

VII. STANDING COMMITTEES**B. Finance, Audit and Facilities Committee****Debt Management Annual Update****INFORMATION:**

The material presented here offers background information on the Debt Management Annual Report that will be presented to the Board of Regents at the February 2011 meeting. The information in this backgrounder is intended to supplement the presentation to the Board.

Attachment

Debt Management Backgrounder

Debt Management Presentation
February 2011
Backgrounder

Internal Lending Program. The Internal Lending Program (ILP) was adopted in mid-2008 after receiving new legislative authority to issue local debt for any university purpose. The ILP makes internal loans to campus borrowers and manages repayment in accordance with financing agreements between the campus borrower and the institution. The University borrows externally to secure the funds for those loans.

Reporting. The Treasury Office reports annually to the Board on ILP activities over the prior year, including an overview of the University's external debt portfolio, the status of internal loans, and institutional debt capacity.

Annual Bond Resolution. The annual bond resolution, which authorizes both the issuance of new debt during the upcoming year and the refunding of existing bonds for economic and portfolio restructuring purposes, is brought to the Board in July of each year. This resolution is limited in the amount of debt that can be issued over the upcoming 12 months.

Accomplishments. The University used its highly-rated credit in October to lock-in a net interest rate of 3.22 percent on a \$150 million long-term debt issue using the Build America Bond program. In December, \$165 million in long-term bonds were issued for the South Lake Union Phase 3.1 facility with a net interest rate of 3.97 percent also using the Build American Bond program.

The University also continues to take advantage of low interest rates on the short end of the yield curve through commercial paper borrowing, with rates averaging well under 1.0 percent. Commercial paper proceeds have been used to bridge fund project expenses.

Loans and borrowings. Since March 2010, the Board authorized \$256 million in internal loans to fund the UW Tacoma Phase 3 and Husky Stadium renovation projects. The Board also approved the issuance of \$50.3 million in building fee bonds for the UW Tacoma Phase 3 and Balmer Hall renovation projects. Based on outstanding debt, approved loans, and loans up for approval in February, the University's total outstanding debt is expected to reach \$2.2 billion in 2013.

Rate stabilization. The ILP offers a uniform internal lending rate to all campus borrowers. The internal lending rate includes a component for rate stabilization that will be used to subsidize the internal lending rate if increases in external borrowing rates put upward pressure on the internal rate.

ATTACHMENT

The rate stabilization reserve has to be large enough to offset substantial increases in external borrowing rates – otherwise, the internal lending rate will have to be raised in order to preserve the solvency of the ILP. Because the ILP is relatively new, the rate stabilization account cannot currently offset any meaningful volatility in external borrowing rates. However, based on projected external borrowing over the next 24 months, the Treasury Office does not foresee the need to raise the internal rate at this time.

Debt structure. The University's external debt portfolio is comprised primarily of amortizing fixed-rate debt issues. The last three General Revenue Bond issues, beginning with the June 2009 Build America Bonds, were non-amortizing ("bullet maturity") fixed-rate issues, which adds structural diversity to the debt portfolio at a relatively low cost. With Build America Bonds, the choice of a non-amortizing debt structure has been based on factors related to the taxable bond market.

Credit rating and debt capacity. In May 2009, Moody's recalibrated the University's credit rating from Aa1 to AAA, placing the University among the top 8 schools in Moody's highest rating category. The University's AA+ credit rating from Standard & Poor's, one notch below S&P's top AAA rating, remained unchanged.

The University's credit rating is a function of the amount of the institution's debt outstanding compared against its financial resources. Based on the current forecast of University financial resources in 2018 and Moody's 2010 medians for public universities, the University will likely be rated in the Aa category. It is important to understand that ratio analysis is just one component of the UW's credit rating. Other components include market position, pricing power, and revenue diversification.

Forward calendar. The Treasury Office expects to issue a long-term bond of up to \$150 million in April or May of 2011 to fund cash flows for previously approved projects. The final amount and timing of this bond will depend on market conditions and actual cash flows.

UNIVERSITY OF WASHINGTON

DEBT MANAGEMENT ANNUAL REPORT



BOARD OF REGENTS

FINANCE, AUDIT AND FACILITIES COMMITTEE

FEBRUARY 17th, 2011

DISCUSSION OUTLINE

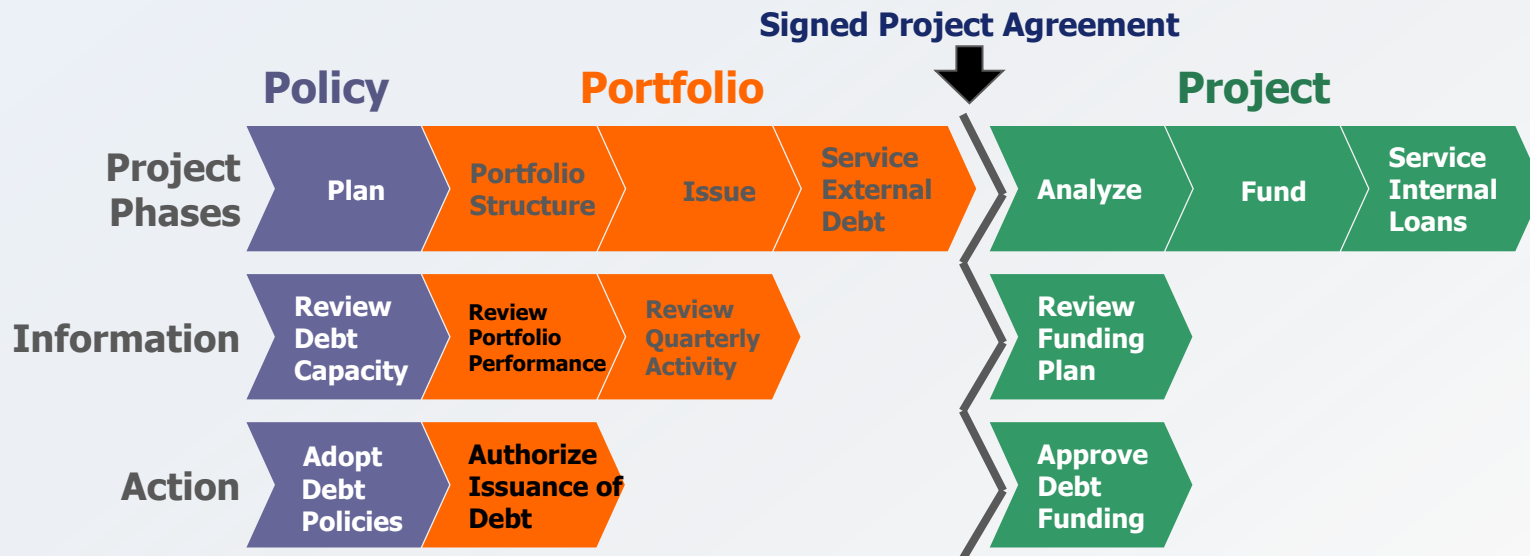
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DEBT MANAGEMENT OUTLOOK

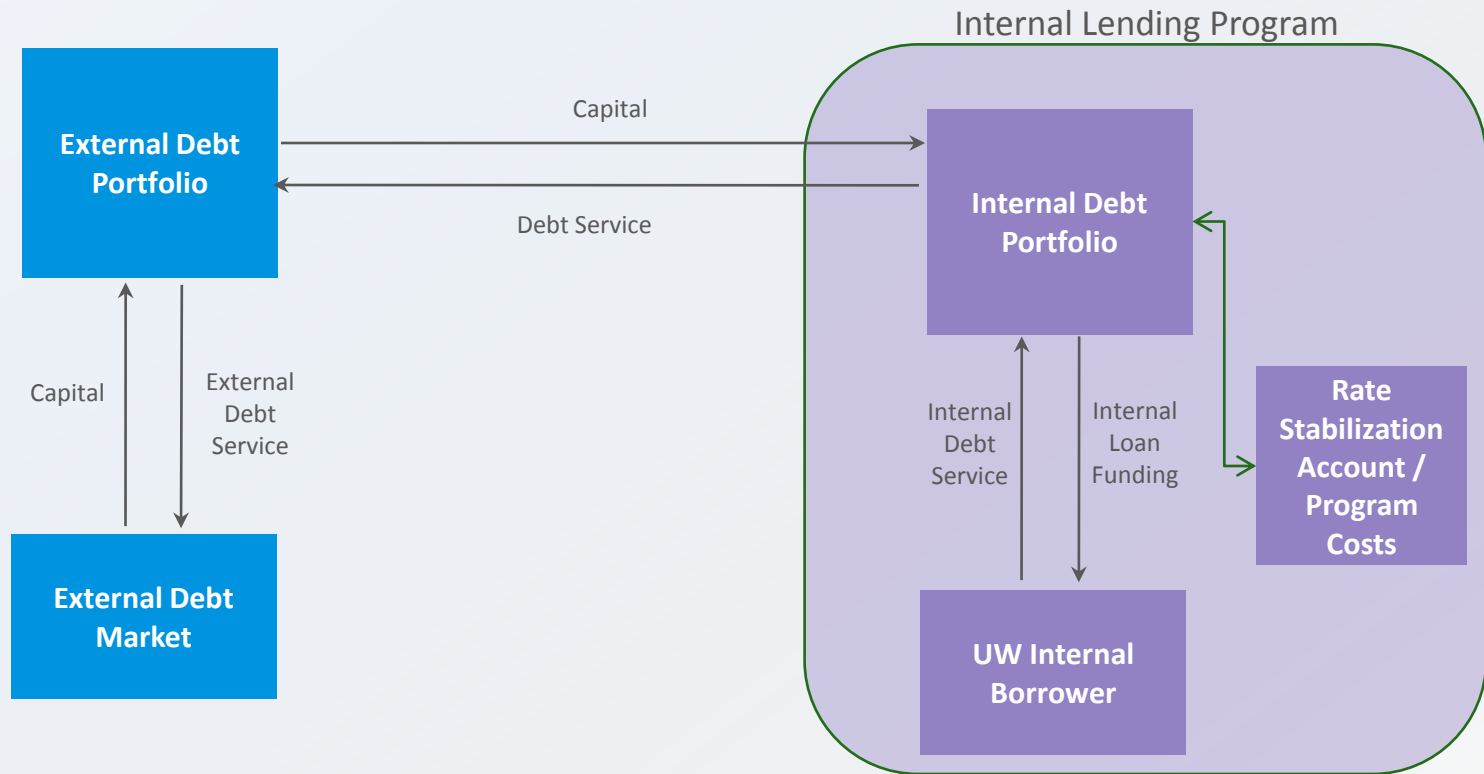
- The University has an aggressive borrowing plan – about \$2 billion through 2021. At the same time, State funding is declining, growth in federal research dollars is uncertain, and overall revenues are slowing, thus making prioritization of capital projects critical.
- The Build America Bond program expired at the end of 2010 and tax-exempt interest rates have increased over the last 60 days. It is expected that rates will continue to rise over the next year.
- The University was able to lock in very low rates on recent debt issuances, however over \$800m in unfunded authorizations creates significant rate risk in the future.

REGENT ROLES

- Adopt debt management policy
- Establish University credit standards (“A” category rating or better)
- Oversee debt outstanding, credit ratings, and compliance with bond covenants and IRS regulations
- Adopt bond resolutions to allow for issuance of external debt
- Approve use of Internal Lending Program to fund capital projects



MISSION AND STRUCTURE



- Maintain cost effective access to the debt markets
- Seek opportunities to reduce long term institutional borrowing costs

- Provide quality underwriting and monitoring of new and outstanding obligations
- Fund rate stabilization account to minimize increases in the internal lending rate

ACCOMPLISHMENTS

Maintain Cost Effective Access to the Debt Markets

- UW recalibrated to Aaa by Moody's and affirmed at AA+ by Standard and Poor's
- Successfully sold \$330 million of General Revenue bonds at rates below 4%

Provide Quality Underwriting and Monitoring of New and Outstanding Obligations

- Completed uniform audits for Intercollegiate Athletics, Housing and Food Services, Parking, Student Life, and the Internal Lending Program
- Completed credit assessments for Husky Stadium and Student Housing Phase 2

Seek Opportunities to Reduce Long Term Institutional Borrowing Costs

- Reduced cost of issuance on South Lake Union Phase 3 by issuing 63-20 bonds
- Maximized the use of the Build America Bond program while it was active

Minimize Likelihood of Internal Lending Rate Increase

- Low rates on recent issuances reduced overall cost of debt by 20 basis points
- Used fixed rate bullet maturity structure to reduce portfolio risk and improve cash flow

Improve Communications and Operations

- Joint presentations with Capital Resource Planning on One Capital Plan and debt capacity
- Presented best practices for internal banks at national higher education treasury conference

GOALS

Maintain Cost Effective Access to the Debt Markets

- Maintain strong credit ratings
- Evaluate addition of third bond rating

Provide Quality Underwriting and Monitoring of New and Outstanding Obligations

- Develop materiality standards for assessing borrowers' risk
- Perform annual review of ILP loans for compliance with financing agreements

Seek Opportunities to Reduce Long Term Institutional Borrowing Costs

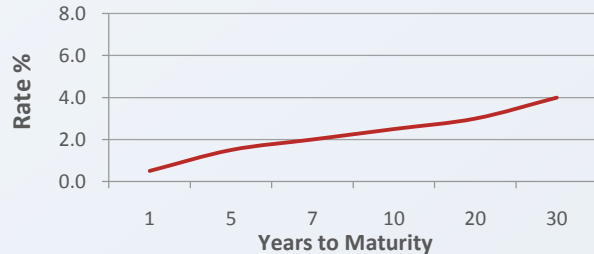
- As interest rates rise, use the yield curve to manage average cost of funds
- Use commercial paper to fund projects prior to long term takeout

Minimize Likelihood of Internal Lending Rate Increase

- Increase ILP rate stabilization fund

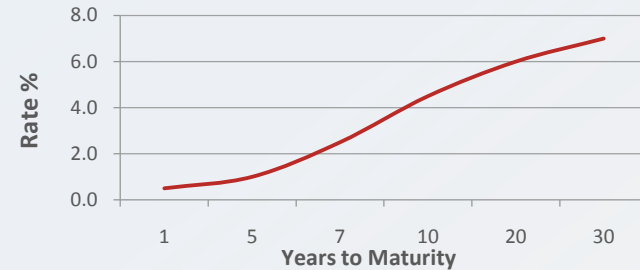
ISSUANCE STRATEGIES IN DIFFERENT MARKET ENVIRONMENTS

Low Fixed Rates, Steep Yield Curve



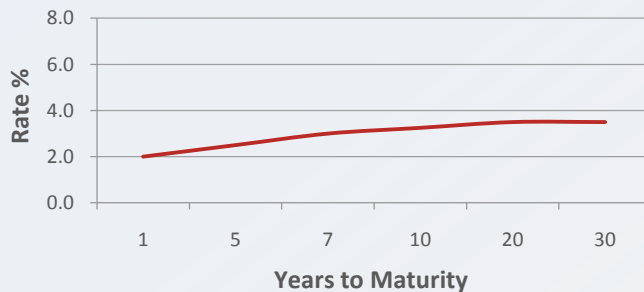
- Long-term fixed rate
- Non-amortizing
- Some variable rate exposure

High Fixed Rates, Steep Yield Curve



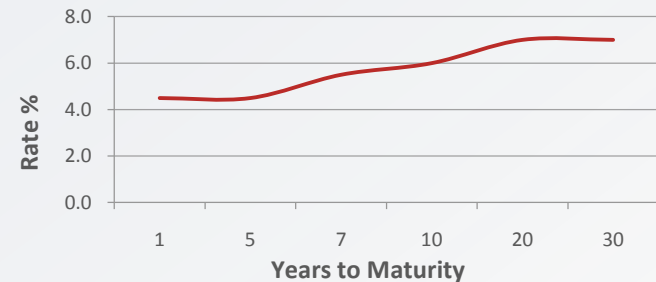
- More short term debt
- More variable rate exposure
- Amortizing debt, bullets unattractive

Low Fixed Rates, Flat Yield Curve



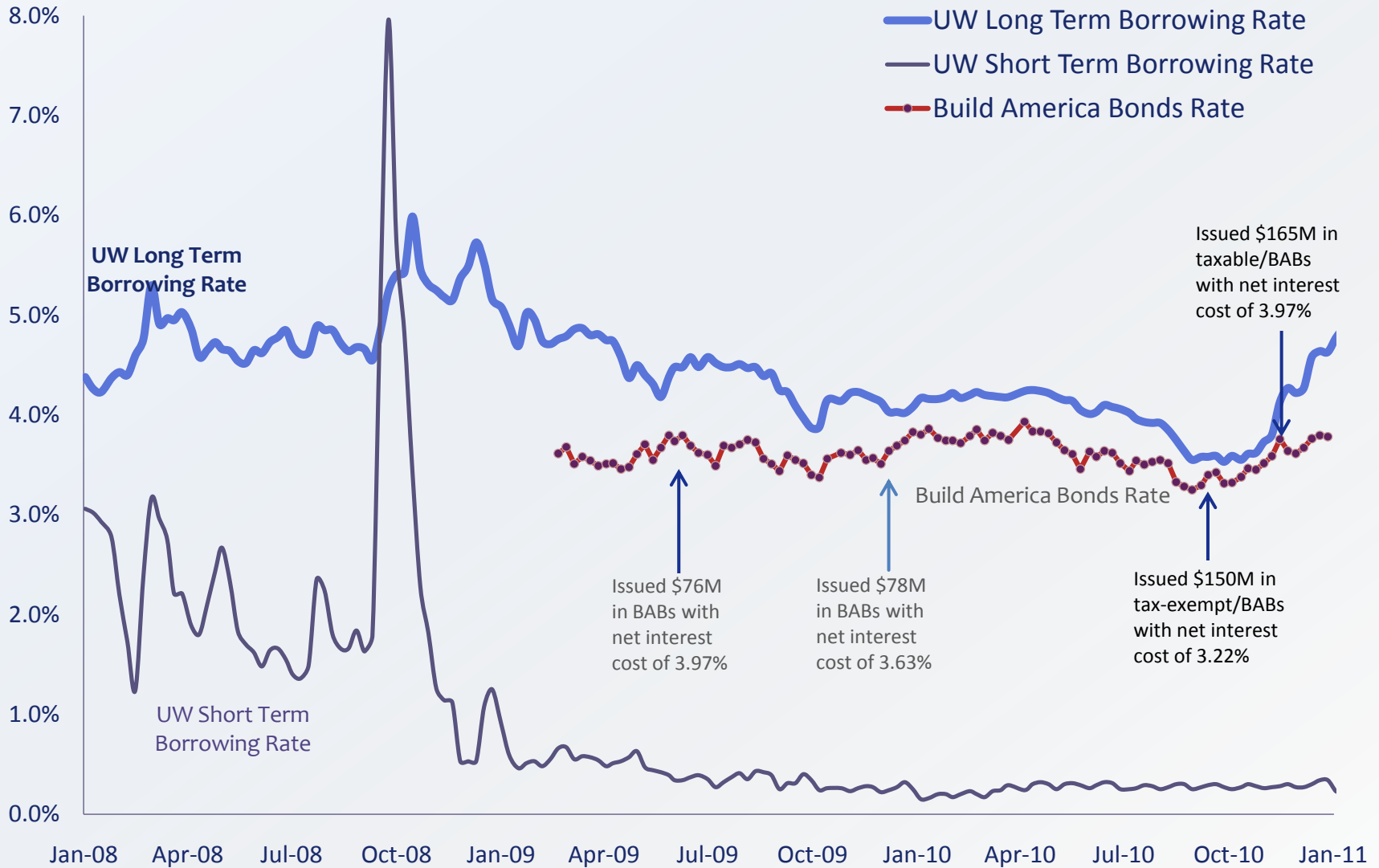
- Long-term fixed rate
- Non-amortizing
- Minimal variable rate exposure

High Fixed Rates, Flat Yield Curve



- Fixed or variable
- Fund with reserves
- Issue with expectation of refunding

TAKING ADVANTAGE OF HISTORIC LOW RATES



Source: Seattle Northwest Securities

ILP FINANCIAL STATEMENTS – JUNE 30, 2010

(AUDITED)

<i>Income Statement</i> <i>(Dollars in Millions)</i>	
Operating revenues	\$30.8
Operating expenses	31.1
Operating income (loss)	(0.3)
Non-operating revenue	1.2
Change in net assets	\$0.9
Net assets at beginning of year	\$2.8
Net assets at end of year	\$3.7

<i>Balance Sheet</i> <i>(Dollars in Millions)</i>	
Assets	
Cash & short-term investments	\$28.7
Current receivables	32.5
Current assets	61.2
Noncurrent receivables	619.3
Long-term investments	3.5
Total assets	\$684.0
Liabilities & Net Assets (equity)	
Current liabilities	\$76.1
Noncurrent liabilities	604.2
Total liabilities	680.3
Net assets	3.7
Total liabilities & net assets	\$684.0

EXTERNAL DEBT PORTFOLIO – DECEMBER 2010

Type of Debt	Issued FY2011	Total Outstanding	Weighted Average Rate	Weighted Average Maturity (yrs)
Commercial Paper	\$30	\$30	0.3%	0.09
Variable Rate	0	0	n/a	n/a
Fixed Rate	117	714	4.2%	17.2
ILP Total	147	744	4.0%	16.5
Non-ILP Debt	213	617	4.4%	14.9
Total	\$360	\$1,361	4.2%	15.7

(Dollars in Millions)

INTERNAL LOAN PORTFOLIO – DECEMBER 2010

	University Mission			Total
	Education	Research	Service	
Beginning Balance Jul-10	\$108	\$111	\$430	\$649
Additions	12	7	63	82
Reductions	(3)	(4)	(9)	(16)
Annual Activity thru Dec-10	9	3	54	66
Total Receivable	\$117	\$114	\$484	\$715

(Dollars in Millions)

INTERNAL RATE ASSESSMENT

The ILP rate will remain at 5.5% for the next 12 months

- Even with recent increases in rates, external rates are lower than the ILP rate
- Recent \$150M issuance locked in an all-in net rate of 3.22%
- Between July – December 2010 the ILP added \$750K to rate stabilization account (RSA) bringing the balance to \$2.4 million
 - Based on current cash flows and recent borrowing cost, the RSA will have \$3M by the end of FY 2011.
 - The relatively small size of the RSA and the delay in collecting internal loan payments mean that it cannot withstand much rate volatility.

INTERNAL BORROWER PROFILE – DECEMBER 2010

Borrower	ILP Outstanding	Non-ILP Outstanding	Additional ILP Approved	Total Outstanding & Approved	Potential Exposure
Central	\$279	\$175	\$42	\$496	Additional budget cuts, decline in ICR reimbursements, and limited additional fund sources for capital
School of Medicine	82	341	0	423	Decline in external support payments & ICR reimbursements
UWMC	150	14	80	244	Decline in patient revenues, state support & impact of health care reform
Student Life	59	0	129	188	Student fee revenue less than forecast
Housing & Food Services	87	86	129	302	Large capital plan reliant on growing freshman class size & market sensitivity to rate increases
Intercollegiate Athletics	4	0	250	254	Stadium project reliant on incremental revenues & strong donor support
Parking	18	1	0	19	Market sensitivity to rate increases & overall lower demand for parking
School of Business	25	0	5	30	Lower enrollment levels in executive MBA program
School of Dentistry	11	0	1	12	Patient revenue less than forecast
Totals	\$715	\$617	\$636	\$1,968	

(Dollars in Millions)

ESTIMATED CONSTRUCTION DRAWS & ISSUANCE

Approved Project	Remaining Draws
Housing, Phase 1	\$129
Student Life Projects	129
Husky Stadium Renovation	250
UWMC Expansion, Phase 1	80
Molecular Engineering – ILP only	20
J-Wing (Microbiology)	16
PACCAR Business School	5
Tacoma Phase 3 – ILP only	6
Pediatric Dentistry Clinic	1
Total	\$636
Debt Proceeds on Hand	\$21
Additional Debt to be issued in FY2011	150
Estimated size of FY2012 Bond Resolution	253
Estimated size of FY2013 & FY2014 Bond Resolutions	212

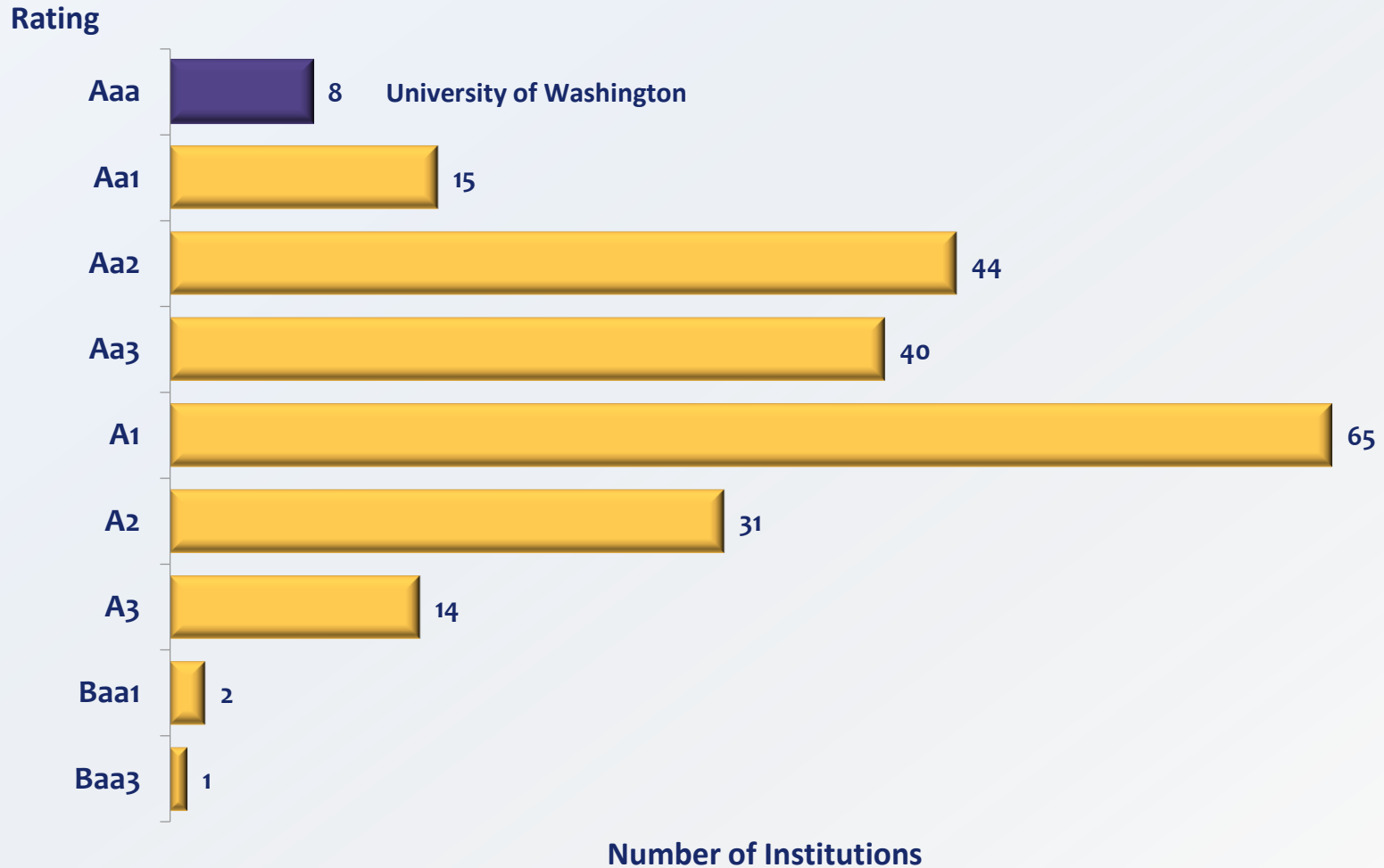
(Dollars in Millions)

FUTURE PROJECTS (IDENTIFIED, NOT YET APPROVED)

Project Name	Estimated Borrowing Amount through 2021
Student Housing, Phase 2-4	\$705
South Lake Union 3, Phases 2-3	308
Metropolitan Tract Recapitalization	200
Enterprise Information System	125
Health and Life Sciences Core Research Facilities	120
UWMC Building Expansion, Phase 2	71
Global Public Health, Nursing and Pharmacy Research Center	60
Innovation Collaboration Center	50
Seattle Parking Improvements	41
UW Bothell Housing Acquisition	13
UW Tacoma Student Union - Phase 1	8
Major Infrastructure Upgrade Projects	7
Sand Point Building 5 - Archival Storage	5
Daycare Center Expansion	4
Intellectual House	3
Total	1,720

(Dollars in Millions)

THE UNIVERSITY'S CREDIT RATING



Source: Moody's rating distribution for fiscal year 2009

Institutions in Aaa rating category: Indiana University; Purdue University; Texas A&M University System; University of Michigan; University of North Carolina-Chapel Hill; University of Texas System; University of Virginia; University of Washington

KEY STATISTICS AND RATIOS

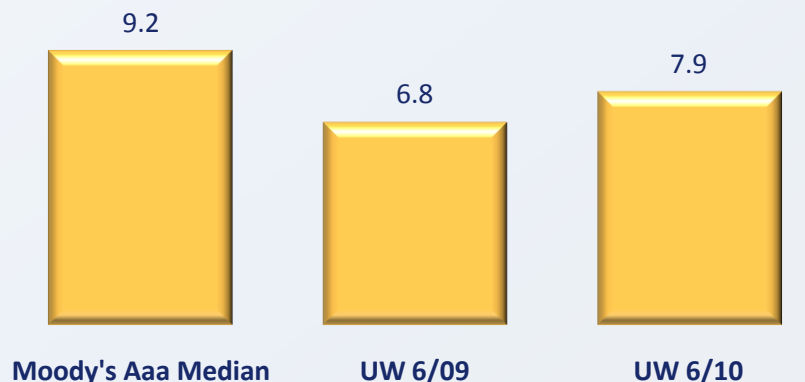
	UW (Aaa)		Moody's 2009 Medians	
	2009	2010	Aaa	Aa1
Key Financial Statistics				
Total Direct Debt (\$, in millions)	1,002	1,046	1,241	
Comprehensive Debt (\$, in millions)	1,220	1,209	1,371	
Unrestricted Financial Resources (\$, in millions)	930	1,163	1,015	
Expendable Financial Resources (\$, in millions)	1,935	2,252	2,153	
Total Financial Resources (\$, in millions)	2,819	3,212	3,516	
Total Cash & Investments (\$, in millions)	2,941	3,266	2,622	
Total Revenues (\$, in millions)	3,441	3,599	2,980	
Total Expenses (\$, in millions)	3,402	3,442	2,725	
Student Enrollment and Ratios				
Total Enrollment FTE (#)	47,835	49,294		43,495
Freshman Matriculation (%)	44%	42%	46%	
Freshman Selectivity (%)	58%	57%	62%	
Net tuition per student (\$)	8,912	9,869	9,284	
State appropriation per student (\$)	8,324	6,344	8,059	
Educational expenses per student (\$)	39,215	37,631	38,352	
Capital Ratios				
*Expendable financial resources-to-direct debt (x)	1.9	2.2	1.8	
*Debt Service to Operations (%)	2.8%	2.7%		3.0%
Direct debt to total revenues (x)	0.3	0.3		0.4
Balance Sheet Ratios				
*Expendable financial resources-to-operations (x)	0.57	0.65		0.53
Operating Ratios				
*Actual debt service coverage (x)	3.0	4.7	4.2	
Average actual debt service coverage (x)	3.6	4.0	3.8	

Source: Moody's median data for fiscal year 2009 for Aaa rated public institutions of higher education. (MFRA database as of February 2011)

Ratios for fiscal year 2010 exclude NW Hospital information

KEY FINANCIAL RATIOS COMPARISON

**Expendable Financial Resources
to Operations (x)** ↑
Good



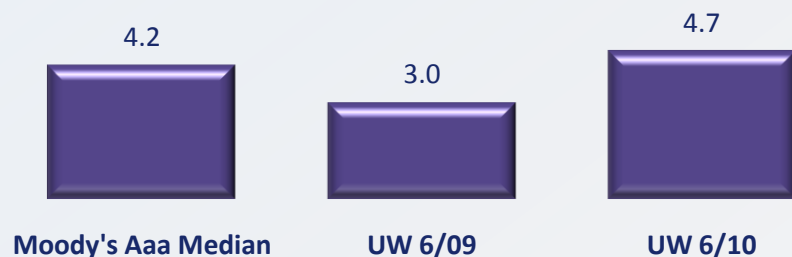
UW has nearly 8 months of expendable resources on hand to fund operations

**Expendable Financial Resources
To Direct Debt (x)** ↑
Good



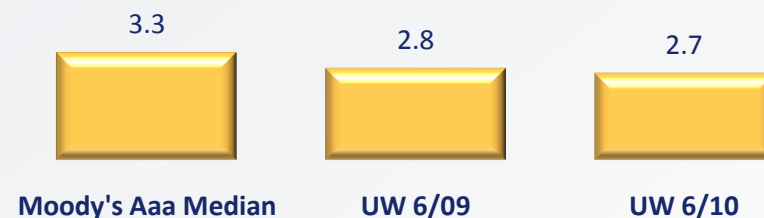
UW's expendable resources are more than 2 times its direct debt

Debt Service Coverage (x) ↑
Good



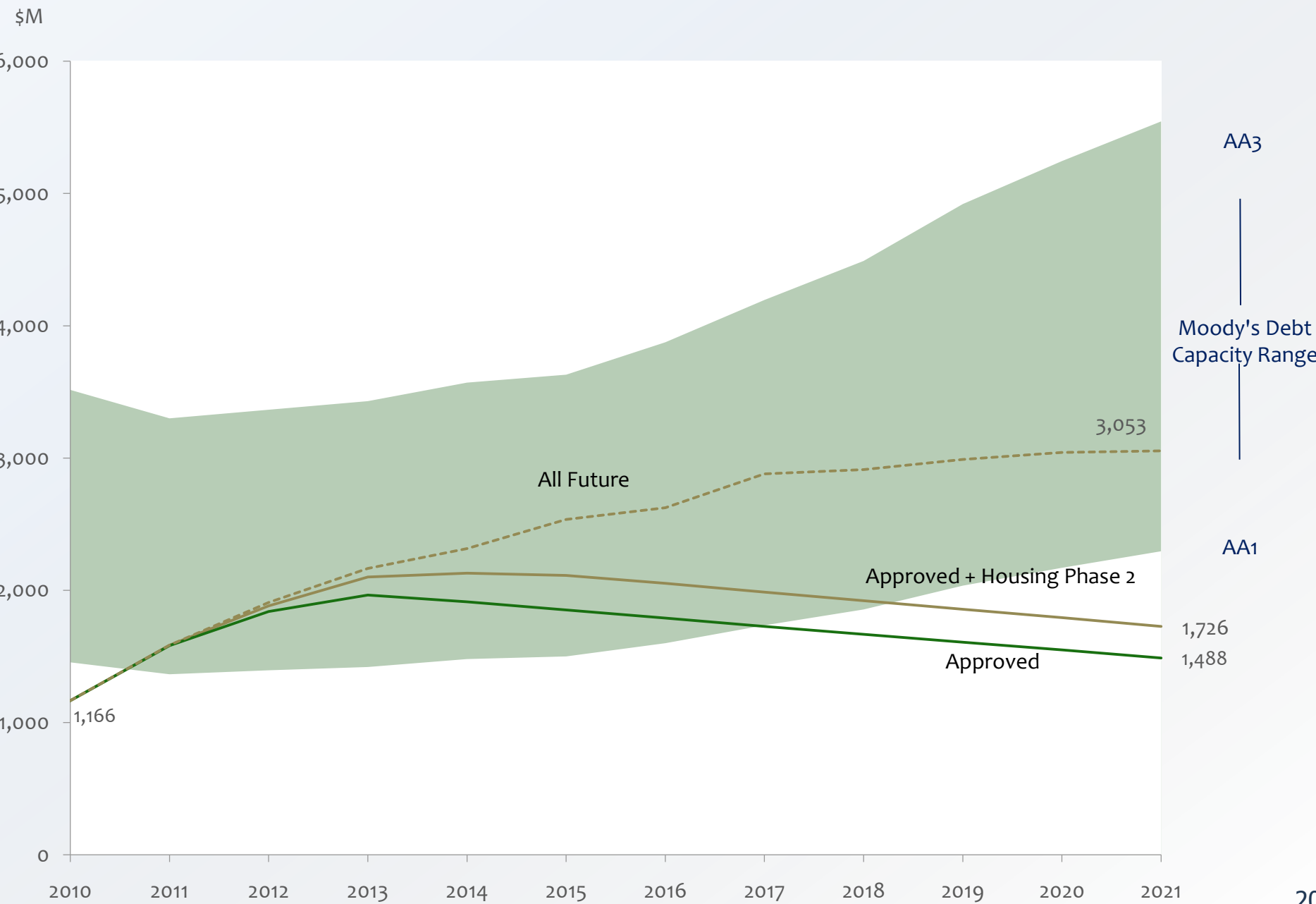
UW's annual operations are sufficient to cover annual debt service payments

Debt Service to Operations (%) ↓
Good

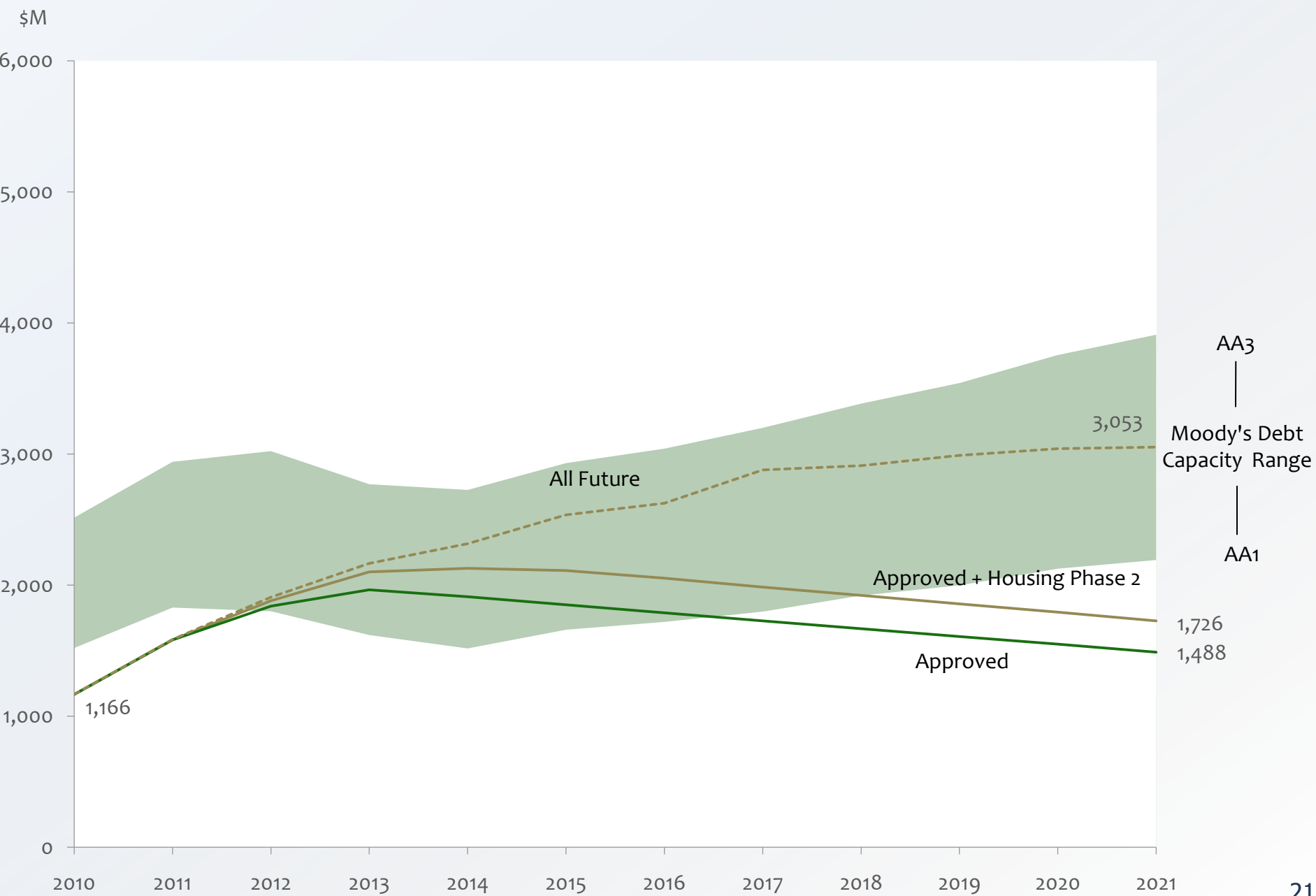


UW's debt service is 2.7% of its annual operating budget

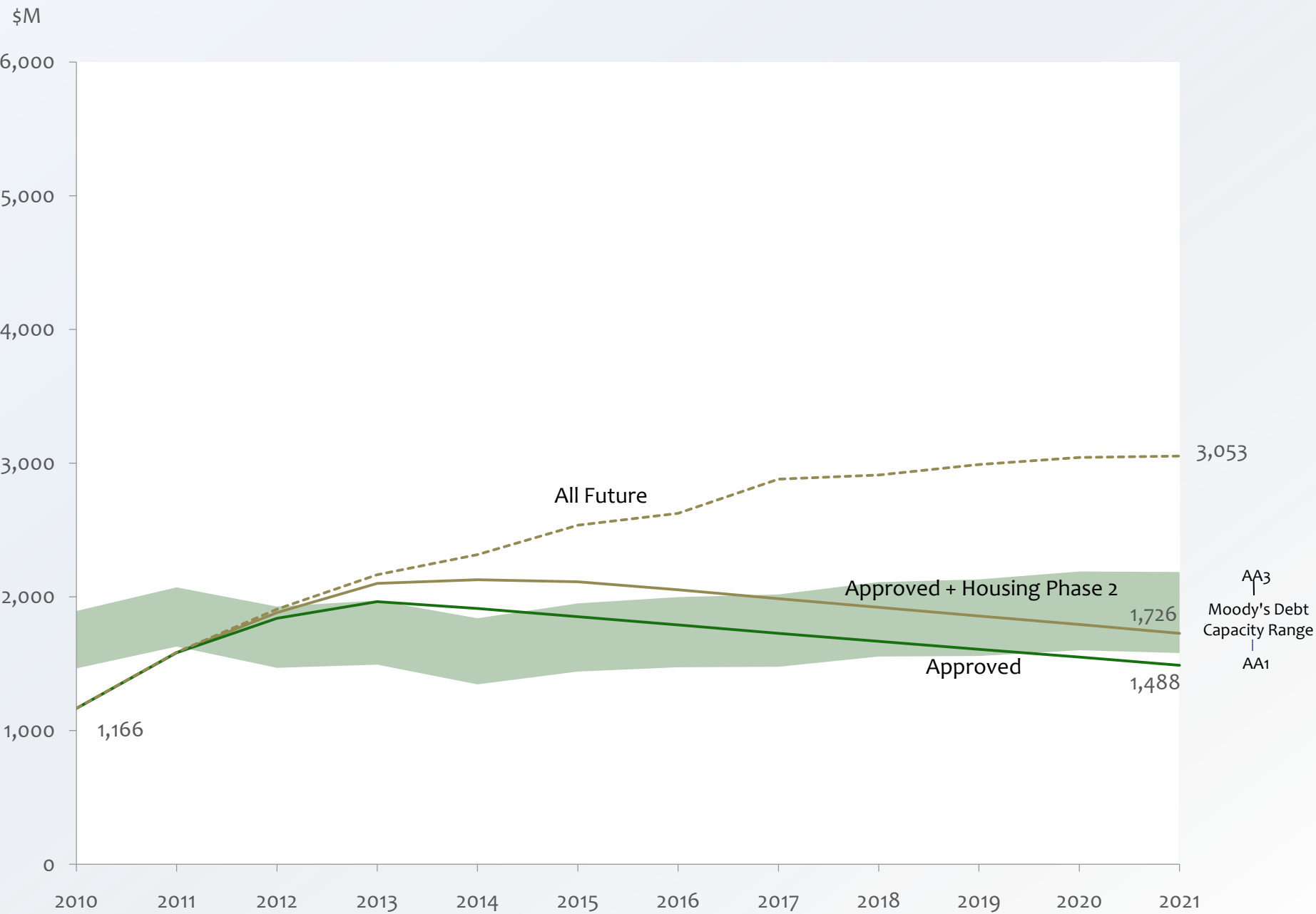
DEBT CAPACITY – EXPENDABLE FINANCIAL RESOURCES TO DIRECT DEBT



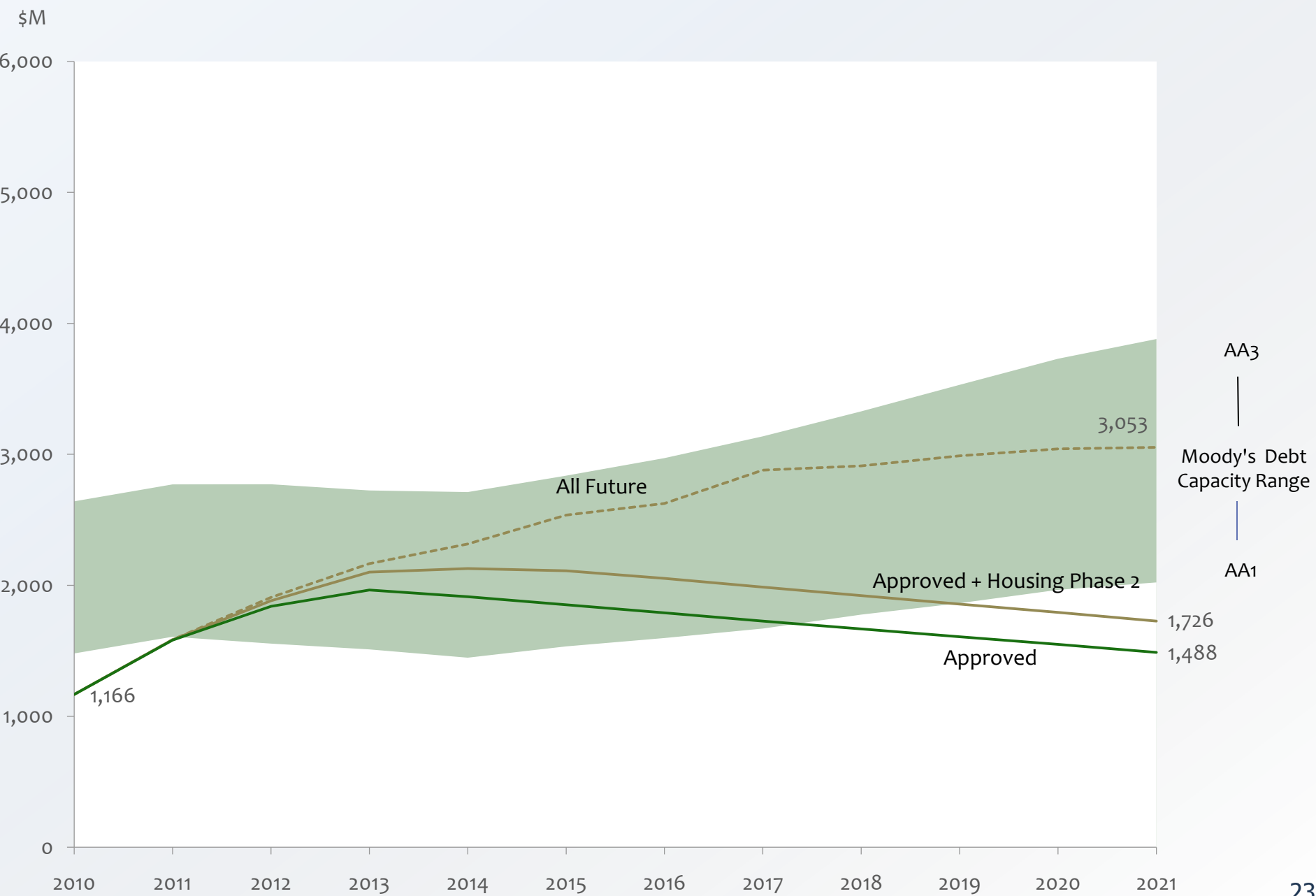
DEBT CAPACITY – ACTUAL DEBT SERVICE COVERAGE



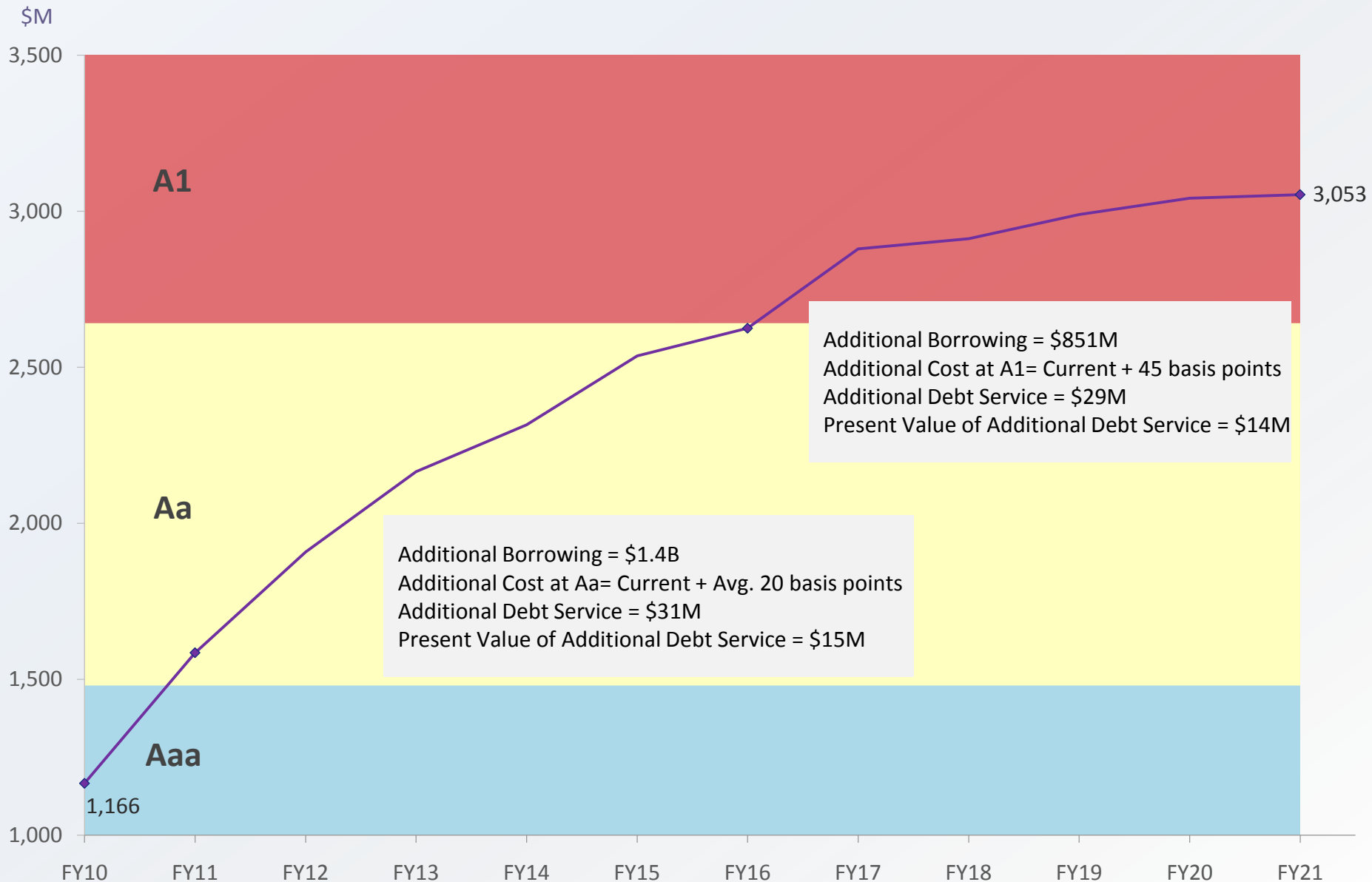
DEBT CAPACITY – DEBT SERVICE TO OPERATIONS



DEBT CAPACITY – AVERAGE OF THREE RATIOS



STRESS TEST - ESTIMATED ADDITIONAL COST OF DEBT



DEBT MANAGEMENT OUTLOOK

- The University has an aggressive borrowing plan – about \$2 billion through 2021. At the same time, State funding is declining, growth in federal research dollars is uncertain, and overall revenues are slowing, thus making prioritization of capital projects critical.
- The Build America Bond program expired at the end of 2010 and tax-exempt interest rates have increased over the last 60 days. It is expected that rates will continue to rise over the next year.
- The University was able to lock in very low rates on recent debt issuances, however over \$800m in unfunded authorizations creates significant rate risk in the future.