UNIVERSITY OF WASHINGTON
Debt Management Annual Report

Board of Regents Finance and Asset Management Committee

May 8, 2025

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 mitigation 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 remains a highly rated institution

- An institutional credit rating is an independent assessment by a rating agency and a broad reflection of financial health. A rating outlook is an opinion regarding the likely rating direction over the medium term
- The University's ratings are Aa1 (stable outlook) / AA+ (stable outlook) (Moody's/S&P)
  - Moody's downgraded the University from Aaa (negative outlook) to Aa1 (stable outlook) in February 2025~~,~~ citing thinning operating margins, expense pressures and ongoing weak margins at UW Medicine
  - Moody's changed the higher ed sector outlook from stable to negative in March of 2025. S&P remains stable

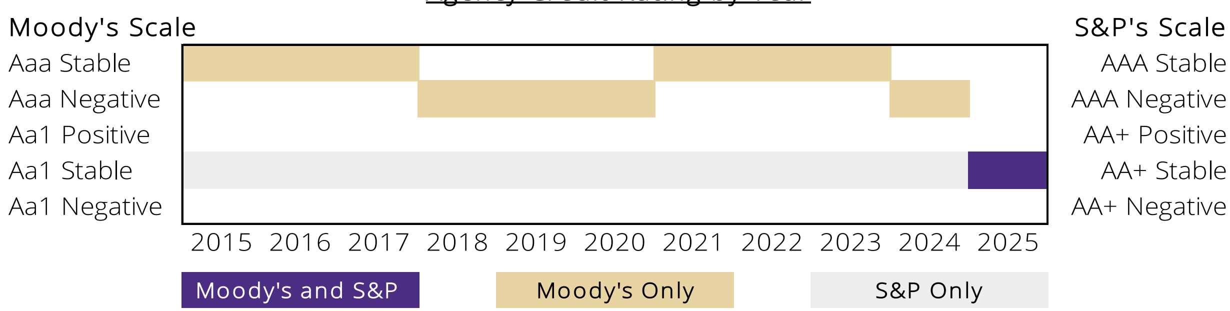
Downgrade factors:

- Sustained, weaker UW operating performance given already thinner reserves versus peers
- Further deterioration in healthcare entities' operating performance
- Material debt plans beyond those outlined or reduction in wealth/liquidity relative to debt and expenses

Upgrade factors:

- Sustained substantial improvement in operating margins
- Stronger operating performance of UW Medicine and health care entities
- Growth in cash and investments to provide more robust coverage of debt and operations

Agency Credit Rating by Year



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
  - As of FY24, the University is worse than its peers in all three metrics, which is the first time this has occurred since FY19
  - The gap between the University and peer metrics has widened in the past few years, particularly in terms of cash flow

UW's Leverage Compared to Peer Median

	FY10	FY11	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21	FY22	FY23	FY24
Cash & Investments to Debt	B	B	E	W	W	W	W	W	W	W	W	W	W	W	W
Debt to Operative Revenue	E	E	E	W	W	E	W	E	E	W	E	E	E	E	W
Debt to Cash Flow	B	W	W	W	W	W	W	W	W	W	W	E	E	W	W

B	= Better
E	= Equal to
W	= Worse

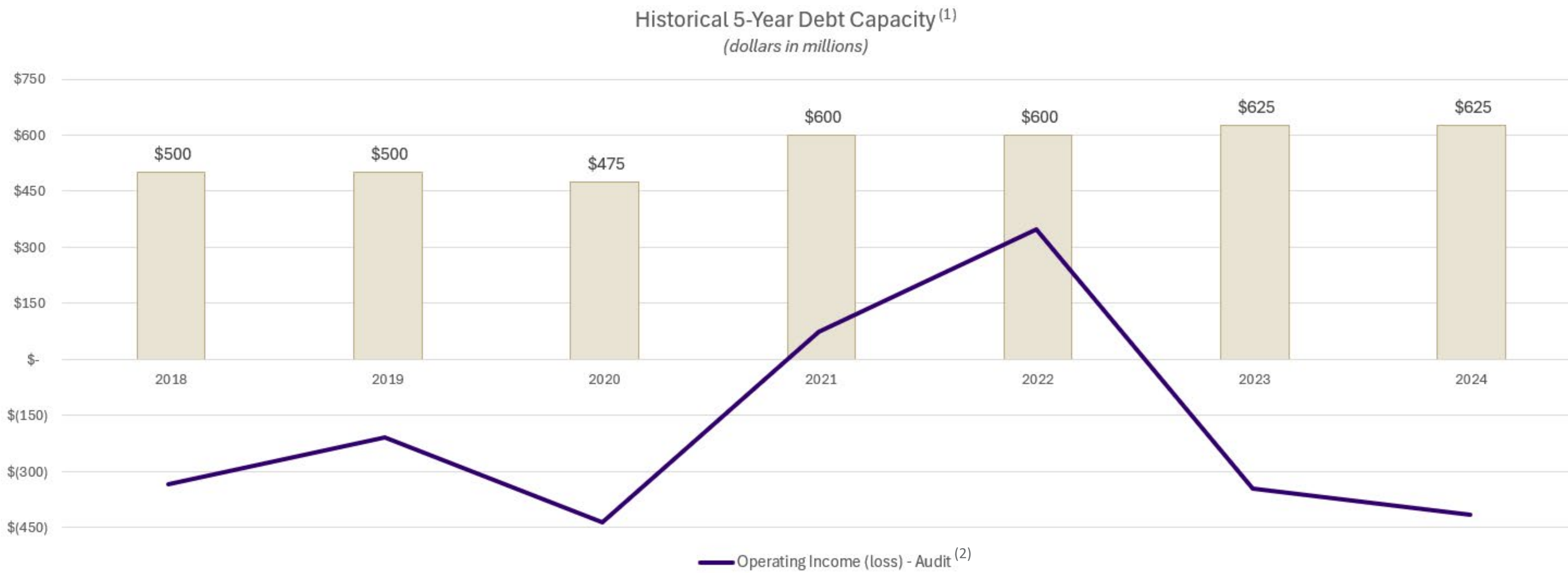
DOWNGRADE IMPACT ON DEBT CAPACITY

- In response to the downgrade from Aaa to Aa1, Treasury explored changes to the debt capacity approach:
  - Peer group remains unchanged and includes institutions rated Aaa to Aa2
    - Aaa rated institutions are retained due to the limited size of peer group and the fact that many Aaa institutions lack indicative scorecards that consistently reflect a true Aaa rating
    - Institutions rated Aa3/AA- and below are still excluded, as there are no comparable national R1 institutions in this range
  - The previous analysis relied on peer median ratios; the updated approach applies less conservative assumptions to peer ratio inputs
- Although the Aa1 rating modestly increases debt capacity, this benefit is offset by the University's weakened operating performance
- The University remains more heavily leveraged as compared to Aa1 peers
- To increase debt capacity, the University must significantly improve its current-year performance and show sustained growth in cash flow and total cash and investments

HISTORY OF 5-YEAR DEBT CAPACITY

> Debt capacity is a long-term planning tool that informs the amount of debt incorporated into the 5-year capital plan

> Following a multi-year period of substantial swings to debt capacity figures, the debt capacity calculation was adjusted (beginning in 2018) to recognize the need for capital planning stability. Rather than eliminate capacity entirely in years of poor operating performance, a "borrow to amount of principal retired" approach was utilized



(1) While current year operating performance informs the analysis, debt capacity is based on projected performance in the 5th year of the forecast
(2) Adjusted operating income, includes State Appropriations

5-YEAR DEBT CAPACITY IS $625M

FY26 – FY30 recommended debt capacity is unchanged from 2024 at $125 million per year

- Debt capacity is a management target 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 FY26-FY30

($ in millions)

Fiscal Year	Beginning Balance	−	Debt Retired	+	Annual Debt Capacity (1)	=	Ending Balance
FY26	2,443 (2)		121		125		2,447
FY27	2,447		125		125		2,447
FY28	2,447		143		125		2,430
FY29	2,430		135		125		2,419
FY30	2,419		137		125		2,407
Totals (3)			662		625 (4)		

(1) $320M has been allocated to projects on the preliminary five-year capital budget

(2) Includes $80M (estimated as of April) in proceeds on hand 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

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 FY24, the ILP had a cash balance of $120 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
    - Roughly the same level of sufficiency as last year
- The Board must approve any changes to the ILP rate or distributions from the ILP

APPENDIX

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 The Past (2008-2021) ILP Rate > UW Borrowing Rate	Yellow Now ILP Rate < UW Borrowing Rate	Red 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