Policy 3-052: Institutional Debt

I. Purpose and Scope

To define institutional policy and associated issues related to issuance and management of long-term debt. This debt policy provides a framework by which decisions are made concerning the use and management of debt. Along with the annual operating budget and capital plan, this policy forms a comprehensive financial planning and monitoring model that can be used in effecting the University's strategic initiatives.

II. Definitions

A. Revenue Bonds - Revenue bonds carry a promise to repay from an identified revenue source or sources. The University typically uses revenue bonds for the bulk of its long-term debt needs.

B. Certificates of Participation - An instrument evidencing a pro rata share in a specific pledged revenue stream, usually lease payments by the issuer that are subject to annual appropriation. The certificate generally entitles the holder to receive a share, or participation, in the lease payments from the particular project.

C. Capitalized Lease - An agreement in which one party gains a long-term rental agreement, and the other party receives a form of secured long-term debt; and which meets certain tests of ownership such that the transaction is reflected as a capital asset for one party and a long-term liability for the other party.

III. Policy

A. Use and Management of Debt

1. Facilitate Capital Planning

The long-term strategic planning process establishes institutional goals, priorities and initiatives - which define capital investment requirements. The University will utilize a mix of financing sources including state appropriations, reimbursed overhead, donations/endowment income (if permitted under the gift agreement), other current income, internal reserves, and debt to fund these capital investments.

2. Maximize credit ratings

   The University seeks to maintain its creditworthiness and the most favorable relative cost of capital and borrowing terms. The University will limit its overall debt to a level that, when viewed in the context of its current and future strategic objectives, is the most advantageous for its financial strength over the long-term.

B. Financing Structures

The University will obtain outside professional advice as necessary to identify and evaluate financing alternatives and opportunities. All potential funding sources will be reviewed within the context of this debt policy and the overall portfolio to ensure that chosen financial products or structures are consistent with the University's objectives. Regardless of which financing structures are utilized, a comprehensive analysis of the transaction will be completed, including quantifying potential risks and benefits and the impact on creditworthiness and debt capacity as indicated in this debt policy.

1. Revenue Bonds

   Three separate revenue bond systems - each having its own revenue stream pledge - have been developed to address the different groupings of capital projects undertaken by the University.

   a. Auxiliary & Campus Facilities System - this system is used for funding construction or renovation of facilities housing auxiliary enterprises and related functions. The net revenues of such enterprises are pledged for the retirement of outstanding long-term debt.
   b. Hospital Facilities System - this system is used for funding construction or renovation of facilities housing health care delivery and support services. Net hospital system revenues are pledged for the retirement of outstanding long-term debt.
   c. Research Facilities System - this system is used for funding construction or renovation of facilities housing basic and applied research functions. Indirect cost (facilities and administration) recovery revenues from federal government

and other research sponsors are pledged for the retirement of outstanding long-term debt.

d. In addition to the revenue streams described above, there may be circumstances that require the University to reach out beyond these defined revenues to provide for servicing of debt. In such cases, the relevant bond documents will define the nature and extent of commitment required on any other legally available resources to be pledged by the University for debt payments.

2. Certificates of Participation (COPs)

   COPs will be used as a financing instrument only when certain infrastructure improvements can be shown to produce cost savings for the University. Such savings can then be passed through the lessor to the certificate holders, typically through a trustee.

3. Capitalized lease obligations

   In accordance with Statement of Financial Accounting Standards No. 13, published by the Financial Accounting Standards Board, a lease is a financing transaction called a capital lease if it meets any one of four specified criteria. If not, it is an operating lease. Capital leases are treated as the acquisition of assets and the incurrence of obligations by the lessee.

4. Other

   Other debt instruments, such as off-balance sheet financings and third-party debt may be considered in financing capital construction, renovation, or equipment purchase.

C. Debt structuring

1. Issuance size and timing

   Debt financings will be coordinated to the extent practical so that multiple project needs can be accommodated in a single borrowing, thereby increasing the efficiency of the debt issuance.

2. Par amount

   The par amount of bonds sold will ordinarily be adjusted to cover the following costs beyond the capital project needs: bond issuance costs, underwriters' discount, original issue discount/premium, debt service reserves, and capitalized interest.

3. Financing considerations

   a. The University, in conjuction with its financial advisor, will consider specific strategies currently applicable for keeping its financing costs low as part of its preparations for each new debt issuance or refinancing.

   b. Maturity/amortization

      The overall maturity would generally not exceed the useful life of the financial asset, and may never exceed 120% of the useful life of the financed asset. Useful economic life will be determined by the University's depreciation practices.Maximum repayment term generally should not exceed 30 years.

      However, consideration shall be given for allowing maturities beyond 30 years, where the institution contemplates issuing debt to finance a series of capital projects, and utilizing such debt proceeds on a revolving basis for ongoing projects. In this sense, the institution may take on a role of being its own financing provider.

   c. Redemption

      Call provisions in the bond indenture give flexibility to redeem bonds prior to maturity if the University is in a position to benefit financially, and assuming current market conditions are favorable.

   d. Interest Rates

      The institution seeks to borrow at the lowest practical cost, while offering a security that will be attractive to potential investors. The University will consider the following factors in evaluating interest rates for specific borrowings:

      i. fixed rates are usually higher than variable rates

      ii. variable rates potentially shorten maturity for the investor

      iii. a portion of the University's debt in a variable-rate mode allows it to better match assets and liabilities

4. Tax-exempt vs. taxable debt

The University its debt portfolio to optimize the utilization of tax-exempt debt and taxable debt, depending upon market conditions. Taxable debt may be utilized to fund projects that are ineligible for tax-exempt financing, or where taxable debt provides additional project or financial flexibility not afforded under the restrictions imposed on tax-exempt debt. Depending upon market conditions, taxable debt may also be utilized to refund previously issued tax-exempt debt for purposes as articulated above. In particular, a combination of taxable and tax-exempt bonds should be considered for projects having a private use component that exceeds Internal Revenue Service (IRS) thresholds for tax-exempt debt. The private use of tax-exempt financed projects will be monitored on an on-going basis as part of the annual continuing disclosure reporting requirements. As a tax-exempt bond project is being considered, the University will collect information related to such project and the uses of the facilities that may be considered benefiting a private party. Any time there is a potential change in use of a tax-exempt bond funded facility, the University will discuss the change with bond counsel, in advance, to ensure that there is no impact on maintenance of the tax-exempt status of the bonds.

5. Fixed rate vs. variable rate debt

The University will constantly evaluate the portfolio's overall interest rate exposure. Fixed-rate debt provides more long-term interest rate stability than variable-rate debt, and will typically be the financing instrument of choice. However, variable-rate debt may be appropriate in cases where it is desirable to

- provide repayment/restructuring flexibility
- benefit from historically lower average interest costs
- provide a “match” or natural hedge to the University's short-term investment balances

The use of variable rate debt does expose the debt portfolio to interest rate risk. The portfolio allocation to variable rate debt may be managed or adjusted through:

- the issuance of debt (new issues and refundings), and
- the use of interest rate swaps and other derivative products

The University's portfolio of traditional variable rate debt may require liquidity support in the event that obligations are put back to the Trustee (actually the "Tender Agent") by investors, requiring an immediate purchase. The University can purchase liquidity support externally from a bank in the form of a standby bond purchase agreement (SBPA) or line of credit; or can use its own capital in the form of self-liquidity.

D. Limitations on debt issuance

1. Institutional equity participation

Debt will be considered a financing tool to fill in the resource gaps that cannot be met by other means. Capital projects will generally not be funded by issuing debt if existing resources are available and adequate to fully fund the cost of construction or renovation being planned, or the cost of a capital asset being purchased. However, consideration should also be given to the concept of "inter-generational equity". That is, the institution should attempt to balance those benefitting from a financing with those paying for it.

2. Authority to issue debt

a. Board of Trustees

Approval of the Board of Trustees is required for the issuance of all bonds and certificates of participation. The Trustees must also approve new lease and other debt obligations exceeding $10 million (in compliance with University of Utah Policy 3-005 (/administration/3-005.php)).

b. Board of Regents

This Debt Policy attempts to provide additional details regarding the issuance and management of debt by the University - within the context granted to it by its legal bonding authority - the State Board of Regents of the State of Utah (the Regents). The relevant Regents' policy governing these matters is contained in Policy R590 (http://higheredutah.org/sbr/policy/pdf/R590.pdf) "Issuance of Revenue Bonds for Facilities Construction or Equipment" and Policy R710 (http://higheredutah.org/sbr/policy/pdf/R710.pdf), “Capital Facilities”. Such policies require getting approvals along the way for the conceptual plan, the financing plan, and the actual debt issuance - including the day of pricing. The University will comply with existing policies issued by the Board of Regents and any future policies dealing with the issuance and management of debt.

c. State Legislature

The State of Utah, through its legislature, has enacted laws relating to the issuance of Revenue Bonds, with which the University will comply (see Utah Code Title 53B, Chapter 21 (http://le.utah.gov/UtahCode/section.jsp?code=53B-21)). Special authority to issue debt below a certain dollar threshold (currently $10 million in any given fiscal year), without legislative approval, is given to the University through the provisions of Utah Code Title 11, Chapter 17 (http://le.utah.gov/UtahCode/section.jsp?code=11-17) (Utah Industrial Facilities and Development Act).

3. Debt capacity

The University has legally-binding indenture-driven obligations that serve as guidelines and limitations for determining debt capacity. Given those limitations, the University will establish meaningful measures, including ratios and coverages, to ensure it continues to operate within generally accepted financial parameters and to enable it to maintain and/or improve its credit rating as determined by the rating agencies. These measures assist management in maintaining the University's credit profile compared to industry benchmarks, peer institutions, and strategic planning objectives. They are intended to serve as a guideline and framework for issuing debt and may assist the University in establishing certain “floors” - especially where long or short-term strategic objectives are paramount.

E. Debt management

1. Refunding/refinancing opportunities

The University will actively consider current or advanced refunding opportunities of outstanding debt in light of the following factors:

a. Savings requirements

The net present value savings will be positive (generally a minimum of 3%), or

b. Other factors

The refunding will support a strategic need by providing relief of certain limitations, covenants, payment obligations, or reserve requirements that reduce flexibility.

2. Relevant ratios

Debt Service Coverage is the key relevant ratio, and will be calculated to show the effect of a new bond issue before funding of a project is presented for approval to the Board of Trustees and the Regents. Debt Service Coverage is calculated by dividing the net revenues of a particular bond system by total debt service (including the debt service on the proposed bond issue). This ratio indicates the direction and degree to which the University has balanced annual operating expenses with revenues, and demonstrates that a net revenue stream exists to meet the current and projected debt burden. The calculation of net revenues should be adjusted for (by adding back) interest expense and depreciation. The University may consider tracking other ratios from time to time, as necessary or desired, in light of its strategic initiatives and expected capital requirements.

3. Credit enhancements

a. Debt service reserve funds/reserve fund instruments (surety bonds)

Setting aside funds in reserve to pay debt service or purchasing a surety bond are both tools that may be used, if necessary, to enhance the issuer's credit with the bond rating agencies and the investors. Both options will provide assurance to the bond holders and others that, in the event of a financial emergency on the part of the issuer, there will be a dedicated source of funds that can be made available to assure that upcoming principal and interest payments can be made.

b. Bond insurance

An insurance policy that guarantees timely payment of interest and principal if the issuer is unable to do so will be purchased when it is economically advisable to do so.

F. Credit worthiness

1. State of Utah moral obligation feature

The University's credit worthiness is enhanced by the existence of a “moral obligation” on the part of the State of Utah. In the event of a financial deficiency on the part of the University is noted - either a draw upon a debt service reserve, or the inability to fully pay upcoming principal and interest payments for the next calendar year, the Board of Regents certifies to the Governor the deficiency; and the Governor may ask the legislature to consider an appropriation to replenish reserves or make the necessary debt service payments.

2. Rating agencies

The ratios described herein are consistent with the measures used by the rating agencies, which monitor a number of ratios and other statistics in developing their rating opinions. Management will review annually all key rating agencies' ratios and benchmarks to monitor compliance with rating guidelines.

G. Other considerations

1. Arbitrage on tax-exempt debt

U.S. Treasury regulations re: arbitrage rebate require monitoring the interest rate earned on a bond, construction, or debt service reserve fund for each bond series compared to the interest rate paid (the so-called “arbitrage yield”). Therefore, bond proceeds from each bond series will be segregated into separate funds. Any excess interest earnings above that allowed under current law will be paid to the IRS as arbitrage rebate. The University will comply with arbitrage requirements on any invested bond funds through establishment of appropriate accounting and reporting procedures. These include tracking investment earnings on unspent bond proceeds, calculating rebate payments, and remitting any arbitrage rebate in a timely manner. Bond proceeds will be invested appropriately to achieve the highest return available under arbitrage limitations.

2. Continuing disclosures

   The University will meet its ongoing disclosure requirements in accordance with the Securities Exchange Commission (SEC) Rule 15c2-12, by submitting financial reports, statistical data, and any other material events, as required, under outstanding bond indentures. Each bond system may have a different deadline for submitting the annual disclosure report to the proper authorities, but in general, the University strives to have these reports completed and submitted within 180 days of the end of the fiscal year.

3. Internal controls

   The University will adhere to the following internal controls relating to debt.

   a. All debt transactions must be initiated by authorized individuals and approved by the Board of Trustees, and (when necessary) the Board of Regents and the State Legislature.

   b. All documents relating to notes, bonds, and other debt instruments are subject to effective custodial controls and physical safeguards.

   c. Adequate detailed accounting records are maintained and appropriate reports issued.

   d. All transactions are properly accumulated, classified, and summarized in the accounts.

4. Capitalized interest

   Interest paid on bonded debt during the construction period may be capitalized as part of the overall asset cost recorded on the University's books at the conclusion of the construction period. The University will follow applicable accounting standards, laws and regulations governing the capitalization of interest.

5. Operating leases

   Operating leases are treated as current operating expenses. The University is required to report annually on its operating leases to both the Board of Regents and the Board of Trustees (see Regents' Policy R710 (http://higheredutah.org/sbr/policy/pdf/R710.pdf), "Capital Facilities".)

IV. Rules, Procedures, Guidelines, Forms, and Other Related Resources

A. Rules *[reserved]*

B. Procedures *[reserved]*

C. Guidelines *[reserved]*

D. Forms *[reserved]*

E. Other Related Resource Materials *[reserved]*

V. References

Financial Accounting Standards Board SFAS No. 13 "Accounting for Leases" (http://www.fasb.org/pdf/aop_FAS13.pdf)

Policy 3-005 (/administration/3-005.php), Board of Trustees Review of Significant Transactions

Board of Regents Policy R590 (http://higheredutah.org/sbr/policy/pdf/R590.pdf) "Issuance of Revenue Bonds for Facilities Construction or Equipment"

Board of Regents Policy R710 (http://higheredutah.org/sbr/policy/pdf/R710.pdf) "Capital Facilities"

Utah Code Title 53B, Chapter 21 (http://le.utah.gov/UtahCode/section.jsp?code=53B-21) (Revenue Bonds)

Utah Code Title 11, Chapter 17 (http://le.utah.gov/UtahCode/section.jsp?code=11-17) (Utah Industrial Facilities and Development Act).

VI. Contacts

Acting as the Policy Owner, the Associate Vice President for Financial & Business Services (http://www.regulations.utah.edu/info/#3)is responsible for answering questions and providing information regarding the application of this policy. Acting as the Policy Officer, the Vice President for Administrative Services (http://www.regulations.utah.edu/info/#3) is responsible for representing the University's interests in enforcing this policy and authorizing any allowable exceptions.

VII. History

New policy as of November 20, 2006; 3-052: Revision 0 (http://www.regulations.utah.edu/administration/revisions_3/3-052.R0.pdf)

Contact information updated to include both Owner and Officer information, February 2, 2012

Revision 1: Approved by Board of Trustees, October 9, 2012. Online copy updated November, 19, 2012; see Executive Summary (http://fbs.admin.utah.edu/download/Regs/ExecSumm3-052-R1.pdf)