

UNIVERSITY OF WASHINGTON STATEMENT OF DEBT POLICY

Adopted by the Board of Regents September 19th, 2002, Amended July 16, 2004

INTRODUCTION

This statement sets forth the policies governing the issuance and servicing of debt by the University of Washington.

A. AUTHORITY

1. The Board of Regents of the University of Washington is vested by statute with the authority to issue bonds to fund certain capital projects and to enter into financing contracts to acquire real and personal property. The University also has the authority to borrow for short term operating purposes so long as the debt is repaid within the biennium issued. (See Appendix A – Table of UW Debt Financing Authorities).
2. The Board of Regents has delegated to the Finance & Audit Committee the authority to consider and make recommendations to the Board concerning the financing of capital projects and any other borrowings which may be required by the University.
3. The Administration is charged with all aspects of managing, issuing and servicing debt for the University. These functions are performed by the Treasury Office.

B. GOALS OF ISSUING DEBT

1. Provide cost-effective funding for acquiring or replacing capital assets.
2. Match costs with benefits over the useful life of capital improvements.
3. Leverage other capital funding sources.
4. Meet short term operating or emergency cash flow needs.

C. CASH VERSUS DEBT FUNDING

1. Generally, debt funding will be considered as the preferred option for larger one-time capital projects. Smaller routine capital projects should be funded on a cash basis unless there is a cost-effective source of borrowing that is readily available.

2. Debt should be considered for capital projects only when there is a dependable long term source of revenue available for repayment. Variable or significant one-time sources of revenue should be used to cash fund capital projects.

D. ISSUANCE CRITERIA

1. **Legal Authority:** All debt will be issued in compliance with the University's legislative authorities (See Appendix A – Table of UW Debt Financing Authorities).
2. **Debt Capacity:** Issuance of debt is subject to the University's overall debt capacity and capital plans as determined by the Planning & Budget Office and approved by the Board of Regents.
3. **Access to Capital Markets:** To maintain cost-effective access to debt capital markets, the University will issue debt only if the financial impact, taking into account future borrowing needs, will not cause the University's overall credit rating to fall below an "A" category as determined by Moody's Investors Service and/or Standard & Poor's. The minimum rating for a single debt issue will be investment grade.
4. **Financial Evaluation:** Issuance of debt is subject to a financial evaluation demonstrating an issuer's financial capacity and ability to meet all current and future debt obligations and covenants on a pro-forma basis.

E. DEBT STRUCTURE

1. **Coverage and Collateral:** Debt coverage and collateral pledges are determined by the debt market. The University's debt authorities determine what revenues and other collateral can be pledged. The University will balance the costs and benefits of coverage and collateral pledges, taking into account the impact on the institution as a whole. The University will only cross-pledge revenues or assets within the same system, auxiliary, or related project.
2. **Maturity of Indebtedness:** The maturity of debt issued by the University will reflect market conditions at issuance. Where financially feasible, debt will be retired as soon as possible to recapture debt capacity for future use. Maturity of debt will not exceed the average economic life of the capital improvements or equipment being financed.
3. **Interest Rates:** In most circumstances, the University will issue fixed rate debt that reflects the University's sources of repayment, which are fixed fees and charges. Variable rate debt will be considered when the financial benefits closely match the financial risk or where the use of variable rate debt significantly benefits the University.

4. **Debt Service Structure:** Debt service payments will be structured to match a borrower's cash flows. Other payment options will be considered if financially appropriate.
5. **Subordination:** New debt obligations will be issued on parity or subordinate to existing debt if secured by the same revenue and/or asset pledge.
6. **Refunding Bonds:** The University will issue current and advanced refunding bonds when a material present value and debt service savings can be obtained.
7. **Redemption Provisions:** The University will seek redemption provisions equal to or better than market.
8. **Credit Enhancement:** The University will consider credit enhancement when it is cost beneficial and/or materially increases the liquidity of the debt obligations in the secondary market.
9. **Payment Agreements:** The University will consider payment agreements where appropriate to reduce expenses (including borrowing costs) and/or manage exposure to interest rates and other risks. See rationale and guidelines in Appendix B.

F. MONITORING AND SERVICING DEBT

1. **Debt Issued:** Each debt issue will be evaluated at the time of closing against other issues with similar credit characteristics.
2. **Debt Servicing:** Debt service payments will be made in an accurate and timely manner. Compliance with debt covenants will be monitored by issuers and external auditors. The Treasury Office will monitor the University's rebatable arbitrage earnings for tax purposes on an annual basis. The Treasury Office will also evaluate compliance with IRS private use rules at issuance and periodically thereafter.
3. **Debt Capacity:** The University's debt capacity will be evaluated at least bi-annually or as often as necessary for capital planning purposes.
4. **Reporting:** The Treasury Office will annually present a report to the Finance & Audit Committee of the Board of Regents on debt issued, debt outstanding, the University's estimated debt capacity and credit ratings.

G. TYPE OF DEBT INSTRUMENTS

1. The types of debt instruments that the University may use include, but are not limited to: revenue bonds, lease-backed or conduit issues, financing contracts, reimbursable State-issued obligations, short-term notes and credit lines.

2. The University does not have the authority to issue general obligation bonds.

H. AUTHORIZED METHODS OF SALE

1. Negotiated Sales will be used when the expertise of the underwriter is considered necessary in the structuring and marketing of debt, and/or when the financial outcome is materially dependent upon the interest rate paid, e.g. in the case of advance refundings.
2. Competitive Sales will be used when an underwriter's expertise is not required to aid in structuring and marketing debt, and when the financial outcome is not materially dependent upon the interest rate paid.
3. Private Placements will be considered when the size and/or structure of the debt issue do not justify a public offering.

I. SELECTION OF SERVICE PROVIDERS

1. **Bond Counsel:** The Attorney General's Office, in consultation with the Treasurer, will select Special Assistant Attorney Generals through a competitive RFP process to represent the University on individual bond transactions and other issues as related to bonds. The Finance & Audit Committee recommends and the Board of Regents approves the selection of bond counsel.
2. **Financial Advisor:** The University's financial advisor is selected through a competitive RFP process. The financial advisor provides a broad range of financial services relating to bond financings. The Finance & Audit Committee recommends and the Board of Regents approves the selection of a financial advisor.
3. **Selection of Other Service Providers:** The selection of other service providers (underwriters, insurers, trustees) associated with individual debt transactions are typically delegated to the University administration by the Board of Regents as recommend by the Finance & Audit Committee. These additional service providers are selected through a competitive RFP process.

Appendix A Table of UW Debt Financing Authorities

I. Debt Incurrence within Regent's Authority

A. Revenue Generated Facility Revenue Debt Financing (includes Housing & Dining, Parking, Husky Stadium Debt and Harborview Credit Line)

Purpose	Statutory Authority (RCW)	Revenue / Fund From Which Payable
Dormitories, hospitals, parking, student services, etc. that generate revenue	28B.10.300 <u>et seq.</u>	"Local" (non-appropriated) revenues derived from facilities constructed or improved with bond proceeds or system of which facility is a part.

B. Metropolitan Tract Revenue Debt Financing

Purpose	Statutory Authority (RCW)	Revenue / Fund From Which Payable
Acquire and Improve Metropolitan Tract Property	28B.20.395 <u>et seq.</u>	Metropolitan Tract Revenues
Erecting, altering, maintaining, equipping and furnishing buildings at the UW (certain reimbursable bond debt service).	28B.20.382 (amended 1999)	Metropolitan Tract Revenues

C. Borrowed Money Payable Within a Single Biennium

Purpose	Statutory Authority (RCW)	Revenue / Fund From Which Payable
Any UW purpose	Implied from 28B.20.145	Any money available to the University not previously pledged, including money appropriated by the Legislature, so long as indebtedness can be repaid within the biennium in which incurred.

D. Research Facilities

Purpose	Statutory Authority (RCW)	Revenue / Fund From Which Payable
Issue revenue bonds or other debt (and enter into financing contracts under Section E below) to acquire, construct, rehabilitate, equip and operate facilities and equipment to promote basic and applied research in the sciences.	RCW 28B.140.010	Fees and revenues of the University derived from its ownership and operation of facilities or conducting research.

E. Financing Contracts

Purpose	Statutory Authority (RCW)	Revenue/Fund From Which Payable
Acquisition of personal property; Acquisition of real property for research facilities*	39.94.010 et seq., 28.10.022, as amended by HB 1280, effective July 27, 2003	Any component of fees and revenues of the University derived from its ownership and operation of its facilities not subject to appropriation by the Legislature and not constituting "general state revenues" as defined in Article VIII, Section 1 of the State Constitution.

* All other financing contracts for real property require Legislative approval.

II. Debt Requiring Action by State Legislature and/or State Finance Committee

A. State General Obligation Bonds Benefiting U.W. (Non-Reimbursable)

Purpose	Statutory Authority (RCW)	Revenue/Fund From Which Payable
Various facilities	Various -- in combination with bonds issued for the benefit of other institutions of higher education. Examples: 28B.14.010 <u>et seq.</u> ; 28B.14B.010 <u>et seq.</u> ; 28B.14E.010 <u>et seq.</u>	General Fund of State Treasury (no U.W. sources of funds obligated)

B. State General Obligation Reimbursable Bonds Benefiting U.W.

Examples		
Purpose	Statutory Authority (RCW)	Revenue/Fund From Which Payable
Various facilities	28B.14C.010 <u>et seq.</u>	U.W. Bond Retirement Fund
Various facilities	28B.14D.010 <u>et seq.</u>	U.W. Building Account
Hospital	28B.20.745 <u>et seq.</u>	U.W. Hospital local fund
Various facilities	43.99G.020(8)	U.W. Building Account or Capital Projects Account
Various facilities including K Wing of Hospital	43.99H.020(18)	U.W. Building Account (but note that RCW 43.99H.020 states expectation that RCW 43.99H.020 non-appropriated local funds are source of reimbursement to State General Fund)
Various facilities including Law School	28B.20.382; Section 4, chapter 380, Laws of 1999	Net proceeds of the Metropolitan Tract

*Payable from General Fund of State Treasury, but U.W. required to reimburse the General Fund from the listed sources

C. Building Fee Revenue Debt Financing (formerly "Tuition Fee Bonds")

Purpose	Statutory Authority (RCW)	Revenue/Fund From Which Payable
Any U.W. facilities "authorized by the Legislature for use by the University"	28B.20.700 <u>et seq.</u>	1/2 Building Fees paid by all students and deposited into U.W. Bond Retirement Fund and, to the extent of any deficiencies in Bond Fund, money in U.W. Building Account

D. Financing Contracts

Purpose	Statutory Authority (RCW)	Revenue/Fund From Which Payable
Acquisition of real property*	39.94.010 <u>et seq.</u> , 28.10.022, as amended by HB 1280, effective July 27, 2003.	Any source

* Financing contracts for real property (other than for research facilities) require Legislative approval. Financing contracts for personal property payable from local funds do not require State Finance Committee or Legislative approval (see I.E above).

Appendix B

Interest Rate Swap Policy

July 16, 2004

Introduction

The purpose of the UW Debt Management Interest Rate Swap Policy ("Swap Policy") is to establish guidelines for the execution and management of the UW interest rate swap program. This amendment to the UW Debt Management guidelines to incorporate this Swap Policy confirms the commitment of the Board, management, staff, advisors, and other decision makers to adhere to sound financial and risk management practices, including achieving the lowest possible cost of capital within prudent risk parameters.

Philosophy Regarding Use of Swaps

Interest rate swaps can be appropriate interest rate management tools. Properly used, swaps can increase the University's financial flexibility, provide opportunities for interest rate savings, or reduce financial risk. Swaps will be integrated into the University's overall debt management.

Interest Rate Swaps, and the related instruments detailed below, are used to accomplish the following:

- Reduce interest expense;
- Hedge and actively manage interest rate, tax, basis, and other risks;
- Optimize capital structure (e.g., achieve targeted debt allocation); and
- Achieve appropriate asset/liability match.

Permitted Instruments

The University may expressly use the following financial products after identifying the specific financial objective to be realized and assessing the attendant risks:

- Interest Rate Swaps -- Immediate or forward starting floating-to-fixed rate swaps, designed to capture current market fixed interest rates or eliminate variable rate exposure. Fixed-to-floating rate swaps, designed to create additional variable interest rate exposure.
- Interest Rate Caps -- Financial contracts (caps, collars, floors) which limit or bound exposure to interest rate volatility.
- Options on Swaps -- Sales or purchases of options to commence or cancel interest rate swaps.
- Basis Swaps -- Floating-to-floating rate swaps to manage basis or tax risk and change the basis on which variable cash flows are determined.
- Rate Locks -- Often based on interest rate swaps, used to hedge an upcoming fixed rate bond issue.

The use of derivative financial products should produce a result not otherwise available in the debt market (lack of advance refunding/non-callable debt) or provide a higher level of savings, lower level of risk, greater flexibility, or other direct benefits.

The University may not use financial instruments that (i) create excessive leverage or financial risk; (ii) lack adequate liquidity to terminate at market; or (iii) provide insufficient price transparency to allow reasonable valuation.

Swap Risk Analysis

The University will evaluate all financial products with respect to the unique risks with which they are associated. A specific determination must be made that the expected benefits exceed the identified risks by an adequate margin over those available in the traditional debt market, if any.

For each transaction in isolation and in the context of all financial assets and liabilities, the University will perform a risk evaluation of the following factors:

- Market or interest rate risk - Does the transaction hedge or create interest rate volatility? By how much?
- Tax Risk - Is the transaction subject to a future change in federal income tax policy? If so, is the tax risk justified by expected benefits?
- Termination Risk - Under what circumstances might the transaction be terminated? What is the probable range of values? How would a possible termination payment be funded?
- Legal Risk - Is the transaction expressly authorized?
- Counterparty Risk - What is the creditworthiness of the counterparty? Is the transaction subject to future material change in counterparty creditworthiness?
- Rating Agency Risk - Is the proposed transaction consistent with current ratings?
- Basis Risk - Do the anticipated payments the University will receive match the payments it makes? If not, is the basis risk justified by the expected benefits?
- Amortization risk – Does the swap amortize in the same amounts and on the same schedule as the related bonds, and if not, what are the consequences of a mismatch, and how will this be handled?
- Rollover risk – If the swap terminates before the final term of the bonds, what is the range of results that could occur in entering into a new swap, and how will an adverse swap rate change be handled?
- Subsequent Business Conditions - Does the transaction or its benefits depend upon the continuation, or realization, of specific industry business conditions?

All swaps entered into by the University will be in compliance with RCW 39.96.

Swap Procurement and Execution

All services related to derivative financial products, including swaps, will be procured in a manner consistent with the University's standing practices for procuring investment banking and other services, so as to provide the University with the highest level of service at the best available terms and pricing.

The Board of Regents approval is required on all interest rate swaps. In the delegation of authority to undertake swaps the Board may also delegate discretion regarding future termination or modifications of the initial transactions provided the resulting structure is otherwise consistent with the Swap Policy (see Active Management, below).

Prior to execution of a swap or similar transaction, Financial Management Office will work with University accounting staff to ensure that all parties (borrowing department, Financial Management Office) have a clear understanding of the cash flow and reporting treatment of the proposed transaction.

Swap Counterparties Policy

The University shall execute credit-sensitive derivative transactions only with counterparties with strong credit ratings. The University shall do business with counterparties rated in the “AA” category or above as of the transaction date on a non-credit enhanced basis.

For lower-rated (below “AA” category) counterparties, the University shall require credit enhancement in the form of:

- Collateral and/or
- Guarantees

Should the rating of the counterparty be below the “AA” category or the counterparty’s rating be downgraded below the “AA” category, if its payment obligations are not guaranteed by another entity, or the entity that guarantees its payment obligations, if so secured, does not satisfy the requirements set forth above:

- The obligations of the Counterparty will be 102% collateralized by cash or Treasuries or Agencies; and
- The cash or obligations will be deposited with the University or with an agent of the University; and
- The collateral obligations will be valued daily.

The University will structure swap agreements to limit losses due to non-performance of its swap counterparties.

The University will establish and review counterparty exposure limits. (Not-to-exceed amounts for a given counterparty).

Swap Documentation

The University will use standard ISDA swap documentation, including the Schedule to the Master Agreement Credit Support Annex, and Confirmation. The University swap documentation will include the following features:

- Key provisions, including those related to early termination and collateral requirements.
- The specified indebtedness related to credit events in the Master Agreement will be narrowly drafted.
- Eligible collateral will be limited to Treasuries, Agencies, and cash.
- Collateral thresholds will be set on a sliding scale based on credit ratings.
- Termination value will be determined by "market quotation" methodology.
- A credit support annex will be used to document swap termination value collateralization procedures.

Active Management

The University will seek to maximize the benefits it accrues and minimize the risks it bears by actively managing its swap program. This will entail continuous monitoring of market conditions, in conjunction with the swap counterparty and the University’s advisors, for emergent opportunities and risks. Active management may entail modifications of existing positions including:

- Early termination;
- Shortening or lengthening the term;
- Sale or purchase of options; and
- Application of basis swaps.

Each proposed modification must be consistent with this Swap Policy and be expected to further the goals of the swap program. The Financial Management Office will have limited yet sufficient flexibility to actively manage existing transactions without Board approvals.

Reporting and Disclosure

The Financial Management Office shall provide the Board of Regents with annual reports on the status of its swap and other derivative transactions in conjunction with annual debt management review. These reports will include market values, cash flows, value at risk and other performance measures, as well as evaluations of each transaction's performance relative to benchmarks or goals. The reports will also note all material changes to swap agreements.

The Financial Management Office will report to rating agencies periodically on the status of its swap and derivative transactions in conjunction with periodic updates on bond debt and debt management.

The University shall ensure compliance with the Swap Policy as well as then-current accounting practices and federal, state, and local regulations and requirements.