VII. STANDING COMMITTEES

B. Finance, Audit and Facilities Committee

Amendments to Debt Management Policy

RECOMMENDED ACTION

It is the recommendation of the administration and the Finance, Audit and Facilities Committee that the Board of Regents adopt the amended "Debt Management Policy: Statement of Objectives and Policies." The amendments include a policy limit of 20 percent for variable-rate debt in the external debt portfolio and minor technical changes.

BACKGROUND

The UW's debt management policy guides the institution's internal lending, debt issuance, and debt portfolio management. The Board first adopted the debt management policy in 2002 and approved amendments in 2004 and 2008. The Internal Lending Program (ILP), a "best practice" among UW's peer higher education institutions, was approved by the Board in the 2008 amendment to the debt management policy.

The debt management policy does not currently specify a limit to the amount of variable-rate debt that can be included in the external debt portfolio. The establishment of a 20 percent limit on variable-rate debt would be viewed as a "credit positive" for the UW by the national bond rating agencies. Including an upper limit to the amount of variable-rate debt in the external debt portfolio is consistent with the debt management policies of UW's peers.

The UW's external debt portfolio does not include variable-rate debt aside from commercial paper, which is currently only used to manage cash flows between long term bond issuances. The Treasury office has no plans to issue variable-rate debt (aside from commercial paper) and would inform the Board of any intent to consider the issuance of variable-rate debt in an upcoming bond sale.

REVIEW AND APPROVALS

The amended debt management policy has been reviewed and recommended for approval by the Senior Vice President and Treasurer, Board of Regents

Attachment
Annotated "Debt Management Policy: Statement of Objectives and Policies"

University of Washington
Debt Management Policy
Statement of Objectives and Policies

Approved by the Board of Regents, September 19, 2002

Amended July 16, 2004, May 15, 2008, and July 12, 2012

Overview

This statement of objectives and policies addresses the University's Internal Lending Program ("Program") and the active management of the institution's external debt portfolio.

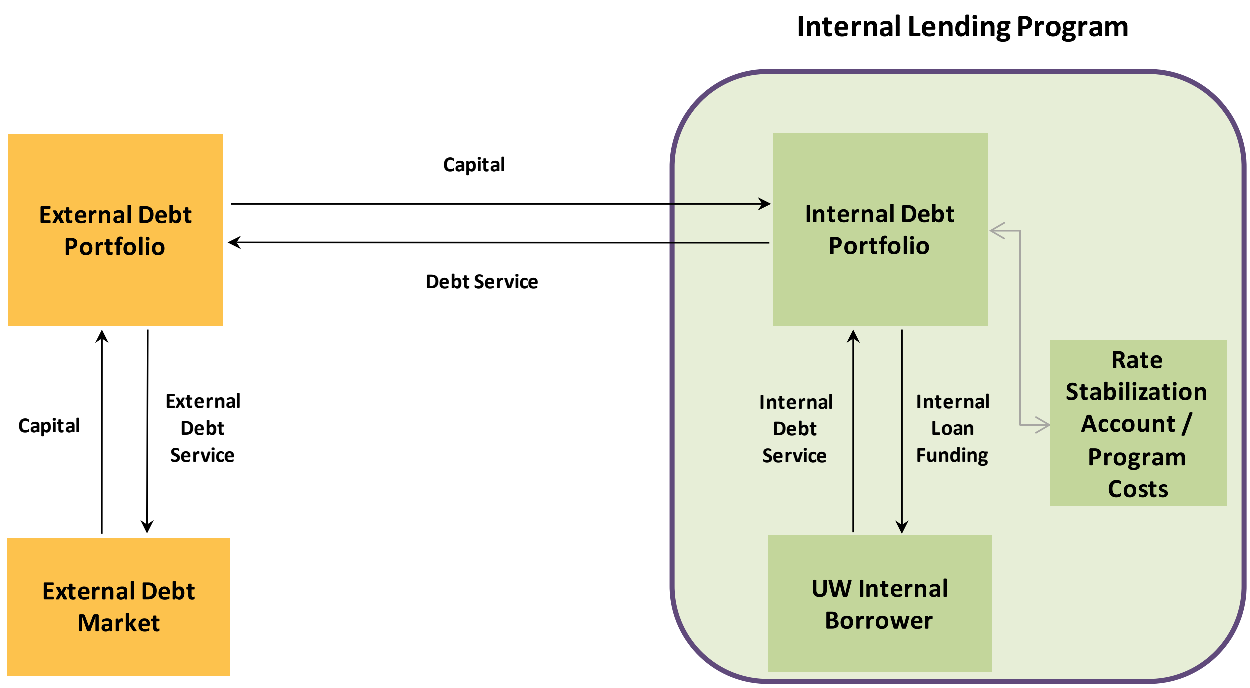
The Internal Lending Program will make loans to internal borrowers at a uniform internal lending rate. These internal loans will be funded through the issuance of University General Revenue debt obligations.

The University's internal loan portfolio will be comprised of the outstanding loans to internal borrowers, while the institution's external debt portfolio will be comprised of the institution's outstanding short-term and long-term debt obligations. The external debt portfolio will be actively managed to reduce the institution's cost of capital and to achieve stability and predictability in the internal lending rate. Active management of the external debt portfolio will entail the use of risk-evaluated debt structures and debt management techniques to achieve the lowest risk-adjusted cost of capital consistent with market conditions and institutional credit considerations.

The management of the Internal Lending Program and the external debt portfolio will be performed in accordance with policies set forth in this document and University debt management guidelines.

The diagram below outlines the relationship between the University's internal borrowers, the Internal Lending Program, and the external debt market:

ATTACHMENT



This statement of objectives and policies includes:

A. Introduction. Statement of overall objectives, management, and reporting.

B. Internal Lending Program. Description of Program scope, loan categories, internal lending rate, loan agreement, and Program fund.

C. Debt portfolio management. Description of external debt portfolio management objectives, institutional credit rating, core financial benchmarks, debt structure, refunding bonds, and financial derivatives.

D. Roles and responsibilities. Description of roles and responsibilities relating to the management of the Program and the University's external debt portfolio.

A. Introduction 1. Objectives. The primary objectives of the Internal Lending Program and active management of the University's external debt portfolio are to provide internal borrowers with access to funds at more stable and predictable interest rates and to reduce the institution's risk-adjusted cost of capital. 2. Management. The Program and the University's external	*No changes*

debt portfolio will be managed by the Treasury Office under authority granted to the President by the Board of Regents. 3. Reporting. A report on the Program and the University's external debt portfolio will be presented annually to the Finance, Audit, and Facilities Committee of the Board of Regents.	
B. Internal Lending Program The Internal Lending Program will make funds available to internal borrowers at a uniform interest rate that reflects the University's cost of capital. 1. Program scope. The Program will encompass all institutional financing needs, except as noted below. Alternative arrangements for any other financing action will require the approval of the Board of Regents. Financing actions exempted from participation in the Internal Lending Program: a. Debt repaid from appropriated University local funds (e.g., debt supported by Metro Tract revenue) b. Debt issued by an external entity on behalf of the University (e.g., 63-20, public-private, conduit financings) c. Personal property capital leases (e.g., equipment leases, equipment certificates of participation) d. Credit lines 2. Loan Types. Loan types for internal borrowing will include: a. Large capital expenditures (above $5 million). The approval of the Board of Regents will be required for capital expenditure loans exceeding $5 million. The maximum term of these loans will be 30 years (or the estimated useful life of the facilities). b. Small capital expenditures (less than $5 million). The approval of the Treasurer of the Board of Regents, will	*Technical changes (please see below)*

be required for capital expenditure loans up to $5 million. The maximum term of these loans will be 15 years (or the estimated useful life of the facilities).

c. Operating loans. Short-term working capital loans up to $25 million and with a maximum term of two years will be available. Operating loans up to $5 million will require the approval of the Treasurer of the Board of Regents. Operating loans exceeding $5 million will require the approval of the Board of Regents. An additional 200 basis points (2.0 percent) above the prevailing internal lending rate will be charged on outstanding balances and a commitment fee of 10 basis points (0.10 percent) will be charged on any unused balance. The aggregate total of operating loan commitments will not exceed 30 percent of the University's commercial paper line of credit without the approval of the Treasurer of the Board of Regents.

3. Internal lending rate. An internal lending rate will be uniformly applied to all loans approved after Program implementation. The rate will reflect the external debt portfolio's weighted average interest rate and will include funding for Program operating costs and a rate stabilization ~~reserve~~ account.

   a. Rate adjustment. The internal lending rate will be reviewed annually and will be subject to adjustment by the Board of Regents. Any adjustment will comply with Program fund policies described in this document. Any preliminary indication of a rate adjustment will be announced to Program participants twelve months in advance of the effective date of the adjustment. Any formal proposal for a final rate adjustment will be announced to Program participants six months in advance of the effective date of the adjustment and updated internal repayment schedules reflecting the new rate will be distributed to Program participants within 45 days of this announcement.

   b. Application. Adjustments to the internal lending rate will apply to all Program debt, including outstanding debt obligations incurred prior to Program implementation.

4. Program fund policies. Payments to the Internal Lending Program will be made monthly and held in a Program fund. External debt service payments will be made from the Program fund and all interest earnings will be retained in the Program fund. The Program fund will be managed according to the policies set forth below. Exceptions to these policies will require the approval of the Board of Regents. a. Operating level. The Program fund will be maintained at a level that enables the University to meet its Program obligations, including Program operating costs, debt portfolio management expenses, principal and interest on external debt, and a rate stabilization ~~reserve~~ account maintained as described below. An accounting of Program fund activities will be included in the annual Program report to the Board of Regents. b. Rate stabilization ~~reserve~~ account. The rate stabilization ~~reserve~~ account will be managed to preserve the stability of the internal lending rate after considering forecasted external borrowing, changes in financial market conditions, and Program operating requirements. The minimum balance of the rate stabilization fund will be sufficient to buffer against an increase in the internal lending rate from a two standard deviation increase in the Municipal Market Data (MMD) long-term municipal bond rate or equivalent index over the next twenty-four months with an 80 percent confidence level. c. Program operating expenses. Program operating expenses, including the costs of staffing, facilities, equipment, supplies, and fees, will be paid from the Program fund. d. Loans funded from reserves. Program reserves may be used to fund internal loans. e. Debt portfolio management expenses. Expenses associated with actively managing the University's external debt portfolio, including the costs of debt issuance, loan restructuring, and financial derivative transactions, will be paid from the Program fund.	

f. Other University purposes. Withdrawals from the Program fund for University purposes other than those described in this section will require the approval of the Board of Regents. A list of Program fund withdrawals will be included in the annual Program report to the Board of Regents. 5. Internal financing agreement. An internal financing agreement describing the loan structure and repayment terms will be required for all loans. The loan agreement may also include the following: a. Borrower's financial condition and performance. Specific operating benchmarks to be achieved and/or maintained by the borrower during the term of the loan, which could include cash reserve targets and/or a plan of remediation for failure to comply with loan covenants. b. Reporting. Annual reviews and/or audits of the borrower's financial condition and performance, including identification of any changes in, or other factors relating to, facility occupancy or facility/equipment use that could affect the tax-related status of University debt.	
C. Debt Portfolio Management The University's external debt portfolio will be actively managed to maintain the stability of the internal lending rate and to minimize the University's risk-adjusted cost of capital over the long term. The University will use short-term and long-term fixed and variable interest rate debt obligations, bond refundings, and financial derivatives to achieve this goal within the following guidelines: 1. Objective. The objective of actively managing the University's external debt portfolio will be to achieve the lowest risk-adjusted cost of capital consistent with market conditions and credit rating parameters set forth below. Active management decisions will take into consideration relevant risks and terms that include, but are not limited to, market conditions, bond refunding savings, call options, variable interest rate bond remarketing and auction	*Changes (please see below)*

expenses, and liquidity, tax, and counterparty risks. 2. Portfolio Credit Standard. The University will manage its external debt portfolio to maintain a minimum “A” category credit rating on its General Revenue obligations as evaluated by Moody's Investors Service and Standard & Poor's rating agencies. 3. Debt structure. The University may issue fixed-rate, variable-rate (up to 20 percent of the external debt portfolio), non-amortizing, and other forms of short-term and long-term debt to achieve its external debt portfolio management objectives. 4. Refunding bonds. The University may issue current and advance refunding bonds to lower or maintain the University's cost of capital over time. Refunding bonds will be issued to capture economic benefit and to restructure the debt portfolio in order to achieve longer-term strategic objectives. 5. Financial derivatives. The University may enter into financial derivative transactions to manage the institution's exposure to interest rate risk, reduce all-in borrowing costs of the external debt portfolio, and/or to manage other risks of the external debt portfolio that could adversely affect the internal lending rate or the Internal Lending Program. The University will enter into financial derivative transactions following guidelines in the University's Interest Rate Swap Policy. The University will not enter into financial derivative transactions for speculative purposes. 6. Core financial ratios. The University will use the following core financial ratios as performance benchmarks to evaluate institutional debt capacity. These ratios will be calculated and reported annually. a. Expendable resources-to-debt. Target range: 1.5 – 3.0 times. This balance sheet ratio measures the availability of unrestricted funds to cover all outstanding debt. Expendable Financial Resources* -- Direct University Debt	 *Limits the total amount of variable rate debt to 20 percent of the external debt portfolio.*

b. <u>Debt service-to-operations</u>. Target range: 2.5% – 5.0%. This statement-of-activities ratio measures the level of debt service on all outstanding debt as a percentage of overall operating expenses. (For non-amortizing bonds, principal will be assumed to be repaid in equal annual amounts). Peak Annual Debt Service* ------------------------------------- Total Operating Expenses (*As defined by Moody's Investors Service)	
<u>D. Roles and Responsibilities</u> 1. Board of Regents a. Approves policies that guide the operation of the Internal Lending Program and the management of the University's external debt portfolio b. Approves the annual bond resolution for the issuance of external debt c. Approves financing plans for loans above $5 million d. Delegates to the President the authority to enter into agreements to complete debt financing transactions above $5 million e. Approves exemptions of eligible financing transactions from participation in the Internal Lending Program f. Approves the adjustment of the internal lending rate g. Approves exceptions to Program fund policies h. Approves withdrawals from the Program fund for University purposes other than those described in Sections B.4.c, B.4.d and B.4.e above i. Approves increases in the size of the commercial paper program	*Changes (please see below)* *Board approval for withdrawals from the Program fund for purposes not in Sections B.4.c, B.4.d and B.4.e* *Board approval for*

2. Finance, Audit, and Facilities Committee a. Recommends proposed financing actions to the Board of Regents b. Receives annual reports on the Internal Lending Program and the University's external debt portfolio 3. President a. Delegates authority to enter into agreements to complete debt financing transactions b. Delegates authority to approve loans up to $5 million 4. Treasurer of the Board of Regents a. Reviews all financing actions b. Approves loans up to $5 million (as delegated) c. Approves aggregate operating loan commitments that exceed 30 percent of the University's commercial paper line of credit d. Approves the selection of bond counsel, financial advisor, and other financial services providers 5. Senior Associate Treasurer a. Oversees the day-to-day activities of the University's Internal Lending Program b. Consults with the Attorney General's Office in the selection of bond counsel	*increasing the size of the CP program*