STANDING COMMITTEES

Finance and Asset Management Committee

Approve Amendments to Debt Management Policy

RECOMMENDED ACTION

It is the recommendation of the administration and the Finance and Asset Management Committee that the Board of Regents adopt the amended Debt Management Policy.

BACKGROUND

The University’s Debt Management Policy guides the University’s debt issuance and portfolio management activities, including the management of the Internal Lending Program (ILP). The Debt Management Policy was first adopted on September 19, 2002 and last revised on July 9, 2015. As the ILP evolves and additional programs are established, the policy requires updates and clarifications.

In addition to various housekeeping items, there are two key amendments to the Debt Management Policy:

1. Creation of a program to provide bridge funding for gift funded projects. Residing within the ILP, this program will provide short-term funding at market-based interest rates.

2. Clarification of delegated authority for various actions to go to the President or his/her designee.

PROGRAM OVERVIEW

The Bridge Loan Program (the “Bridge”) addresses the timing gap between capital project expenditures and the receipt of gift funds and establishes parameters around how ILP reserves will be lent for gift-funded capital projects.

Below are the basic principles and terms of the Bridge:

- The Bridge will be funded from the ILP Residual Account
- The Bridge can only be used for a Board approved or Board delegated capital project with all funding sources identified
- Bridge loans will be charged market-based interest rates with a maximum term of five years
- Interest will be paid monthly
- There will be no fees for cost of issuance
STANDING COMMITTEES

Finance and Asset Management Committee

Approve Amendments to Debt Management Policy (continued p. 2)

- The minimum loan size will be $2 million
- The maximum loan size:
  - Shall be no greater than the uncollected pledge amount at the date of project approval
  - Will be limited by available Residual Account sufficiency
- The borrower may be required to hold unrestricted reserves as long as the loan is outstanding
- Treasury will report program status to the Board as part of the Semi-Annual ILP Report

Since the Bridge will be funded from the Residual Account of the ILP, it is prudent to ensure program sufficiency before any loans are made. Sufficiency is calculated annually using the following guidelines:

- There is a positive cash balance in the Residual Account in the current year, and
- Residual Account balances remain positive each year for the five years after the Bridge Loan is made

Use of the Bridge will have no impact on institutional debt capacity.

The following is an example of how the Bridge would be used for a hypothetical $100 million capital project:
STANDING COMMITTEES

Finance and Asset Management Committee

Approve Amendments to Debt Management Policy (continued p. 3)

### Bridge Loan Program Example

<table>
<thead>
<tr>
<th>$100 million project ($000)</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
<th>Year 4</th>
<th>Year 5</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Timing of Construction Costs</td>
<td>40,000</td>
<td>40,000</td>
<td>20,000</td>
<td>-</td>
<td>-</td>
<td>100,000</td>
</tr>
<tr>
<td>Timing of Pledges Received</td>
<td>60,000</td>
<td>10,000</td>
<td>10,000</td>
<td>10,000</td>
<td>10,000</td>
<td>100,000</td>
</tr>
</tbody>
</table>

### Pledge Summary

<table>
<thead>
<tr>
<th></th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
<th>Year 4</th>
<th>Year 5</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pledge Beginning Balance</td>
<td>60,000</td>
<td>30,000</td>
<td>10,000</td>
<td>10,000</td>
<td>10,000</td>
<td></td>
</tr>
<tr>
<td>Pledges Used for Construction</td>
<td>(40,000)</td>
<td>(30,000)</td>
<td>(10,000)</td>
<td>-</td>
<td>-</td>
<td>(80,000)</td>
</tr>
<tr>
<td>Pledges Used for Repayment</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>(10,000)</td>
<td>(10,000)</td>
<td>(20,000)</td>
</tr>
</tbody>
</table>

| Pledge Ending Balance     | 20,000 | -      | -      | -      | -      |       |

### Bridge Loan Summary

<table>
<thead>
<tr>
<th></th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
<th>Year 4</th>
<th>Year 5</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bridge Loan Beginning Balance</td>
<td>-</td>
<td>-</td>
<td>10,000</td>
<td>20,000</td>
<td>10,000</td>
<td></td>
</tr>
<tr>
<td>Bridge Loan Used for Construction</td>
<td>-</td>
<td>10,000</td>
<td>10,000</td>
<td>-</td>
<td>-</td>
<td>20,000</td>
</tr>
<tr>
<td>Repayment from Pledges</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>(10,000)</td>
<td>(10,000)</td>
<td>(20,000)</td>
</tr>
</tbody>
</table>

| Bridge Loan Ending Balance | -      | 10,000 | 20,000 | 10,000 | -      | -      |
| Interest Accrued and Paid @3% | -      | 300    | 600    | 300    | -      | 1,200   |

### REVIEWS AND APPROVALS

This item has been reviewed and approved by the interim Vice President for Finance and Facilities and the Associate Vice President, Treasury.

**Attachment**

UW Debt Management Policy, Statement of Objectives and Policies – Annotated Draft
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; July 12, 2012; February 13, 2014; May 8, 2014; July 10, 2014; and July 9, 2015; and November 10, July 14, 2016

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 and from University reserves.

The University's internal loan portfolio will include 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 external debt obligations, and borrowing from University reserves. 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 rates. 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:
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 rates, 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 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 and Asset Management 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. Financings consisting solely of personal property

d. Credit lines

2. Loan Types. Loan types for internal borrowing will include:

a. Large capital expenditures (above $15 million and above). The approval of the Board of Regents will be required for capital expenditure loans exceeding of $15 million and above. The maximum term of these loans will be 30 years after facility opening (or the estimated useful life of the facilities).

b. Small capital expenditures (less than $15 million). The approval of the President or his or her designee will be required for capital expenditure loans up to $15 million. The maximum term of these loans will be 15 years after facility opening (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 $15 million will require the approval of the Treasurer of the Board of Regents. Operating

Conforms dollar thresholds to BOR Standing Order regarding Delegation of Authority; clarifies commencement date of ILP loan terms.

Delegates to President or his or her designee for
loans exceeding $15 million and above 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 or his or her designee.

e-d. Bridge financing. The approval of the Board of Regents will be required for loans to bridge gift-funded capital projects with a project amount of $15 million and above. The approval of the President or his or her designee will be required for loans to bridge gift-funded capital projects with a project amount less than $15 million. Bridge loans may be made in an amount less than or equal to uncollected pledges on the date of approval of the project. The maximum term of these loans will be five years.

3. Internal lending rates. An internal lending rate will be uniformly applied to all loans for large and small capital expenditures under 2.a. and 2.b. above approved after Program implementation (the “standard internal lending rate”). The internal lending rate for all bridge financing will be a market-based rate (the “bridge internal lending rate”). The standard internal lending rate will reflect the external debt portfolio’s weighted average interest rate and will include funding for Program operating costs and a rate stabilization account.

a. Rate adjustment. The standard 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 increase will be announced to Program participants twelve months in advance of the effective date of the increase. 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 standard internal lending rate will apply to all applicable Program debt, including outstanding debt obligations incurred prior to
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 account maintained as described below. An accounting of Program fund activities will be included in the Debt Management report to the Board of Regents.

b. **Rate stabilization account (RSA).** The rate stabilization 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.

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. Bridge financing is subject to the availability of short-term funds, and will be limited by current and projected balances after consideration of other reserve requirements.

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.

Notes that bridge financing is subject to availability of short-term funds.
5. Internal Borrower Responsibilities.

a. Agreement. Borrowers will be required to enter into an internal financing agreement for all loans describing the loan structure and repayment terms.

b. Reporting. Annual reviews and/or audits of financial condition and performance will be provided by the borrower.

c. Loan covenants. Loan covenants may include 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 debt coverage, among others. Failure to comply with loan covenants will require the following actions by the borrower:

   i. Borrower must present a mitigation plan for approval by the Board during the October Board meeting (unless otherwise determined); and

   ii. Periodic reviews will be conducted to measure progress and compliance with mitigation plan.

C. Debt Portfolio Management

The University's external debt portfolio will be actively managed to maintain the stability of the standard 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 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 standard 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. **Private Use.** At least every five years, the University will identify any changes in, or other factors relating to, facility occupancy or facility/equipment use that could affect the tax-related status of University debt.

7. **Core financial ratios.** The University will use the following core financial ratios as performance benchmarks to evaluate institutional debt capacity as compared to a public higher education peer group. These ratios will be calculated and reported annually.

   a. **Expendable resources-to-debt.** This balance sheet ratio measures the availability of unrestricted funds to cover all outstanding debt.

      \[
      \frac{\text{Expendable Financial Resources}^*}{\text{Direct University Debt}}
      \]

   b. **Debt service-to-operations.** 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).

\[
\text{Peak Annual Debt Service}^* = \frac{\text{Total Operating Expenses}}{\text{Annual Operating Surplus (deficit) plus interest and depreciation expenses plus additional, unusually large non-cash expenses, divided by actual principal and interest payments.}}
\]

(*As defined by Moody's Investors Service)

c. **Debt service coverage.** This statement-of-activities ratio measures actual margin of protection for annual debt service payments from annual operations.

Annual operating surplus (deficit) plus interest and depreciation expenses plus additional, unusually large non-cash expenses, divided by actual principal and interest payments.

\[
\text{Adjusted Annual Operating Surplus} = \frac{\text{Annual Operating Surplus (deficit) plus interest and depreciation expenses plus additional, unusually large non-cash expenses, divided by actual principal and interest payments.}}{\text{Annual Debt Service}}
\]

**D. Roles and Responsibilities**

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 and internal borrowing, delegating to the President and his or her designee authority to approve external debt up to the maximum amount and within other parameters set forth in the resolution

   c. Approves financing plans for loans above $15 million and above; approves bridge financing loans for projects of $15 million and above

   d. Delegates to the President or his or her designee the authority to enter into agreements to complete debt financing transactions up to $15 million or the amount approved by the Board of Regents

   e. Approves exemptions of eligible financing transactions from participation in the Internal Lending Program

   f. Approves the adjustment of the standard internal lending rate

   g. Approves exceptions to Program fund policies

Clarifies that annual bond resolution delegates external debt issuance to President or designee within parameters. Conforms to dollar threshold in BOR Standing Order (regarding Delegation of Authorities) unless specifically approved by the Board of Regents. Standard ILP rate is fixed from time to time; bridge financing rate is market-based.
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

2. Finance and Asset Management 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 $15 million, lines of credit up to $15 million or the amount approved by the Board of Regents, and bridge financing loans for projects up to $15 million

b.

4. Treasurer of the Board of Regents

a. Reviews all financing actions

Approves loans up to $15 million (as delegated)

b. Approves aggregate operating loan commitments that exceed 30 percent of the University’s commercial paper line of credit

c. 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 and external debt portfolio

b. Consults with the Attorney General’s Office in the selection of bond counsel

Conforms delegation to dollar thresholds for each type of loan.

Further delegations are addressed by Administrative Order, Presidential Order or other designation by the President.