

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

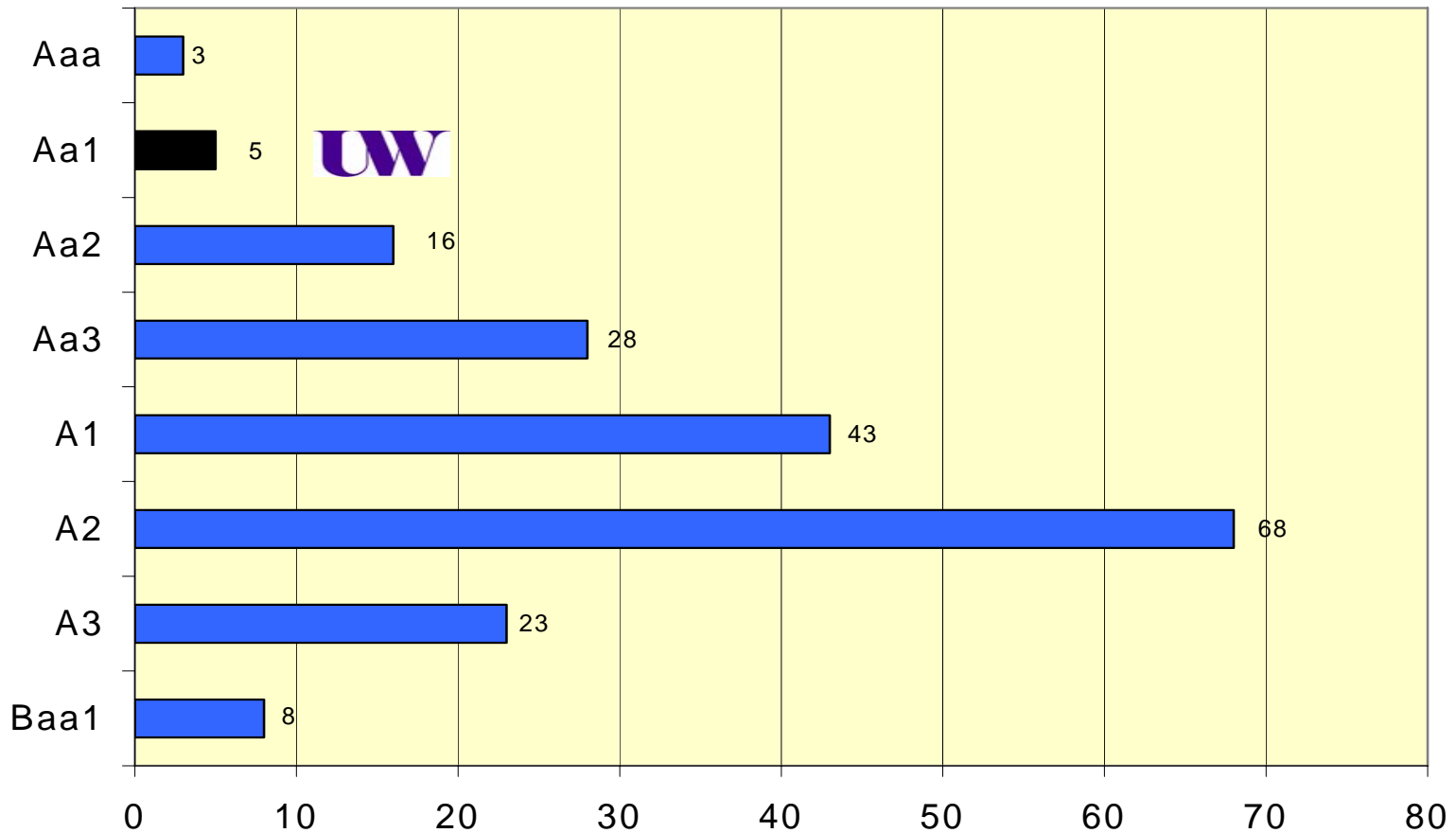
DISCUSSION OUTLINE

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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?

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

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?

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

* 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?

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

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

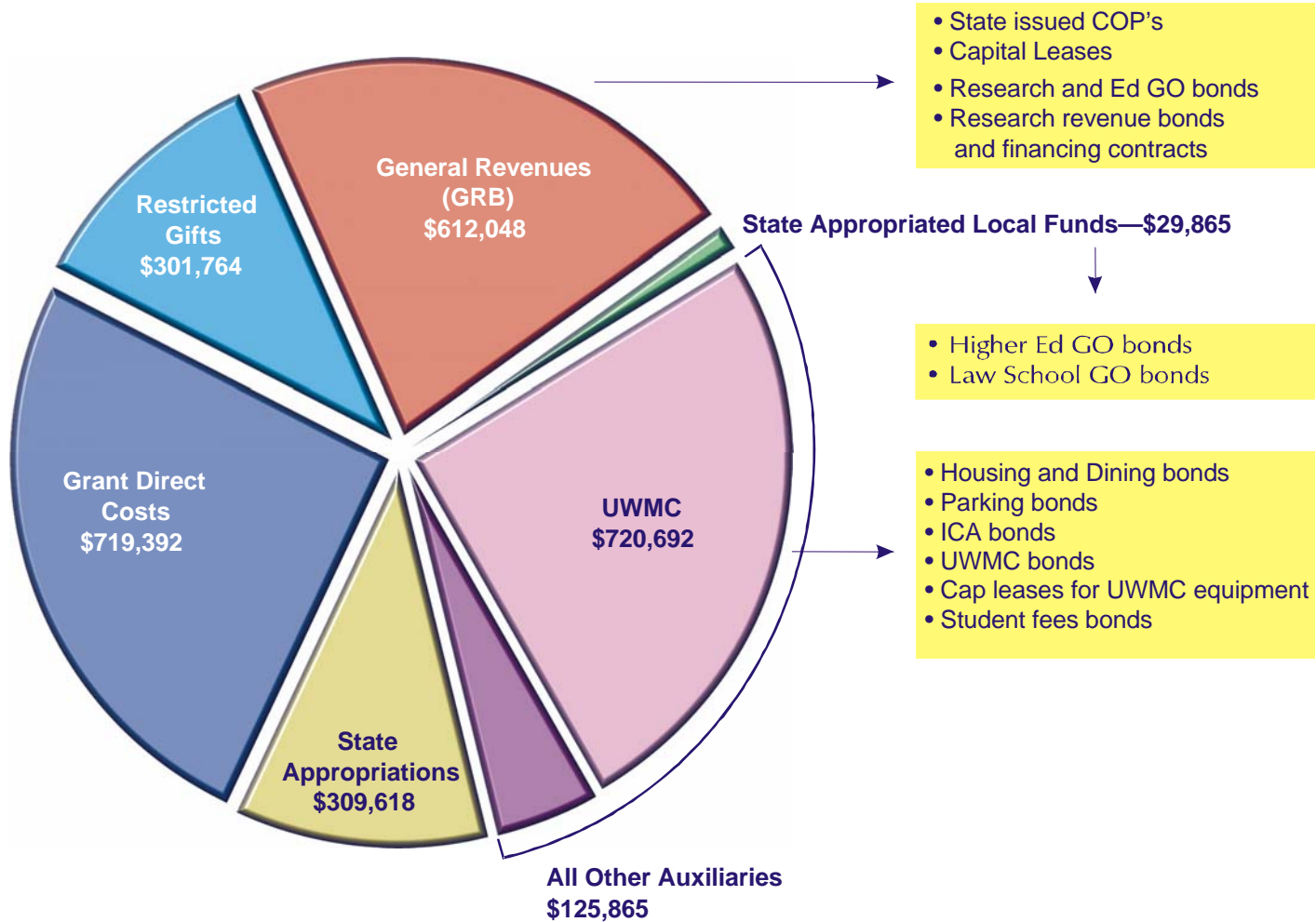
Note: The University also has access to State issued reimbursable bonds and Certificates of Participation (COP's) with legislative approval

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?

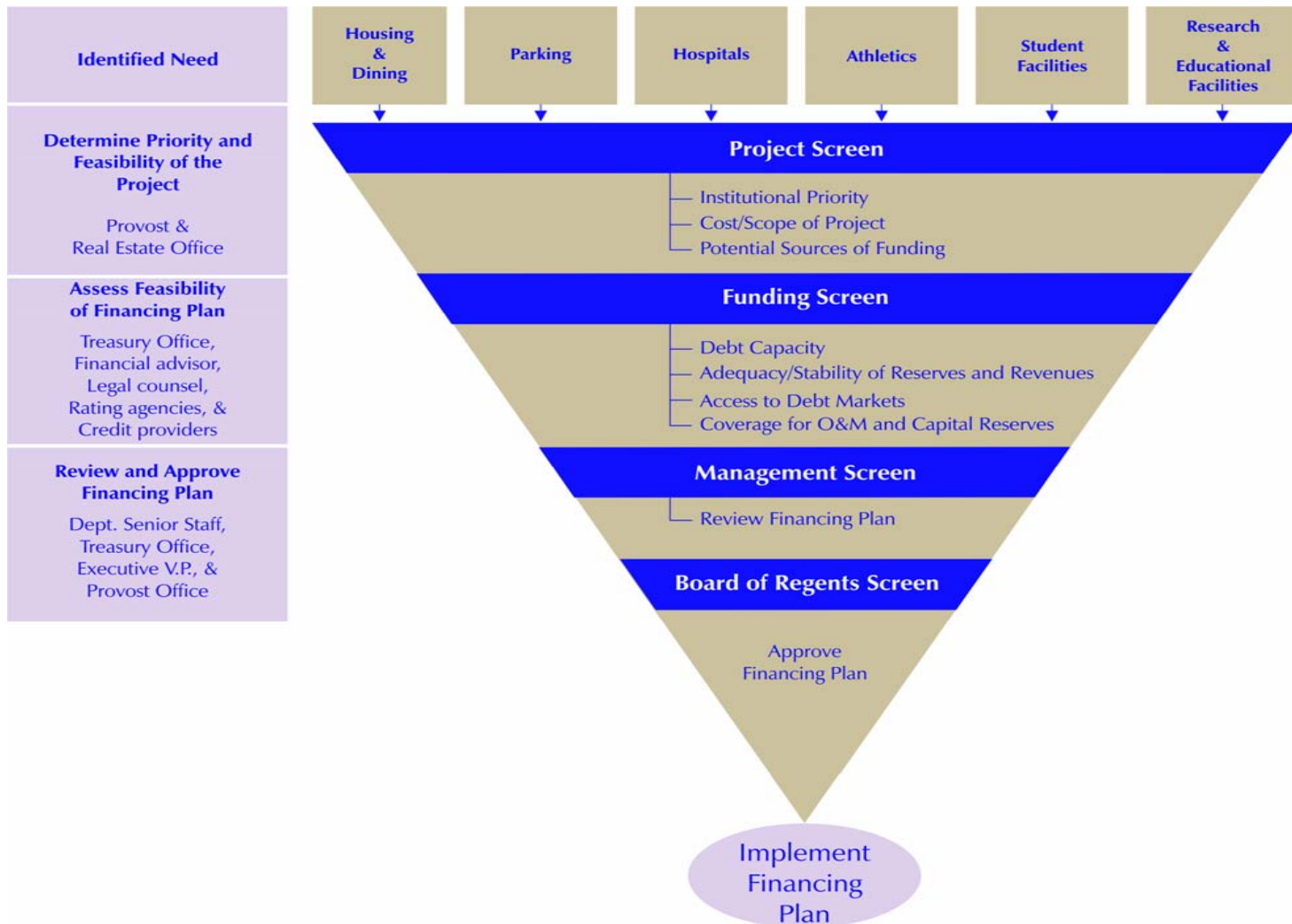
Fiscal Year 2004: All UW Revenues \$2.82 Billion



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

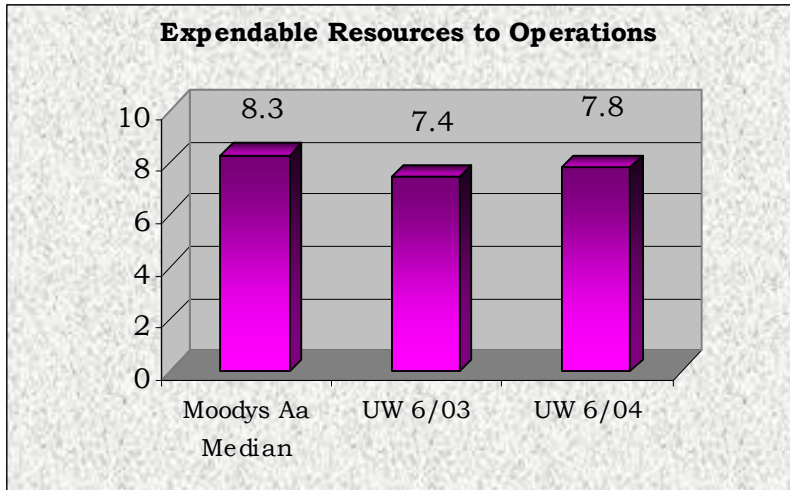
WHAT IS THE APPROVAL PROCESS FOR PROJECTS FINANCED WITH DEBT?



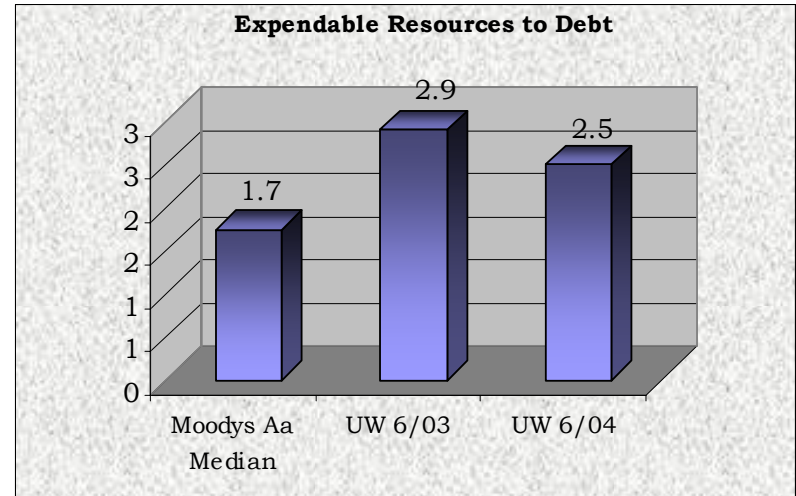
WHAT ARE THE UNIVERSITY'S CREDIT RATINGS?

	<u>Moody's</u>	<u>S&P</u>
➤ Institution (GRB)	Aa1	AA+
➤ Auxiliaries		
- Student Facilities	Aa2	AA+
- Housing & Dining	Aa2	A+
- Parking	Aa2	A+
- ICA	Aa3	A+
- UWMC	not rated	not rated
- HMC	not rated	not rated
➤ Metro Tract	not rated	not rated

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

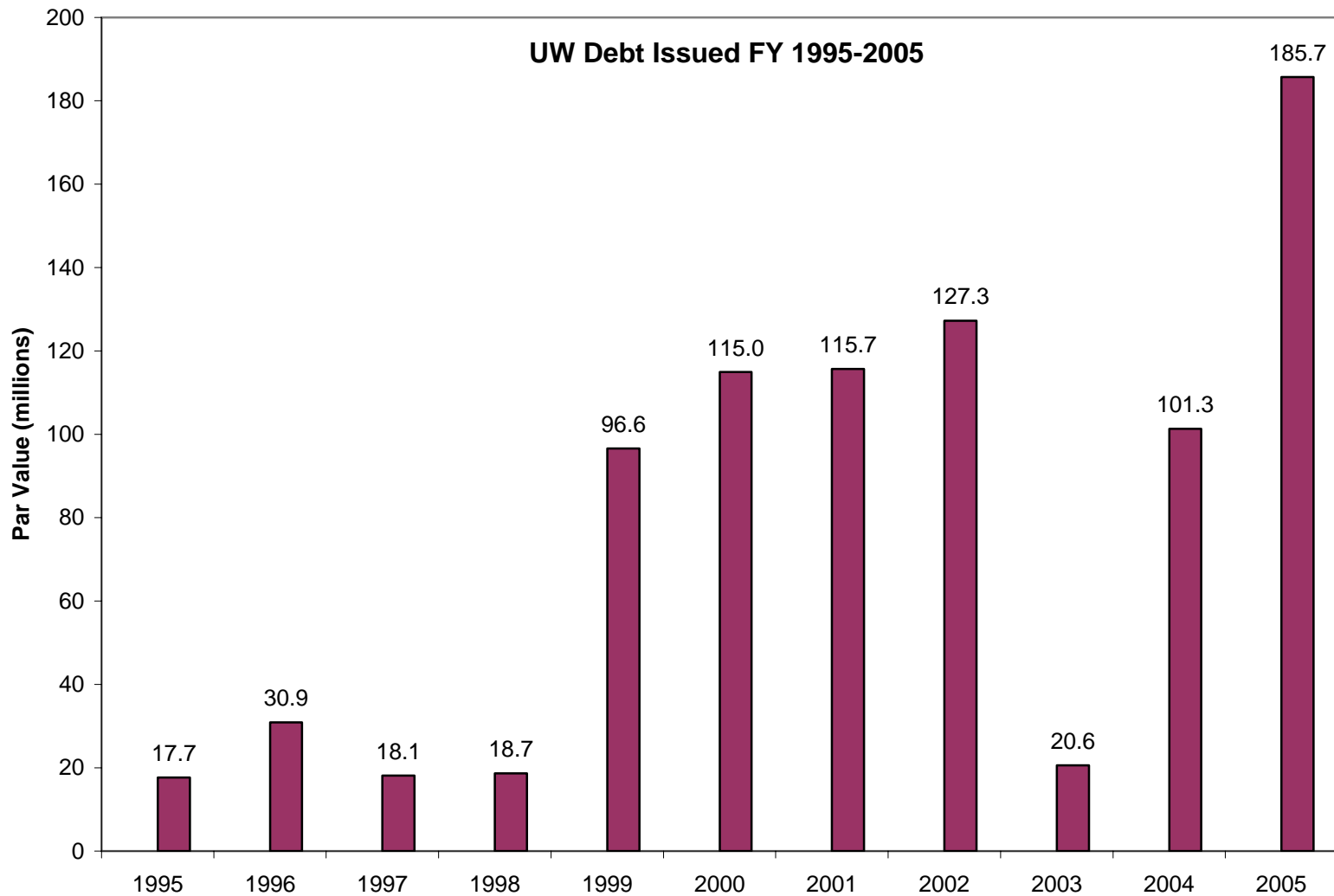
Source: Moody's. Median data as of fiscal year 2004 published in July 2005 for Aa rated public institutions of higher education

WHAT IS OUR CAPACITY FOR FUTURE DEBT AT THE CURRENT LEVEL OF EXPENDABLE RESOURCES?

	“Aa” Category	“A” Category
Expendable Resources to Debt *	1.7x	1.0x
Total Debt Capacity	\$1 Billion	\$1.5 Billion
Projected Debt at 6-30-05	\$767M	\$767M
Capacity for ADDED debt as of 6-30-05	\$200M to 400M	\$500M to 800M

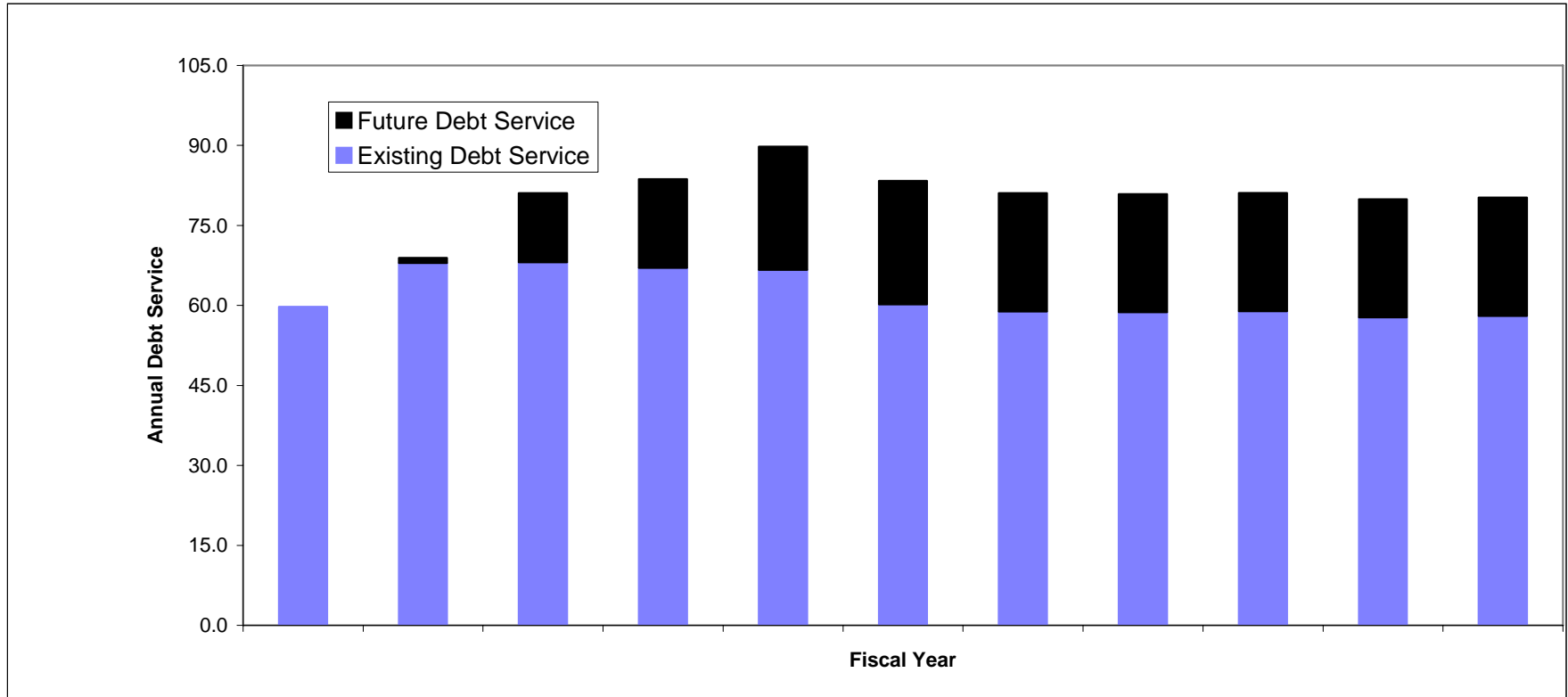
* Source: Moody's. Median data as of fiscal year 2004, published July 2005

HOW MUCH HAVE WE BORROWED HISTORICALLY?



Note: Balances include capital leases and/or off balance sheet debt

WHAT IS OUR FUTURE DEBT SERVICE ?



Amounts in Millions	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Outstanding Debt	781.5	744.6	705.8	668.1	629.1	597.2	566.2	534.4	500.3	362.9	336.7
Total Debt Service	59.7	68.9	81.1	83.7	89.8	83.3	81.1	80.9	81.1	79.9	80.2

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

Presentation to the University of Washington Board of Regents

Presented by:

Susan Fitzgerald

Sr. Vice President



September 2005

Moody's Investors Service

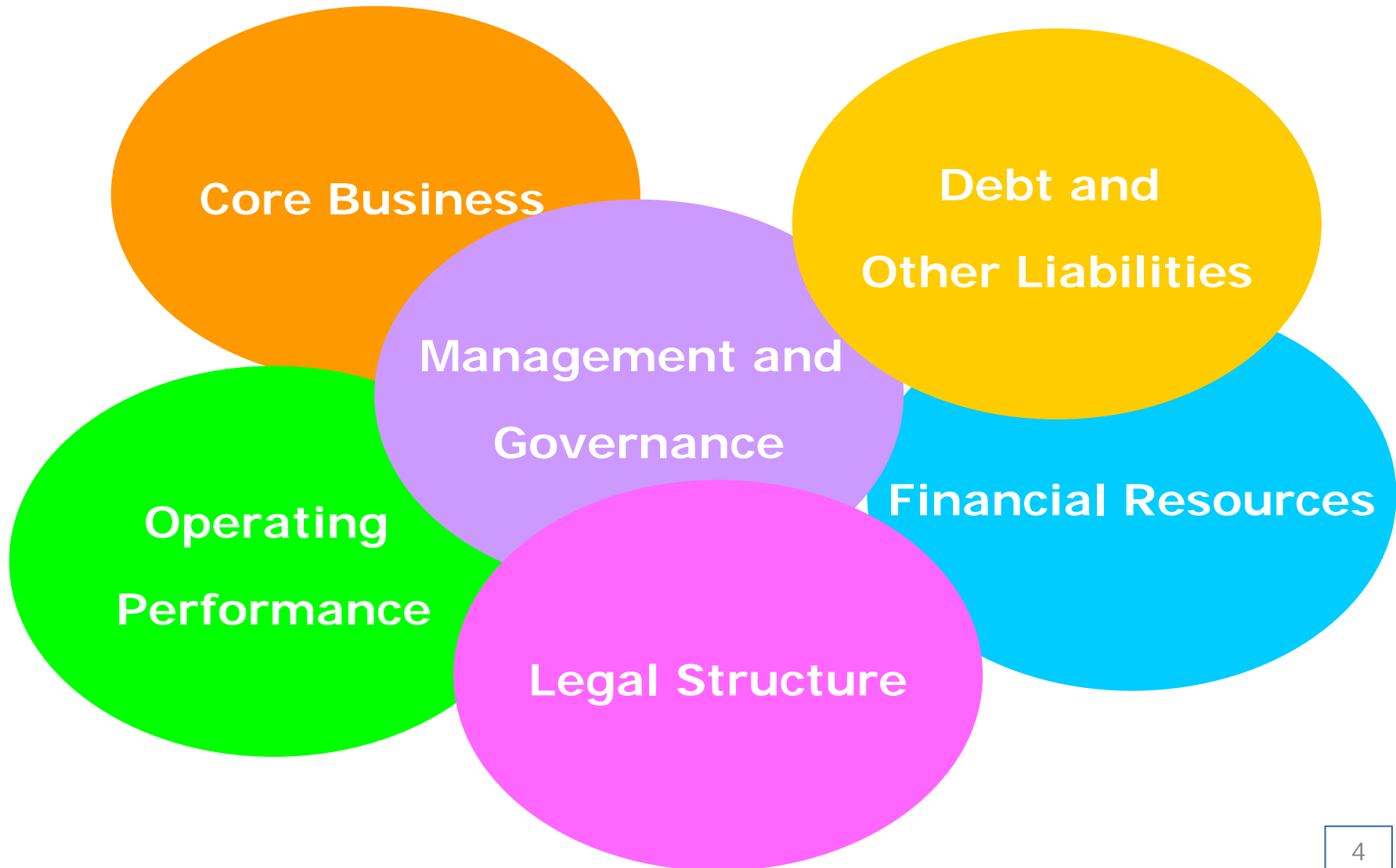
Agenda

- **Context for Ratings**
- **Outlook for Higher Education Industry**
- **Challenges Facing Research Universities**
- **University of Washington**

Higher Education and Not-for-Profit Ratings Group

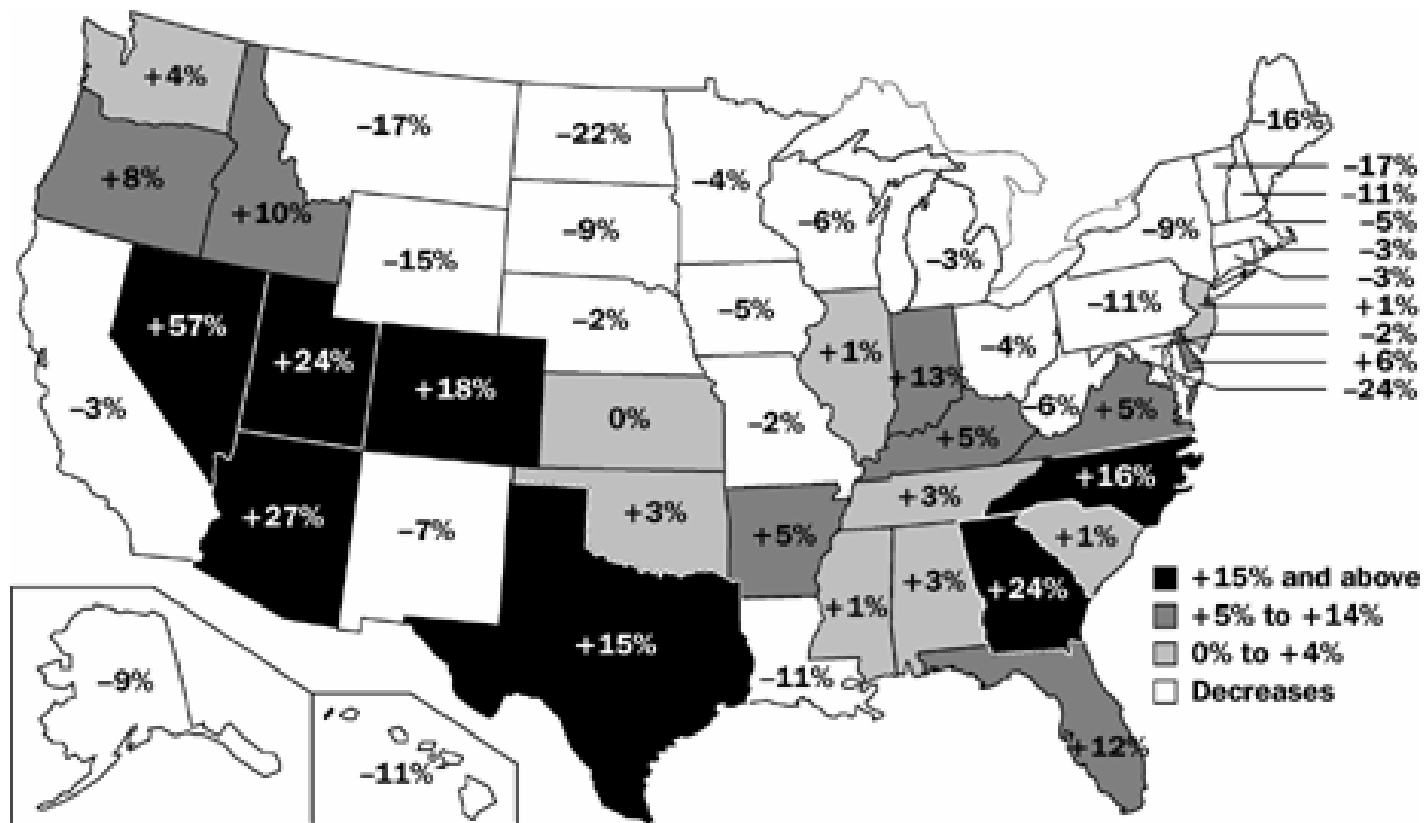
- **Private Higher Education:** Nearly 300 organizations with over \$37 billion of outstanding debt; Median rating of A3
- **Public Higher Education:** Approximately 200 organizations with \$50 billion of outstanding debt; Median rating of A1
- **Not-for-Profit Organizations:** More than 80 organizations 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

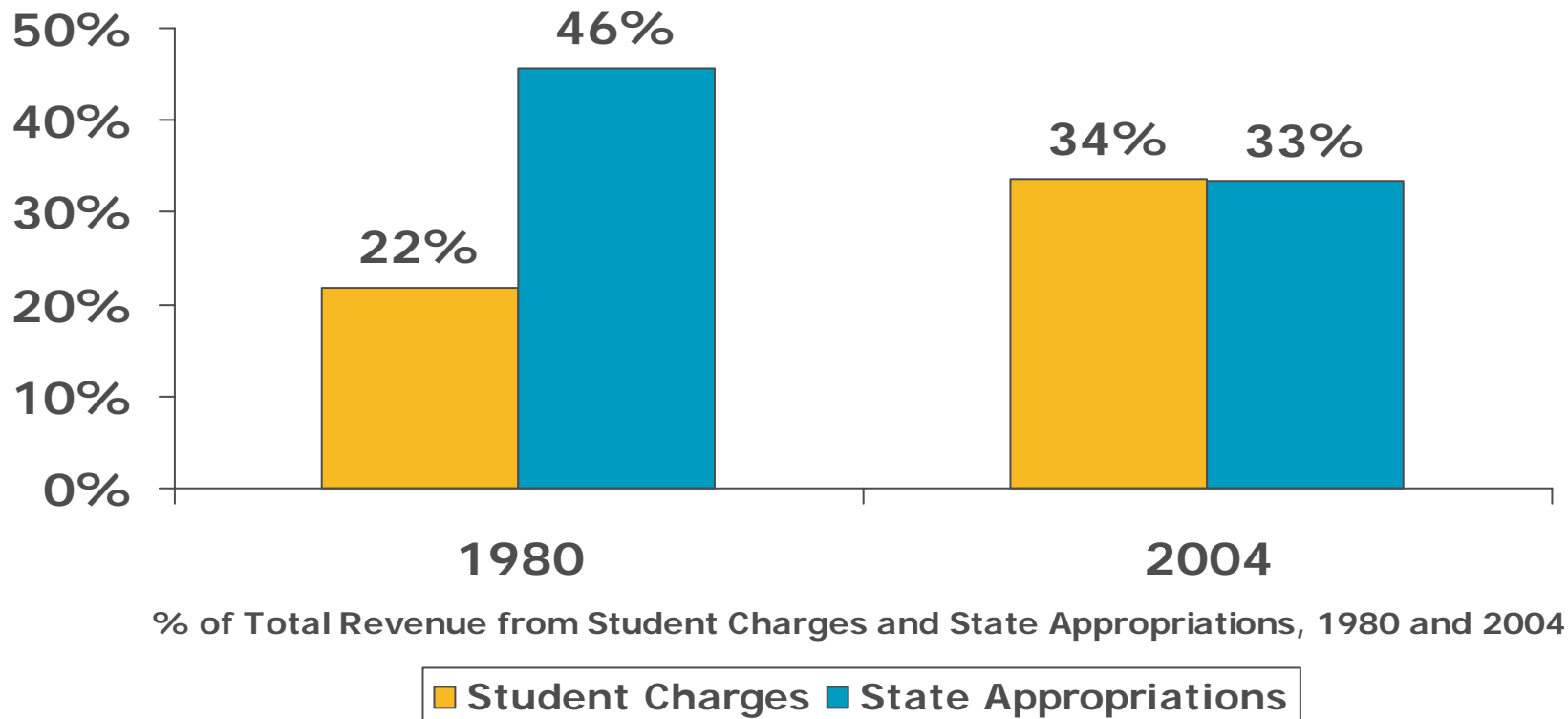


Demographics Vary Widely by Region

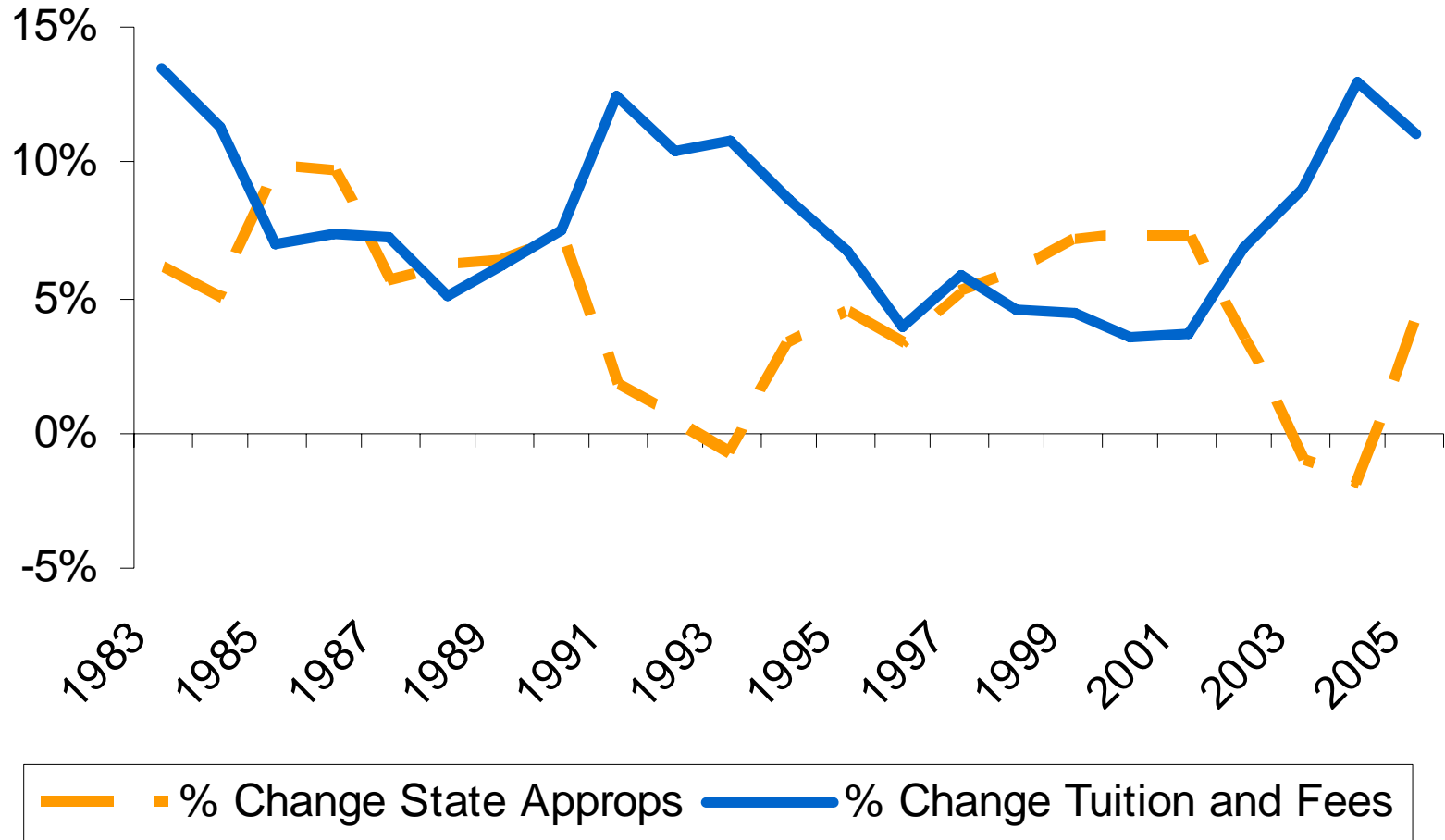
Projected Change in High School Grads, 2005-2015



Reliance on State For Publics Continues Decline: Policy Questions?



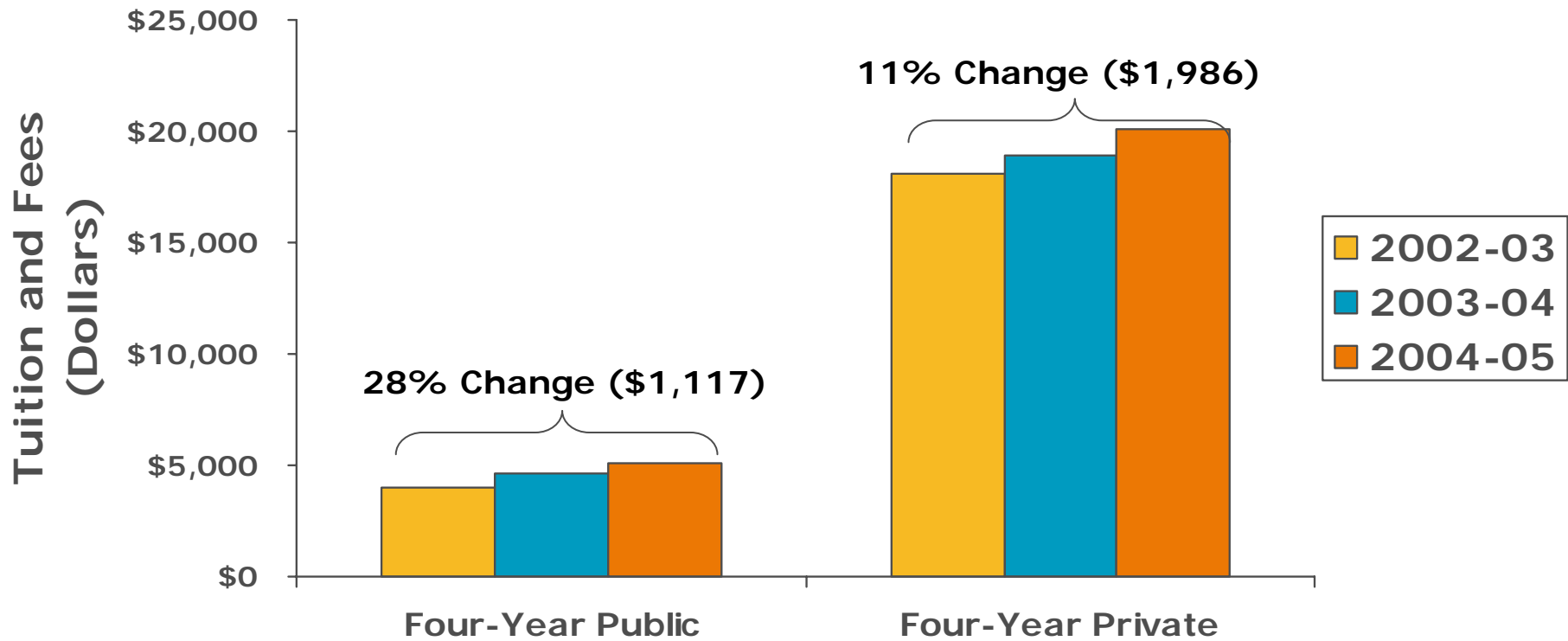
Public University Tuition Increases Linked to State Funding Environment



Sources: Center for the Study of Education Policy, Illinois State University;
The College Board

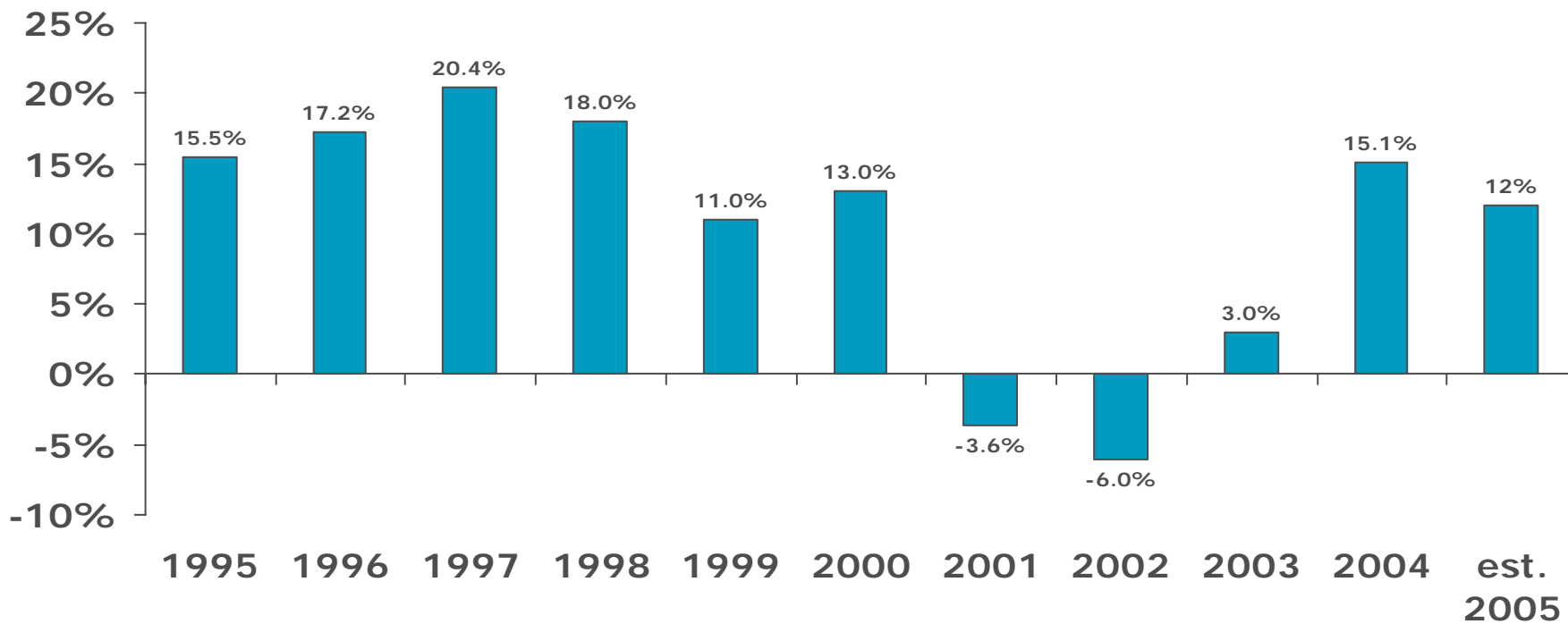
Tuition Gap Between Publics and Privates Remains

Average Fixed Charges for Undergraduates



Source: The College Board

Endowment Performance Sharply Positive in FY 2004, 2005

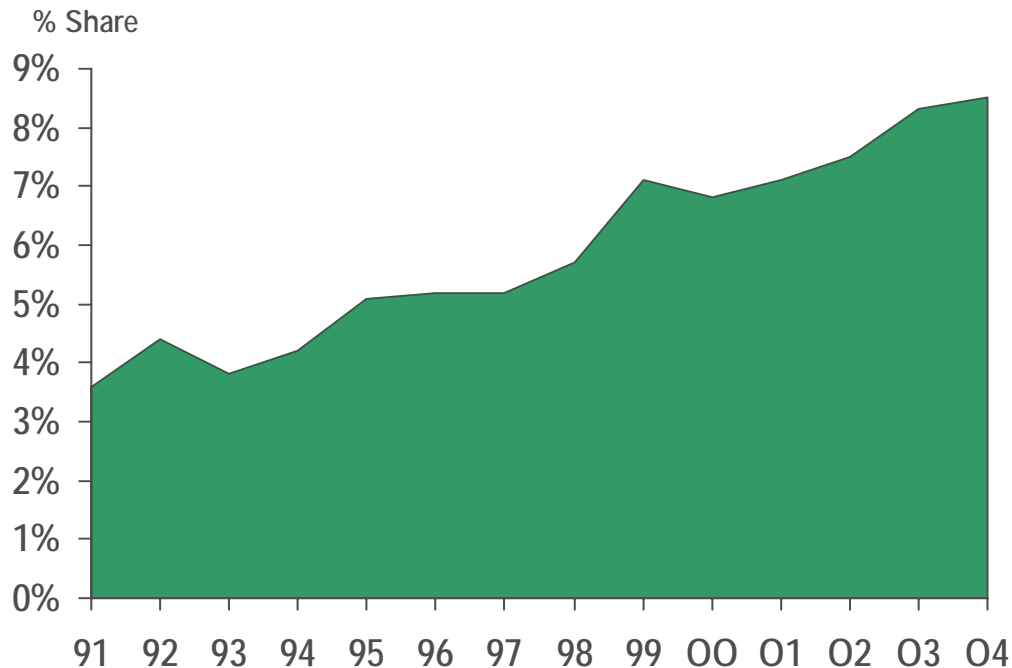


Average Annual Investment Return

Source: NACUBO Endowment Study

Higher Education in a Borrowing Boom

Rising Share of Bond Market 1991-2004

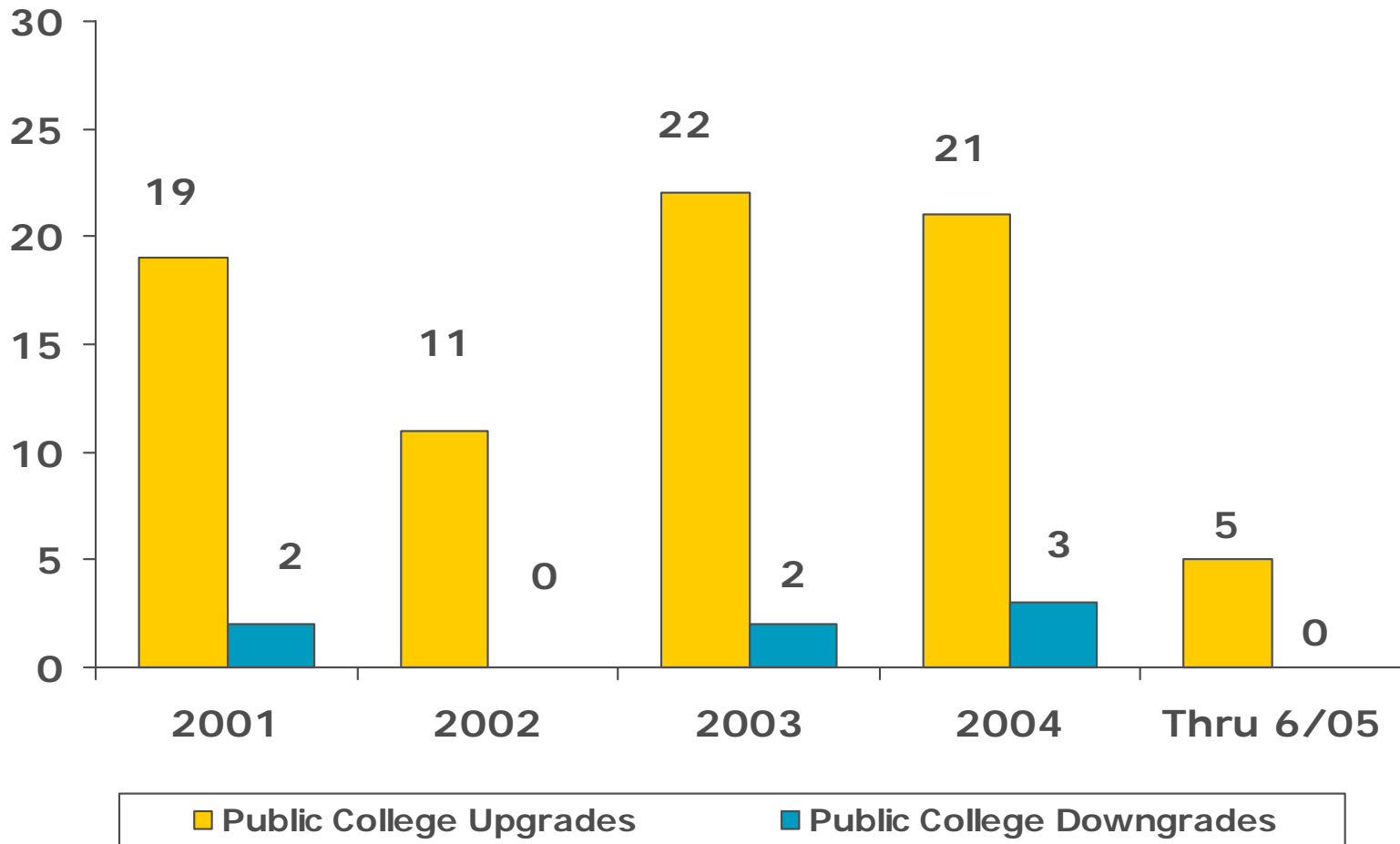


- Record borrowing in the last 4 Years
- Stock Market drop, low interest rates, student demand, research facilities drive borrowing

Public University Median Trends

	2002	2003	2004
Direct Debt (\$ million)	100	113	129
Total Resources (\$ million)	152	163	183
Total Enrollment (FTE)	15,487	15,832	16,037
Expendable Resources to Debt	1.25	1.06	0.99
Expendable Resources to Operations	0.4	0.39	0.44
Annual Operating Margin	1.5%	1.1%	2.5%
Net Tuition per Student	\$ 3,205	\$ 3,559	\$ 4,050
State Appropriations per Student	\$ 7,109	\$ 6,945	\$ 6,745
Reliance on the State	38%	36%	33%

Rating Changes Reflect Continued Strength of Public Universities



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?

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