

**AGENDA ITEM VII-D  
DRAFT**

# **Financial Condition Analysis of Texas Public Community College Districts**

**May 2016**

## Texas Higher Education Coordinating Board



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### Agency Mission

The Texas Higher Education Coordinating Board promotes access, affordability, quality, success, and cost efficiency in the state's institutions of higher education, through Closing the Gaps and its successor plan, resulting in a globally competent workforce that positions Texas as an international leader in an increasingly complex world economy.

### 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 competent workforce.

**Excellence:** We strive for preeminence 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.

## Executive Summary

The objective of this 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.

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-205), 84th Texas Legislature. The rider states the following:

"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."

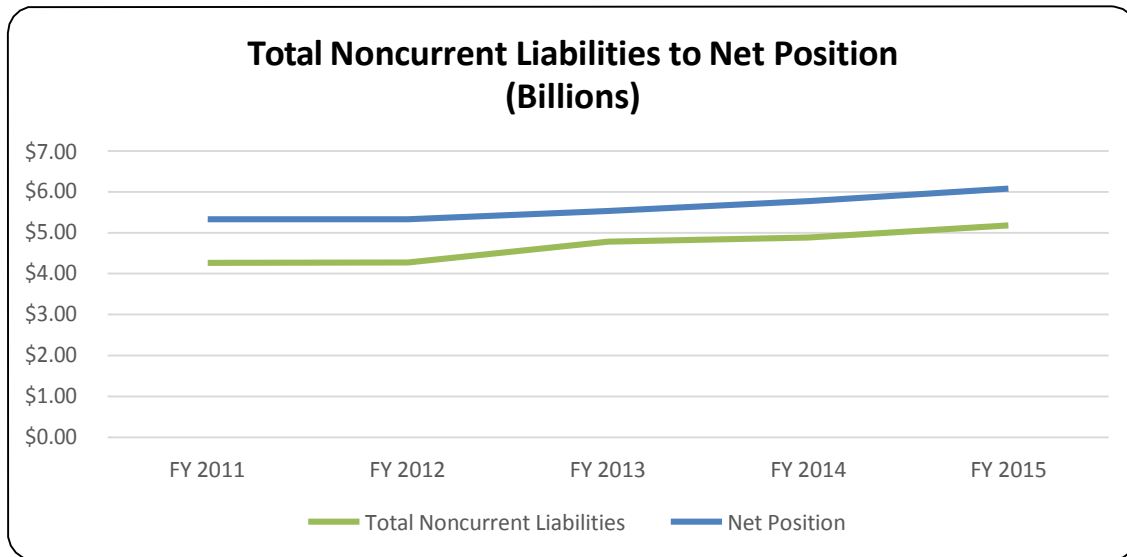
The overall financial health of an institution can be measured using two dimensions of inquiry. First, is the institution financially capable of successfully carrying out its current programs? Second, is the institution able to carry out its intended programs into the future?

Community college districts experienced a significant change in Accounting Principal with the implementation of Governmental Accounting Standards Board (GASB) 68. 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 financial condition of community college districts was substantial and is reflected below. By using estimated amounts, this report attempts to indicate the financial condition of institutions if GASB 68 had not been implemented.

For a year-to-year comparison of total noncurrent liabilities and net position, estimated amounts for GASB 68 implementation have been removed. Total noncurrent liabilities have increased \$2.10 billion since Fiscal Year (FY) 2008. Most of the increase is due to the general obligation bonds issued by districts. For FY 2015, the total noncurrent liabilities for Texas public community colleges was \$5.18 billion. Overall, Texas public community colleges are managing the growth they have experienced. Net position has increased \$1.94 billion since FY 2008 to \$6.08 billion in FY 2015.



Financial Ratio	FY 2008 (Base Year)	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015
Total Noncurrent Liabilities	\$3.08	\$4.26	\$4.28	\$4.78	\$4.88	\$5.18
Net Position	\$4.14	\$5.33	\$5.33	\$5.53	\$5.77	\$6.08

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.

The institutions were given an opportunity to provide feedback to the report no later than March 24, 2016.

The only comment received was from Northeast Texas Community College as follows:

**Mitchell Walker. Acting Chief Financial Officer. Northeast Texas Community College**

*"Northeast Texas Community College budgeted for a negative operating margin for the year in order to fund an ERP upgrade. On June 24, 2015, Standard & Poor's affirmed the District's underlying credit rating of "A"."*

## 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 new districts created 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 Coordinating Board rules impose some limitations, but local autonomy and demographics account for much of the variation in resource allocation and revenue collection.<sup>1</sup>

Districts receive a majority of their revenue from four 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.

### Financial Analysis in Higher Education<sup>2</sup>

The concept of using selected indicators, such as ratios, during the course of financial analysis is nothing new in higher education and dates 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.

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<sup>1</sup> Texas Research League, *Bench Marks for Community and Junior Colleges in Texas*, August 1993.

<sup>2</sup> For more information, see *Strategic Financial Analysis for Higher Education*, 6th edition, KPMG, Prager, Sealy & Co., Bearing Point, 2005.

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

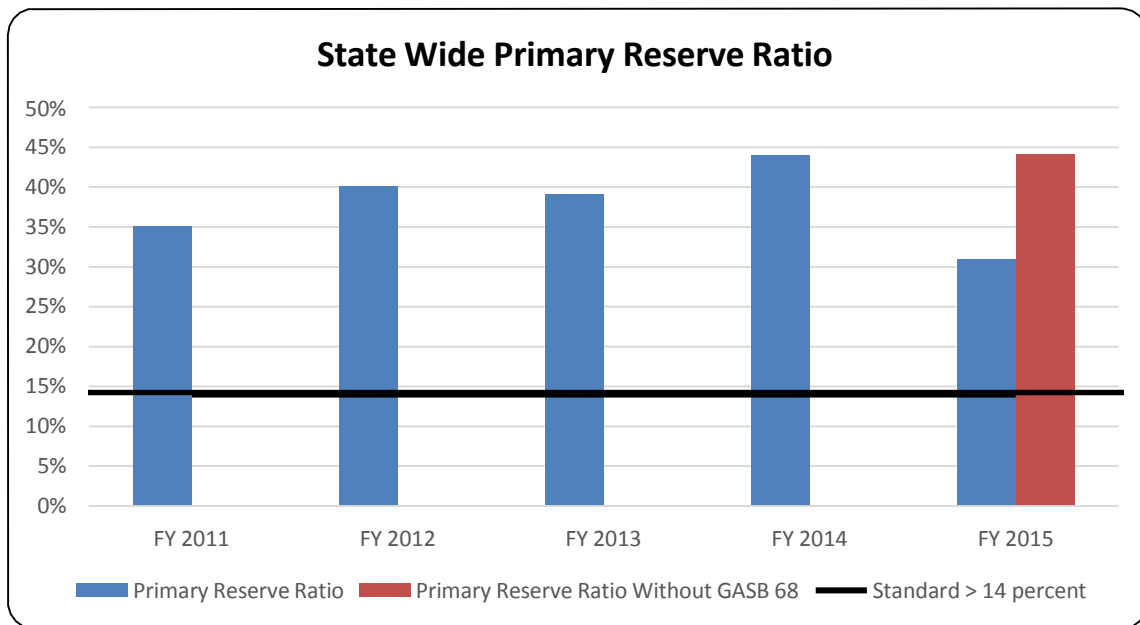
The CFI includes the following four core ratios: Primary Reserve, Viability, Return on Net Position, and Operating Margin.

**Primary Reserve Ratio** – measures financial strength and flexibility by comparing expendable net position to total expenses. 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\*.

**Results** – The 2015 statewide ratio for public community colleges is .31, which is a decrease from .44 in 2014. A ratio of 0.14 or greater is the standard used in this report. The standard was met by 31 of the 50 districts. The community college statewide ratio would have remained .44 in comparison to FY 2014, if GASB 68 had not been implemented.

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

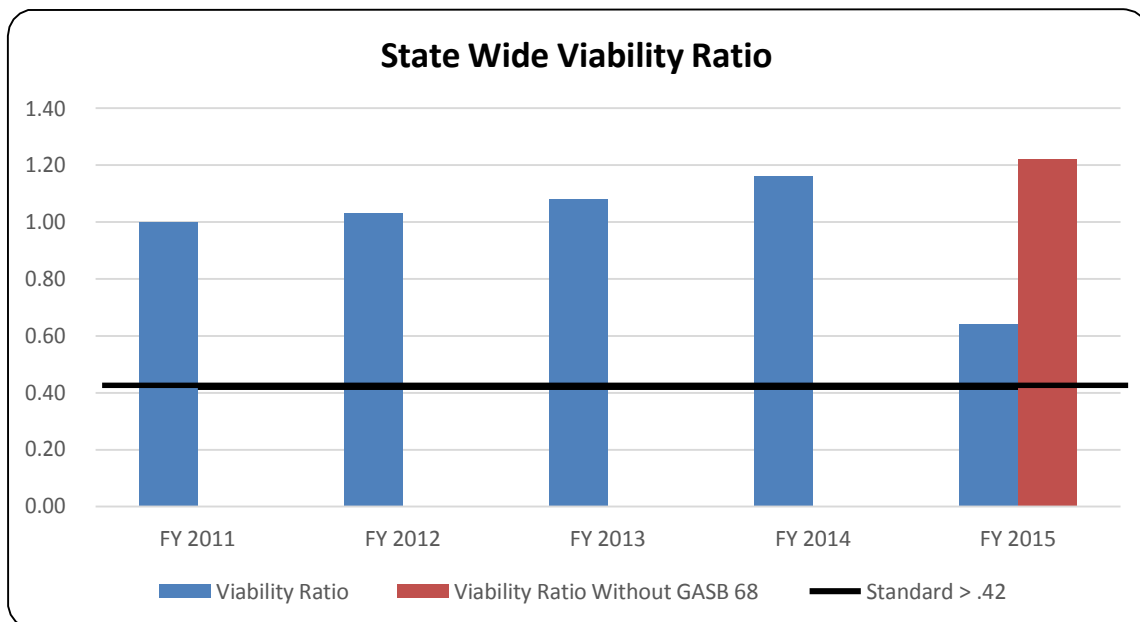


Financial Ratio	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015
Primary Reserve Ratio	35%	40%	39%	44%	31%
Primary Reserve Ratio Without GASB 68					44%
Standard > 14 percent	14%	14%	14%	14%	14%

**Viability Ratio** – measures the financial health of the institution by comparing total expendable net position to total noncurrent liabilities. 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 2015 statewide ratio for public community colleges is .64, which is a decrease from 1.16 in 2014. A ratio of 0.42 or greater is the state standard. The standard was met by 31 of the 50 districts. The community college statewide ratio would have increased to 1.22, an increase of .06 from FY 2014, if GASB 68 had not been implemented.



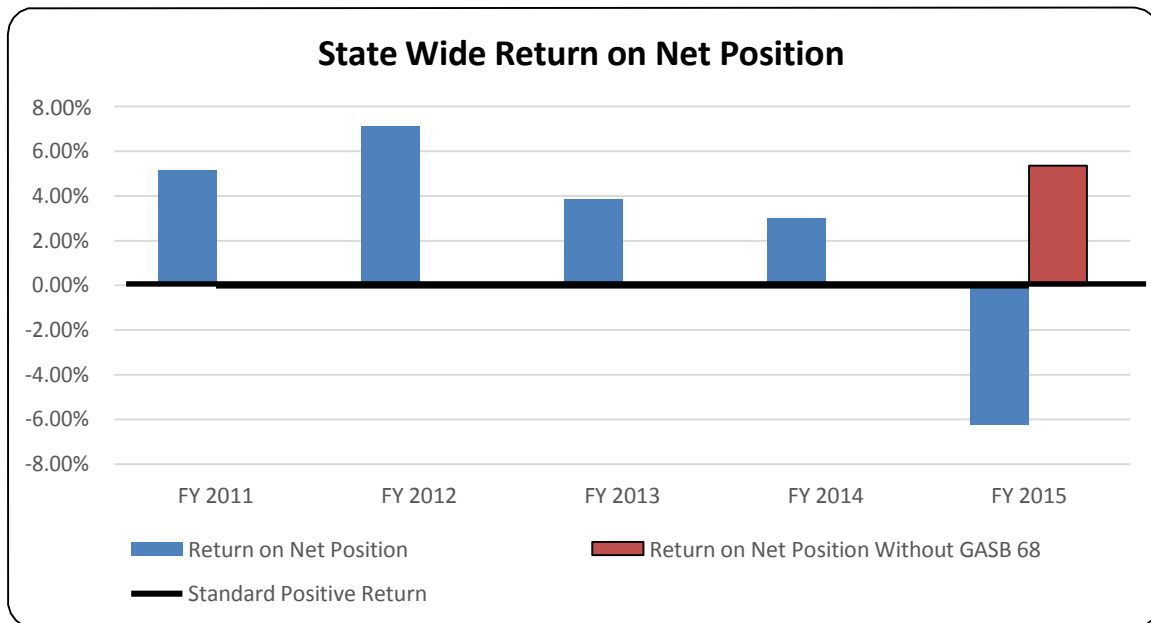
Financial Ratio	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015
Viability Ratio	1.00	1.03	1.08	1.16	0.64
Viability Ratio Without GASB 68					1.22
Standard > .42	0.42	0.42	0.42	0.42	0.42



**Return on Net Position** – measures total economic return during the fiscal year. This measure is similar to the return on equity ratio used in examining for-profit concerns and answers the question, “Are they better off financially than they were a year ago?”

**Calculation** –  $\text{Change in net position} / \text{Total net position (beginning of year)}$

**Results** – The 2015 statewide ratio for public community colleges is -6.24 percent, which is a decrease from 3.00 percent in 2014. A positive return is the standard used in this report. The standard was met by 7 of the 50 districts. The community college statewide ratio would have been 5.36 percent, an increase of 2.36 from FY 2014, if GASB 68 had not been implemented.



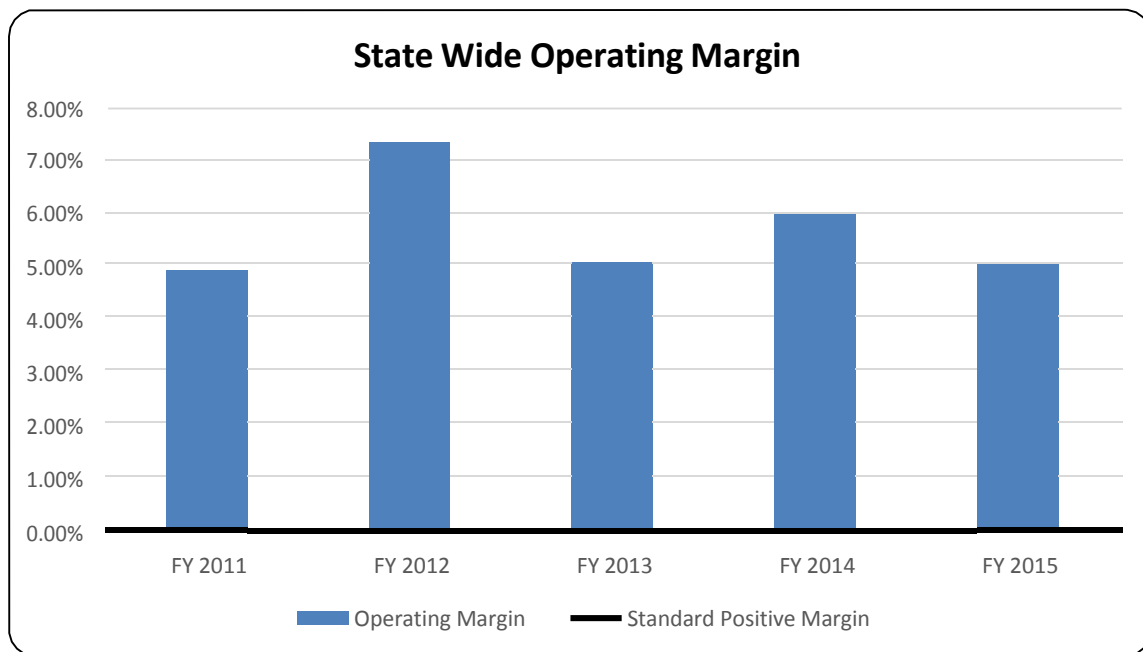
Financial Ratio	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015
Return on Net Position	5.15%	7.10%	3.86%	3.00%	-6.24%
Return on Net Position Without GASB 68					5.36%
Standard Positive Return	0.00%	0.00%	0.00%	0.00%	0.00%

**Operating Margin** – indicates an operating surplus or deficit in the given fiscal year. 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\*

**Results** – The 2015 statewide margin for public community colleges is 5.01 percent, which is a decrease from 5.90 percent in 2014. A positive margin is the standard used in this report. The standard was met by 41 of the 50 districts. The operating margin ratio was unaffected from GASB 68 implementation.

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



Financial Ratio	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015
Operating Margin	4.85%	7.32%	5.13%	5.90%	5.01%
Standard Positive Margin	0.00%	0.00%	0.00%	0.00%	0.00%

## 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. An explanation of these metrics follows.

**Composite Financial Index** – measures the overall health of an institution by combining four ratios into one metric. The four core ratios include return on net position, operating margin, primary reserve, and viability ratio.

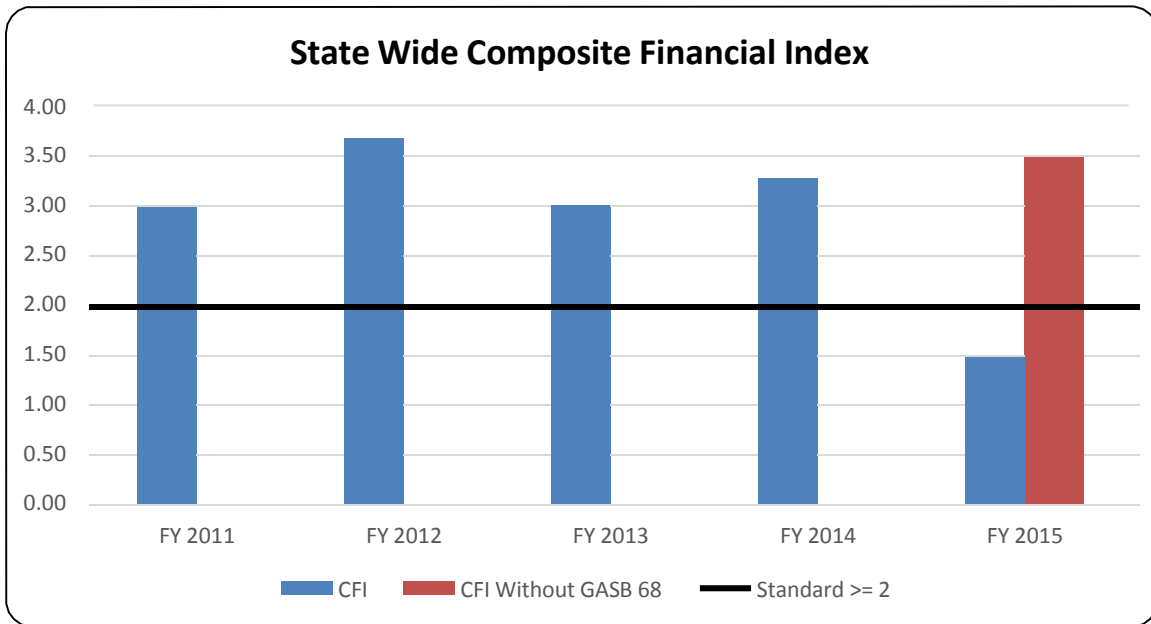
**Calculation** – The CFI is computed using a four-step methodology:

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. Totalling the resulting scores to obtain the Composite Financial Index

<i>Core Ratio</i>		<i>Value</i>		<i>Strength Factor</i>		<i>Weight</i>		<i>Score</i>
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 =								<u>Total Score</u>

**Results** – The 2015 combined CFI for public community colleges is 1.44, which is a decrease from 3.27 in 2014 and falls below the statewide standard of 2.0 or greater. The standard was met by 19 of the 50 districts. The community college statewide ratio would have been 3.43, which would have been an increase over FY 2014, if GASB 68 had not been implemented. 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.

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 2015 would have been the fifth year of improvement, with a statewide CFI index of 3.43, if GASB 68 had not been implemented.

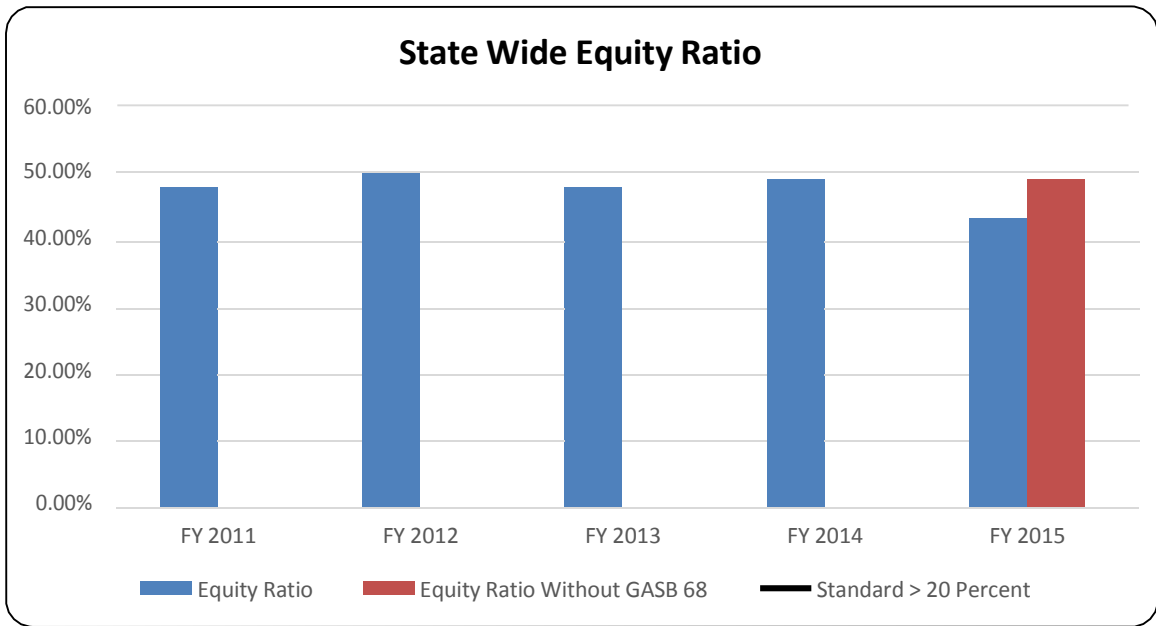


Financial Ratio	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015
CFI	2.96	3.67	3.06	3.27	1.44
CFI Without GASB 68					3.43
Standard >= 2	2.00	2.00	2.00	2.00	2.00

**Equity Ratio** – measures capital resources available and a college’s ability to borrow. The U.S. Department of Education (DOE) introduced this ratio to enhance reporting for institutions that do not have long-term debt. The DOE 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 2015 statewide ratio for public community colleges is 43.4 percent, which is a decrease from 48.8 percent in 2014. A ratio of 20 percent or greater is the standard used in this report. The standard was met by 47 of the 50 districts. The community college statewide ratio would have increased to 48.82 percent, an increase of 0.02 percent from FY 2014, if GASB 68 had not been implemented.



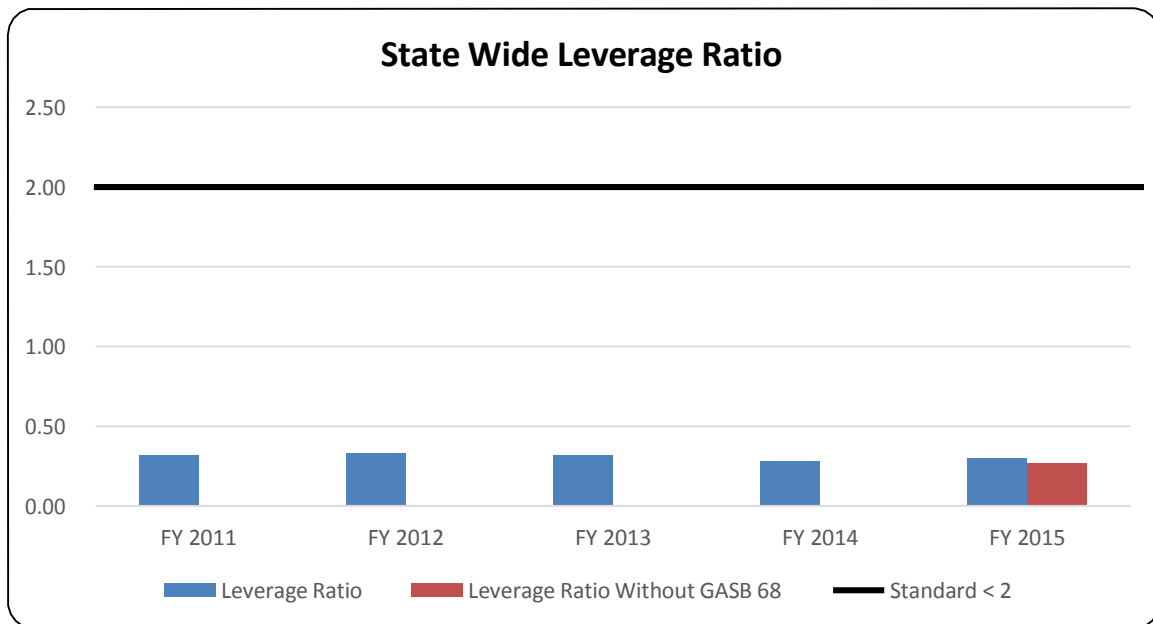
Financial Ratio	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015
Equity Ratio	47.60%	49.50%	48.10%	48.80%	43.44%
Equity Ratio Without GASB 68					48.82%
Standard > 20 Percent	20.00%	20.00%	20.00%	20.00%	20.00%

**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. 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.

**Calculation** – Long term debt\* / Total net position

**Results** – The 2015 statewide ratio for the public community colleges is .30, which is an increase from .28 in 2014. A ratio of less than 2.0 is the standard used in this report. The standard was met by 47 of the 50 districts. The community college statewide ratio would have been .27, which would have been a decrease from FY 2014, if GASB 68 had not been implemented.

\*Long-term debt includes bonds payable, excluding GO bonds and long-term liabilities.



Financial Ratio	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015
Leverage Ratio	0.32	0.33	0.32	0.28	0.30
Leverage Ratio Without GASB 68					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 2015. An Excel workbook is available that contains all the financial data used for the indicators and includes data for Fiscal Years 2003 to 2015.

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.theccb.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**

Twenty-five of the 50 Texas public community college districts have little or no indication of financial stress, which means they met five or more of the seven indicators. Six of these meet the threshold for all indicators. In FY 2014, 44 community college districts had little or no indication of financial stress. Currently, 25 community college districts do not meet the threshold for three or more indicators, which means they could be experiencing some financial stress.

For Fiscal Year 2015, absent GASB 68 implementation, 30 community college districts would have met the threshold for all indicators, and 43 of the 50 Texas public community college districts would have shown little or no indication of financial stress. The remaining seven, however, are worthy of additional discussion:

- 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 fell \$289,000, which lowered the primary reserve and viability ratios below the state standard. In the previous five years, the college has had a negative operating margin and has not met the 2.0 threshold on the CFI.
- 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 — are below the standard used for this report. The college's reduction of \$9 million in expendable and unrestricted net position dropped 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 \$11 million and expendable and unrestricted net position decreased by \$9 million, causing the primary reserve ratio to decrease below standard. On April 8, 2013, though, the rating agency Moody's gave ACC a rating of Aa1 on a bond issue and indicated the outlook for the college was stable.
- Northeast 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. The college's reduction of \$2 million in expendable and unrestricted net position dropped the institution's viability and primary reserve ratios below the state standard.

- Lee College did not meet three of the indicator thresholds. The institution's return on net position and operating margin was negative, and the CFI is below the standard of 2.0.
- Lone Star College did not meet three of the indicator thresholds. The institution's return on net position and operating margin was negative, and the CFI is below the standard of 2.0.
- San Jacinto College did not meet three of the indicator thresholds. The institution's return on net position and operating margin was negative, and the CFI is below the standard of 2.0.
- Vernon College did not meet three of the indicator thresholds. The institution's return on net position was negative, and the CFI is below the standard of 2.0. Expendable and unrestricted net position fell \$633,000, which lowered the viability ratio below the state standard.

### Summary

Evaluating the overall state financial health of community colleges in regards to individual indicators is more turbulent, and the individual indicators are better used to assess an individual institution, either for a given year or on a longitudinal assessment. However, looking at the individual indicators on an aggregate basis is not without value, despite the year-to-year variability. As seen in the table below, FY 2015 saw 25 of 50 districts meeting five or more individual indicators of financial health. The other 25 districts did not meet three or more indicators. If GASB 68 had not been implemented, 43 of 50 districts would have met five or more individual indicators of financial health, and only seven districts would have met less than five indicators.

	<b>FY 2015 WO GASB 68</b>	<b>FY 2015 W GASB 68</b>	<b>FY 2014</b>	<b>FY 2013</b>	<b>FY 2012</b>	<b>FY 2011</b>	<b>FY 2010</b>
Met all 7 indicators	30	6	29	31	39	33	22
Met 6 indicators	6	12	5	5	6	8	10
Met 5 indicators	7	7	10	7	1	4	6
Met 4 indicators	4	8	4	3	2	2	7
Met 3 indicators	2	9	0	2	1	1	5
Met 2 or fewer indicators	1	8	2	2	1	2	0



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

Fiscal Year 2015 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
4	Alamo	(0.12)	(0.16)	0.01	0.122	0.2058	26.24%	0.35
5	Alvin	(1.08)	(0.28)	(0.02)	0.007	0.0490	35.51%	-
3	Amarillo	0.62	(0.11)	(0.04)	0.253	1.3803	47.01%	0.04
1	Angelina	3.21	(0.05)	0.02	0.302	3.1335	58.07%	-
6	Austin	0.10	(0.53)	0.07	(0.028)	(0.0211)	4.43%	10.53
4	Blinn	0.75	(0.06)	0.09	0.089	0.1800	48.11%	0.40
3	Brazosport	0.78	(0.04)	0.02	0.129	0.6296	34.81%	0.11
1	Central Texas	4.79	(0.09)	0.01	0.758	4.8406	78.57%	-
4	Cisco	(0.44)	(0.22)	0.01	0.039	0.0791	36.90%	0.79
3	Clarendon	(0.08)	(0.10)	0.00	0.166	0.3030	64.61%	0.07
4	Coastal Bend	(0.19)	(0.19)	0.08	(0.085)	(0.1958)	32.42%	0.81
2	College Of The Mainland	0.98	(0.22)	0.01	0.216	1.1962	58.73%	-
0	Collin	8.07	0.01	0.12	1.334	10.4432	84.86%	0.00
1	Dallas	4.46	(0.03)	0.11	0.444	3.0773	49.12%	-
1	Del Mar	2.36	(0.01)	0.05	0.365	0.9502	46.43%	-
2	El Paso	1.53	(0.08)	0.08	0.28	0.68	50.30%	0.35
5	Frank Phillips	(1.96)	(0.18)	(0.02)	(0.16)	(0.49)	63.68%	0.16
1	Galveston	4.06	(0.04)	0.11	0.43	2.73	81.73%	-
0	Grayson	4.47	0.01	0.05	0.73	2.09	48.58%	0.17
1	Hill	3.52	(0.03)	0.06	0.38	2.37	76.81%	0.05
3	Houston	1.35	(0.03)	0.11	0.18	0.15	23.97%	1.16
2	Howard	0.25	(0.08)	0.00	0.23	0.46	51.00%	0.32
2	Kilgore	2.73	(0.08)	(0.00)	0.40	2.97	84.96%	0.08
5	Laredo	1.02	(0.12)	0.09	0.25	0.21	13.04%	2.27
5	Lee	(0.85)	(0.17)	(0.06)	0.08	0.18	29.51%	0.25
6	Lone Star	(1.00)	(0.21)	(0.06)	0.04	0.10	19.70%	0.64
5	Mclennan	(0.47)	(0.13)	(0.00)	0.07	0.22	30.64%	0.32
1	Midland	2.23	(0.03)	0.05	0.35	1.06	62.03%	0.12
4	Navarro	0.76	(0.07)	0.07	0.10	0.19	44.98%	0.51
2	North Central Texas	1.75	(0.09)	0.03	0.33	1.54	57.32%	0.12
5	Northeast Texas	(1.33)	(0.22)	(0.05)	(0.03)	(0.06)	24.62%	0.63
1	Odessa	2.66	(0.06)	0.07	0.50	1.13	29.79%	0.33
0	Panola	6.97	0.09	0.14	0.72	3.79	42.51%	0.06
1	Paris	2.44	(0.02)	0.10	0.42	0.68	58.66%	0.41
2	Ranger	1.46	(0.16)	0.10	0.29	0.59	38.87%	0.75
3	San Jacinto	(0.28)	(0.16)	(0.09)	0.18	0.52	30.11%	0.30
4	South Plains	0.54	(0.07)	0.05	0.10	0.30	62.22%	0.30
0	South Texas	7.26	0.01	0.12	1.02	7.40	59.06%	-
4	Southwest Texas	0.27	(0.37)	0.02	0.22	0.24	20.53%	2.51
1	Tarrant	5.11	(0.01)	0.07	0.45	3.72	90.94%	-
2	Temple	1.60	(0.08)	0.02	0.43	1.17	40.71%	0.26
3	Texarkana	0.63	(0.08)	0.05	0.12	0.55	64.83%	-
0	Texas Southmost	8.48	0.05	0.09	1.34	4.17	60.21%	0.11
3	Trinity Valley	0.47	(0.13)	0.02	0.11	0.88	81.04%	-
4	Tyler	0.35	(0.07)	0.07	0.03	0.02	34.78%	1.11
4	Vernon	(0.65)	(0.24)	0.00	0.03	0.04	38.83%	0.76
3	Victoria	(0.01)	(0.08)	0.01	0.08	0.56	42.13%	0.04
1	Weatherford	2.80	(0.06)	0.05	0.60	1.43	61.84%	0.24
1	Western Texas	2.87	0.06	0.19	0.37	0.31	44.67%	0.88
0	Wharton	5.73	0.02	0.14	0.57	3.55	74.38%	0.04
2	Statewide	1.44	(0.0624)	0.05	0.31	0.64	43.44%	0.30

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.



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

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