Chapter 145: Debt and Derivatives

145.015 Debt Management Guidelines

Bd. Min. 1-31-13, Amended Bd. Min. 4-17-25

A. **Introduction** - These debt management guidelines are designed to provide a framework for implementing the University's debt issuances, to impose discipline on capital financing and operating budget decisions, to manage interest rate risk and to assist in the continued investment in the University's facilities. Further, these guidelines shall help ensure adequate financial strength to service existing and proposed debt, to maintain leverage within an acceptable risk tolerance while investing in strategic capital and other initiatives, and to enhance a strong financial profile to ensure continued access to the capital and money markets. Finally, this guidance will aid management in ensuring that an appropriate mix and type of funding resources are utilized and that the University's debt capacity continues to be used strategically.

B. **Responsibilities and Authorities** – See CRR 145.010 "Policy for Management and Oversight of Debt and Derivatives."

C. **Approach to Debt Issuance -** While the University attempts to maximize the use of philanthropy, grants, internal funds and state and federal appropriations to fund capital projects, the strategic use of both taxable and tax-exempt debt can provide additional support for mission-critical investments and increase financial flexibility.

The University recognizes that debt is a limited resource. Debt should be used prudently within the University's constitutional and statutory authority for capital projects that are consistent with the mission and vision of the University. To assure that this criteria is met, an analysis of the ongoing impact of the projects on the University's finances must be performed in connection with any incurrence of debt.

Debt will be managed on a portfolio-wide basis with the goal of achieving the most favorable cost of capital within acceptable risk parameters.

The University recognizes that there is a relationship between debt and overall

University liquidity. The University needs appropriate liquidity for its operations and debt and investment obligations. In order to manage this relationship, regular analysis of the on-going impact of debt on the University's liquidity must be performed.

The University will manage its exposure to lenders, debtholders and other similar external parties by diversifying its financial service providers in the roles of bond sales, variable rate bond remarketing, commercial paper dealers, swap counterparties, and providers of other banking services or others forms of credit enhancements.

D. **Debt Capacity and Debt Affordability** - The University intends to maintain a debt rating that ensures adequate funding for University capital projects and provides ready access to the capital markets at attractive rates relative to market conditions then existing. It is understood that higher credit ratings provide market access at lower interest rates but also limit the amount of debt that may be issued. Debt capacity is a subjective measure, typically associated with balance sheet leverage. The University's risk tolerance and capital needs will inform how much leverage can comfortably be assumed. Debt affordability is in part a subjective measure, in this case associated with income statement leverage as well as ability to cover debt service from operations. Therefore the University's operating performance – either on a University, campus or project basis, as appropriate in the specific circumstance - along with projections of new revenue associated with debt-financed projects, will determine the affordability of additional debt.

The following ratios are intended to be guidelines for use in determining the University's tolerance for additional debt and not to be an impediment to achieving the University's strategic objectives.

These ratios are used to measure the amount of outstanding debt compared to University's balance sheet resources (debt capacity) and the ability to service debt annually from operations (debt affordability). Such ratios shall be:

- Derived from audited financial statements;
- Calculated consistent with industry standards and peer institutions;

- Monitored on an on-going basis (annually and at the time of debt issuance);
- Re-evaluated as the University's capital needs and strategic initiatives evolve; and
- Compared with peer institutions.

1. Expendable Resources to Debt (Debt Capacity)

   Unrestricted Net Assets + Restricted Expendable Net Assets / Outstanding Debt

   This ratio is considered one of the most basic determinants of financial health by measuring coverage of direct debt by expendable financial resources. This ratio typically corresponds strongly with credit rating categories for rated institutions, so it is considered a good measure of *debt capacity* at a given rating level.

2. Debt to Revenue (Debt Capacity)

   Outstanding Debt / Operating Revenues

   This ratio measures the University's debt as a percent of total revenue and provides an overall measure of income statement leverage.

3. Debt Service to Operations (Debt Affordability)

   Annual Debt Service / Total Operating Expense

   This ratio measures the burden of debt service on the University's budget. This ratio is monitored to maintain the University's long-term operating flexibility to fund existing requirements and new initiatives.

4. Debt Service Coverage (Debt Affordability)

   Operating Surplus (Deficit) + Interest and Depreciation Expense/A nnual Debt Service

   Debt service coverage measures the margin by which the University can repay its outstanding debt obligations. When assessing the potential incurrence of new debt, the additional revenues expected to be received by the University as a result of a debt- financed project may be considered in calculating the debt service coverage ratio if appropriately stress-tested.

E. **Debt Portfolio Risk Management** - Risk management is an enterprise-wide endeavour and understanding the University's exposure to various risks requires an integrated view of assets, liabilities and operations. Debt portfolio risks exist within this wider context and must inform and be informed by it.

Risks in the debt portfolio can broadly be categorized as interest rate risks or liquidity risks. The former impacts the budget and its ability to absorb volatility in interest expense. The latter impacts the balance sheet and its ability to absorb unexpected calls on liquidity. The following risks will be assessed at the time of each debt or derivatives transaction and will be routinely monitored and managed on a portfolio-wide basis.

The components of interest rate risk include the following:

1. Market Rate Risk: The risk of rising interest rates on variable rate exposure from bank lines, bonds, commercial paper or Derivative Transactions. Although not part of the then-current debt portfolio at a given point in time, the University recognizes that debt yet to be issued for future projects also represents interest rate exposure.
2. Tax Risk: The risk that tax-exempt bond rates may unexpectedly increase or fluctuate due to changes in the tax code.
3. Bank Facility Re-pricing Risk: The risk that the pricing for bank lines or letters of credit (if any) used to support variable rate bonds or commercial paper will increase after expiration.
4. Credit Risk: The risk that the University's underlying credit ratings and/or the credit ratings of a bank providing bank lines or letters of credit to support variable rate bonds or commercial paper are downgraded.
5. Basis Risk (swap related): The risk that any swap receipts do not fully offset borrowing costs.
6. Counterparty Performance Risk (swap related): The risk that a swap counterparty fails to perform under a swap agreement.

The components of liquidity risk include the following:

7. Remarketing Risk: The risk that variable rate demand bonds, put bonds or commercial paper cannot be remarketed and the Remarketing Agent puts the debt back to the University or the bank providing a bank line or letter of credit.
8. Roll Risk: The risk that bullet maturities, commercial paper or other balloon payments cannot be refinanced at maturity.
9. Bank Facility Renewal Risk: The risk of acceleration from the failure to renew an existing bank facility or to find a substitute facility.
10. Liquidity Provider Performance Risk: The risk that a liquidity provider fails to perform under an applicable bank line, letter of credit, or other liquidity agreement.
11. Swap Collateralization Risk: the risk that the mark-to-market of a swap declines and triggers a collateral posting requirement.
12. Swap Termination Risk: the risk that an automatic termination event from a counterparty results in a swap termination in which the University must pay to settle the swap.

The University will quantify its potential exposure to interest rate and liquidity risks under various risk scenarios. The University recognizes that risk can change rapidly in response to external and internal factors, and that adequate contingency plans need to be in place to address different environments.

The University recognizes that there is a trade-off between pursuing the lowest cost of funds and assuming risk in the debt portfolio. The amount of risk that the University will be willing to assume within its debt portfolio will be evaluated in the context of other risk factors affecting the institution, including investment risk, operational risk, and external economic factors.

F. **Structuring Guidelines** - The University will review all potential funding sources for its projects, with the goal of achieving the lowest overall cost of capital that is consistent with the University's risk profile. In determining the structure for a specific financing, the University will take into account a number of factors, including prevailing market conditions and its existing debt portfolio.

1. Fixed / Variable Mix: In general, fixed rate financing is used in order to avoid unexpected increases in interest costs in the future. Variable rate debt may be considered for funding in anticipation of gifts or when prepayment/restructuring flexibility is desired, or when long-term fixed interest rates are considered undesirable for locking in long- term rates, or for diversifying the University's debt portfolio. Since the use of variable rate instruments may require liquidity, the University will take such requirements into consideration when using variable rate debt and will manage its liquidity needs considering the entire asset and debt portfolio as well as different variable rate instruments, which may or may not require liquidity support. Exposure to and reliance on external parties, such as remarketing agents, commercial paper dealers and liquidity providers, will be considered on a comprehensive~~, University-wide~~ basis.

2. Tax-Exempt/Taxable Debt: The University will evaluate the use of tax-exempt versus taxable debt based on market conditions at the time of issuance, type of facility being financed (as not all projects qualify for tax-exempt financing) and taking into account other strategic considerations, such as restrictions (or lack thereof) on the use of debt proceeds.

3. Refunding Criteria: The University will continuously monitor its outstanding debt for refunding and/or restructuring opportunities. For refundings, the University will consider transactions that produce appropriate present value savings, taking into account the level of interest rates, the remaining time before the call date and costs of issuance. Additional factors to be considered include negative arbitrage (if any) and the use of derivatives or non-traditional bond structures.

4. Other Financing Sources: Opportunities for alternative and non-traditional transaction structures may be considered, including off-balance sheet financings. The University recognizes that these types of transactions can often be more expensive than traditional University debt structures; therefore, the benefits of any potential transaction must outweigh any potential costs and risks. Non-traditional structures should only be considered once the benefits have been identified and the likely impact on the University's debt capacity and credit has been determined.

5. Derivative Products: The University recognizes that derivative products

may enable more opportunistic and flexible management of the debt portfolio. The University will consider the utilization of derivative products, subject to the provisions of CRR 145.020 "*Derivatives Policy.*"

G. **Methods of Debt Issuance** – The University will select the preferred method of issuance for each debt sale dependent upon the type of transaction, market conditions, and the projects to be financed. The most common types of sale are negotiated, using one or more selected underwriters; competitive; or ~~via~~ private placements. When using a negotiated transaction, the University may either select one or more underwriters for an individual transaction or a series of transactions, or establish a pool of qualified underwriters from which the University will select one or more specific underwriter(s) for each transaction. In all cases, underwriters shall be selected as part of a competitive process based on a variety of factors, including but not limited to, the execution capabilities of the firm, service provided to the University, fees, and other strategic considerations. If utilized, an underwriting pool shall last no longer than five (5) years before a new competitive process establishes another pool.

H. **Rating Agency and Investor Relations** - The University recognizes that an active program of credit rating agency and investor relations is critical for maintaining favorable capital market access. While the University recognizes that changes to its credit rating can affect its borrowing costs, decisions related to borrowing and structure will be driven first and foremost by strategic issues, including the University's capital needs and its ability to afford debt, and not governed by issues relating to a specific credit rating.

I. **Compliance** - The University will comply with all legal and contractual requirements for ongoing continuing disclosure related to its debt portfolio, including disclosure requirements under applicable SEC or MSRB rules and regulations contained in applicable continuing disclosure undertakings. The University may employ one or more dissemination agents to assist it in compliance with such requirements.

The University will comply with all applicable legal, contractual and other requirements for post-issuance compliance related to tax-exempt or other debt, including any applicable University policy and/or procedures adopted from time to time in order to so comply. Matters to be monitored and complied with pursuant thereto may include the investment, use and expenditure of proceeds of such debt; restrictions on the use of projects financed thereby; record retention and maintenance; ongoing compliance monitoring; interaction with bond counsel and/or disclosure counsel; monitoring of tax-exempt bond expenditures; arbitrage rebate monitoring, compliance and filings, and private business use monitoring and compliance.