NUMBER:	1640
TITLE:	Debt Management Policy
APPROVED:	

The level of variable rate debt will also be managed in conjunction with the University's levels of cash and short-term investments, which serve as a natural hedge against rising interest rates. The actual percentage for outstanding variable rate debt will vary due to financing needs, asset/liability management goals, interim financing structures, and prevailing interest rates at the time of each borrowing.

Tax-exempt and Taxable - Tax-exempt debt will be the preferred method of financing projects. However, in instances where the capital projects do not qualify for tax-exempt financing, the University will consider taxable alternatives.

University-issued vs. Commonwealth-issued debt - In determining the most cost-effective means of issuing debt, the University will evaluate the merits of issuing debt directly as compared to Commonwealth issuance, either directly by the Commonwealth or through one of its issuing entities (such as the Virginia College Building Authority). This analysis will include an evaluation of cost, timing, and future management flexibility.

Alternative Financing Sources - There are alternative financing sources that may be considered, such as off-balance sheet financings. These financings may be more costly than traditional structures and will be used only when the economic benefit and likely impact on the University's debt capacity and credit quality are fully understood. Specifically, for any third party or developer-based financing, management will determine and quantify the full credit impact of the structure.

Debt Capacity & Affordability Measures - The University will utilize the following ratio as guidelines for issuing new debt.

Debt Burden no greater than 7%
(Debt Burden Ratio = Annual debt service / Total operating expenses)

This ratio is adjusted to reflect any non-amortizing or non-traditional debt structures that could result in significant single year fluctuations. The debt burden ratio may exceed 7% in instances involving debt of revenue producing projects when the debt used to finance the project is secured by income from the operation of the project.

Refinancings - The University will consider refinancing existing debt when net present value savings are positive. Federal tax law limits advance refunding of tax-exempt bonds. Consequently, it is vitally important to use these opportunities wisely. The Vice President for Administration and Finance will evaluate refinancing opportunities considering the value of the call option to be exercised, including the time period to the call date and the time period form the call date to final maturity. Based on this analysis, the Vice President of Administration and Finance will establish the minimum savings threshold for each refinancing. There are cases where refundings that do not produce savings will be considered, including eliminating restrictive bond covenants.

<u>Capital Funding Source</u>

- *Debt Service Funding* - Prior to the issuance of any amount of debt, the Vice President for Administration and Finance or designee will identify and analyze the funding source(s) for the debt repayment. Sources may include but are not limited to:

- State appropriations
- The general revenue pledge of the University
- Revenues from the specific project being financed
- Indirect cost recoveries from sponsored programs
- Gifts and bequests
- University affiliated foundations
- Unaffiliated third parties including joint ventures with private sector entities and grants from private foundations

- *Capital Maintenance Funding* - The University will determine how to fund the ongoing capital maintenance cost for each capital financed project prior to issuing the debt. If it is anticipated that additional borrowing will be required to fund the capital maintenance for a project, then the amount of additional borrowing will be taken into account in its debt capacity analysis.

Statement of Effect on Student Costs

The Vice President for Administration and Finance or designee will determine if the proposed debt will result in additional cost to University students. A Statement of Effect on Student Costs will be included in the material presented to the Board any time the Board is asked to approve a debt issuance.

Interest Rate Risk Management Guidelines

The University will consider the use of interest rate swaps and other interest rate risk management tools after carefully evaluating the risks and benefits of any proposed transactions. These tools will be employed primarily to manage the University's variable rate debt exposure. The use of these instruments in conjunction with variable interest rate exposure will be evaluated within prudent guidelines to achieve more flexibility in meeting the University's overall financial objectives. Interest rate swaps will be evaluated in light of existing market and interest rate conditions, the savings that can be achieved as compared to other debt structures available in the bond market, and the overall asset/liability management practices of the University.

Risk management strategies will not be utilized unless the contract or structure is fully understood, can be monitored and managed, and the risk imposed has been evaluated and concluded to be appropriate for the University. Prior to entering into any risk management agreement, the University will have received evidence of legal authorization to enter into such agreement. The Vice President for Administration and Finance, in consultation with the Administration & Finance Committee of the Board, is authorized to enter into any risk management contract or agreement that is determined to be necessary or appropriate. Interest rate management tools shall not be used for speculative purposes or in cases involving Financial Instruments that create extraordinary leverage or financial risk.

Financial Instruments -

- Interest Rate Swaps - Spot or forward starting interest rate swaps may be utilized to capture current market rates, eliminate variable rate exposure, or create incremental variable interest rate exposure.

- Interest Rate Caps or Collars - Interest Rate Caps, Collars and Floors may be utilized to limit or bound exposure to interest rate volatility.

- Swap Options - The sale or purchase of options may be utilized to commence or cancel

Financial Instruments Risk Analysis

Risk Type	Description	Evaluation

Active Management - The University will seek to maximize the benefits it accrues and minimize the risks it bears by actively managing its interest rate risk management program. This will entail monitoring of market conditions (such as current interest rates, counterparty credit ratings and other relevant factors) in conjunction with the swap counterparty and the University's advisors for potential opportunities and risks. Active management may entail modifications of existing transactions including:

- Early termination;
- Shortening or lengthening the term of the agreement;
- Sale or purchase of options; and
- Application of basis swaps.

Each proposed modification must be consistent with this policy and should be expected to further the goals of the University interest rate risk management program.

Rating Agencies - The University will seek Rating Agency review to determine materiality of any financial instrument transaction on the credit quality of the University as part of its overall rating agency strategy.

Financial Instrument Analysis - The University will undertake a financial risk analysis of the application of Financial Instruments prior to entering any proposed transaction. Utilizing Financial Instruments requires an ongoing commitment for the University's management. Therefore, to help ensure understanding and knowledge of considered transactions, a specific approach will be developed for each potential transaction evaluating the risks, rewards and exit strategies. The approach will include, but not necessarily be limited to the following:

- The goals the University is trying to achieve by implementation.
- The swap counterparty's rating and the University=s credit exposure to the counterparty.
- Cash flow projections and sensitivity analysis.
- An evaluation of potential risks, including basis risk, tax risk, rollover risk, termination risk and counterparty risk.
- Events that may trigger an early termination under the agreement.
- A sensitivity analysis of potential market valuations in various market conditions.
- A discussion or example of how the University plans to report and monitor the transaction in the future.

Disclosure & Reporting Requirements

Disclosure - The University will provide updated financial information and operation data and

Reporting Requirements - On an annual basis the Vice President for Administration and Finance will prepare a report for the Board that will include the following items:

- Composite debt service schedule
- Financial ratio analysis
- Debt use and purpose
- Current and future debt as it relates to the strategic plan and debt strategy
- Financial instrument review