FACT SHEET

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How Higher Tuition Translates into More Debt for State Universities

By Simon Wong

The S.C. Budget and Control Board recently announced a moratorium halting construction at four-year public institutions that raised tuition by 7 percent or more for the 2010-2011 school year.

The moratorium applies only to institutions that raised tuition by 7 percent or more. This means it does not apply to the University of South Carolina, which raised tuition by 6.9 percent. But it does apply to Clemson, which raised tuition by 7.5 percent.

So how is tuition connected to capital building projects?

Strictly speaking, state institutions issue bonds to raise the cash needed for capital building projects. As dictated by section 59-107-40 of the state code, however, bond applications must contain a schedule of tuition fees that shows how the "annual principal and interest requirements on the proposed bonds and on all outstanding state institution bonds issued" shall be financed. In turn, state law caps annual debt service to a formula gauged against tuition fees. Reads S.C. Code of Law, section 59-107-90:

> "The maximum amount of annual debt service on all outstanding state institution bonds for each state institution shall not exceed ninety percent of the sums received by such state institution from tuition fees for the preceding fiscal year, as provided in Section 13(6)(b) of Article X of the South Carolina Constitution."

In other words, the maximum amount of annual bond debt service for each institution cannot exceed 90 percent of what's collected from tuition fees specifically pledged to cover additional debt services. The more tuition collected, the more debt may be issued.

In Clemson's case, raising tuition by 7.5 percent would enable the school to raise its borrowing levels by a significant amount.

As of FY2009, Clemson collected $205.488 million in student tuition and fees, excluding receipts from scholarships. (Tuition and fees are reported together, and it's unclear whether they are considered separately for the purpose of calculating bond debt.) A tuition increase of 7.5 percent would translate into $15.412 million in additional revenue if the entire increase were allocated to debt service.

In itself, that's not a lot of money. If Clemson had followed USC's lead and only raised tuition by 6.9 percent, the result would have been $1.233 million in reduced revenue.

That $1 million-plus difference, however, can be leveraged to borrow millions more using institutional bonds.

This is how it works:

- Note that the law uses the phrase, "annual debt service." This is very different from the term, "principal outstanding." Annual debt service means the amount paid per year to cover principal and interest payments.

- Because an institutional general obligation bond may have a maturity of up to 20 years, this means that for every $1 in additional tuition revenue, an institution may increase its cumulative debt service by $18 (that is, 90 percent of 20). That's a 1 to 18 ratio.

In Clemson's case, $1.233 million in additional revenue translates into a maximum of $22.194 million in cumulative debt service for capital projects.

This $22.194 million is the maximum in additional debt that could be leveraged from the tuition increase. But historically, Clemson has pledged about 4 percent to 8 percent of tuition revenue for general obligation bond service (from FY04-2005 to FY08-2009). If Clemson allocated 8 percent of additional tuition revenue for annual debt service for FY10-2011 (as was done in FY08-2009), the 7.5 percent tuition increase would increase annual debt service by $1.165 million – which translates into $15.411 million in cumulative debt service over 20 years.[1]

Generally speaking, each institution that has reached its maximum debt service limit must raise its tuition fees pledged to general obligation bonds in order to borrow more money. Normally, the bond proceeds that result are used to acquire/build capital assets.

In FY08-2009, for instance, South Carolina State University exceeded its legal debt service limit by about $223,000. As a result, S.C. State explicitly acknowledged in the South Carolina Comprehensive Annual Financial Report that it would "adjust tuition fees in subsequent years to cover the debt requirement." S.C. State raised tuition by 5.7 percent for the 2010-2011 school year.

And, so, the cycle continues.

Over the past five years (FY2004 to FY2009), the state's university system has acquired over $1.845 billion in capital assets. During the same period, the total depreciation of capital assets was about $712 million. Thus, the net acquired assets amounted to about $1.133 billion.

Cumulatively, universities issued about $1.083 billion in bonds to acquire these capital assets.

During the same period, in-state tuition increased by 52 percent at South Carolina's public, 4-year institutions.

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[1]Other schools allocate a much greater percentage of tuition revenue for maximum annual debt service. In FY08-2009, for example, Lander University pledged $19 million out of $19 million (or 100 percent) in student tuition and fees generated from the prior fiscal year.

The irony in all this is that as tuition increases, fewer students will be able to afford to attend college in South Carolina. That means new buildings and facilities will be underutilized. A better solution, as we discuss in our new report on higher education, is to look to current building utilization reports with any eye toward maximizing existing resources, investing in distance/virtual education programs, and reducing spending and borrowing.

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