Strategic Planning and Funding

AGENDA ITEM V-B

60x30TX

Texas Higher Education Coordinating Board

Financial Condition Analysis of Texas Public Community College Districts

March 2018

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Texas Higher Education Coordinating Board

Agency Mission
The mission of the Texas Higher Education Coordinating Board is to provide leadership and coordination for the Texas higher education system and to promote access, affordability, quality, success, and cost efficiency through 60x30TX, resulting in a globally competitive workforce that positions Texas as an international leader.

Agency Vision
The THECB will be recognized as an international leader in developing and implementing innovative higher education policy to accomplish our mission.

Agency Philosophy
The THECB will promote access to and success in quality higher education across the state with the conviction that access and success without quality is mediocrity and that quality without access and success is unacceptable.

The Coordinating Board’s core values are:
Accountability: We hold ourselves responsible for our actions and welcome every opportunity to educate stakeholders about our policies, decisions, and aspirations.
Efficiency: We accomplish our work using resources in the most effective manner.
Collaboration: We develop partnerships that result in student success and a highly qualified, globally competitive workforce.
Excellence: We strive for excellence in all our endeavors.

The Texas Higher Education Coordinating Board does not discriminate on the basis of race, color, national origin, gender, religion, age or disability in employment or the provision of services.

Please cite this report as follows: Texas Higher Education Coordinating Board. (2018). Financial condition analysis of Texas public community college districts. Austin, TX.

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Executive Summary

An annual report about the financial condition of the state's community colleges is required by a rider in House Bill 1, General Appropriations Act (Section 13, page III- 211), 84th Texas Legislature (See Appendix B). The objective of the report, and the accompanying Excel workbook, is to provide an assessment of the overall financial health of public community colleges and to identify the potential for financial stress at specific community colleges.

This analysis is intended to be a broad financial evaluation. Other key performance indicators must be taken into account to gain a more robust and complete understanding of institutional strength. This analysis is not intended for peer-group comparisons or for benchmarking purposes.

With the implementation of Governmental Accounting Standards Board (GASB) pronouncement 68, community college districts experienced significant turbulence in the financial condition metrics for Fiscal Year (FY) 2015. According to the statement 68 summary,

"The primary objective of this Statement is to improve accounting and financial reporting by state and local governments for pensions. It also improves information provided by state and local governmental employers about financial support for pensions that is provided by other entities. This Statement results from a comprehensive review of the effectiveness of existing standards of accounting and financial reporting for pensions with regard to providing decision-useful information, supporting assessments of accountability and interperiod equity, and creating additional transparency."

To create additional transparency, the GASB 68 implementation transferred pension liability from the state-level financial statements of the Teachers Retirement System (TRS) to the individual financial statements of the institutions. This transfer increased the visibility of pension liability at the community college district level. The overall effect to statewide financial ratios and to the financial condition of community college districts was substantial and is reflected in the report.

Ratios referenced in this report are commonly used by external entities to measure the health of higher education institutions. A Composite Financial Index (CFI) has been calculated to provide one metric to efficiently analyze the financial health of all districts. Other ratios used in this analysis include an equity ratio and a leverage ratio.

Overview

There are 50 public community college districts in Texas, the oldest dating back to 1869. They are locally controlled governmental entities established via an election process.

State statute specifies that newly created districts must have 15,000 secondary students and a minimum assessed property valuation of $2.5 billion. Seven of the existing districts do not currently meet that standard.

To a significant degree, local control enables districts to determine their own financial destiny. State law and rules of the Texas Higher Education Coordinating Board (THECB or Coordinating Board) impose some limitations, but local autonomy and demographics account for much of the variation in resource allocation and revenue collection.[1]

Community college districts have four primary funding sources: state formula funding, local property tax revenue, tuition and fee revenue, and other income that is largely from federal funds. Although some districts have endowments, they are more commonly found in universities. Revenue from endowments is most often used for tuition assistance, as opposed to operations.

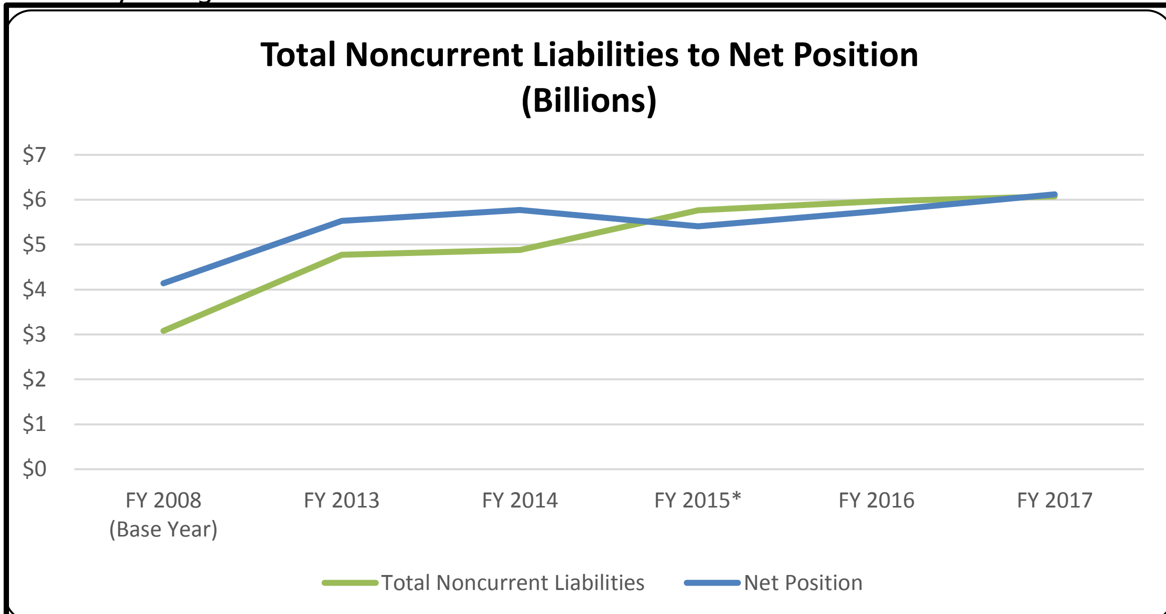
[1] Texas Research League, *Bench marks for community and junior colleges in Texas*, August 1993.

Noncurrent Liabilities to Net Position Comparison

There are two financial components considered in analyzing the financial condition of Texas community colleges. A comparison of an institution's noncurrent liabilities or long-term debt to its cash or net position would be instrumental in determining an institutions financial condition.

The year-to-year comparison in figure 1 shows total noncurrent liabilities to net position; this includes the impacts of GASB 68 implementation. Total noncurrent liabilities have increased $2.99 billion since FY 2008. Most of the increase is due to the general obligation (GO) bonds issued by districts and the addition of the Net Pension Liability in FY 2015. For FY 2017, the total noncurrent liabilities for Texas public community colleges was $6.08 billion. Overall, Texas public community colleges are managing the growth they have experienced. Net position has increased $1.98 billion since FY 2008 to $6.12 billion in FY 2017.

Figure 1. Comparison of statewide noncurrent liabilities to net position of Texas public community colleges.



*Year of GASB 68 implementation.

Financial Ratio	**FY 2008 (Base Year)**	**FY 2013**	**FY 2014**	**FY 2015***	**FY 2016**	**FY 2017**
Total Noncurrent Liabilities	$3.08	$4.78	$4.88	$5.77	$5.97	$6.08
Net Position	$4.14	$5.53	$5.77	$5.41	$5.75	$6.12

Financial Analysis in Higher Education[1]

The concept of using selected indicators, such as ratios, during the course of financial analysis is nothing new in higher education, dating back to at least 1980. Financial analysis can measure success against institutional objectives and provide useful information that can form a basis for sound planning.

The overall financial health of an institution can be assessed via two dimensions of inquiry. First, is the institution financially capable of successfully carrying out its current programs? Second, is the institution able to carry out its intended programs well into the future?

Along with these two dimensions, four key financial questions need to be asked:

- Are resources sufficient and flexible enough to support the mission?
- Are resources, including debt, managed strategically to advance the mission?
- Does asset performance and management support the strategic direction?
- Do operating results indicate the institution is living within available resources?

A widely accepted metric called the Composite Financial Index (CFI) is often used to address these four key questions. The index was developed over time by a consortium of consulting companies led by KPMG and introduced in 1999. Many institutions, including the U.S. Department of Education, the State of Ohio Board of Regents, credit-rating agencies, and countless institutions of higher education, employ the index or similar approaches.

The CFI blends four core financial ratios into one metric, providing a more balanced view of an institution's finances since weakness in one measure can be offset by strength in another. Additionally, measuring the index over time provides a glimpse of the progress institutions are making toward achieving financial goals.

The Coordinating Board has been calculating the CFI and sharing related data with community college districts since 2007.

The CFI includes the following four core ratios: Primary Reserve, Viability, Return on Net Position, and Operating Margin.

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[1] For more information, see *Strategic financial analysis for higher education*, 6th edition, KPMG, Prager, Sealy & Co., Bearing Point, 2005.

Metrics Used in This Report

This report uses a Composite Financial Index (CFI) to provide one metric to efficiently analyze the financial health of all Texas community college districts. Other metrics used in this analysis include an equity ratio and a leverage ratio.

The threshold for the CFI was established by considering the original work conducted by KPMG in creating the index and industry practice. Using the CFI is the single best method to assess overall financial condition. While variability exists in the statewide CFI when looking at a year-to-year comparison, the overall financial condition of public community colleges improved in the four years prior to 2015, with the statewide CFI increasing from 2.96 in FY 2011 to 3.27 in FY 2014. FY 2017 has shown improvement from the FY 2015 GASB 68 implementation, moving back above the state standard with a statewide CFI index of 2.81.

Composite Financial Index

The composite financial index (CFI) measures the overall health of an institution by combining four ratios into a single metric. The four core ratios used in the CFI include return on net position, operating margin, primary reserve, and viability ratio.

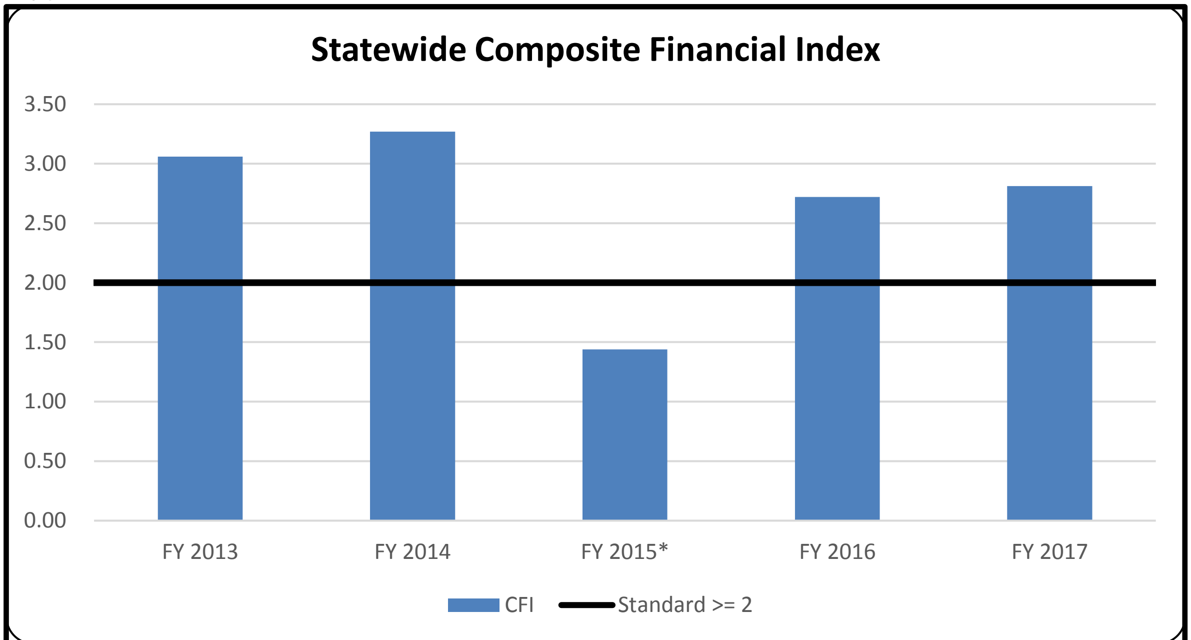
Calculation – The CFI is computed using a four-step methodology:

1. Computing the values of the core ratios
2. Calculating strength factors by dividing the core ratios by threshold values
3. Multiplying the factors by specific weights
4. Totaling the resulting scores to obtain the Composite Financial Index

Core Ratio		*Value*		*Strength Factor*		*Weight*	*Score*
Return on Net Position	/	0.02	=	Factor	X	20%	= Score
Operating Margin	/	0.007	=	Factor	X	10%	= Score
Primary Reserve	/	0.133	=	Factor	X	35%	= Score
Viability Ratio	/	0.417	=	Factor	X	35%	= Score
				Composite Financial Index		=	Total Score

Results – The 2017 combined CFI for public community colleges is 2.81, which is an increase from 2.72 in 2016 and exceeds the statewide standard of 2.0 or greater. The standard was met by 29 of the 50 districts. CFI numbers generally range from 0.00 to 10.00, although it is possible to have a CFI higher than 10.0 or below zero. A year to year comparison of statewide CFI can be seen in figure 2 on the following page.

Figure 2. A year to year comparison of the Texas public community colleges composite financial index.



*Year of GASB 68 implementation.

Financial Ratio	FY 2013	FY 2014	FY 2015*	FY 2016	FY 2017
CFI	3.06	3.27	1.44	2.72	2.81
Standard >= 2	2.00	2.00	2.00	2.00	2.00

Financial Ratios

Primary Reserve Ratio

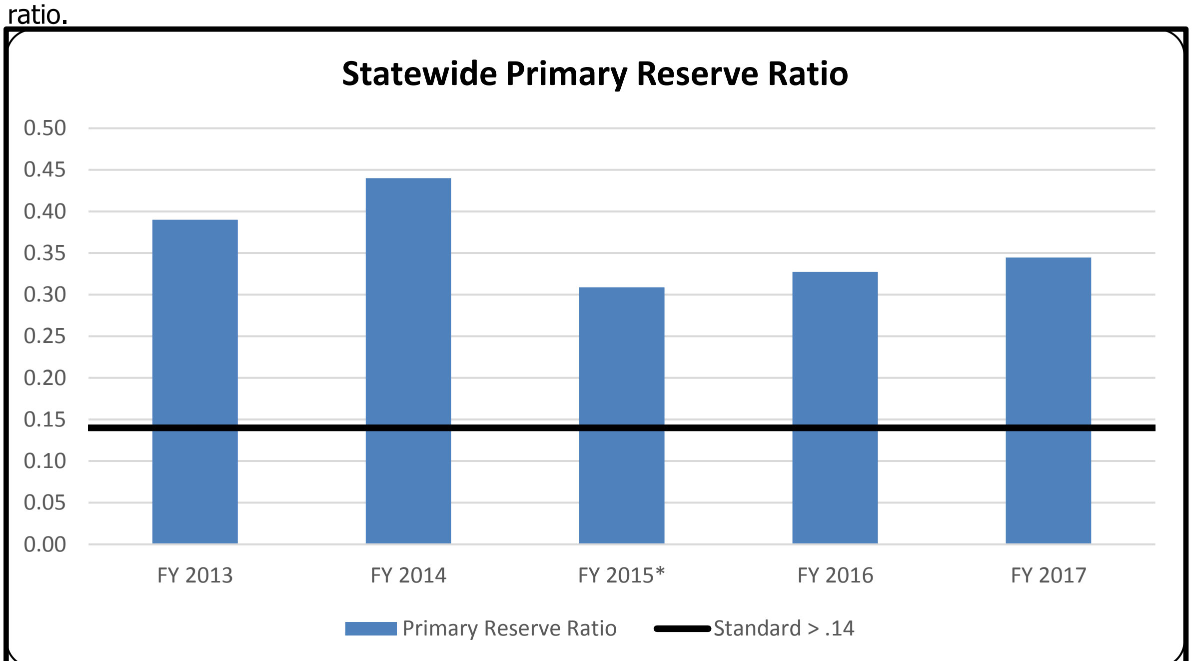
The primary reserve ratio measures financial strength and flexibility by comparing expendable net position to total expenses, as expressed in figure 3. This measure answers the question, "How long can the institution survive without additional net position generated by operating revenue?"

Calculation – Total expendable net position + unrestricted net position / operating expenses + interest expense on debt.*

*Interest expense on debt includes all debt, both tax and other revenue supported.

Results – The 2017 statewide ratio for public community colleges is .34, which is an increase from .33 in 2016. A ratio of 0.14 or greater is the standard used in this report. The standard was met by 33 of the 50 districts.

Figure 3. A year to year comparison of the Texas public community colleges primary reserve ratio.



*Year of GASB 68 implementation.

Financial Ratio	FY 2013	FY 2014	FY 2015*	FY 2016	FY 2017
Primary Reserve Ratio	0.39	0.44	0.31	0.33	0.34
Standard > .14	0.14	0.14	0.14	0.14	0.14

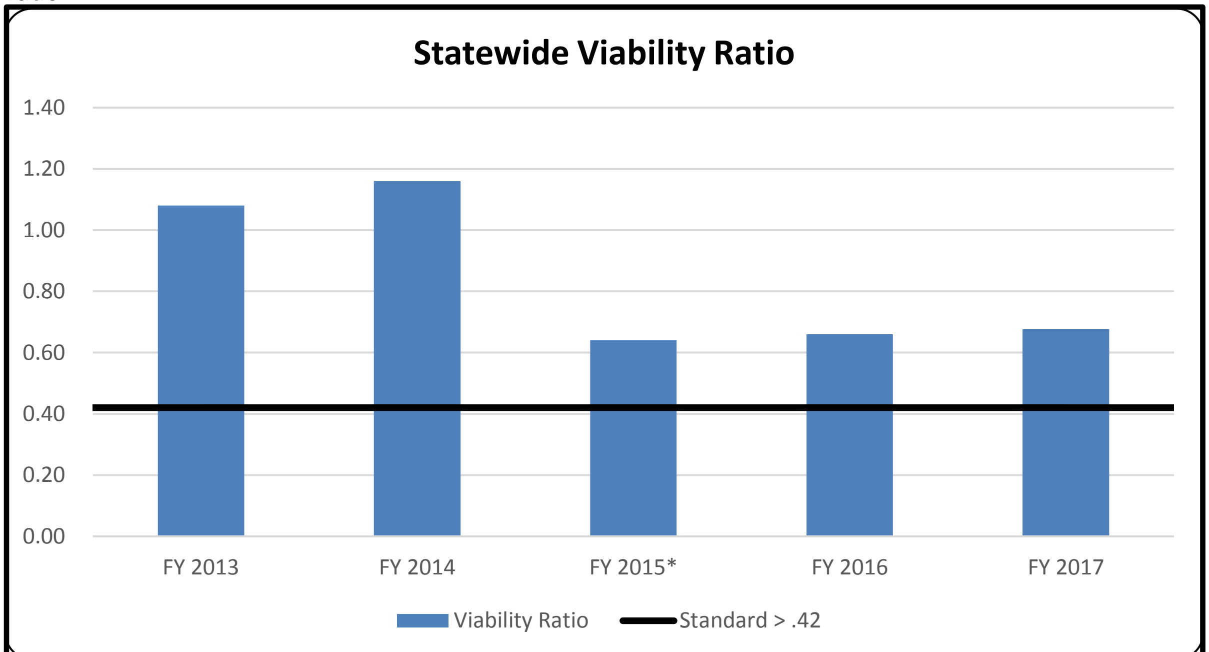
Viability Ratio

The viability ratio measures the financial health of the institution by comparing total expendable net position to total noncurrent liabilities, as expressed in figure 4. This ratio is similar to a coverage ratio used in the private sector to indicate the ability of an organization to cover its long- term debt and answers the question, "How much of the debt can the institution pay off with existing resources?"

Calculation – Total expendable net position + unrestricted net position / noncurrent liabilities, excluding general obligation (GO) debt.

Results – The 2017 statewide ratio for public community colleges is .68, which is an increase from .66 in 2016. A ratio of 0.42 or greater is the state standard, which was met by 29 of the 50 districts.

Figure 4. A year to year comparison of the Texas public community colleges statewide viability ratio.



*Year of GASB 68 implementation.

Financial Ratio	FY 2013	FY 2014	FY 2015*	FY 2016	FY 2017
Viability Ratio	1.08	1.16	0.64	0.66	0.68
Standard > .42	0.42	0.42	0.42	0.42	0.42

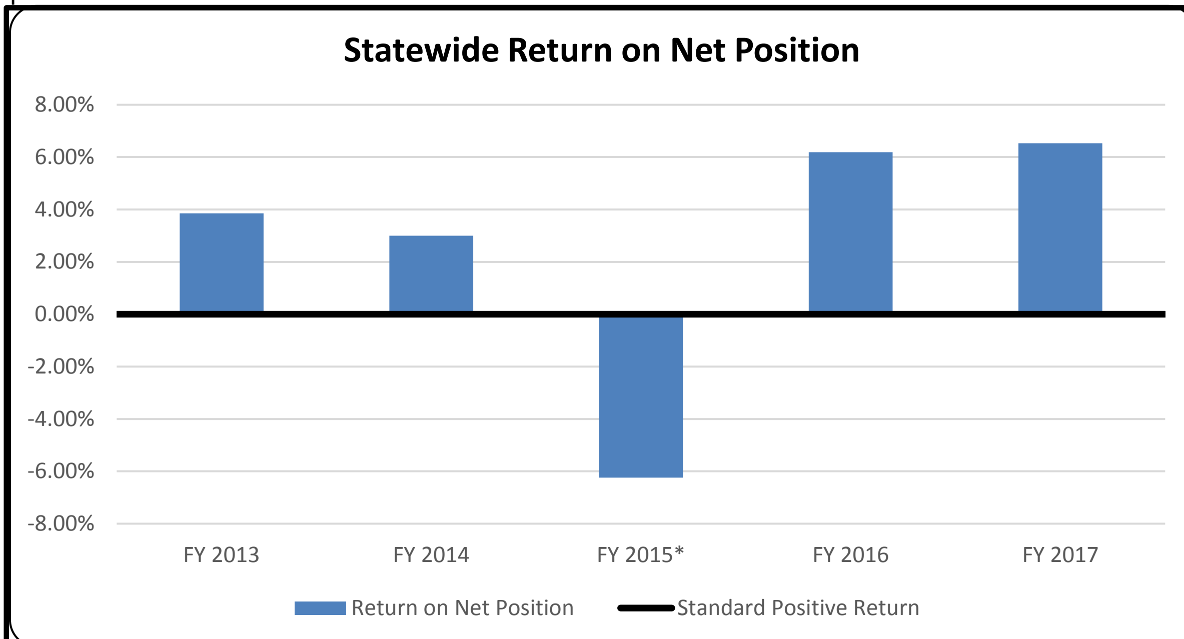
Return on Net Position

Return on net position measures total economic return during the fiscal year, as expressed in figure 5. This measure is similar to the return on equity ratio used in examining for-profit concerns and answers the question, "Is the institution better off financially than it was a year ago?"

<u>Calculation</u> – Change in net position / Total net position (beginning of year)

<u>Results</u> – The 2017 statewide ratio for public community colleges is 6.53 percent, which is an increase from 6.19 percent in 2016. A positive return is the standard used in this report and this standard was met by 42 of the 50 districts.

<u>Figure 5.</u> A year to year comparison of the Texas public community colleges statewide net position.



*Year of GASB 68 implementation.

Financial Ratio	FY 2013	FY 2014	FY 2015*	FY 2016	FY 2017
Return on Net Position	3.86%	3.00%	-6.24%	6.19%	6.53%
Standard Positive Return	0.00%	0.00%	0.00%	0.00%	0.00%

Operating Margin

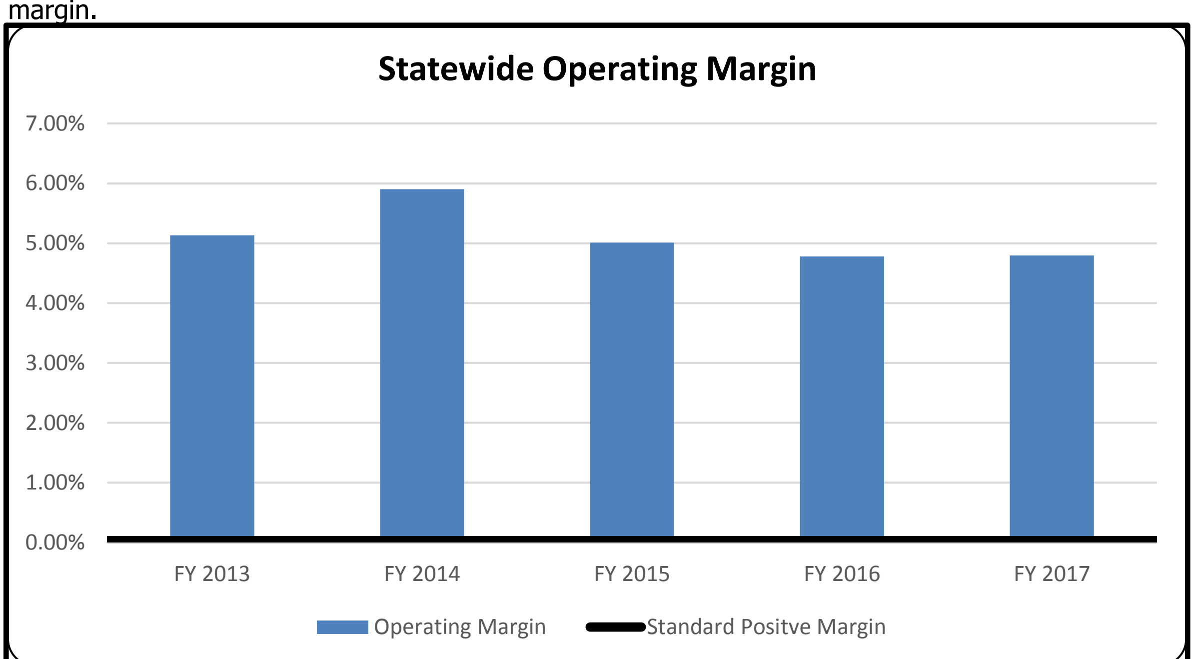
Operating Margin indicates an operating surplus or deficit in the given fiscal year, as expressed in figure 6. This ratio is similar to a profit margin and answers the question, "Did they balance operating expenses with available revenue?" Depreciation expense is included to reflect the use of physical assets in measuring operating performance.

Calculation – Total income - total operating expense / Total income*

*Includes all operating revenue plus formula funding, property tax, and Title IV federal revenue.

Results – The 2017 statewide margin for public community colleges is 4.80 percent, which is an increase from 4.78 percent in 2016. A positive margin is the standard used in this report. The standard was met by 36 of the 50 districts.

Figure 6. A year to year comparison of the Texas public community colleges statewide operating margin.



Operating Margin was not affected by GASB 68 implementation.

Financial Ratio	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017
Operating Margin	5.13%	5.90%	5.01%	4.78%	4.80%
Standard Positive Margin	0.00%	0.00%	0.00%	0.00%	0.00%

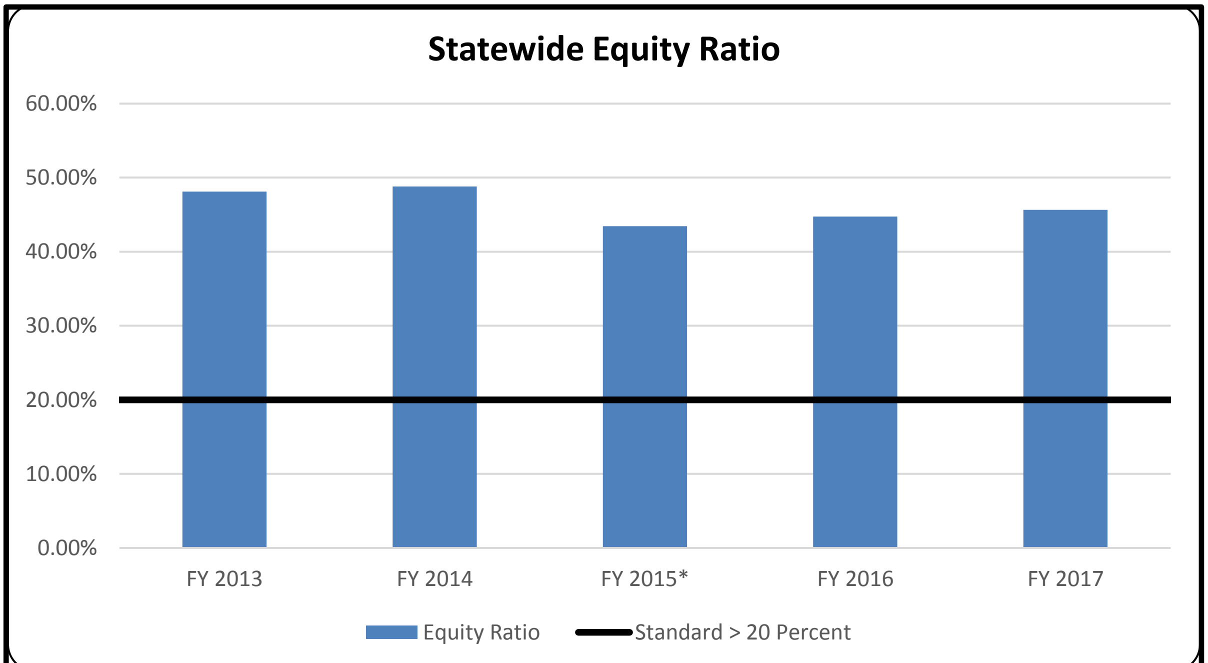
Equity Ratio

The equity ratio measures capital resources available and a college's ability to borrow, as expressed in figure 7. The U.S. Department of Education (ED) introduced this ratio to enhance reporting for institutions that do not have long-term debt. The ED uses financial ratios, in part, to provide oversight to institutions participating in programs authorized under Title IV of the Higher Education Act.

Calculation – Net position / Total assets

Results – The 2017 statewide ratio for public community colleges is 45.65 percent, which is an increase from 44.76 percent in 2016. A ratio of 20 percent or greater is the standard used in this report. The standard was met by 46 of the 50 districts.

Figure 7. A year to year comparison of the Texas public community colleges statewide equity ratio.



*Year of GASB 68 implementation.

Financial Ratio	FY 2013	FY 2014	FY 2015*	FY 2016	FY 2017
Equity Ratio	48.10%	48.80%	43.44%	44.76%	45.65%
Standard > 20 Percent	20.00%	20.00%	20.00%	20.00%	20.00%

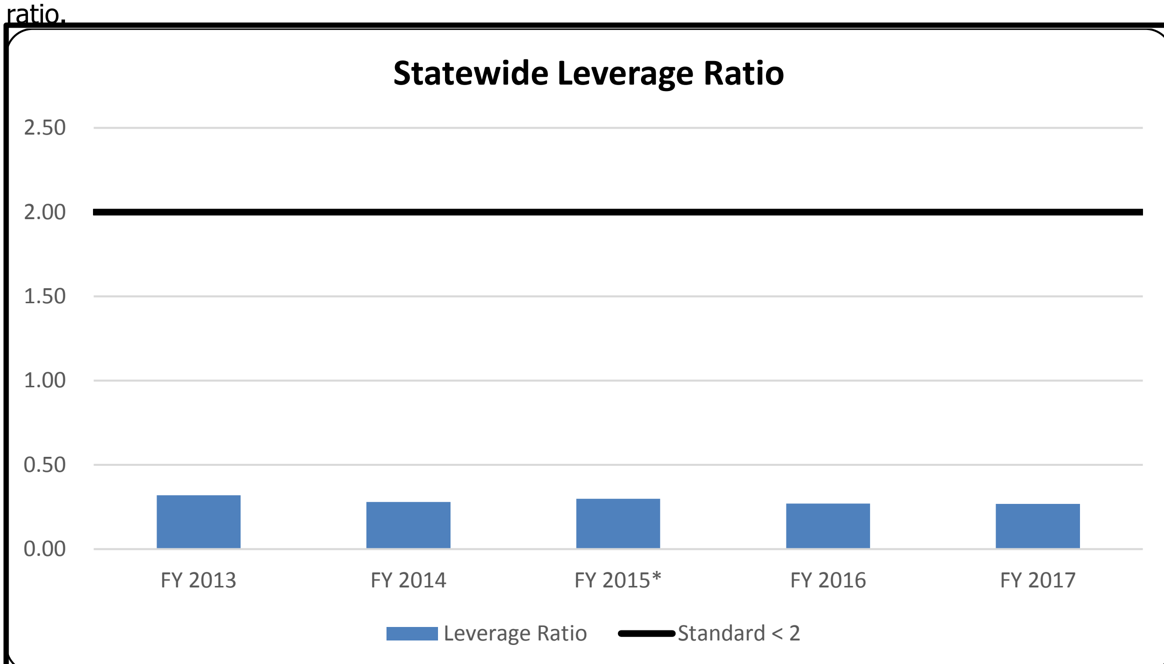
Leverage Ratio

The leverage ratio measures the amount of debt in relation to net position and provides an indication of the amount of interest and principle the institution must absorb in the future, as expressed in figure 8. This ratio is similar to the debt-to-equity ratio used in the private sector. The leverage ratio differs from the viability ratio in that investment in physical plant assets is included as part of the numerator. Long-term debt includes bonds payable, excluding GO bonds and long-term liabilities.

Calculation – Long term debt / Total net position

Results – The 2017 statewide ratio for the public community colleges is .27, which remains the same as 2016. A ratio of less than 2.0 is the standard used in this report. The standard was met by 47 of the 50 districts.

Figure 8. A year to year comparison of the Texas public community colleges statewide leverage ratio.



*Year of GASB 68 implementation.

Financial Ratio	FY 2013	FY 2014	FY 2015*	FY 2016	FY 2017
Leverage Ratio	0.32	0.28	0.30	0.27	0.27
Standard < 2	2.00	2.00	2.00	2.00	2.00

Appendix A contains the indicators for the 50 districts for FY 2017. An Excel workbook is available that contains all the financial data used for the indicators and includes data for Fiscal Years 2003 to 2017.

The financial data used in this analysis came from the Community College Annual Reporting and Analysis Tool (CARAT) and is available online at: http://www.thecb.state.tx.us/index.cfm?objectid=148BEF9C-EC8D-06F7- A85154FCA9C2D191.

Data are reported by the institutions and came from published annual financial reports.

Financial Condition

Forty of the 50 Texas public community college districts have moderate or no indication of financial stress, which means they met four or more of the seven indicators. Twenty of these meet the threshold for all indicators. In FY 2016, 40 community college districts had moderate or no indication of financial stress. Currently, 10 community college districts do not meet four or more indicators, which means they could be experiencing some financial stress.

As seen in the table 1 below, FY 2017 saw 40 of 50 districts meeting four or more individual indicators of financial health. The other 10 districts did not meet four or more indicators.

Table 1. A year to year comparison of the number of Texas public community colleges meeting the individual indicators.

	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015*	FY 2016	FY 2017
Met all 7 indicators	33	39	31	29	6	24	20
Met 6 indicators	8	6	5	5	12	4	6
Met 5 indicators	4	1	7	10	7	4	4
Met 4 indicators	2	2	3	4	8	8	10
Met 3 indicators	1	1	2	0	9	4	7
Met 2 or fewer indicators	2	1	2	2	8	6	3
*Year of GASB 68 implementation.							

The 10 institutions below were requested to provide a brief detail explanation as to the cause of their not meeting four or more indicators. The remaining 10 are worthy of additional discussion:

Austin Community College.

Austin Community College (ACC) did not meet four of the indicator thresholds. The ratios that include total assets and noncurrent debt — the equity and leverage ratios have improved over FY 2016 — but remain below the standard used for this report. The college's ratio of high noncurrent liabilities and low expendable net position kept the institution's viability ratio below the state standard. The college met the threshold for operating margin, return on net position, and CFI. Operating and nonoperating expenses grew by $15 million, causing the primary reserve ratio to remain below standard.

Institutional Comments – Neil Vickers, Executive Vice President, Finance & Administration

"Primary Reserve Ratio
The primary reason ACC is under the THECB standard is the impact of GASB 68. This is the relatively new GASB standard that requires us to record a liability for our proportionate share of the State's TRS liability. ACC's net TRS liability is $47 million for 2017. This liability is a reduction to unrestricted net assets which is part of the numerator in this ratio. If that liability was excluded, then ACC's Primary Ratio would be just over 0.18 which would be above the 0.14 standard. ACC has no intention of building a reserve fund in order to support this liability.

Consideration: ACC would like the THECB to consider a different definition of "reserve". Due to these reasons, internally ACC has chosen to stop using "unrestricted net position" as the basis for reserves and instead has defined reserves on unrestricted cash and investment balances. After all, if the desire is to measure how long the institution can continue to pay the bills in the case of an emergency, then ready access to cash is the real question.

Viability Ratio
The reason ACC is below the standard is simply due to the significant number of facilities projects we have underway. ACC is in a building phase in order to be prepared for future enrollment growth. While ACC does have some GO Bond debt (which is excluded from this ratio), ACC has also had to rely on other debt structures to fund its buildings. Our low ratio is also impacted by the impact of GASB 68 as noted above.

Additionally, I don't think this ratio has a lot of value for governmental entities. I understand why it exists and how it is used for the private sector, but why would a governmental entity need to pay off a significant portion of its debt immediately and with existing resources? This implies a "going concern" situation which is an incredibly rare event for a government entity.

Equity Ratio
My response to ACC being below the 20% standard is a combination of the two responses below. Liabilities like the GASB 68 liability above artificially reduce our net position. At the same time if you are in a building phase, as we are, then your total assets are at an all-time high. To help make my point, ACC could do nothing for the next 10 years to increase our Net Position, however our capital assets will decrease in book value due to depreciation. In this scenario our Equity Ratio will improve over those 10 years even though the college has not done anything to improve the financial standing of the institution. In other words, a strong Equity Ratio could just as much be a reflection of old and fully depreciated capital assets as it is a reflection of strong net position. As such, it is unclear to me as to the true value of this ratio. If the State is interested in our "ability to borrow", then I would focus on our Bond Ratings. Those will be the best indicators of our ability to borrow. ACC's current S&P bond rating is AA+ (the same as the US Federal Government).

Leverage Ratio
This ratio is very similar to the Equity Ratio above. As such, my explanation for this ratio is the same as the Equity Ratio. ACC is in a building phase and therefore our Long-term Debt is at an all-time high. At the same time our Net position is skewed lower due to accounting standard changes like GASB 68."

Clarendon College.

Clarendon did not meet four of the indicator thresholds. The return on net position improved but remained negative. Expendable and unrestricted net position fell $0.4 million which, coupled with increased noncurrent liabilities, kept the primary reserve and viability ratios below the state standard.

Institutional Comments – Rit Christian, VP of Administrative Services

"GASB Statement No. 68, Accounting and Financial Reporting for Pensions, requires liabilities for future pension benefits. During FY17 this liability increased by 75,097 to a total of 1,891,594. The College's Primary Reserve Ratio without this requirement would be .2733.

The Viability Ratio calculated without Net Pension Liability and disregarding GASB 68 impact on the institution's Unrestricted Net Position is .6379 which meets the state standards.

The Return on Net Position fell short during the current year with a ratio of (.0002) almost meeting the standard of being positive.
The Composite Financial Index is composed of the preceding ratios and is not met but is improving from .01 to .6358 in the current year."

Frank Phillips College.

Frank Phillips College did not meet five of the indicator thresholds. The return on net position, operating margin, and CFI were negative. Expendable and unrestricted net position was negative, which lowered the primary reserve and viability ratios below the state standard. In the previous seven years, the college has had a negative operating margin and has not met the 2.0 threshold on the CFI.

<u>Institutional Comments</u> – Dr. Jud Hicks, President

"On behalf of Frank Phillips College, we would like to provide an explanation regarding the College's financial ratios for the year ending 2017. We understand that these ratios do show financial stress but we would like to acknowledge that we have had some improvement in the last year.

From a financial perspective we as a college operate on a balanced budget excluding depreciation expense. Every year we book depreciation expense of about $350,000 which directly relates to our decrease in net position. Our Net position improved this year from $-368,414 to $-244,618, this is directly related to an increase in Federal, State and Local grants received. We believe our small community college is headed in the right direction and will continue in this direction in the future.

Last year we discussed growing new programs and increasing our contact hours, we are working hard to accomplish this goal. Our overall contact hours were flat this year with a slight increase on the academic side and a slight decrease on the career and technical side. In our Career and Technical Education we have employed a new Dean with a new drive and focus on expanding our CTE programs. We have also employed a liaison to work directly with industry in our service area to offer enhanced programs for their specific needs while improving the robust relationship related to the two entities. We are starting a new CTE program at both our branch campuses that should bring additional revenue with little related expense. We have updated our Distance Learning Classrooms on all of our campuses so that we can teach from any of these campuses, which will lead to a direct decrease in instructional salaries while increasing tuition revenue. Another positive about the updates to these classrooms is that we can tap into the expertise of the citizens in our rural communities and broadcast it anywhere in our service area.

In September of 2017 we started receiving revenues from our new taxing district in Dalhart Texas. To date we have received a little more than $500,000 in additional tax revenue from Dallam and Hartley counties. Also, the $4 million building in Dalhart is nearing completion and construction has started on a second building that will house our Career and Technical education classrooms and labs. A local business has completed their $72 Million expansion, with that and the increased tax values in the area we have seen additional tax revenue of around $500,000.

We believe that the things above and additional strategies not listed, along with the support of our local communities and employers we are headed in a positive direction and am confident that with a little more time this will relieve our financial stress."

Lee College.

Lee College did not meet four of the indicator thresholds. The institution's operating margin was negative, and the CFI is below the standard of 2.0. Even though the college improved its expendable and unrestricted net position and noncurrent liabilities, the increase in operating and nonoperating expenses resulted in the primary reserve and viability ratios to remain below the state standard.

Institutional Comments – Dr. Dennis Brown, President

"The Lee College administration and Board of Regents are aware of the college's financial ratios, and stress indicators. The college is in the process of determining the appropriate steps necessary to address the stress indicators, and meet the standard ratios to the extent possible."

Lone Star College.

Lone Star College did not meet five of the indicator thresholds. The institution's operating margin was negative, and the CFI is below the standard of 2.0. Even though the institution's net position increased, the equity ratio fell below the state standard. Expendable and unrestricted net position fell $35.9 million which, coupled with increased operating and nonoperating expenses and noncurrent liabilities, lowered the primary reserve and viability ratios below the state standard. The institution's equity ratio fell slightly below the state standard of 20 percent.

Institutional Comments – Jennifer Olenick, Vice Chancellor of Business Affairs and Chief Financial Officer

"Operating Margin -1.89 Standard Positive

The operating margin has been negative since 2015, but steadily improving from -6.05% to -4.63%, and in 2017 to -1.89%. In both fiscal years 2016 and 2017, operating expenses have been reduced, even as total income increased from year to year. I expect this trend to continue.

Primary Reserve .09 Standard .14

While below the standard, the primary reserve ratio improved significantly in 2017, increasing from .02 to .09. Operating and non-operating expenses did increase by $7 million, but this was more than offset by an increase in the expendable and unrestricted net position of $36 million.

Viability Ratio	.15	Standard	.42

While below the standard, the viability ratio improved significantly in 2017, increasing from .03 to .15. Just as the primary reserve ratio was positively impacted, here to, a positive impact is seen from the significant increase in the expendable and unrestricted net position of $36 million. This ratio would have increased more except for a $45 million increase the non-current liability. This increase was due to (1) $16 million received from Aldine ISD for the construction of an early college high school, this is booked as a local government liability, and (2) an $18 million increase in the unamortized bond premium, which is due the 2017 issuance of general obligation bonds.

Equity Ratio	19.13%	Standard	20%

The equity ratio last year was above the standard, but this year has dropped just below the standard primarily due to the issuance of 2017 general obligation bonds that resulted in a significant increase in cash and cash equivalents. Net Position and Total Assets both increased, but Total Assets increased by a relatively larger amount causing the ratio to decrease."

McLennan College.

McLennan did not meet four of the indicator thresholds. The institution's operating margin was negative, and the CFI is below the standard of 2.0. The institution's decline in expendable and unrestricted net position, and the increase in noncurrent liabilities and operating and nonoperating expenses, caused the primary reserve and viability ratios to fall below the state standard.

<u>Institutional Comments</u> – Stephen Benson, Vice President of Finance and Administration and CFO

"Operating Margin: -1.87
Standard: Positive Margin

McLennan Community College's operating revenues have declined based on a strategic decision to provide a discounted dual credit tuition rate and increases we have seen in other tuition exemptions (required and optional). Additionally, declines in the amount of state grants and contracts for workforce training are contributing to a negative operating margin. The College is evaluating the financial impacts and continues to be conservative with expenditures to offset the revenue decreases.

Primary Reserve: .08
Standard: .14

Viability Ratio: .24
Standard: .42

McLennan Community College's Primary Reserve Ratio and Viability Ratio dropped between 2014 and 2015 from .20 to .07 and .95 to .23 respectively. This was the result of the implementation of GASB 68 and the requirement to reflect pension liability. Since 2015, these ratios have improved slightly and we continue to monitor and work on strategies to continue that trend. The operating expenses of the College decreased in each of the three years since implementing GASB 68, which has helped to improve these ratios."

Northeast Texas College.

Northeast Texas College did not meet six of the indicator thresholds. The return on net position, operating margin, and CFI were negative. The college's expendable and unrestricted net position was negative, which dropped the institution's viability and primary reserve ratios below the state standard. The institution's net position and total assets were lower, resulting in the equity ratio falling below the state standard.

<u>Institutional Comments</u> – Jeffrey W. Chambers, Vice President of Administrative Services

"Return on Net Position and Equity Ratio

We did not meet this indicator mainly due to expenditures of fund balance for capital improvements and advanced debt refunding.

Operating Margin

We missed this indicator due to significant higher debt requirements for restricted sources of Ad-valorem taxes revenues. While overall Ad-valorem taxes fell 3.16%, the amount allocated to unrestricted use fell 19.12% from prior year.

Primary Reserve and Viability Ratio

Although expendable net position and unrestricted net position improved in FY 16-17 by $82,869, the implementation of GASB 68 in FY 14-15 has resulted in Northeast Texas Community College missing these indicators. GASB 68 cost the college $3.58 million in net position in FY 14-15."

South Plains College.

South Plains College did not meet four of the indicator thresholds. The return on net position and operating margin were negative, and CFI is below the standard of 2.0. The college's noncurrent liability increased $7 million, which dropped the institution's viability ratio below the state standard.

<u>Institutional Comments</u> – Teresa Green, Vice President for Business Affairs

"South Plains College increased bond liability by $6.5 million during FY17. The debt was incurred to complete the renovation for building a new technical center in Lubbock. SPC began renovation in FY16 and completed construction in FY17. The total amount funded by bonds was $8,850,000. SPC received $8.9 million in grant funds to help fund the building and equipment. South Plains College has paid $4 million towards the debt (from grant funds) since September. South Plains College will receive $1 million for each of the next three fiscal years (from grant funds) to help fund the debt service. The additional $1.9 million received from grant funds were used to fund the equipment and furniture for the building. The additional bond liability negatively impacted the return on net position ratio as well as the viability ratio.

Additionally, South Plains College lost $3 million in property taxes because we reached our cap of .40 per $100 valuation after the valuation decreased by $2.4 billion over a two year period. We did recover approximately $750,000 in property taxes in the current year. South Plains College had two large items approved by the board that were not budgeted. We entered into a contract for a new ERP (computer system) and the board approved for us to begin implementation so we would not have to wait until September to get started with the transition to the new system. We spent $1.1 million on this purchase in FY17. We also got an emergency approval from the board to purchase dorm furniture for $531,000 that was not budgeted. The loss of property taxes and the unbudgeted expenditures negatively impacted the operating margin."

Southwest Texas College.

Southwest Texas College did not meet four of the indicator thresholds. The institution's improved CFI went from being negative to just below the state standard of 2.0. Expendable and unrestricted net position was negative which, coupled with increased operating and nonoperating expenses, lowered the primary reserve and viability ratios below the state standard. The leverage ratio improved over the previous year but remained below the state standard.

Institutional Comments – Anne H. Tarski, Vice President - Finance

"Southwest Texas Junior College issued $20,500,000 in bond obligations in order to build facilities for several campuses from 2012-2016. This, along with the required posting of pension liabilities, caused our ratios to tumble in 2016. In response, the Board of Trustees and administration prepared a rigid budget that planned for an increase in net assets. The actual increase in net assets for 2017 was $1,279,612. The College is committed to maintaining this type of austere budgeting in order to improve our financial condition. We have already moved from six financial stress indicators in 2016 to four in 2017."

Tyler Junior College.

Tyler Junior College did not meet four of the indicator thresholds. The return on net position was negative, and CFI is below the state standard of 2.0. The increase in noncurrent liabilities and operating and nonoperating expenses caused the primary reserve and viability ratios to fall below the state standard.

Institutional Comments – Sarah E. Van Cleef, CPA, Vice President for Financial and Administrative Affairs, Chief Financial Officer

"On August 16, 2016, Standard and Poor's assigned a AA+ rating to Tyler Junior College's series 2016 maintenance tax notes and affirmed its AA+ rating on the district's outstanding general obligation (GO) bonds with a stable outlook.

The ratios used for the Financial Condition Analysis are inclusive of the impacts of GASB 68. The Standards that are expected to be met were established prior to the implementation of GASB 68. The net impact of GASB 68 on Tyler Junior College has been a decrease in Net Position of over $10 million. Additionally, TJC recognized $579,540 additional pension expense as a direct result of GASB 68.

The calculations for the ratios in the Financial Condition Analysis allow institutions to exclude the debt generated by the issuance of General Obligation Bonds; however, the treatment of the debt generated by the issuance of Maintenance Tax Notes is treated like Combined Fee Revenue Bonds - which they are not. Maintenance Tax Notes have the same dedicated debt service as General Obligation Bonds, property taxes. Therefore, the Maintenance Tax Note debt should be excluded as well. The exclusion of Maintenance Tax Note debt decreases TJC's Noncurrent Liabilities by over $20 million.

Lastly, TJC recognized over $500,000 in expenses for WiFi infrastructure for the campus community that are considered non-routine in nature.
Taking into consideration the impacts of GASB 68, the treatment of Maintenance Tax Notes, as well as the non-routine expenditures, the adjustments to the ratio calculations are significant and would drastically improve the ratio analysis for FY2017."

Appendix A: Composite Financial Index, Core Financial, and Other Financial Ratios

Fiscal Year 2017 General Obligation Bond Debt Excluded

Financial Stress Indicators	District	Composite Financial Index	Return on Net Position	Operating Margin	Primary Reserve	Viability Ratio	Equity Ratio	Leverage Ratio
3	Alamo	**1.99**	11.32%	3.36%	**0.09**	**0.15**	30.99%	0.45
1	Alvin	2.13	12.52%	2.10%	**0.07**	0.46	42.72%	-
2	Amarillo	**1.19**	0.93%	**-1.91%**	0.22	0.94	47.73%	0.04
0	Angelina	4.16	4.42%	0.24%	0.37	3.22	60.07%	-
4	Austin	3.16	51.66%	9.43%	**0.05**	**0.04**	**8.90%**	**4.37**
1	Blinn	3.68	15.32%	15.96%	0.32	**0.38**	47.13%	0.62
3	Brazosport	**0.95**	3.56%	1.04%	**0.10**	**0.23**	33.35%	0.11
0	Central Texas	5.49	0.85%	1.46%	0.75	3.82	78.03%	-
3	Cisco	**1.23**	5.92%	3.88%	**0.02**	**0.04**	40.24%	0.63
4	Clarendon	**0.63**	**-0.02%**	2.00%	**0.09**	**0.14**	61.60%	0.04
2	Coastal Bend	2.26	14.49%	4.76%	**0.03**	**0.07**	39.19%	0.50
3	College Of The Mainland	**0.73**	**-2.39%**	**-1.19%**	0.17	0.84	56.93%	-
0	Collin	8.71	7.13%	16.44%	1.35	9.95	88.37%	-
0	Dallas	6.52	9.35%	5.35%	0.50	4.30	58.14%	-
2	Del Mar	**1.84**	4.01%	**-1.60%**	0.31	1.02	39.57%	-
1	El Paso	3.57	12.12%	10.12%	0.39	**0.39**	40.27%	0.90
5	Frank Phillips	**(1.46)**	**-2.40%**	**-1.58%**	**-0.18**	**(0.63)**	61.62%	0.10
0	Galveston	6.10	8.78%	10.95%	0.59	3.20	82.55%	-
0	Grayson	5.63	7.95%	5.18%	0.89	2.08	55.86%	0.11
0	Hill	3.27	1.61%	2.01%	0.30	2.43	75.90%	0.01
1	Houston	3.01	12.55%	7.41%	0.22	**0.21**	30.52%	0.77
0	Howard	2.16	3.80%	1.91%	0.36	0.68	56.18%	0.29
0	Kilgore	3.49	3.47%	2.12%	0.32	2.38	85.05%	0.01
2	Laredo	4.34	21.09%	10.33%	0.40	**0.34**	**18.14%**	1.57
4	Lee	**1.19**	13.18%	**-5.64%**	**0.05**	**0.15**	34.79%	0.17
5	Lone Star	**0.53**	4.25%	**-1.89%**	**0.09**	**0.15**	**19.13%**	0.44
4	McLennan	**0.41**	2.78%	**-1.87%**	**0.08**	**0.24**	33.68%	0.25
0	Midland	3.09	3.77%	3.36%	0.42	1.34	66.79%	0.10
3	Navarro	**1.97**	6.07%	5.71%	**0.13**	**0.24**	47.35%	0.39
3	North Central Texas	**1.40**	**-1.33%**	**-0.81%**	0.25	1.19	58.52%	0.08
6	Northeast Texas	**(0.78)**	**-3.55%**	**-3.46%**	**0.00**	**(0.01)**	**19.97%**	0.64
0	Odessa	3.88	10.54%	7.59%	0.36	1.05	36.77%	0.18
0	Panola	6.99	8.51%	7.66%	0.62	4.55	50.51%	0.01
0	Paris	4.11	6.88%	11.05%	0.59	1.04	67.58%	0.27
3	Ranger	**1.88**	4.27%	5.05%	0.22	**0.18**	24.98%	**2.08**
3	San Jacinto	**0.29**	**-1.51%**	**-4.19%**	0.17	0.47	23.28%	0.31
4	South Plains	**0.22**	**-2.58%**	**-1.35%**	0.15	**0.33**	58.70%	0.39
0	South Texas	8.03	6.77%	8.81%	1.08	6.63	62.69%	-
4	Southwest Texas	**1.96**	12.05%	5.92%	**-0.02**	**(0.03)**	21.96%	**2.18**
0	Tarrant	6.02	3.35%	8.34%	0.54	3.89	91.74%	-
1	Temple	2.25	3.01%	**-0.27%**	0.44	0.99	42.84%	0.29
0	Texarkana	2.25	1.75%	3.34%	0.24	1.14	68.08%	-
1	Texas Southmost	5.80	0.17%	**-0.78%**	1.25	3.12	64.56%	0.09
0	Trinity Valley	4.37	18.59%	5.69%	0.22	1.32	82.06%	-
4	Tyler	**0.68**	**-0.17%**	3.67%	**0.05**	**0.05**	35.67%	1.05
3	Vernon	**1.13**	4.80%	4.19%	**0.01**	**0.02**	39.22%	0.63
3	Victoria	**1.17**	6.79%	**-3.61%**	**0.10**	0.74	47.32%	0.01
0	Weatherford	3.83	2.32%	2.33%	0.70	1.69	63.46%	0.20
0	Western Texas	3.99	7.85%	12.92%	0.65	0.58	52.32%	0.63
0	Wharton	4.95	2.01%	3.10%	0.56	3.37	74.30%	0.03
0	Statewide	2.81	6.53%	4.80%	0.34	0.68	45.65%	0.27

Bold fonts indicate ratios that do not meet the state standard.

- Zero to one financial stress indicators, which indicates no financial stress.
- Two to three financial stress indicators, which indicates little to moderate financial stress.
- Four to seven financial stress indicators, which indicates financial stress.

Appendix B House Bill 1 Authorizing Financial Condition Report

House Bill 1, General Appropriations Act (Section 13, page III- 211), 84th Texas Legislature

"Each community college shall provide to the Texas Higher Education Coordinating Board financial data related to the operation of each community college using the specific content and format prescribed by the Coordinating Board. Each community college shall provide the report no later than January 1st of each year.

The Coordinating Board shall provide an annual report due on May 1 to the Legislative Budget Board and Governor's Office about the financial condition of the state's community college districts."

Appendix C General Comments from Institutions

Institutions were given an opportunity to provide feedback on the report no later than February 26, 2018.

This document is available on the Texas Higher Education Coordinating Board website:
http://www.thecb.state.tx.us

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