

VII. STANDING COMMITTEES

B. Finance, Audit and Facilities Committee

Debt Management Annual Report

There will be an oral report for information only.

*Attachment*

Debt Management Annual Report

# UNIVERSITY OF WASHINGTON DEBT MANAGEMENT ANNUAL REPORT



BOARD OF REGENTS  
FINANCE, AUDIT AND FACILITIES COMMITTEE  
March 14<sup>th</sup>, 2013

ATTACHMENT

# DISCUSSION OUTLINE

|                         |               |
|-------------------------|---------------|
| Outlook and Overview    | Pages 4 - 9   |
| External Debt Portfolio | Pages 11 - 12 |
| Internal Debt Portfolio | Pages 14 - 16 |
| Financial Forecasting   | Pages 18      |
| Additional Materials    | Pages 20 - 21 |

# **OUTLOOK AND OVERVIEW**

# OUTLOOK

Macro challenges are similar to those faced by all of public higher education

- Uncertainties around federal research funding, Medicare and Medicaid reimbursements and Pell Grant support
- Declining state funds
- Tuition pricing sensitivity
- Aging plant and IT infrastructure
- Rapidly evolving model for delivering higher education (MOOC's)
- Impact of potential changes in tax law on gifts and interest deductions

The University has an ambitious capital plan – about \$5.7 billion through 2023 – with \$1.8 billion coming from debt

- Increasing amount of leverage has pressured credit ratings and could increase borrowing cost
- Higher fixed costs reduce financial flexibility and ability to withstand shocks
- Thoughtful capital planning and careful debt management is a positive factor

Interest rates continue to be attractive for high grade issuers like UW

- Short and long term rates are near historical lows
- The spread between taxable and tax-exempt debt is narrow
- The addition of variable rate debt can blend down the portfolio rate in an inflationary environment

# ACCOMPLISHMENTS

## Issuance

- Sold \$300 million of General Revenue Bonds in November 2012 at 3%
- Realized savings of \$14 million by refinancing lease-backed bonds as General Revenue Bonds in July 2011 and March 2012
- Funded project cash flows with short term commercial paper prior to long term takeout at an average rate of 0.2%. This generated an estimated savings of \$2.8 million vs. borrowing long term.

## Debt Portfolio / Internal Lending Program

- Policy amendment to establish a 20% limit on variable rate debt in the portfolio
- Developed methodology for assessing adequacy of the rate stabilization account

## Disclosure

- Piloted Semi-Annual Borrower Reports in October 2012

## Recruiting

- Hired Associate Treasurer with municipal underwriting experience to manage the ILP and external debt portfolio

# INITIATIVES

## Debt Capacity

- Debt targets being developed using financial ratios and credit ratings
- Joint Provost / Treasury presentation to regents in Spring 2013

## Enterprise financial forecasting and analysis

- Five year proforma
- Institutional stress tests
- Variance analysis
- Campus partnerships

## Rate stabilization account

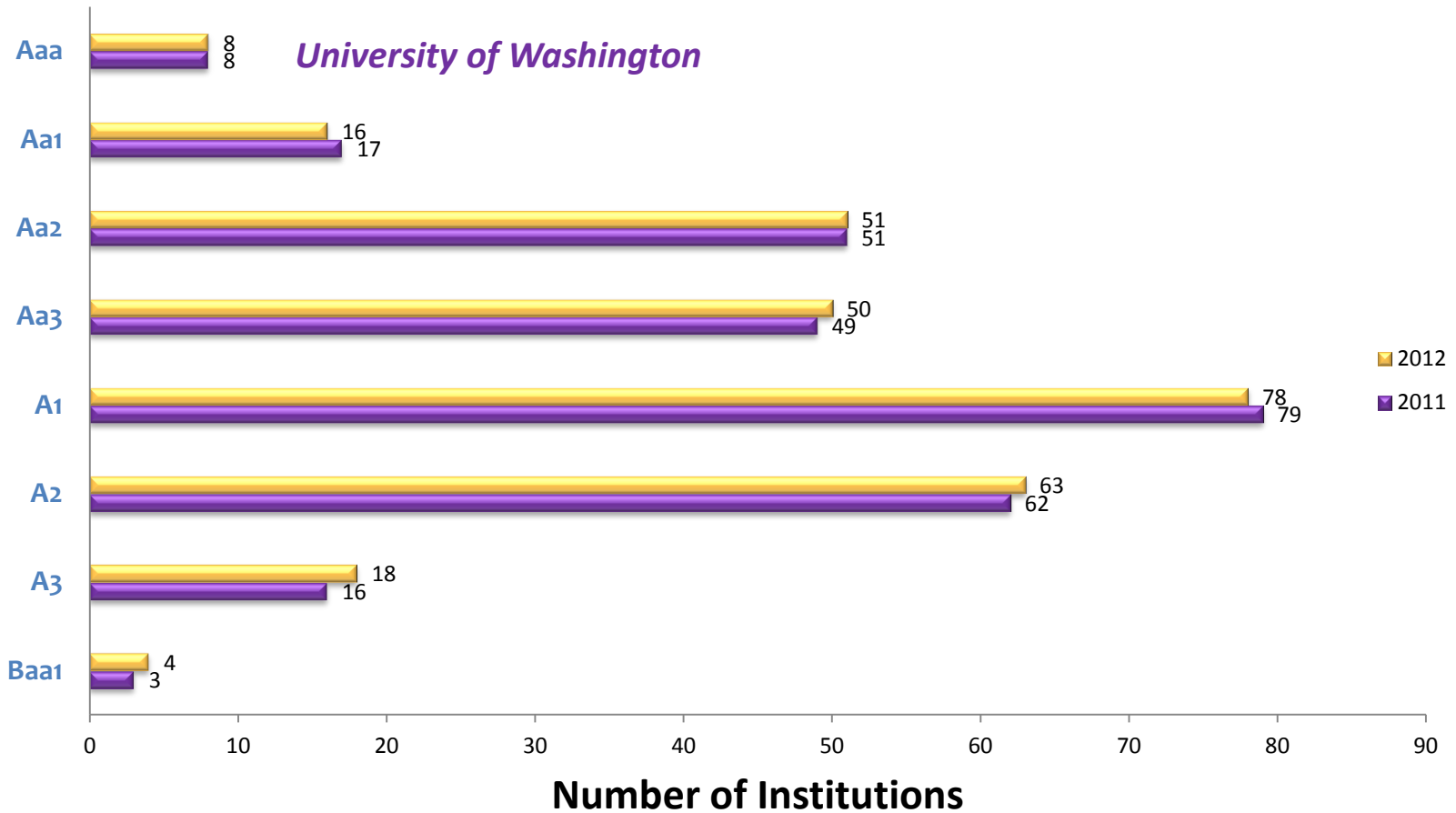
- Projected balances
- Distribution approach

## Ongoing due diligence on internal loans

- Semi annual reporting to Regents on large borrowers
- Formalizing internal review of loan covenants
- Institutional risks

## Private use review

# PUBLIC HIGHER EDUCATION CREDIT RATINGS



Source: Moody's rating distribution for fiscal year 2012

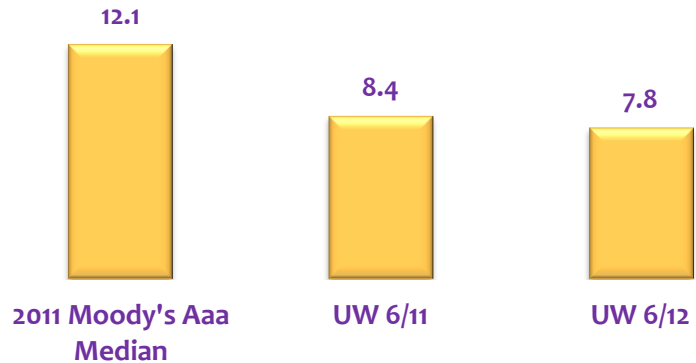
Notes:

- 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
- Standard & Poor's rates UW at AA+, one notch below AAA. The UW is not rated by Fitch.



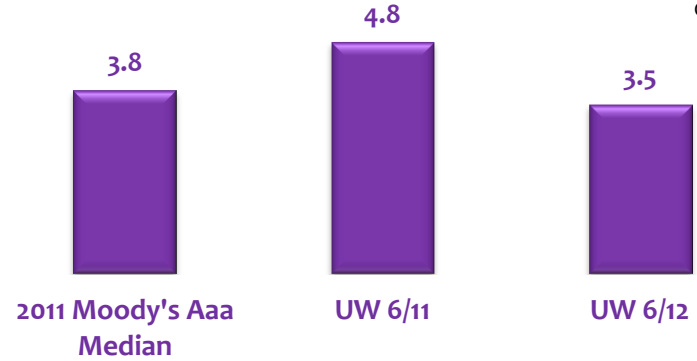
# FINANCIAL RATIOS COMPARISON

Expendable Financial Resources to Operations (x)



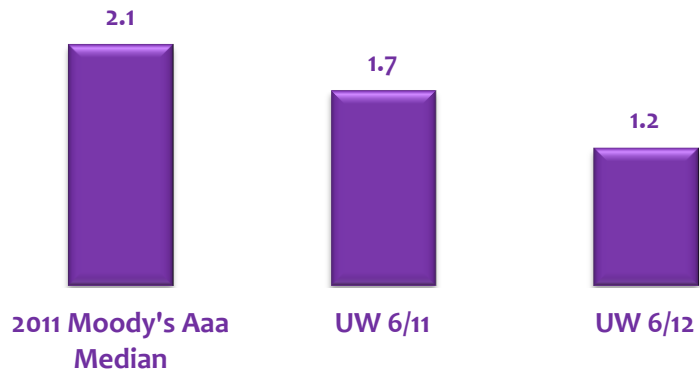
UW has nearly 8 months of expendable resources on hand to fund operations.

Debt Service Coverage (x)



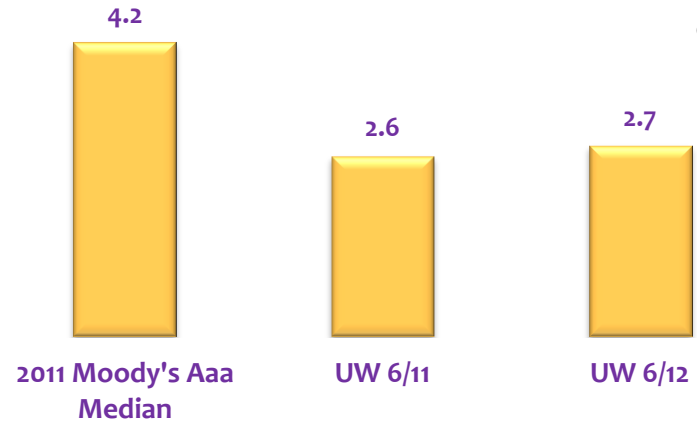
Debt service coverage has declined as external debt service payments come on line before new revenues from financed projects.

Expendable Financial Resources to Direct Debt (x)



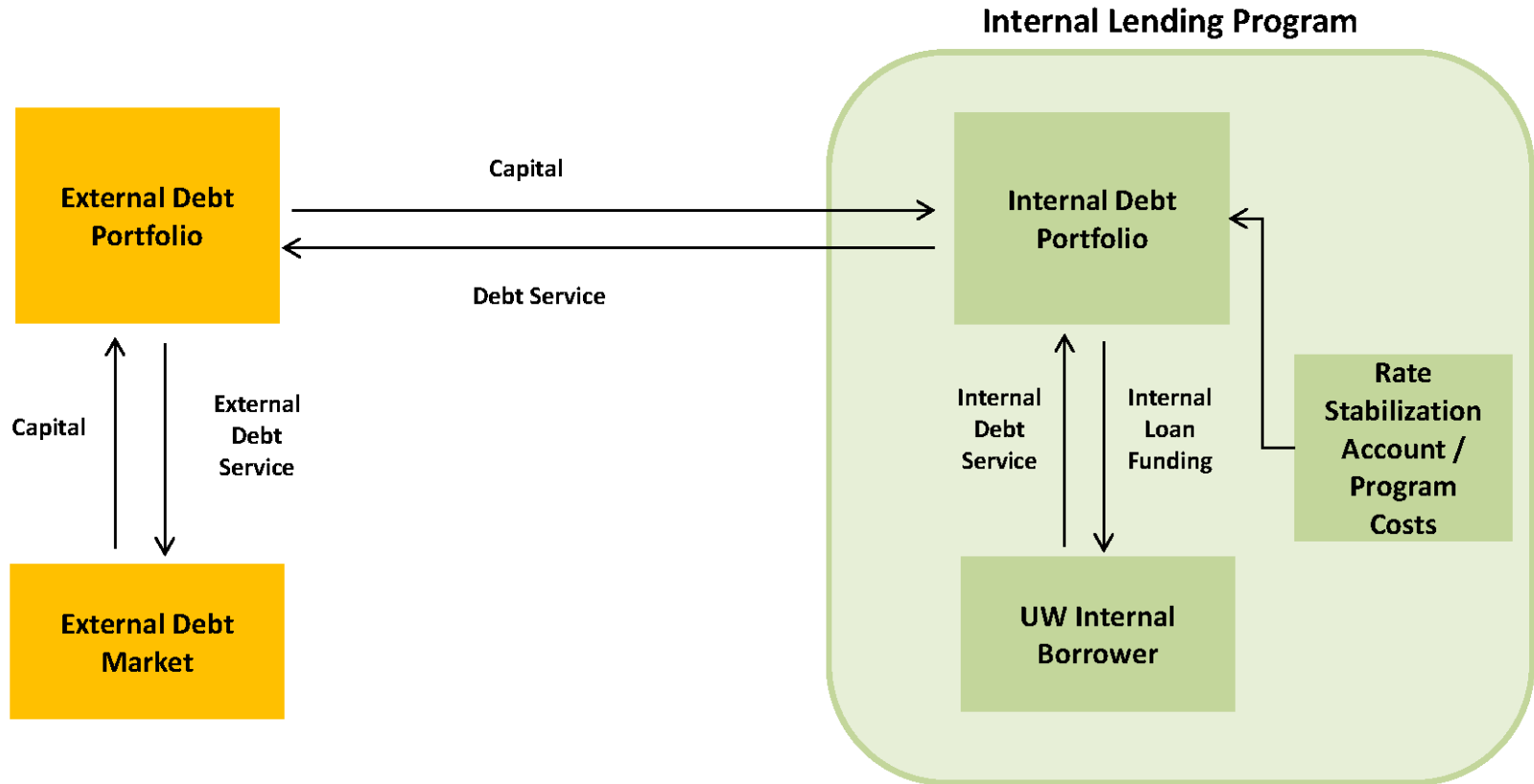
Ratio has declined slightly as outstanding debt has grown faster than reserve levels.

Debt Service to Operations (%)



Ratio has remained stable and below the median for the last two years.

# DEBT PORTFOLIO DIAGRAM

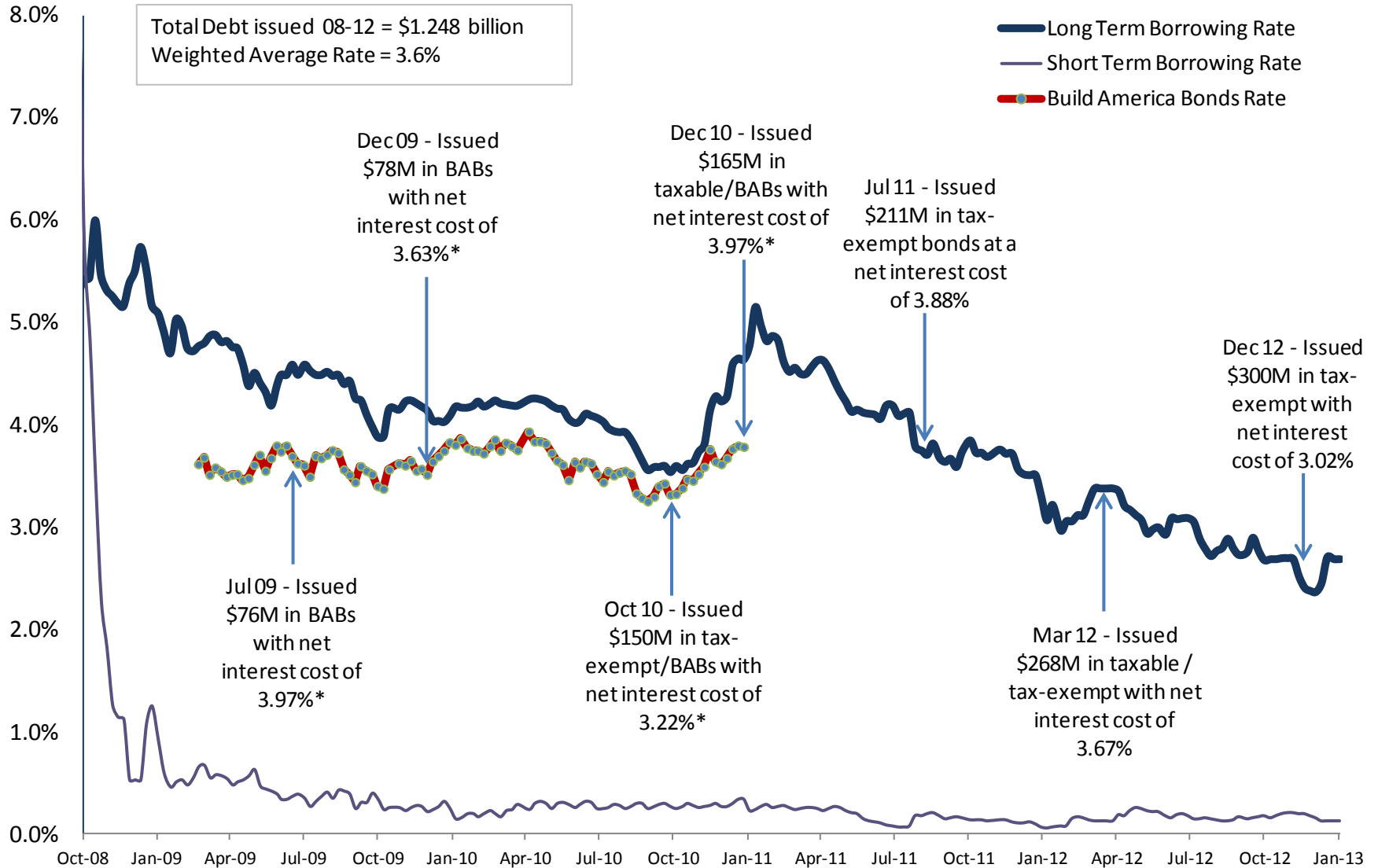


- Maintain cost effective access to the debt markets
- Seek opportunities to reduce long-term institutional borrowing costs

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

# EXTERNAL DEBT PORTFOLIO

# INTEREST RATES AND ISSUANCES OCTOBER 2008 – DECEMBER 2012



\*Sequestration will increase the cost of Build America Bonds by 0.1% in the first year, resulting in increased interest payments of  $F_{-14.1/203-13}$  approximately \$500,000 for the year. The impact would be ongoing if the cuts are made permanent.

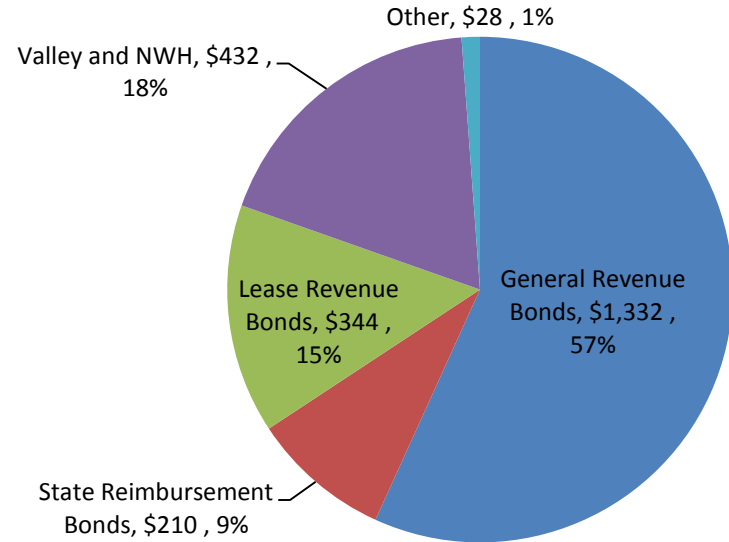
# UW DEBT PROFILE

(in millions as of December 31, 2012)

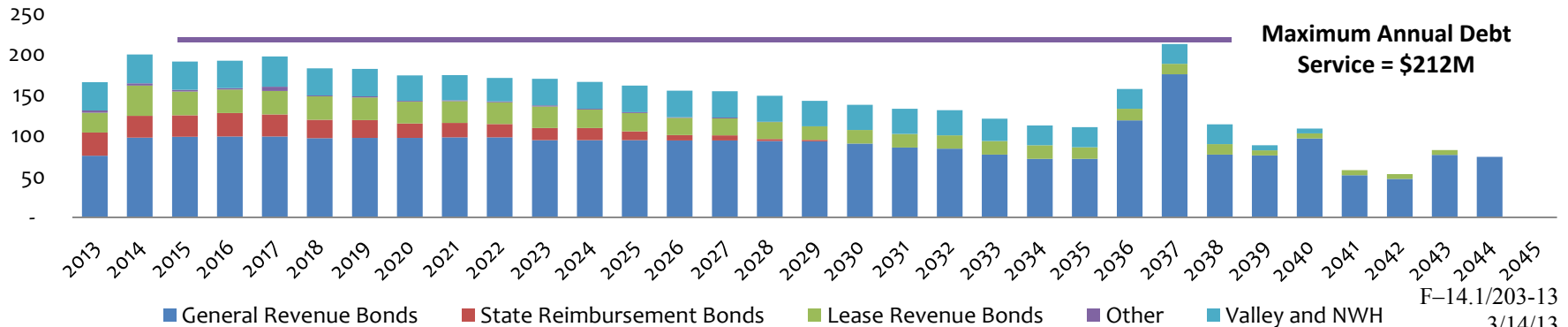
- The debt portfolio consists primarily of fixed rate debt (\$25 million of variable rate debt)
- Average borrowing rate for portfolio is 4.1% (3.6% for internal lending program)
- There is \$318 million in authorized debt remaining to be issued over the next five years
- An average of \$60 million in principal is repaid annually

## Outstanding Debt by Type

Total Debt: \$2,346



## Total Debt Service



# **INTERNAL DEBT PORTFOLIO**

# INTERNAL LOAN PORTFOLIO – DECEMBER 2012

|                                 | University Mission |              |                | Total          |
|---------------------------------|--------------------|--------------|----------------|----------------|
|                                 | Education          | Research     | Service        |                |
| <b>Beginning Balance Jul-12</b> | <b>\$88</b>        | <b>\$128</b> | <b>\$920</b>   | <b>\$1,136</b> |
| Additions                       | 7                  | 1            | 176            | 184            |
| Reductions                      | (3)                | (6)          | (14)           | (23)           |
| <b>Activity thru Dec-12</b>     | <b>4</b>           | <b>(5)</b>   | <b>162</b>     | <b>161</b>     |
| <b>Total Internal Loans</b>     | <b>\$92</b>        | <b>\$123</b> | <b>\$1,082</b> | <b>\$1,297</b> |

*(Dollars in Millions)*

# ESTIMATED CONSTRUCTION DRAWS AND ISSUANCE

*(\$ in millions)*

| <b>Approved Project</b>          | <b>Remaining Draws</b> |
|----------------------------------|------------------------|
| UWMC Expansion, Phase 2          | \$132                  |
| Husky Stadium                    | 104                    |
| Housing, Phase 2                 | 108                    |
| Housing, Phase 3                 | 131                    |
| Husky Ballpark                   | 13                     |
| Student Life Projects            | 12                     |
| UWMC Expansion, Phase 1          | 10                     |
| Housing, Phase 1                 | 6                      |
| <b>Total</b>                     | <b>\$516</b>           |
| Less funds on hand               | (\$198)                |
| Fiscal Year 2014 Bond Resolution | \$318                  |



# INTERNAL RATE ASSESSMENT

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

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- Weighted average borrowing rate in the ILP portfolio as of December 2012 is 3.6%
- November 2012 issuance of \$300 million at a net rate of 3%
- Between July 2012 – December 2012 the ILP added \$3.4 million to the rate stabilization account (RSA) bringing the balance to \$25.3 million
- Unfunded authorizations of \$318 million through 2018 create some risk to the ILP rate
- Recent low interest rates have contributed to the RSA balance, but continued need for debt funding in a rising rate environment could put pressure on the RSA
- Comprehensive assessment of RSA adequacy is under way; report to regents in late spring

# FINANCIAL FORECASTING

# FINANCIAL FORECASTING INITIATIVE STATUS REPORT

Integrated approach to measuring and reporting on the financial health of the institution

Provides institutional perspective on University finances

- Enables institution-wide proforma and stress tests
- Allows linkages between primary drivers and associated impacts (example: student demand drives faculty levels which drives need for residence hall beds)
- Connects project-based proformas to institutional impacts
- Generates more robust debt capacity analysis

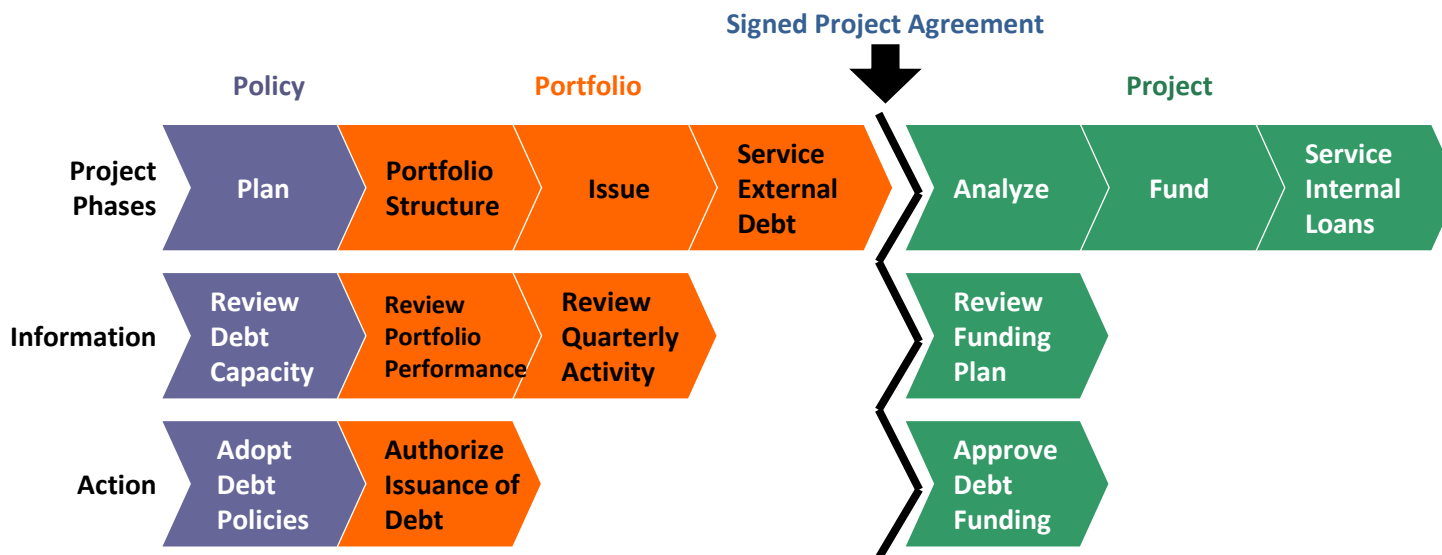
Future Perfect financial planning platform

- Excel workbook that projects business lines across UW over a ten year period
- Annual updates to reflect new growth assumptions and audited financial results
- On target to be operational by Spring 2013

# **ADDITIONAL MATERIALS**

# 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



# KEY STATISTICS AND RATIOS

|  | UW (Aaa) |        | Moody's 2011 Medians |        |
|--|----------|--------|----------------------|--------|
|  | 2011     | 2012   | Aaa                  | Aa1    |
| <b>Key Financial Statistics</b>                    |          |        |                      |        |
| Total Direct Debt (\$, in millions)                | 1,581    | 2,078  | 1,441                | 1,216  |
| Comprehensive Debt (\$, in millions)               | 1,750    | 2,254  | 1,600                | 1,343  |
| Unrestricted Financial Resources (\$, in millions) | 1,405    | 1,351  | 1,285                | 1,319  |
| Expendable Financial Resources (\$, in millions)   | 2,633    | 2,513  | 2,619                | 1,996  |
| Total Financial Resources (\$, in millions)        | 3,710    | 3,628  | 3,443                | 2,600  |
| Total Cash & Investments (\$, in millions)         | 4,028    | 3,769  | 3,868                | 2,027  |
| Total Revenues (\$, in millions)                   | 4,153    | 3,927  | 3,280                | 3,007  |
| Total Expenses (\$, in millions)                   | 4,002    | 3,844  | 3,079                | 2,942  |
| <b>Student Enrollment and Ratios</b>               |          |        |                      |        |
| Total Enrollment FTE (#)                           | 50,527   | 51,400 | 57,026               | 61,743 |
| Freshman Matriculation (%)                         | 40%      | 39%    | 44%                  | 33%    |
| Freshman Selectivity (%)                           | 58%      | 59%    | 63%                  | 74%    |
| Net tuition per student (\$)                       | 10,905   | 12,288 | 11,009               | 10,325 |
| State appropriation per student (\$)               | 6,020    | 4,321  | 6,750                | 8,955  |
| Educational expenses per student (\$)              | 43,956   | 37,699 | 39,353               | 23,736 |
| <b>Capital Ratios</b>                              |          |        |                      |        |
| Expendable financial resources-to-direct debt (x)  | 1.7      | 1.2    | 2.1                  | 1.6    |
| Debt Service to Operations (%)                     | 2.6%     | 2.7%   | 4.2%                 | 3.1%   |
| Direct debt to total revenues (x)                  | 0.4      | 0.5    | 0.5                  | 0.4    |
| <b>Balance Sheet Ratios</b>                        |          |        |                      |        |
| Expendable financial resources-to-operations (x)   | 0.7      | 0.7    | 1.0                  | 0.7    |
| <b>Operating Ratios</b>                            |          |        |                      |        |
| Actual debt service coverage (x)                   | 4.8      | 3.5    | 3.8                  | 4.1    |
| Average actual debt service coverage (x)           | 4        | 4.5    | 4.0                  | 3.9    |

Source: Moody's median data for fiscal year 2011 for Aaa and Aa1 rated public institutions of higher education. (MFRA database as of March 2012)  
Ratios for fiscal year 2010 exclude NW Hospital information