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ROGER L. ANDERSON  
*Executive Director*

November 15, 2007

The Honorable W. Cary Edwards, Chair  
State of New Jersey Commission of Investigation  
28 West State Street  
P.O. Box 045  
Trenton, New Jersey 08625

Re: Report of the State Commission of Investigation on Governance, Oversight and Accountability of Public Higher Education in New Jersey

Dear Mr. Edwards:

I am surprised and disappointed that the above-mentioned Report reflects a lack of understanding of the process of issuing tax-exempt bonds. I had believed that a thorough such understanding was present in our discussions during my testimony, but it is not to be found in the Report.

Because the Referrals and Recommendations in the Report under the heading "Establish Capital Plans for Each Institution and Strengthen Due Diligence Requirements for Capital Improvements and Bonded Indebtedness" are based on this lack of understanding, they themselves are flawed.

We feel impelled to correct the record. The Report can have a beneficial effect on higher education and the citizens of New Jersey only if it is based on complete and accurate information.

#### **NJEFA'S MISSION**

The Legislature created the New Jersey Educational Facilities Authority ("NJFEA") in 1966 because it found that:

[A] serious public emergency exists affecting and threatening the welfare, comfort, health, safety and prosperity of the people of the state . . . resulting from the fact that financial resources are lacking with which to construct required dormitory and other educational facilities at public and private institutions of higher education; that it is essential that this and future generations of youth be given the fullest opportunity to learn and to develop their intellectual and mental capacities . . . and that it is the purpose of this [Act] to provide a measure of assistance . . . to enable

institutions of higher education in the state to provide the facilities which are sorely needed to accomplish the purposes of this [Act], all to the public benefit and good.<sup>1</sup>

At the time, Governor Hughes said, "Our State's economic and social potential are bound closely to a well-educated vigorous citizenry."<sup>2</sup> Earlier, he had said:

The surest measure of a government's concern for the development of a state, as well as the personal growth of each individual citizen, is the support of its educational institutions. . . . Our youth should be encouraged to seek the best education from which they, as individuals, can profit. And this profit accrues to the individual, but also to the state and the nation.<sup>3</sup>

His words have proved true. College graduates on average earn significantly more money than do those without higher education. As a result, they contribute more in taxes. Further, they tend to require fewer public services. College graduates are more likely to vote, more likely to volunteer for charities, more likely to donate blood, more likely to exercise and less likely to smoke. They also tend to raise the earnings of less well-educated workers in their surroundings.<sup>4</sup>

Governor Corzine has also identified the nexus between higher education and economic prosperity. World-class higher education is one of the six priorities in the State's Economic Growth Strategy, which says that, "[T]he state's universities and colleges . . . require state-of-the-art equipment, buildings, libraries and distance-learning capacity."<sup>5</sup> NJEFA is required to promote the goals of the Economic Growth Strategy.<sup>6</sup>

The Strategy builds on the fact that nearly three out of every eight adults in New Jersey holds at least a bachelor's degree, the 10<sup>th</sup> highest percentage in the country. That high level of educational achievement has caused total personal income in the State to be 12% higher than the national average.<sup>7</sup>

New Jersey cannot rest on these accomplishments, however. The United States is one of only two OECD countries whose older population is more educated than its younger. At the same time, the Bureau of Labor Statistics estimates that nearly half of all job growth in the U.S. in the next ten years will be in positions requiring college degrees.<sup>8</sup> New Jersey's economic success depends on more people getting higher education.

It is this "bigger picture" to which NJEFA is dedicated.

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<sup>1</sup> N.J.S.A. § 18A:72-1.

<sup>2</sup> Hughes, Governor Richard J., "Special Message on Higher Education to the Legislature," May 25, 1966.

<sup>3</sup> Hughes, Governor Richard J., "Inaugural Address to the Legislature," January 16, 1962.

<sup>4</sup> The College Board, *Education Pays 2007: The Benefits of Higher Education for Individuals and Society*.

<sup>5</sup> *Economic Growth Strategy for the State of New Jersey* (2006).

<sup>6</sup> Executive Order No. 37 (Corzine), September 26, 2006.

<sup>7</sup> The National Center for Public Policy and Higher Education, *Measuring Up 2006*.

<sup>8</sup> Lumina Foundation, *Hitting Home: Quality, Cost, and Access Challenges Confronting Higher Education Today* (2007).

## COLLEGE DEBT

Over more than four decades, NJEFA has issued tax-exempt obligations for each of New Jersey's nine senior public higher education institutions, the three public research institutions, several county colleges and eighteen private institutions of higher education.<sup>9</sup> We have fulfilled our statutory mission by helping the institutions construct and acquire facilities at a lower cost than would otherwise have been available.

The Report's analysis of public colleges' debt is incomplete. No evaluation can be useful unless it considers first, why the colleges have issued so much debt and second, what the debt has been used to build.

First, the colleges have had to finance their own capital projects because of what Moody's Investors Service has called "the historic lack of state support for capital projects."<sup>10</sup> For example, the last State general obligation bond for higher education was 19 years ago, and New Jersey ranks 45<sup>th</sup> among the 50 states in enrollment capacity at public colleges and universities on a per capita basis.<sup>11</sup> Moody's has also observed that:

Public colleges and universities in the State face an intense need to renovate, upgrade and expand facilities in order to accommodate changing student tastes and the growing population of high school graduates seeking admission. . . . The lack of state funding for capital projects has left most colleges and universities highly leveraged, since they have had to borrow for academic as well as auxiliary facilities.<sup>12</sup>

Second, the colleges' borrowings have been used to build the facilities needed to educate growing numbers of students. Since the last State general obligation bond issue for higher education, the number of students at public institutions has increased by more than 30%. The colleges have had to finance the capacity to educate these additional students on their own. That they have succeeded is shown by the fact that, over the same period, the number of degrees and certificates awarded by those colleges has grown by almost 60%, all to the greater benefit of New Jersey.<sup>13</sup>

*The Economist* identified the major challenges of higher education in the 21<sup>st</sup> century as the demands for both excellence and access.<sup>14</sup> Despite the lack of State funds, New Jersey's public institutions have faced these challenges head-on. The public colleges have used self-government

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<sup>9</sup> NJEFA has also provided financing to some public libraries and boarding schools pursuant to programs authorized by the Legislature.

<sup>10</sup> Moody's Investors Service, "New Jersey Public Colleges and Universities: Outlook Remains Cautiously Stable Despite Recent Downgrade of State of New Jersey's Rating" (2004).

<sup>11</sup> New Jersey Association of State Colleges and Universities, *NJ State College/University Accountability Source Book 2007*.

<sup>12</sup> Moody's Investors Service, "New Jersey Public Colleges and Universities: Outlook Remains Cautiously Stable Despite Recent Downgrade of State of New Jersey's Rating" (2004).

<sup>13</sup> New Jersey Commission on Higher Education, Statistical Tables, [www.state.nj.us/highereducation/](http://www.state.nj.us/highereducation/).

<sup>14</sup> "The brains business," *The Economist*, September 10, 2005.

to define and distinguish themselves, to appeal to distinct markets and to serve growing numbers of New Jersey students.

As I mentioned in my August 8<sup>th</sup> letter to Mr. Rockoff, a copy of which is enclosed, the public colleges are unique within State government in being competitive institutions. They must compete for students, faculty and funds. In doing so, they compete not only with each other, but also with private institutions in New Jersey, as well as both public and private institutions outside the State. In fact, New Jersey exports a higher percentage of its high school students to colleges in other states than does any other state.<sup>15</sup>

To compete successfully, the colleges must have the programs and facilities to provide educations appropriate for the 21<sup>st</sup> century. At the same time, they compete on cost. Prospective students, and their parents, are discriminating customers. Colleges must strive for the proper balance between facilities and tuition levels to attract students. That they have generally done so is evidenced by the rising demand for admissions to the institutions.

There are also restraints on borrowing inherent in the financing process. If investors are concerned that a financing could impair the viability of an institution, the institution will not be able to borrow the money it seeks. Thus, the institution's decision to invest in its facilities is subject to the oversight of the capital markets. For this reason, bonds cannot be sold without a due diligence review of the borrower's operations, goals and decision-making process.

The Report, without explanation, denigrates both kinds of competitive forces and their effects on colleges.

The Report also fails to explain how additional bureaucratic oversight could do a better job than either of these competitive forces or than the existing opportunities for State review.

- The trustees of public colleges are nominated by the Governor and must be confirmed by the State Senate.
- Both the State Treasurer and the Chair of the Commission on Higher Education are *ex officio* Members of NJEFA, before whom all financings are brought for approval.
- The public Members of NJEFA are also nominated by the Governor and confirmed by the Senate.
- The Legislature has the opportunity to disapprove any financing of a non-revenue producing project by a public institution.
- The Governor has the power to disapprove any action of NJEFA.

These various levels of review are thorough, and additional opportunities for State oversight are unnecessary.

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<sup>15</sup> National Center for Education Statistics, "Residence and migration of all freshman students in degree-granting institutions, by state or jurisdiction, Fall 2004".

**DUE DILIGENCE**

NJEFA's long experience with New Jersey's colleges and universities has given us a thorough understanding of these institutions. We consult with them frequently, and therefore we do not need a formal application prior to a financing. We do not require application fees, because we want to keep colleges' costs as low as possible. To infer that the lack of formal applications means that we do not concern ourselves with colleges' projects is insupportable.

Both federal tax and securities laws, as well as market practice, require a "due diligence" process to ensure that a particular project qualifies for tax-exempt financing and that all material information about a college is presented to investors. In this process, NJEFA has a well earned reputation for being more "hands-on" than other authorities in the state and across the country. Our review during the financing process is more detailed, more particular and more iterative than any application form.

We pride ourselves on not being bureaucratic and on adding value, both during and after a financing. Our frequent financings give us financial market expertise that the colleges do not have. We bring our expertise to bear to help all colleges, both public and private, analyze their financing options to achieve the lowest cost of funds.

Each college knows the competitive forces affecting it better than anyone else does. It is therefore in the best position to determine what facilities it needs within the context of what it can afford. Moreover, in our experience, each institution has already developed its own capital facilities plan (contrary to the implication in the Report) and makes its facilities determinations based on such plan.

As a conduit issuer, NJEFA does not substitute its judgment for that of a college or university as to whether a particular facility is appropriate. We work with all of our clients, however, on issues of affordability. If a financing may cause an institution's debt to be downgraded, we discuss the options with the institution. Nevertheless, if the institution decides that a particular project or series of projects is important enough to its long-term mission to accept the costs of a downgrade, it, not NJEFA, is in the best position to analyze that tradeoff.

In our 41-year history, NJEFA's staff has never presented a financing to NJEFA's Members for approval without conducting extensive due diligence and concluding that the financing is appropriate for NJEFA and in furtherance of its statutory mission. There has never been a default in payment by any institution.

**OTHER ERRORS**

There are other errors in the Report.

The most glaring is the statement, referring to public colleges, that "any bond proceeds remaining after completion of the approved projects are released to the school's general operating accounts." To the contrary, federal tax law treats public and private borrowers exactly the same

and requires that either type of borrower apply any excess funds to the payment of outstanding bonds.<sup>16</sup>

The Report's discussion of NJEFA's proposal to finance working capital loans in A-3677 is misleading, because it neglects both the discussions during my testimony as well as my response to Mr. Rockoff. The Report ignores: (1) the limitations on working capital borrowings in federal tax law;<sup>17</sup> (2) the fact that some institutions already have working capital loans from banks, on which they pay taxable rates of interest, and the availability of tax-exempt working capital loans would not increase their indebtedness but would instead lower their costs; (3) that smaller, private institutions would be more likely to use these working capital loans than would public colleges; and (4) that we have already requested that A-3677 be amended in accordance with your suggestion.

The Report's implication that the public is given notice and the opportunity to comment on private institutions' financings but not for those for public colleges and universities is also wrong. As noted in the Report, federal tax law requires that a public hearing (referred to as a "TEFRA" hearing) be held before a financing for a private institution may occur but does not impose this requirement on financings for governmental entities, including public colleges and universities. New Jersey law, however, requires that public colleges and universities provide advance notice of their meetings and conduct those meetings in accordance with the Open Public Meetings Act.<sup>18</sup> In addition, all approvals of NJEFA are subject to the notice and public meeting requirements of such Act.

**CONCLUSION**

NJEFA would welcome recommendations for improvement based on an accurate understanding of the tax-exempt financing process. We stand ready to continue to provide our full cooperation to help the SCI achieve such an understanding.

Sincerely,



Roger L. Anderson  
Executive Director

Attachment

- c: The Honorable Jon S. Corzine, Governor
- New Jersey Senate
- New Jersey General Assembly
- New Jersey Educational Facilities Authority Members
- Commission on Higher Education Members

<sup>16</sup> I.R.C. § 148 and Treasury Regulations thereunder.

<sup>17</sup> *Ibid.*

<sup>18</sup> N.J.S.A. §§ 10:4-6 *et seq.*



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August 8, 2007

ROGER L. ANDERSON  
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VIA Overnight delivery

Alan A. Rockoff  
Executive Director  
State of New Jersey  
Commission of Investigation  
28 West State Street  
P.O. Box -045  
Trenton, New Jersey 08626-0045

Re: Notice of Proposed Report Dated July 27, 2007  
Dissemination No. 07-07-014 (the "Notice")

Dear Mr. Rockoff:

Thank you for sending me the captioned notice from the State of New Jersey Commission of Investigation (the "Commission") regarding the Commission's forthcoming report (the "Report") on the public institutions of higher education in New Jersey. As permitted by the statute you cited, I am submitting this response to the Notice.

The Notice recaps some of the information I provided to the Commission about the New Jersey Educational Facilities Authority, its procedures, and its interaction with New Jersey colleges and universities in carrying out its mission to assist New Jersey institutions of higher education in obtaining financing for capital projects. At the conclusion of the Notice is the following excerpt from the Report:

The Commission is concerned, meanwhile, that legislation currently pending before the New Jersey Senate and General Assembly could inject a disturbing new facet into this bonded indebtedness picture. The bill, A-3677, would allow NJEFA to issue new types of debt not currently permitted under existing law on behalf of the state's nine senior public colleges and universities. The most troubling aspects of this bill are provisions that would allow NJEFA to issue bonds on behalf of the schools to raise funds for the so-called "working capital". According to Anderson, this term refers to short-term operating expenses, and the money borrowed would be intended to help the schools cover such expenses during periods when their cash flow is restricted. As currently

written, however, the measure would provide far more expansive borrowing abilities, enabling public colleges and universities to actually borrow in anticipation of future budget shortfalls.

I start with two technical corrections:

First, A-3677 has not yet been introduced in the New Jersey Senate, so it is not pending there.

Second, A-3677 would enhance the Authority's ability to serve all of our clients, not just the nine senior public institutions.

Moving on to the substance of the criticism, I have three responses.

First, we do not expect this provision to increase colleges' overall debt levels. Many of our smaller clients must already obtain short-term loans to cover seasonal cash flow needs. Since NJEFA cannot currently provide such loans, the colleges must seek these loans directly from banks, which charge taxable rates. A-3677 will allow the colleges to replace those taxable loans with tax-exempt loans, thereby lowering the cost of their debt and reducing the debt service burden on colleges' budgets.

Second, it is our smaller private clients that need these cash flow loans. The public institutions are generally large enough to be able to manage through their seasonal declines in cash. Therefore, we do not expect this provision of A-3677 to be used much by public institutions.

Third, A-3677, as originally drafted, would amend NJEFA's enabling legislation by adding the following new definition:

"Working capital" means, with respect to any public institution of higher education or private college situated within the State, funds to be used in or reserved for the operation of the institution.

As the Report states, our intention is to be able to offer our clients tax-exempt financing to cover their seasonal short-term cash flow needs. NJEFA has no interest in deficit financing. I explained in my testimony before the Commission that tax-exempt working capital loans are subject to federal tax restrictions on the maturity and use of short-term working capital loans. Specifically, unless (1) the borrowed proceeds are expected to be spent within 13 months under Treasury Regulation 1.148-2(e)(2), and (2) at least 90% of the borrowed proceeds are actually spent within 6 months under Section 148(f)(4)(B)(iii) of the Internal Revenue Code of 1986, as amended, there are strict limitations on the investment of the borrowed proceeds and the earnings on those proceeds.

During my testimony, the Commission's Chair suggested that it would be appropriate to have limitations on working capital borrowings in State law as well as in federal law, so that such borrowings could not be used to finance operating deficits.

NJEFA took this suggestion to heart and, on March 30, 2007, we suggested to the sponsor of A-3677 and the staff of the Assembly Higher Education Committee that the proposed definition of "Working capital" be changed by inserting the text that appears in bold type below:

**"Working capital" means, with respect to any public institution of higher education or private college situated within the State, funds to be used in, or reserved for, the operation of the institution *which are borrowed and repaid within the same budget year.***

I further requested this change in my testimony before the Assembly Higher Education Committee regarding A-3677 on May 17, 2007.

Accordingly, NJEFA has already addressed this specific criticism.

More generally, I note that the Report's discussion of the requirement that public colleges and universities must submit non-revenue-generating projects to the Legislature improperly lists "dorms" as an example of such a project. In fact, student housing projects are revenue-generating projects and, as such, are not subject to the legislative submission requirement.

I also take exception to the title "**UNBRIDLED BORROWING**".

Any discussion of debt incurred by colleges and universities in New Jersey is incomplete if it does not consider both the facilities financed with such debt as well as the competitive market forces faced by colleges and universities.

Unlike most institutions of government, institutions of public higher education operate in a competitive environment. They must compete for students, faculty and resources. They are not guaranteed any of those.

The market for higher education has become globally competitive at the same time that State support for college facilities has evaporated. As New Jersey's institutions have worked to build the facilities to attract and prepare New Jersey's students for the technologically advanced economy of the 21<sup>st</sup> century, they have had to balance the costs of such facilities against their other needs for resources and against their limited abilities to raise additional resources, either from students or philanthropists.

Both students (and their parents) and philanthropists are competitive market forces that evaluate colleges' facilities plans and costs, and their judgments serve as limiting factors on what colleges can do.

In addition, the credit markets, including both the rating agencies and investors, serve as additional limiting factors. Borrowing too much will cause a college's borrowing costs to increase, placing further strain on the balance described above.

In our experience, all the colleges and universities in New Jersey weigh the costs of new facilities against the need for such facilities, against competing needs and against the challenge of raising resources. NJEFA believes each institution is in the best position to evaluate its own competitive position in determining whether or not a project is both needed and affordable. Therefore, NJEFA focuses on the viability of a proposed borrowing—an area in which we believe we have greater expertise than do our clients and consequently provide value—and does not interject itself into the internal decision making of an institution.

Evaluating competitive positions is not common within government and is not often appreciated. I submit that any proposal to require greater bureaucratic evaluation of college facilities must first show how the competitive forces affecting higher education today are inadequate to the task, and second how distant bureaucrats will be in a better position to evaluate an institution's needs and resources than are the institution's leaders.

The Legislature determined in 1994, when it adopted the Higher Education Restructuring Act, that:

[T]he institutions of higher education are one of the most valuable and underutilized resources in the State; and  
[T]he elimination of unnecessary State oversight and its accompanying bureaucracy will serve to unleash the creativity and innovation of these institutions . . . .

We believe the Legislature has been proved right. The public colleges have used self-government to define and distinguish themselves, to appeal to distinct markets and to serve growing numbers of New Jersey students. The State should be proud of these institutions.

I hereby certify that, under penalties of perjury, to the best of my knowledge and belief, the information I have provided is true, correct and complete.

Sincerely,



Roger L. Anderson  
Executive Director