



**OregonLive.com**

Everything Oregon

## University of Oregon plan for financial stability offers more money, more risk

Published: Friday, May 14, 2010, 8:44 PM Updated: Saturday, May 15, 2010, 8:28 AM



By **Ted Sickinger, The Oregonian**



[View full size](#) University of Oregon president Richard Lariviere

**University of Oregon's** plan to wean itself from limited and unpredictable state funding could create a lucrative cash machine over the long term, throwing off more money than it could hope to win in the biennial state budget brawl.

But the plan assumes generous investment returns, adds considerable financial risk to its budget and, in the short run, results in less cash support of the university's operating budget from the state.

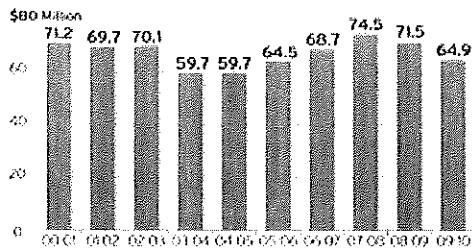
It's also far from clear that the state could accommodate the plan under its current debt limits without crowding out other projects.

The proposal advanced this week by **UO President Richard Lariviere** is a radical departure from current practice, and hinges on a borrowing scheme in which taxpayers would seed the university's endowment with \$800 million in bond proceeds. The university has pledged to match that amount with private donations, then invest the combined cash and live on the proceeds, without further state support.

If adopted, the proposal would fix taxpayers' obligation to the university at the annual debt payments on the state bonds -- \$65 million. Meanwhile, the university would assume control over its financial destiny, with less of the whipsawing appropriations that come from a state budget dependent on volatile income tax revenues.

### University of Oregon state funding

UO President Perford Lunsford wants to utilize the university's endowment, cutting money from the state budget, to offset state cuts.



Source: University of Oregon

More on the Oregonian

[View full size](#)

"It's a trade-off of risk," said John Chalmers, a UO finance professor who worked on the plan. "We're trading political risk for investment risk, and we can plan for investment risk. That's what endowments do."

The university's proposal rests on two basic assumptions: that it would generate 9 percent annual returns, and draw 4 percent of the endowment's principal into its operating budget each year.

Recent history doesn't bear out the investment scenario. While the UO Foundation generated investment returns of 10 percent last year as financial markets snapped back from the meltdown in 2008, its returns have averaged 5.2 percent over the past five years and 5.5 percent over the past decade.

Most market watchers consider 2008 and early 2009 an aberration, the equivalent of a hundred year flood in the financial markets.

The UO Foundation's annual return is about 9.5 percent measured over the past 15 years, according to the foundation's chief investment officer, Jay Namyet.

Yet many institutional investors are pessimistic about a return to the growth, productivity gains and low interest rates that drove an almost uninterrupted bull market between the early 1980s and 2007. Consequently, they are trimming their forecasts.

Namyet says the foundation makes healthy allocations to alternative investments -- private equity, real estate and hedge funds -- that he expects to outpace the stock market. So he thinks the 9 percent average is realistic.

"We're in uncharted territory right now," he said. "We try to find fund managers who can make money regardless of the economic environment."

If the university generates 9 percent returns, the cash being generated by the state's bond proceeds would initially be less than the state support today.

In the first year, a 4 percent draw on the state's \$800 million amounts to \$32 million, less than half the \$65 million appropriation last year.

The distribution would grow as the university reinvested its excess earnings and the endowment grew -- the

beauty of compound interest. But it would take 15 years before the 4 percent draw amounted to more than \$65 million. The cumulative budget shortfall over those first 15 years -- assuming the state's appropriation to UO remained constant and the models assumptions hold -- would amount to more than \$280 million.

"They'll have to make up the deficiency," said Eric Press, chairman of the accounting department at Temple University and a UO alumnus who examined the proposal. "They have to pay salaries every year ... and they do that with real dollars, not accrual dollars."

The university proposal assumes the shortfall on the state side would be made up by earnings on private donations. It has pledged to match the state investment dollar for dollar with private donations.

A 4 percent annual draw on a \$1.6 billion endowment would amount to \$64 million in the first year, and grow from there, quickly outpacing the annual and unpredictable state budget contribution.

But the university would accrue a marginal benefit only to the extent that the state investment enables it to tap donors that don't give today, or entice existing donors to give more than they would otherwise.

"Our expectation is that we're not going to see a substitution effect," said Phil Weiler, a spokesman for the university.

The University of Oregon is already a regular fundraiser. In 2008, it concluded a campaign that raised \$853 million from more than 90,000 individual donors. Even in 2009, one of the worst years for foundations around the country, **Lariviere** says the foundation raised more than \$100 million.

Matching grants are a popular fundraising tool, and the promise to "leverage" state dollars with private contributions is a common lobbying pitch to legislators. But whether the state and private donations are truly interdependent is debatable.

But in the end, the UO's proposal may depend more on the state's ability to accommodate the borrowing request without damaging its credit rating or crowding out other priorities, such as road building or new state hospitals. According to the latest report from the State Debt Policy Advisory Commission, debt capacity "has become a scarcer resource," and "Oregon's credit standing would be damaged if public debt is used to pay for operational expenses, rather than for capital projects."

The Legislature approved \$985 million in general fund-supported debt in 2009, and the commission says the state should be able to issue \$1.3 billion in each of the next two bienniums.

Seattle Northwest Securities, which reviewed the university's financial model, says the resulting increase in the state's annual debt service would not be significant, and would be offset by lower budget numbers for higher education.

But neither sitting state **Treasurer Ted Wheeler** nor his Democratic opponent in Tuesday's election, **Sen. Rick Metsger, D-Welches**, appear supportive of using the state's borrowing capacity to fund stock market speculation.

"I am interested in ideas to create stable funding for higher education, but I am skeptical of using long-term debt to cover operating expenses," Wheeler said Friday. "Debt is more appropriate for funding capital projects."

-- **Ted Sickinger**

© 2011 OregonLive.com. All rights reserved.