that this topic be put on a future Financial Affairs Committee meeting agenda.

The USNH endowment pool and affiliated foundation pools were discussed with the difference between true endowment (both restricted and unrestricted) and quasi endowment (restricted and unrestricted) described and the percentages of each reported. It was noted that KSC and UNH have separate foundations as well as investments in the USNH endowment pool. Vice Chancellor Provencher explained that over the years, transfers of short-term investments to the endowment pool were made to enable those funds to have a higher return. Balances and purposes in the larger unrestricted quasi-endowments were shared as well as commitments against the balances. It was noted that these funds pay out to the campuses' investment income, so any decision to liquidate a portion would have some impact on that annual amount available to campuses as well as a possible negative effect on credit ratings.

III. <u>Debt Report</u>

Vice Chancellor Provencher introduced June Matte, Joe DaBreo, and Andrew Estrada, from PFM. She asked them to comment on the advisability of issuing debt in an industry that is downsizing, the impact of a rating downgrade, and to point out any opportunities that might exist to refinance existing debt. She noted that USNH can only use debt financing for self-supporting facilities such as residence and dining halls.

Ms. Matte said that ratings are only one piece of the puzzle and USNH should do what is necessary to further its mission and communicate the strategy of their decisions. She said the rating agencies have been impressed with USNH's financial management and ability to do more with less.

Mr. DaBreo gave an overview of the structure and size of USNH's debt portfolio. He reviewed several refinancing opportunities and the possibility of a new debt issue and described the timing, potential savings, advantages, and disadvantages of each. Current ratings by S&P (AA- with stable outlook) and Moody's (AA3 with negative outlook) were shared, and Ms. Matte pointed out that the entire sector has a negative outlook. The Committee discussed the impact a refinancing would have on cash and debt service. If money is borrowed to renovate dorms, a portion of any additional income would be encumbered to pay back the debt.

Regarding a new debt issue's impact on ratings, Ms. Matte said that leverage makes up only about 20% of a credit profile saying that operations, the ability to attract students and strategic position count more. The practical effect of a rating downgrade was discussed, and Mr. DaBreo said it would have a minimal impact on current debt. It could also have some impact on the cost of banking products and SBA support. The Chairman summarized that the impact of a refinancing is marginal, and the impact of a rating downgrade is marginal.

IV. Consideration with the Endowment Pool

Vice Chancellor Provencher introduced Jeff Croteau, Kate Dumas, and Ryan O'Quinn from Prime Buchholz.

Mr. Croteau gave a brief overview of the two USNH portfolios, their performance and objectives, and asset allocation. He described how the target return is estimated and addressed the question of whether a 6.5% target remains reasonable. He said periods of high inflation or deflation can impact the return, but Prime Buchholz thinks 6.5% continues to be an appropriate target based on the nominal return range of the USNH portfolio policy index of 6.7% to 7.7%

Mr. Croteau described several scenarios USNH might implement to free up cash from the endowment and compared the outcomes and risks of each. Scenarios considered were: Increasing the endowment payout to purpose from 4% to 5%; Withdrawing $50 million from the portfolio immediately and keep the payout to purpose at 4%; and increasing the annual spend rate to the amount at which the median outcome of dollars spent for the next five years is comparable to withdrawing $50 million in an initial draw. Mr. Croteau explained there is a range of outcomes for each scenario which are dependent on market volatility. Based on its analysis and simulations, Prime Buchholz recommends that the targeted amount of funds be withdrawn in the near future and invested in the short-term investment pool. This scenario reduces the risk of exposure to equity market volatility and allows the endowment spending policy to remain the same. It was noted that a $50 million withdrawal was used in the scenario, but it does not have to be $50 million.

The Committee discussed the risks associated with withdrawing $50 million including interest rate risks, inflation, the uncertainty caused by the pandemic, and impact on payout to the campuses.

V. Building Blocks of the Opportunities

Vice Chancellor Provencher shared a list of potential cash and operating margin opportunities and reviewed their annual impact on operating margin and the cumulative impact of cash. Among the opportunities discussed in more depth that were not previously discussed were seeking reimbursement from FEMA for currently unreimbursed COVID-19 related costs, space utilization and right sizing the physical plant.

Summarizing the meeting, Chairman Morone provided an overview of the general conclusions to set the stage for further discussion:

1) **Operating Margin:** Each campus should budget a 1% operating margin and annual capital spending should be at 1 X depreciation. If a campus exceeds a 1% margin, they can use the excess for investment.
2) **Debt:** System has borrowing capacity; but shrinking revenue means any incremental debt should be taken on with great caution. New debt being used for investments that would increase revenues and/or reduce costs more than the incremental costs associate with the new debt
3) **Endowment:** FAC recommends that the Investment and Capital Planning Committee work with Prime Buchholz to set aside $50M from the quasi endowment for strategic investments.
4) **Federal Funding:** Opportunities for federal funding from FEMA for COVID-19 related costs and other federal stimulus programs for future projects such as ERP should be aggressively pursued.
5) **Asset Utilization**: In FY22, the system office should conduct a comprehensive asset utilization review of the opportunities to reduce the total cost of occupancy and optimize the USNH footprint.
6) **State Support:** It will be difficult to hold tuition flat or decrease tuition for resident students without increased support from the State of NH. To increase market share of resident students, it will be important and necessary to open a dialogue with the State.

VI. Other Business:

The Committee adjourned at 12:30 p.m.