UNIVERSITY OF WASHINGTON
Debt Management Annual Report

Board of Regents Finance and Asset Management Committee

May 9, 2024

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

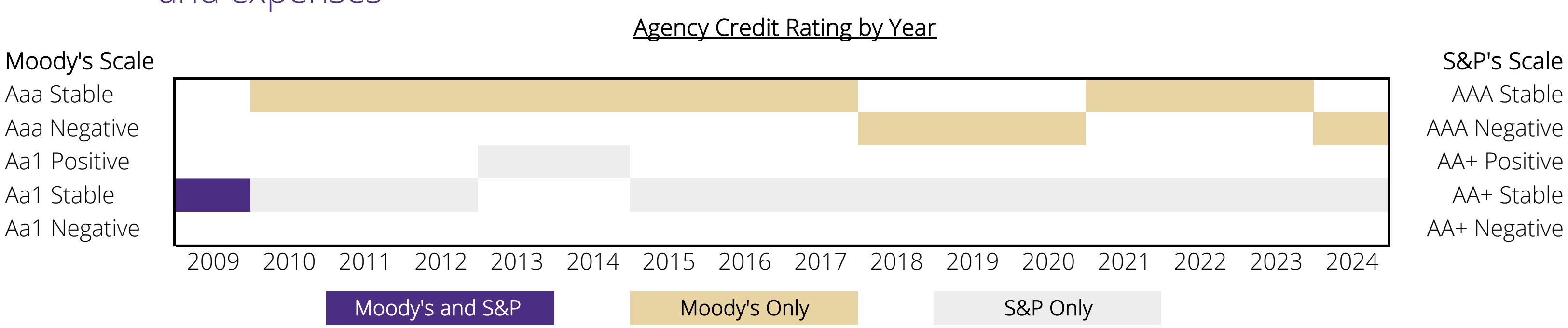
Reporting

- 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

- An institutional credit rating is an independent assessment by a rating agency and a broad reflection of financial health
- The University's ratings are Aaa (negative outlook) / AA+ (stable outlook) (Moody's/S&P)
  - Moody's revised their outlook from "stable" to "negative" in January 2024, citing thinning operating margins, expense pressures and ongoing weak margins at UW Medicine
  - A rating outlook is an opinion regarding the likely rating direction over the medium term
  - With a "split" credit rating, the University's bonds generally price closer to the lower "AA+" rating than to the higher "Aaa" rating
- The following factors could lead to a rating downgrade:
  - Further deterioration in healthcare entities' operating performance
  - Sustained, weaker operating performance given already thinner reserves versus Aaa-rated peers
  - Material debt plans beyond those outlined or reduction in wealth/liquidity relative to debt and expenses



ESTIMATING DEBT CAPACITY

The University estimates debt capacity by projecting institutional growth and benchmarking to peers

> Debt capacity is evaluated annually using audited institutional results, updated forecasts, peer performance comparisons, and the long-term capital plan

> The analysis includes rating agency metrics for wealth, revenue, and affordability relative to debt
  - From a leverage ratio perspective, has UW compared unfavorably to peers since FY12
  - Institutional debt capacity has seen only modest growth over time

UW's Leverage Compared to Peer Median

	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21	FY22	FY23
Cash & Investments to Debt	B	B	B	E	W	W	W	W	W	W	W	W	W	W	W
Debt to Operative Revenue	E	E	E	E	W	W	E	W	E	E	W	E	E	E	E
Debt to Cash Flow	B	B	W	W	W	W	W	W	W	W	W	W	E	E	W

B	= Better
E	= Equal to
W	= Worse

5-YEAR DEBT CAPACITY IS $625M

FY25 – FY29 recommended debt capacity is unchanged from 2023 at $125 million per year

- Debt capacity is a management <u>target</u> not an explicit maximum
  - Accelerated borrowing increases pressure on institutional credit ratings
  - While debt capacity is calculated at an institutional level, the ability to pay is measured at the unit level
- Debt capacity may be impacted by other debt-like obligations (e.g. FHCC loan, public private partnerships (P3s), and MMR advances)

Projected Debt Balances FY25-FY29
($ in millions)

Fiscal Year	Beginning Balance	−	Debt Retired	+	Annual Debt Capacity [1]	=	Ending Balance
FY25	2,471 [2]		116		125		2,480
FY26	2,480		119		125		2,486
FY27	2,486		120		125		2,492
FY28	2,492		138		125		2,479
FY29	2,479		131		125		2,473
Totals [3]			623		625 [4]		

[1] $346M has been allocated to projects on the preliminary five-year capital budget
[2] Includes $54M (estimated as of April) in proceeds of pre-funding for approved capital projects
[3] Totals may not foot due to rounding
[4] Includes approved debt for UW 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 capability to maintain rate stability for campus for a number of years despite inflationary pressures, elevated external rates, and 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 and the ability to pre-pay loan at any time without penalty
  - Augmented oversight of unit performance through Board reporting (e.g. Semi-Annual Unit Performance Report) and financial performance metrics
  - Lower overall institutional borrowing costs compared to issuing stand-alone credits by unit

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 UWFT from ILP balances; 2022: $10M distribution to ICA 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 - 2021: ICA ILP debt service restructured three times; 2024: UWM ILP debt service restructure
ILP/Borrower Compliance Management	2016 - 2017: ICA, Dentistry, & UWM enter FSP; 2020 - 2022: FSP covenant waiver approved by BOR & more frequent reporting (QBRRs)
2008: Creation of ILP	2015; 2020; 2025

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

Least Impact on Sufficiency

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
  - A stable ILP rate provides budget certainty for campus
- Sufficiency changes over time:
  - Sufficiency decreases if the ILP rate is <u>below</u> the external UW borrowing rate, if a distribution is made, and/or if internal loans are not repaid (repayment/default risk)
  - Sufficiency increases if the ILP rate is <u>above</u> the external UW borrowing rate

Green	Yellow	Red
The Past (2008-2021) ILP Rate > UW Borrowing Rate	Now ILP Rate < UW Borrowing Rate	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 maintaining the ILP rate at 4.00%

- The current ILP rate of 4.00%:
  - Withstands "super shock" external borrowing rates for up to 4 years
  - Does not account for non-repayment risk from internal borrowers
- As of FY23, the ILP had a cash balance of $111 million, which includes:
  - Funds reserved for future principal payments (timing differences)
  - Minimum balance to support ILP programs (e.g. FASTer)
  - ~10 years of rate stability (sufficiency) for internal borrowers
    - Within, but at low end of, target sufficiency range of 10-15 years