UNIVERSITY OF WASHINGTON
Debt Management Annual Report

Board of Regents Finance and Asset Management Committee

May 11, 2023

AGENDA

- Portfolio Overview
  - External Borrowing and Internal Lending Overview
  - Institutional Credit Overview
- Debt Capacity
  - 5-Year Debt Capacity Update
- Internal Lending Rate (ILP) Assessment
  - Why have an ILP?
  - Why is Sufficiency Important?
  - Rate Recommendation
  - ILP History
  - Internal Debt Summary
- FY24 Areas of Focus

OVERVIEW OF DEBT PORTFOLIOS

The University manages two separate but related portfolios

External Borrowing

Mission

- Achieve the lowest risk adjusted cost of capital
- Assure continued access to capital markets

Regental Roles

- Adopt Debt Policy
- Approve annual Bond Resolution
- Review portfolio performance
- Guide University credit and issuance standards, including debt capacity

Reporting

- Bondholders Report including audits to investors
- Semi-Annual Debt Report to Regents
- Future debt issuance and liquidity information to rating agencies

Internal Lending

Mission

- Offer stable and predictable interest rates to campus borrowers and allow for capital funding in a rising rate environment

Regental Roles

- Approve and monitor ILP loans
- Approve ILP rate changes and distributions
- Approve use of Capital Assets Pool
- Review and approve Financial Stability Plans
- Approve emergency exceptions to Debt Policy

Reporting

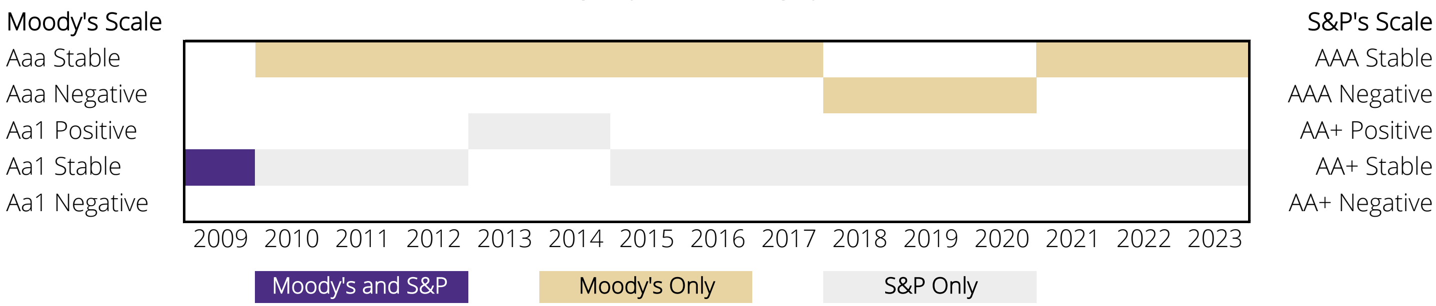
- Semi-Annual Unit Performance Reports
- Annual ILP Report
- Debt Management Annual Report
- Annual ILP Audit

INSTITUTIONAL CREDIT OVERVIEW

UW is one of the highest rated universities

- The institutional credit rating is an independent assessment by the rating agencies and a broad reflection of financial health
- The University's ratings remain at Aaa (stable) /AA+ (stable) (Moody's/S&P)
  - With a "split" credit rating, the University's bonds price closer to the lower "AA+" rating than to the higher "Aaa" rating
- While not direct debt issued by the University, partnerships (P3s) likely considered "other debt like obligations"
- The following factors could lead to a rating downgrade:
  - Further deterioration in healthcare entities' operating performance
  - Sustained, weaker operating performance given already thinner reserves vs peers
  - Material debt plans beyond those outlined
  - Reduction in same day liquidity or increased calls on liquidity
  - Weakening of debt and treasury management

Agency Credit Rating by Year



5-YEAR DEBT CAPACITY IS $625M

FY24 – FY28 debt capacity is slightly higher than 2022 at $125 million per year

- The analysis includes an affordability metric
- Debt capacity is evaluated annually based on institutional financial performance (audit), updated forecast, peer behaviors, and the long-term capital plan
  - Institutional Total Spendable Cash and Investments forecasted to grow at 4% per year
  - University at or below peer leverage ratios (for Aa1 ratios)
- Debt capacity is a management <u>target</u> not an explicit maximum
  - Accelerated borrowing increases pressure on credit rating
  - While debt capacity is calculated at an institutional level, the ability to pay is measured at the unit level

Projected Debt Balances FY24-FY28
($ in millions)

Fiscal Year	Beginning Balance	– Debt Retired	+ Debt Issued	+ Unallocated	= Ending Balance
FY24	2,409[1]	102	244[3]	11	2,562
FY25	2,562	114	85	40	2,573
FY26	2,573	116	76	49	2,581
FY27	2,581	122	74	51	2,584
FY28	2,584	119	75	50	2,590
Totals[2]		573	554[3][4]	201	

[1] Includes $15M in proceeds on-hand from FY22 GRB to fund FY24 projects
[2] Totals may not foot due to rounding
[3] Includes $130M from FY21-23 debt capacity associated with Finance Transformation
[4] Includes approved debt for Medicine and preliminary five-year capital budget estimate

INTERNAL LENDING PROGRAM (ILP)

The primary mission of the ILP is to make loans to campus borrowers at a stable and predictable long-term rate

- Rising rates are focusing attention on ILP sufficiency
  - The ILP has the resources to maintain rate stability for a number of years despite inflationary pressures, higher project costs, rising rate environment, and/or increased market volatility
- There are numerous additional benefits of the ILP:
  - Substantial flexibility in structuring internal loans, including more favorable internal loan covenants than required by external market investors
  - Rigorous due diligence for debt funded projects
  - Greater transparency into unit performance through audited financial statements, Board reporting (e.g. Semi-Annual Unit Performance Report), and performance metrics
  - Easier project funding with more flexibility for campus borrowers
  - Reduced net borrowing cost versus issuing as a stand-alone credit by unit
  - Ability to pre-pay loan at any time without penalty
  - Opportunity to fund additional lending programs to campus using ILP balances (e.g. Bridge, FAST, University Housing Assistance Program)
  - Annual transfer to Provost to support troubled borrowers through Credit Support Fee

WHY IS SUFFICIENCY IMPORTANT?

Sufficiency is the primary tool used to assure a stable and predictable long-term interest rate to campus

> Sufficiency represents:
  - The maximum number of years the ILP rate can be held stable for internal borrowers as external rates increase

> Sufficiency increases if the ILP rate is <u>above</u> the external UW borrowing rate:
  - Budget certainty is important to campus
  - Smaller, incremental ILP rate increases are preferred but take longer to execute

Green The Past (2008-2021) ILP Rate > UW Borrowing Rate	Yellow Now ILP Rate < UW Borrowing Rate	Red The Future? ILP Rate < UW Borrowing Rate for sustained period
Funds flow into rate stabilization account and years of sufficiency increases.	Funds flow into rate stabilization at a slower rate and years of sufficiency stabilize/start to decrease.	No funds flow into rate stabilization, years of sufficiency decreases and reserves become depleted.
RESULTS: • ILP rate reductions • Loan restructuring • Distributions	RESULTS: • Stable ILP rate • Limited loan restructuring • Limited – if any – distributions	RESULTS: • ILP rate increases • Limited – if any – restructuring • No distributions

ILP RATE RECOMMENDATION

Treasury Office recommends no change to the ILP rate of 4.00%

- The current ILP rate of 4.00% is:
  - Below historic average external borrowing rates and current 30-year market rates
  - In the range for similar programs at higher education peer institutions
  - As of FY22, the ILP had a cash balance of $90 million, which includes:
    - Funds reserved for future principal payments
    - ~10 years of rate stability (sufficiency) for internal borrowers
    - Minimum balance to support ILP programs
- The Board must approve any changes to the ILP rate or distributions from the ILP

ILP HISTORY

ILP SUPPORT TIMELINE (2008 – CURRENT)

Grouped by impact on sufficiency

Most Impact on Sufficiency

ILP Rate Reductions

- 2015: 5.50% to 4.75%
- 2017: 4.75% to 4.50%
- 2020: 4.50% to 4.25%
- 2022: 4.25% to 4.00%

ILP Use of Balances

- 2018: Payoff of $25M in Commercial Paper
- 2020-2021: $50M distribution to Finance Transformation from ILP balances
- 2022: Distribution to ICA of $10M from ILP balances

Support from ILP to Campus

- 2017: Provost Credit Support fee of 15bps begins
- 2018: Interest earnings on balances no longer retained in ILP
- 2019: 1st ICA ILP debt service restructured
- 2021: 2nd ICA ILP debt service restructured
- *2023: UWM ILP FY24 debt service restructuring [PROPOSED]*

ILP/Borrower Compliance Management

- 2016: ICA & Dentistry enter FSP
- 2017: UWM enter FSP
- 2020 - 2022: FSP covenant waiver approved by BOR & more frequent reporting (QBRRs)

2008: Creation of ILP

Least Impact on Sufficiency

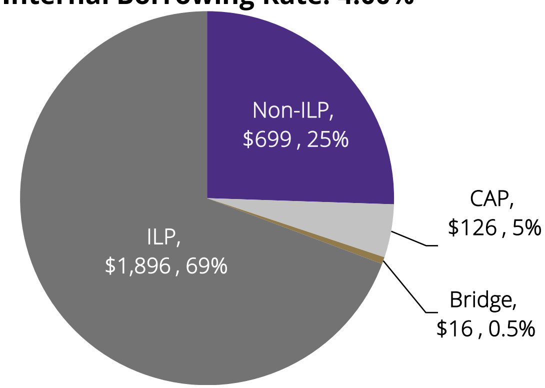
2015 — **2020** — **2023**

Global pandemic: ILP sufficiency used to aid ILP borrowers through two rate reductions and one distribution

INTERNAL DEBT SUMMARY

- The Internal Lending Program (ILP) outstanding balance as of December 31, 2022 was $2.04 billion (including Capital Assets Pool & Bridge programs)
  - The ILP consists of 68 individual loans
  - Loans are funded through a combination of external debt and internal reserves
- Non-ILP debt outstanding balance as of December 31, 2022 totaled $699 million
  - 26 individual loans, including (but not limited to):
    - South Lake Union ($283 million)
    - FHCC Promissory Note ($140 million)
    - Finance Transformation ($70 million – still drawing)
    - Molecular Engineering Building ($54 million)

Total Outstanding Balance: $2.74 billion
Internal Borrowing Rate: 4.00%



Borrower	ILP debt as of 12/31/22	Non-ILP debt 12/31/22	% Internal Debt
HFS	$642 million	$15 million	24.0%
Central	$509 million	$229 million [2]	27.0%
UW Medicine			
UWM Select Units [1]	$472 million	$5 million [3]	17.5%
School of Medicine		$286	10.4%
FHCC		$140	5.1%
ICA	$244 million	$0.5 million	8.9%
Student Life	$115 million		4.2%
UW Tacoma	$33 million	$0.8 million	1.2%
UW Bothell	$22 million	$22 million	1.6%
Total Internal Debt	**$2.04 billion**	**$699 million**	**100.0%**

(1) Includes UWMC, UW Physicians, Neighborhood Clinics, Airlift NW, and Shared Services
(2) Includes $70 million for FT (project still drawing)
(3) NW Hospital – 4.65% Mortgage Note

FY24 AREAS OF FOCUS

- Financial Stability Plan Review
  - By policy, underperforming loans must have a Financial Stability Plan (FSP) approved by the Board
  - FSPs are not intended to support internal borrowers on a prolonged basis due to systemic challenges of a unit or sector
  - Treasury is partnering with OPB to outline how longer-term financial challenges will be addressed going forward
- Long-term Sufficiency Strategy in Inflationary Environment
  - Variable Rate Strategy
    - Many issuers use variable rate debt to lower the cost of external borrowing
    - Policy target of 10-15% for portfolio management purposes
    - Developing framework outlining strategy to meet policy target