VII. STANDING COMMITTEE

B. Finance, Audit and Facilities Committee

Annual Debt Management Update

Please see Attachments.
University of Washington
Annual Debt Management Update

Board of Regents
Finance, Audit, and Facilities Committee
September 16, 2005
<table>
<thead>
<tr>
<th>DISCUSSION OUTLINE</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Mission</td>
<td>3</td>
</tr>
<tr>
<td>• Credit Ratings and Debt Capacity</td>
<td>4</td>
</tr>
<tr>
<td>• Debt Outstanding &amp; Future Borrowings</td>
<td>6</td>
</tr>
<tr>
<td>• 2006 Initiatives</td>
<td>9</td>
</tr>
<tr>
<td>• Conclusion</td>
<td>10</td>
</tr>
</tbody>
</table>
WHAT IS THE MISSION OF DEBT MANAGEMENT?

• Maintain cost effective access to the debt markets by:
  
  – Seeking opportunities to reduce borrowing costs
  
  – Ensuring quality underwriting and monitoring of new and outstanding obligations
WHAT IS THE UNIVERSITY’S CREDIT RATING?

Source: Moody’s Public University Ratings July 2005
WHAT IS THE UNIVERSITY’S DEBT CAPACITY?

- $1.0 TO $1.5 billion based on a credit rating of A to AA*
- Factors that affect the University’s credit rating are:
  - Revenues (past and prospective)
  - Reserves (Net Assets)
  - Strategic importance of projects being financed
  - Demand for services
  - Financial management discipline
  - Quality of institution

* Based on expendable resources as defined by Moody’s Investor Services
WHAT IS OUR OUTSTANDING DEBT?

<table>
<thead>
<tr>
<th>Category</th>
<th>6/30/2004</th>
<th>6/30/2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Research and Educational Facilities</td>
<td>315,417,799</td>
<td>410,124,688</td>
</tr>
<tr>
<td>Housing and Food Services (2)</td>
<td>165,680,000</td>
<td>162,600,000</td>
</tr>
<tr>
<td>Intercollegiate Athletics</td>
<td>15,105,000</td>
<td>13,890,000</td>
</tr>
<tr>
<td>Parking</td>
<td>3,960,000</td>
<td>19,915,000</td>
</tr>
<tr>
<td>Student Facilities</td>
<td>48,200,000</td>
<td>48,670,000</td>
</tr>
<tr>
<td>Harborview Medical Center</td>
<td>1,375,000</td>
<td>1,375,000</td>
</tr>
<tr>
<td>UWMC</td>
<td>122,853,987</td>
<td>124,931,673</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>672,591,786</strong></td>
<td><strong>781,506,361</strong></td>
</tr>
</tbody>
</table>

Notes
(1) Balances include capital leases and/or affiliated non-profit borrowings
(2) H&D System revenue bonds, state issued COP's & public private partnerships
## HOW MUCH DID WE BORROW IN THE LAST YEAR?

<table>
<thead>
<tr>
<th>Debt Issued (July 2004 - June 2005)</th>
<th>Date Issued</th>
<th>Rate</th>
<th>Par Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>UWMC Credit Line ($20 million limit)</td>
<td>June-04</td>
<td>Variable</td>
<td>12,000,000</td>
</tr>
<tr>
<td>WBRP I (Blue Flame)</td>
<td>August-04</td>
<td>4.8%</td>
<td>38,225,000</td>
</tr>
<tr>
<td>UWMC Equipment</td>
<td>August-04</td>
<td>3.0%</td>
<td>1,576,000</td>
</tr>
<tr>
<td>Parking System Revenue and Refunding</td>
<td>September-04</td>
<td>3.5%</td>
<td>20,410,000</td>
</tr>
<tr>
<td>Genome Sciences / BioE / R&amp;T</td>
<td>October-04</td>
<td>3.7%</td>
<td>60,720,000  *</td>
</tr>
<tr>
<td>UWMC Equipment</td>
<td>December-04</td>
<td>2.9%</td>
<td>3,800,000</td>
</tr>
<tr>
<td>UWMC Equipment</td>
<td>March-05</td>
<td>3.0%</td>
<td>4,181,000</td>
</tr>
<tr>
<td>Blue Flame Equipment</td>
<td>April-05</td>
<td>3.8%</td>
<td>1,221,000</td>
</tr>
<tr>
<td>Student Facilities Refunding (IMA)</td>
<td>May-05</td>
<td>4.5%</td>
<td>43,610,000</td>
</tr>
<tr>
<td><strong>Total Debt Issued FY 2005</strong></td>
<td></td>
<td></td>
<td><strong>185,743,000</strong></td>
</tr>
</tbody>
</table>

* This was a variable to fixed rate swap transaction. UW is paying a swap rate of 3.27% plus costs and basis risk of 42 basis points for a total effective rate of 3.69% over the last ten months. This compares favorably to the fixed rate alternatives at the time of 4.31%.
## HOW MUCH DO WE PLAN TO BORROW?

<table>
<thead>
<tr>
<th>FORWARD CALENDAR BEGINNING FY 2006</th>
<th>Date of Issue</th>
<th>Par Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Research and Educational facilities</td>
<td>2006-2007</td>
<td>161,465,000 (1)</td>
</tr>
<tr>
<td>Housing and Food Services</td>
<td>n/a</td>
<td>0</td>
</tr>
<tr>
<td>Harborview Medical Center</td>
<td>n/a</td>
<td>0</td>
</tr>
<tr>
<td>ICA</td>
<td>2006-2007</td>
<td>14,000,000 (2)</td>
</tr>
<tr>
<td>Parking Revenue and Refunding Bonds</td>
<td>n/a</td>
<td>0</td>
</tr>
<tr>
<td>Student Facilities</td>
<td>n/a</td>
<td>0</td>
</tr>
<tr>
<td>UWMC</td>
<td>2007-2008</td>
<td>30,000,000 (3)</td>
</tr>
<tr>
<td>Equipment Leases</td>
<td>2006-2007</td>
<td>13,700,000 (4)</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td><strong>$219,165,000</strong></td>
</tr>
</tbody>
</table>

### Notes

1. Includes SLU Phase 2 ($126.3M 10/05), UWT Parking ($4.1M 11/05), 4545 Building ($17.5M 1/06), and Educational Outreach $13.5M 12/05
2. Subject to obtaining 5% PV savings
3. Estimated
4. Includes equipment for Blue Flame building, South Lake Union Phase 2, and UWMC
WHAT ARE OUR INITIATIVES FOR 2006?

Lower Borrowing Costs

- Extend credit enhancement benefits of new General Revenue Bonds (GRB) borrowing platform to auxiliaries
- Begin discussions on establishing an internal cost of funds based on the GRB platform

Quality Underwriting and Monitoring

- Formalize/establish internal financial standards, reporting requirements, and ongoing due diligence reviews for all issuers
- Continue annual compliance efforts
SUMMARY

- The UW is financially strong with adequate reserves
- Operating ratios are stable despite funding environment
- The UW’s strong credit rating and cost-effective access to debt markets are the result of:
  - Strong student and research demand
  - The ability to offset declining state support by controlling costs and increasing local revenues
  - Successful fundraising efforts
  - Effective institutional governance and debt management
- General Revenue Bond (GRB) platform has increased financing options and has the potential to reduce cost of borrowing for the UW
Debt Management Presentation
Background Materials
WHAT IS THE ROLE OF THE BOARD OF REGENTS?

Debt Management

- Approve debt management guidelines
- Establish credit standards ("A" category rating or better)
- Oversight of debt outstanding, credit ratings, and compliance with bond covenants and IRS rules

Debt Issuance

- Approve financing plans and adopt bond resolutions
- Authorize issuance of bonds and other debt instruments
- Appoint financial advisor and investment bankers
- Approve changes to bond resolutions
WHY DO WE BORROW?

- To better match costs with benefits of long-term capital projects

- To fund capital projects for auxiliary units that are not funded by the State

- To complement State funding for educational and research facilities

- To manage cash reserves
WHAT TYPES OF DEBT INSTRUMENTS DO WE USE?

- Credit lines and short-term notes
- Revenue bonds
- Reimbursable State debt
- Lease-backed obligations
WHAT IS THE UW’S LOCAL AUTHORITY TO BORROW?

- For short-term operating needs (within current biennium)
- For personal property (equipment)
- For auxiliary capital projects
- For the Metropolitan Tract
- For research facilities

Note: The University also has access to State issued reimbursable bonds and Certificates of Participation (COP’s) with legislative approval
HOW ARE RESEARCH BUILDINGS BEING FINANCED?

- In 2004 the University created a “general revenue bond” or GRB borrowing platform to support the UW’s recently acquired authority to issue research revenue bonds.

- GRBs are secured by all non-appropriated local funds excluding restricted funds, state appropriations, and auxiliary revenues. GRB revenues totaled $612 million in fiscal 2004.

- The cost of borrowing using the GRB platform is comparable to the State.

- GRBs issued for the Genome Sciences and R&T research facilities were rated AA+ by S&P and Aa1 by Moody’s.

- The GRB platform is a source of security that reduces borrowing costs.

- As with all other financing options a separate and unencumbered source of revenues must be identified before issuing GRB’s.

- GRB platform increases flexibility, not capacity.
WHAT ARE THE SOURCES OF REPAYMENT FOR UW DEBT?

Fiscal Year 2004: All UW Revenues $2.82 Billion

- General Revenues (GRB) $612,048
- Restricted Gifts $301,764
- Grant Direct Costs $719,392
- State Appropriations $309,618
- UWMC $720,692
- All Other Auxiliaries $125,865
- State Appropriated Local Funds—$29,865

- State issued COP’s
- Capital Leases
- Research and Ed GO bonds
- Research revenue bonds and financing contracts
- Higher Ed GO bonds
- Law School GO bonds
- Housing and Dining bonds
- Parking bonds
- ICA bonds
- UWMC bonds
- Cap leases for UWMC equipment
- Student fees bonds
HOW DO WE EVALUATE FUTURE BORROWINGS?

- Follow a standard evaluation and approval process

- Manage to an “A” credit rating standard or better to maintain cost-effective access to capital markets

- New projects must stand on their own based on existing debt capacity and/or potential to generate new marginal revenues

- Take into consideration impact of capital leases and affiliated non-profit financings when evaluating debt capacity
WHAT IS THE APPROVAL PROCESS FOR PROJECTS FINANCED WITH DEBT?

- Identified Need
  - Determine Priority and Feasibility of the Project
    - Provost & Real Estate Office
  - Assess Feasibility of Financing Plan
    - Treasury Office, Financial advisor, Legal counsel, Rating agencies, & Credit providers
  - Review and Approve Financing Plan
    - Dept. Senior Staff, Treasury Office, Executive V.P., & Provost Office

- Project Screen
  - Institutional Priority
  - Cost/Scope of Project
  - Potential Sources of Funding

- Funding Screen
  - Debt Capacity
  - Adequacy/Stability of Reserves and Revenues
  - Access to Debt Markets
  - Coverage for O&M and Capital Reserves

- Management Screen
  - Review Financing Plan

- Board of Regents Screen
  - Approve Financing Plan

- Implement Financing Plan
## WHAT ARE THE UNIVERSITY’S CREDIT RATINGS?

<table>
<thead>
<tr>
<th></th>
<th>Moody’s</th>
<th>S&amp;P</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Institution (GRB)</strong></td>
<td>Aa1</td>
<td>AA+</td>
</tr>
<tr>
<td><strong>Auxiliaries</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Student Facilities</td>
<td>Aa2</td>
<td>AA+</td>
</tr>
<tr>
<td>- Housing &amp; Dining</td>
<td>Aa2</td>
<td>A+</td>
</tr>
<tr>
<td>- Parking</td>
<td>Aa2</td>
<td>A+</td>
</tr>
<tr>
<td>- ICA</td>
<td>Aa3</td>
<td>A+</td>
</tr>
<tr>
<td>- UWMC</td>
<td>not rated</td>
<td>not rated</td>
</tr>
<tr>
<td>- HMC</td>
<td>not rated</td>
<td>not rated</td>
</tr>
<tr>
<td><strong>Metro Tract</strong></td>
<td>not rated</td>
<td>not rated</td>
</tr>
</tbody>
</table>
HOW DOES THE UW COMPARE FISCALLY WITH ITS PEERS?

Expendable Resources to Operations:
UW has nearly 8 months of expendable resources on hand to fund operations

Expendable Resources to Debt:
UW’s debt ratio is well above the median

Conclusion: Key ratios are in line with or better than peers

Source: Moody’s. Median data as of fiscal year 2004 published in July 2005 for Aa rated public institutions of higher education
### WHAT IS OUR CAPACITY FOR FUTURE DEBT AT THE CURRENT LEVEL OF EXPENDABLE RESOURCES?

<table>
<thead>
<tr>
<th></th>
<th>“Aa” Category</th>
<th>“A” Category</th>
</tr>
</thead>
<tbody>
<tr>
<td>Expendable Resources to Debt *</td>
<td>1.7x</td>
<td>1.0x</td>
</tr>
<tr>
<td>Total Debt Capacity</td>
<td>$1 Billion</td>
<td>$1.5 Billion</td>
</tr>
<tr>
<td>Projected Debt at 6-30-05</td>
<td>$767M</td>
<td>$767M</td>
</tr>
<tr>
<td>Capacity for ADDED debt as of 6-30-05</td>
<td>$200M to 400M</td>
<td>$500M to 800M</td>
</tr>
</tbody>
</table>

* Source: Moody’s. Median data as of fiscal year 2004, published July 2005
HOW MUCH HAVE WE BORROWED HISTORICALLY?

UW Debt Issued FY 1995-2005

Note: Balances include capital leases and/or off balance sheet debt
What is our future debt service?

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Amounts in Millions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Outstanding Debt</td>
<td>781.5</td>
</tr>
<tr>
<td>Total Debt Service</td>
<td>59.7</td>
</tr>
</tbody>
</table>

Note - includes affiliated non-profit borrowings debt and capital leases.
WHAT ARE OUR COMPLIANCE OBLIGATIONS?

- Perform of annual financial audits of auxiliary system to insure compliance with bondholder covenants
  - Non compliance: Bond default subject to defined remedies

- Produce annual Bondholders Report to meet public market reporting requirements and investors needs
  - Non compliance: Bond default subject to defined remedies

- Annual assessment of rebatable arbitrage earnings on bond proceeds. Performed by Ernst & Young and reviewed by tax counsel
  - Non compliance: IRS fines

- Reviews of private use of facilities financed with tax-exempt bonds
  - Non compliance: Bonds could be declared taxable by IRS, fines
Agenda

- Context for Ratings
- Outlook for Higher Education Industry
- Challenges Facing Research Universities
- University of Washington
Higher Education and Not-for-Profit Ratings Group

- **Private Higher Education:** Nearly 300 organizations with over $37 billion of outstanding debt; Median rating of A3

- **Public Higher Education:** Approximately 200 organizations with $50 billion of outstanding debt; Median rating of A1

- **Not-for-Profit Organizations:** More than 80 organizations with $7.6 billion of outstanding debt; Median rating of A1

- **Preparatory Schools:** Over 60 organizations with $1.3 billion of outstanding debt; Median rating of A2
Rating: Many Factors

- Core Business
- Debt and Other Liabilities
- Management and Governance
- Financial Resources
- Operating Performance
- Legal Structure
Demographics Vary Widely by Region
Projected Change in High School Grads, 2005-2015
Reliance on State For Publics Continues Decline: Policy Questions?

% of Total Revenue from Student Charges and State Appropriations, 1980 and 2004

- 1980: 22% Student Charges, 46% State Appropriations
- 2004: 34% Student Charges, 33% State Appropriations
Public University Tuition Increases Linked to State Funding Environment

Sources: Center for the Study of Education Policy, Illinois State University; The College Board
Tuition Gap Between Publics and Privates Remains
Average Fixed Charges for Undergraduates

Source: The College Board
Endowment Performance Sharply Positive in FY 2004, 2005

Average Annual Investment Return
Source: NACUBO Endowment Study
Higher Education in a Borrowing Boom

Rising Share of Bond Market
1991-2004

- Record borrowing in the last 4 Years
- Stock Market drop, low interest rates, student demand, research facilities drive borrowing
## Public University Median Trends

<table>
<thead>
<tr>
<th></th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Direct Debt ($ million)</td>
<td>100</td>
<td>113</td>
<td>129</td>
</tr>
<tr>
<td>Total Resources ($ million)</td>
<td>152</td>
<td>163</td>
<td>183</td>
</tr>
<tr>
<td>Total Enrollment (FTE)</td>
<td>15,487</td>
<td>15,832</td>
<td>16,037</td>
</tr>
<tr>
<td>Expendable Resources to Debt</td>
<td>1.25</td>
<td>1.06</td>
<td>0.99</td>
</tr>
<tr>
<td>Expendable Resources to Operations</td>
<td>0.4</td>
<td>0.39</td>
<td>0.44</td>
</tr>
<tr>
<td>Annual Operating Margin</td>
<td>1.5%</td>
<td>1.1%</td>
<td>2.5%</td>
</tr>
<tr>
<td>Net Tuition per Student</td>
<td>$3,205</td>
<td>$3,559</td>
<td>$4,050</td>
</tr>
<tr>
<td>State Appropriations per Student</td>
<td>$7,109</td>
<td>$6,945</td>
<td>$6,745</td>
</tr>
<tr>
<td>Reliance on the State</td>
<td>38%</td>
<td>36%</td>
<td>33%</td>
</tr>
</tbody>
</table>
Rating Changes Reflect Continued Strength of Public Universities

- Public College Upgrades
- Public College Downgrades

<table>
<thead>
<tr>
<th>Year</th>
<th>Upgrades</th>
<th>Downgrades</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001</td>
<td>19</td>
<td>2</td>
</tr>
<tr>
<td>2002</td>
<td>11</td>
<td>0</td>
</tr>
<tr>
<td>2003</td>
<td>22</td>
<td>2</td>
</tr>
<tr>
<td>2004</td>
<td>21</td>
<td>3</td>
</tr>
<tr>
<td>Thru 6/05</td>
<td>5</td>
<td>0</td>
</tr>
</tbody>
</table>
Challenges Facing Research Universities

- Slowing of federal research funding
- Funding of new capital projects
- Relationship with the state (publics)
- Investment management
- Sustaining philanthropic flow
- Student demand and tuition pricing pressures
University of Washington

**Strengths**

- Flagship institution with strong demand
- One of nation’s top research organizations
- Good financial reserves, strong fundraising
- Consistently positive operating performance, diversified revenue sources
- Sophisticated debt management

**Challenges**

- Capital intensive organization with ongoing capital needs
- Slowing federal research funding
- Ability of State to sustain support
- Health care operations
- Initiative state
## How does the U stack up?

<table>
<thead>
<tr>
<th></th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>Median</th>
</tr>
</thead>
<tbody>
<tr>
<td>Direct Debt ($ million)</td>
<td>523</td>
<td>520</td>
<td>681</td>
<td>129</td>
</tr>
<tr>
<td>Total Resources ($ million)</td>
<td>1,901</td>
<td>2,008</td>
<td>2,205</td>
<td>183</td>
</tr>
<tr>
<td>Total Enrollment (FTE)</td>
<td>39,022</td>
<td>38,630</td>
<td>38,614</td>
<td>16,037</td>
</tr>
<tr>
<td>Expendable Resources to Debt</td>
<td>2.7</td>
<td>2.9</td>
<td>2.4</td>
<td>0.99</td>
</tr>
<tr>
<td>Expendable Resources to Operations</td>
<td>0.63</td>
<td>0.62</td>
<td>0.65</td>
<td>0.44</td>
</tr>
<tr>
<td>Annual Operating Margin</td>
<td>1.3%</td>
<td>5.2%</td>
<td>0.3%</td>
<td>2.5%</td>
</tr>
<tr>
<td>Net Tuition per Student</td>
<td>$5,327</td>
<td>$5,991</td>
<td>$6,488</td>
<td>$4,050</td>
</tr>
<tr>
<td>State Appropriations per Student</td>
<td>$8,906</td>
<td>$8,521</td>
<td>$8,015</td>
<td>$6,745</td>
</tr>
<tr>
<td>Reliance on the State</td>
<td>15%</td>
<td>13%</td>
<td>12%</td>
<td>33%</td>
</tr>
</tbody>
</table>