# BOV-015 University of Virginia Debt Policy

**Effective Date** Friday, February 22, 2013

**Status** Final

**Policy Type** Board of Visitors

**Contact Office** Treasury Management

**Oversight Executive**
Executive Vice President and Chief Operating Officer

**Applies To** Academic Division, Medical Center, and College at Wise.

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Policy Statement
Related Information

**Reason for Policy**

To formalize the practices of the University's Debt Management Program.

**Definition of Terms**

**Derivative Instruments (Derivatives)**

**Description**

A financial instrument or contract whose value is derived from the performance of underlying market factors, such as interest rates. For purposes of the policy, they are used to manage the risk of interest rate fluctuations.

**Policy Statement**

**UNIVERSITY'S REVISED DEBT POLICY RESOLUTION**
(Approved February 22, 2013)

WHEREAS, the University employs a Debt Portfolio Management Program to provide external financing for its capital projects; and

WHEREAS, this policy requires periodic updating to assure debt management practices are in line with changing market conditions and strategic priorities;

RESOLVED, the Board of Visitors approves the revised University Debt Policy, enumerated in Attachment B.

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**University of Virginia**
**Debt Policy**
(Attachment B)

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## I. Overview

In support of its mission, the University of Virginia maintains a long-term strategic plan. The strategic plan establishes University-wide priorities as well as divisional programmatic objectives. The University develops a capital plan to support these priorities and objectives.

The University's use of debt plays a critical role in ensuring adequate funding for the capital plan as well as providing a cost-effective source of funding for other strategic purposes. By linking the objectives of its Debt Policy to its strategic objectives, the University ultimately increases the likelihood of achieving its mission.

The Debt Policy is intended to be a "living" document that will evolve over time to meet the changing needs of the University

## II. Scope and Objectives

*Scope*

The Debt Policy covers all forms of debt including long-term, short-term, fixed-rate variable-rate, and tax-exempt and taxable debt. It also covers other forms of financing intended for capital projects including both on-balance sheet and off-balance sheet structures, such as leases, and other structured products.

The use of derivatives is considered when managing the debt portfolio and structuring transactions. Conditions guiding the use of derivatives are addressed in a separate Interest Rate Risk Management Policy.

*Objectives*

The objectives of this policy are to:

(i) Outline the University's philosophy on debt
(ii) Establish a control framework for approving and managing debt
(iii) Define debt reporting guidelines
(iv) Establish debt management guidelines

The policy establishes a control framework to ensure that appropriate discipline is in place regarding capital rationing, reporting requirements, debt portfolio composition, debt servicing, and debt authorization. It establishes guidelines to ensure that existing and proposed debt issues are consistent with financial resources needed to maintain an optimal amount of leverage, and a strong financial profile.

*Goals*

Under this policy, debt is being managed to achieve the following goals:

(i) Maintain cost effective access to financial markets: capital, money, and bank markets
(ii) Manage the University's credit profile to meet its strategic objectives while maintaining the highest acceptable creditworthiness and most favorable relative cost of capital and borrowing terms
(iii) Optimize the University's debt mix (e.g., short-term and long-term, fixed-rate and floating-rate, traditional and synthetic)
(iv) Manage the structure and maturity profile of debt to meet liquidity objectives as well as repayment objectives

## III. Oversight and Approvals

*Oversight*

The Office of the Executive Vice President and Chief Operating Officer ("EVP & COO") is responsible for implementing this policy and for all debt financing activities of the University. The policy and any subsequent, material changes to the policy are approved by the University's Board of Visitors ("BOV".) The approved policy provides the framework under which debt management decisions are made.

Compliance with this policy is monitored by the Treasury Management Department with oversight from the Office of the EVP & COO. The office of the EVP & COO reports regularly to the BOV on the University's debt position and plans.

*Approval of New Debt*

The BOV must pass a resolution before any long-term debt is issued. As part of this resolution, the BOV will also establish financing parameters to be followed by the University when issuing long-term debt. Additionally, prior to issuing tax-exempt debt of which at least a portion will be used to reimburse the University for prior expenditures, federal tax law requires the BOV to pass a resolution declaring its intent to issue tax-exempt debt.

The University issues, on its own behalf, debt under Chapter 3 of Title 23 of the Virginia Code or non-State Tax Supported Debt under the State's Restructured Higher Education Financial and Administrative Operations Act of 2005, Chapter 4.10 of Title 23 (the "Restructuring Act") and pursuant to that certain Management Agreement dated November 15, 2005, by and between the Commonwealth of Virginia and The Rector and Visitors of the University of Virginia, as amended (the "Management Agreement"). For debt issued under Chapter 3 of Title 23, the University will comply with all statutory requirements for State and BOV approval. For debt issued under the Restructuring Act and pursuant to the Management Agreement, the University will comply with all statutory and regulatory requirements including notifying the State Treasurer of each such bond issuance. For debt issued under the Restructuring Act and pursuant to the Management Agreement, the BOV delegates the authority to approve the pricing of such debt to the EVP & COO or his designee, with the Chair of the Finance Committee or such other BOV member as may be designated by the Rector. Such pricing must be within the financing parameters established for the debt by the BOV (or the Executive Committee as authorized by Virginia Code § 23-75.)

## IV. Debt Affordability and Capacity

In assessing its current debt levels, and when planning for additional debt, the University takes into account both its debt affordability and debt capacity. Debt affordability focuses on the University's ability to service its debt through its operating budget and identified revenue streams and is driven by strength in income and cash flows. Debt capacity focuses on the University's financial leverage in terms of debt funding as a percentage of the University's total capital.

Multiple factors can affect the University's debt capacity and debt affordability. These include trends in student demand and research funding, the relationship with the Commonwealth of Virginia, current and projected financial reserves, operating performance and the ability to generate cash flow in support of debt service, competing needs for University resources, and the external market environment, including the level of interest rates, among other factors.

Prior to undertaking any new borrowing, the University will assess its ability to absorb additional debt based on its current and projected financial condition. The University assesses its debt affordability and capacity by gathering input from various sources. This includes the analysis and opinions of its banking partners and financial advisor. The University also uses Moody's Investors Service Scorecard to assess its debt factors (see Attachment A for the Moody's Scorecard). The Moody's Scorecard is a composite of quantitative factors including market position, operating performance, and balance sheet and capital investment, and qualitative factors including governance and management, legal security and debt structure, and healthcare exposure. Because the qualitative factors can result in ratings that are multiple levels different from the quantitative factors, it is recognized that the Scorecard output is simply another tool to provide one view of the comparative assessment of credit strength. The University will create a composite assessment of its debt affordability and capacity by using inputs from all of these sources. The University will also compare itself to other public schools in its rating cohort to assess its relative strength among similarly-rated peers. This information will be used in aggregate to provide an estimate of incremental debt affordability and capacity.

Use of Ratios in Managing University Credit Ratings

Ratios and limits are not intended to track a specific rating, but rather to help the University maintain a competitive financial profile, funding for facilities needs and reserves, and compliance with Commonwealth debt service to budget guidelines.

## V. Portfolio Management

The University considers its debt portfolio holistically, that is, it optimizes the portfolio of debt for the entire University rather than on a project-by-project basis. Therefore, management makes decisions regarding project prioritization, debt portfolio optimization, and financing structures within the context of the overall needs and circumstances of the University.

The University recognizes that there are numerous types of financing structures and funding sources available, each with specific benefits, risks, and costs. All potential funding sources are reviewed by management within the context of the Debt Policy and the overall portfolio to ensure that any financial product or structure is consistent with UVA's objectives. Regardless of what financing structure(s) is utilized, due-diligence review must be performed for each transaction, including (i) quantification of potential risks and benefits, and (ii) analysis of the impact on University creditworthiness* and debt affordability and capacity.

The University will regularly monitor its debt portfolio for refunding and restructuring opportunities and will pursue these when they either provide for appropriate savings or meet other strategic objectives of the University.

The University recognizes that a degree of exposure to variable interest rates within the University's debt portfolio is desirable in order to take advantage of repayment/restructuring flexibility; benefit from historically lower average interest costs; and provide a "match" between debt service requirements and the

projected cash flows from the University's assets. The amount of variable rate debt shall not exceed 40% of the University's outstanding debt exclusive of derivative instruments.

Management will monitor overall interest rate exposure and will analyze and quantify potential risks, including interest rate, liquidity and rollover risks. The University may manage the liquidity risk of variable rate debt either through its own working capital/investment portfolio, the type of instrument used, or by using third party sources of liquidity. The University may manage interest rate risk in its portfolio through specific budget and internal bank management strategies or through the use of derivative instruments.

**Note that Moody's considers the component units' debt as part of the University's aggregate debt portfolio.*

## VI. Derivative Instruments

In certain circumstances, derivatives are an effective way for the University to adjust its mix of fixed-and floating-rate debt and manage interest rate exposures. Derivatives may also be an effective way to manage liquidity risks. The University's philosophy is to use derivatives strategically to achieve asset and liability portfolio objectives and hedge existing exposures. Derivatives will not be used to create leverage or to speculate on the movement of interest rates.

The University maintains an Interest Rate Risk Management Policy which provides guidelines on the authorization and management of derivatives as they relate to the debt portfolio. The Interest Rate Risk Management Policy does not apply to derivatives used by the University of Virginia Investment Management Company in its management of the University's endowment and assets or any University-related foundations.

Any decisions made regarding the use of derivatives must take into consideration the resulting impact under the Debt Policy.

## VII. Counterparty Diversification

The University recognizes that counterparty diversification is desired as a risk management strategy. Therefore, the University will maintain relationships with multiple financial partners for the provision of investment banking, derivative, and liquidity services.

Such counterparty diversification will also take into account the services such institutions provide for other areas of the University, such as working capital management, investment management, etc.

Specific guidelines for the use, and limit, of counterparties related to derivative transactions can be found in the University's Interest Rate Risk Management Policy.

## VIII. Post-Issuance Compliance

The University realizes the importance of complying with federal and institutional requirements regarding the issuance and ongoing management of its tax-exempt debt. As such, the University maintains a Tax-Exempt Debt Compliance Policy that is intended to define compliance practices including compliance actions, records management, and process continuity within the Office of Treasury Management and the Office of the University Controller.

## IX. IX. Communication with External Parties

In order to maintain cost-effective access to the capital markets, the University recognizes that it needs to provide appropriate information to the rating agencies which maintain ratings on the University's debt as

well as investors who purchase such debt. The University will provide necessary information to these parties on a timely basis, including posting of required continuing disclosure information.

**Related Information**

Moody's Scorecard (Attachment A)
BOV-016: Interest Rate Risk Management Policy
VPFI-001: Tax-Exempt Debt Compliance

**Major Category** Board of Visitors

**Category Cross Reference**
Finance and Business Operations

**Approved By** Board of Visitors

**Approved Date** Friday, February 22, 2013