UNIVERSITY OF WASHINGTON
Debt Management Annual Report

Board of Regents Finance and Asset Management Committee

May 12, 2022

AGENDA

- Portfolio Overview
  - External Borrowing and Internal Lending Overview
  - Why Issue Debt?
  - Institutional Credit Overview
- Debt Capacity
  - 5-year Debt Capacity Estimate
  - Debt History and Future
- Internal Lending Rate (ILP) Assessment
  - Why have an ILP?
  - University Lending Overview
  - Rate Recommendation

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

Reporting

- Annual Borrower Reports / Quarterly Borrower Risk Reports[1]
- Annual ILP Report
- Debt Management Annual Report
- Annual ILP Audit

[1] Provided through June 30, 2022. Reporting to be revised as of June 30, 2022 (post BOR FSP waiver expiration)

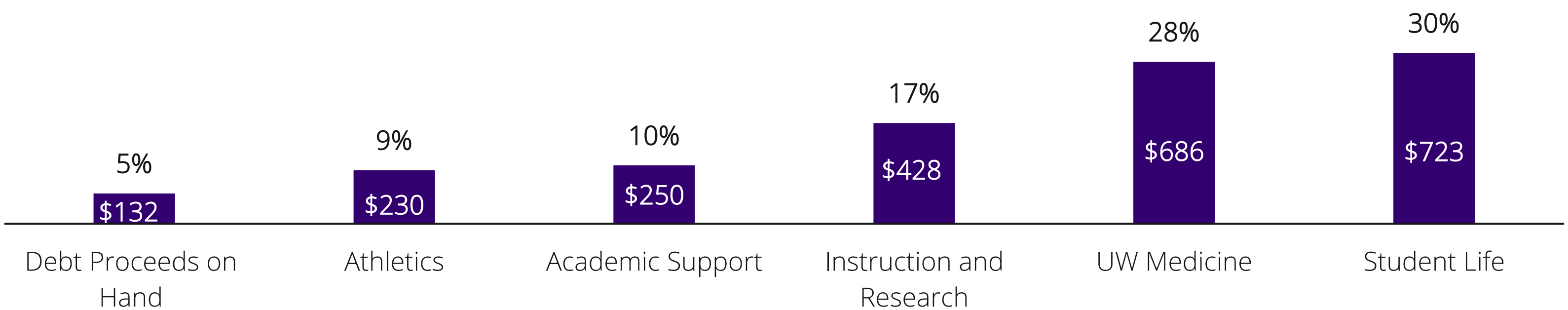
WHY ISSUE DEBT?

The University utilizes debt to support institutional missions and priorities

- Debt is a powerful tool to fund campus capital projects
  - Accelerates the timeline for completing projects versus waiting to cash fund
  - Spreads the project cost over the useful life of the asset
  - Represents a commitment of future revenues to make debt payments (principal and interest)
- Debt is a finite resource that must be prudently allocated
  - Debt funding must have a repayment source from incremental revenue, repurposing of existing revenue, or capacity from the expiration of existing debt service
  - Institutional debt capacity considers both the impact on UW's credit rating and ability to repay external debt
  - Individual project due diligence considers the unit's ability to repay internal loan

External Debt Allocated by University Mission

($ in millions)



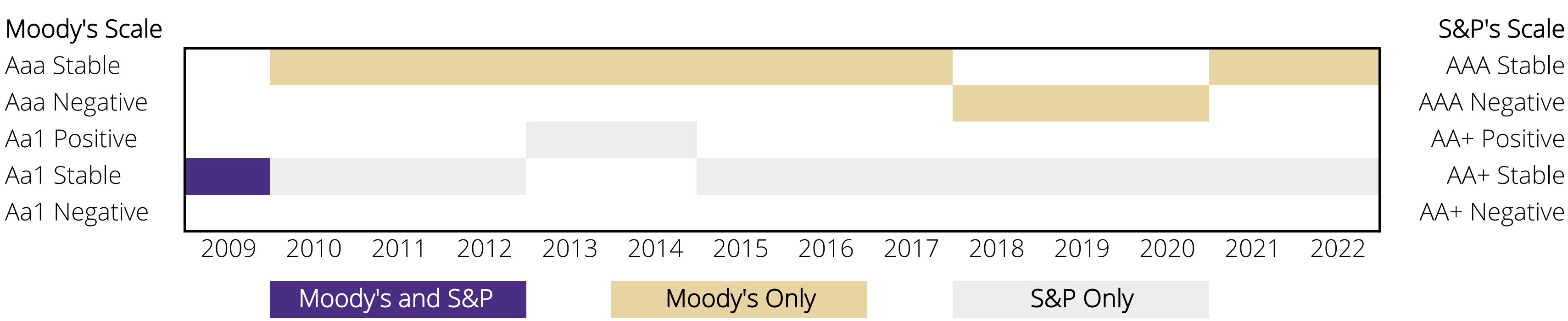
(1) "Debt Proceeds on Hand" represents proceeds from bond proceeds for funding Destination One, Childbirth Center, CoEng Interdisciplinary Building, HSEB, UW Medicine small-works allocation, and other University projects. External debt balances shown as of 2/28/22

INSTITUTIONAL CREDIT OVERVIEW

UW is one of the highest rated universities in the US

- 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
- The following factors could lead to a rating downgrade:
  - Sustained weakening of operating performance, or revenue pressures on major revenue streams such as patient care, state funding or research funding
  - 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 $600M

FY23 – FY27 debt capacity is unchanged from 2021 at $120 million per year

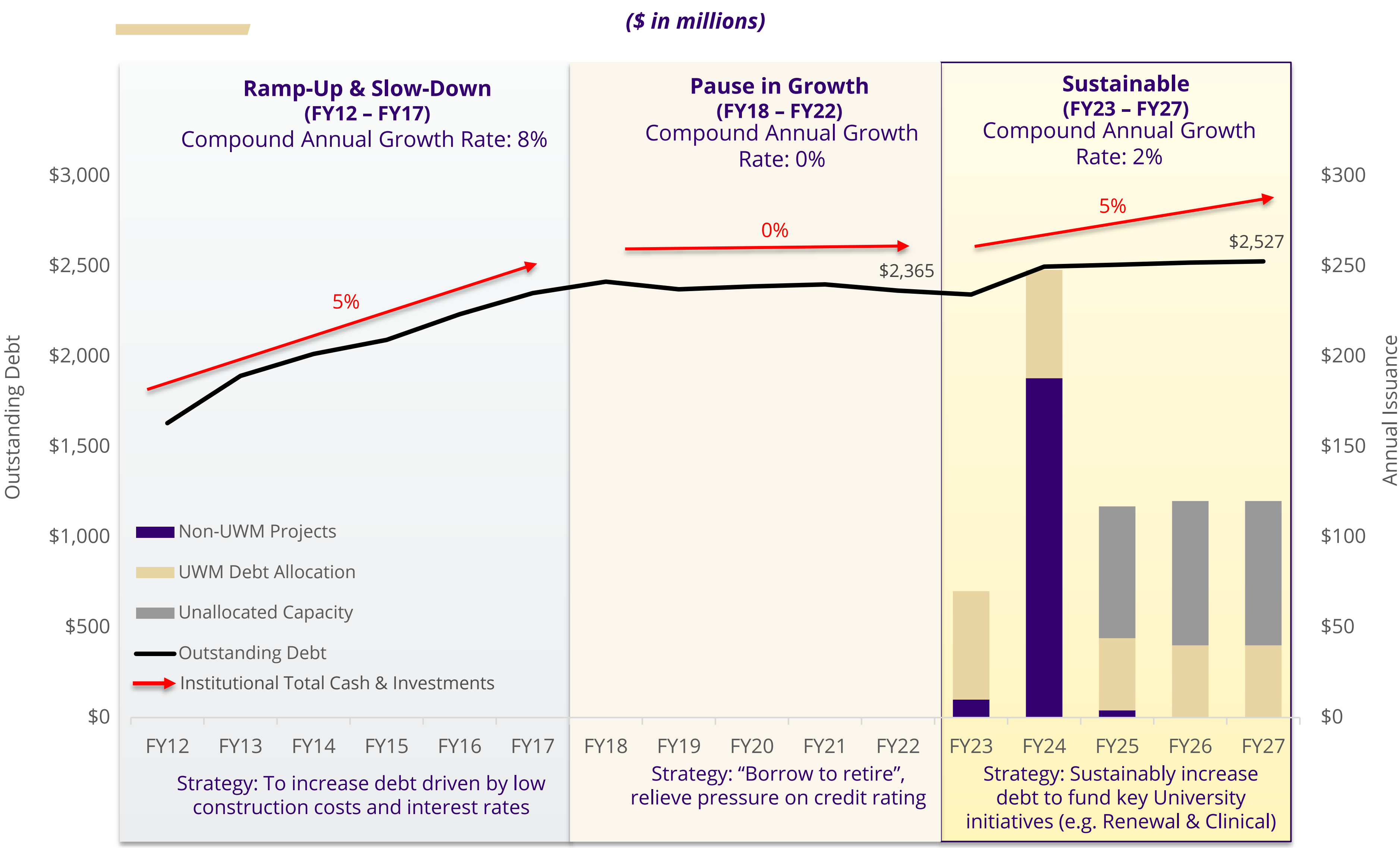
- The analysis includes an affordability metric
- Debt capacity is evaluated annually based on institutional financial performance (audit), updated forecast, peer behaviors, and the long-term capital plan
  - Institutional Total Cash and Investments forecasted to grow at 5% per year
  - University at or below peer leverage ratios (for Aa1 ratios)
- Debt capacity is a management target 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 FY23-FY27 [1]
($ in millions)

Fiscal Year	Beginning Balance −	Debt Retired +	Non-UWM Debt Allocation[2] +	UWM Debt Allocation[3] +	Unallocated Capacity =	Ending Balance
FY23	2,365	92	10	60	0	2,344
FY24	2,344	94	188	60	0	2,498
FY25	2,498	106	4	40	73	2,509
FY26	2,509	108	0	40	80	2,521
FY27	2,521	113	0	40	80	2,527
Totals		**513**	**202**	**240**	**233**	

[1] Table excludes the 2022 UW Medicine ~$141.4M Promissory Note
[2] Includes approved projects and projects pending approval on preliminary five-year capital budget. FY24 includes $75m from prior year's allocation to Finance Transformation
[3] Includes approved debt for Medicine and preliminary five-year capital budget estimate

DEBT HISTORY AND FUTURE



Note: Outstanding Debt and Annual Issuance values exclude the 2022 UW Medicine ~$141.4M Promissory Note

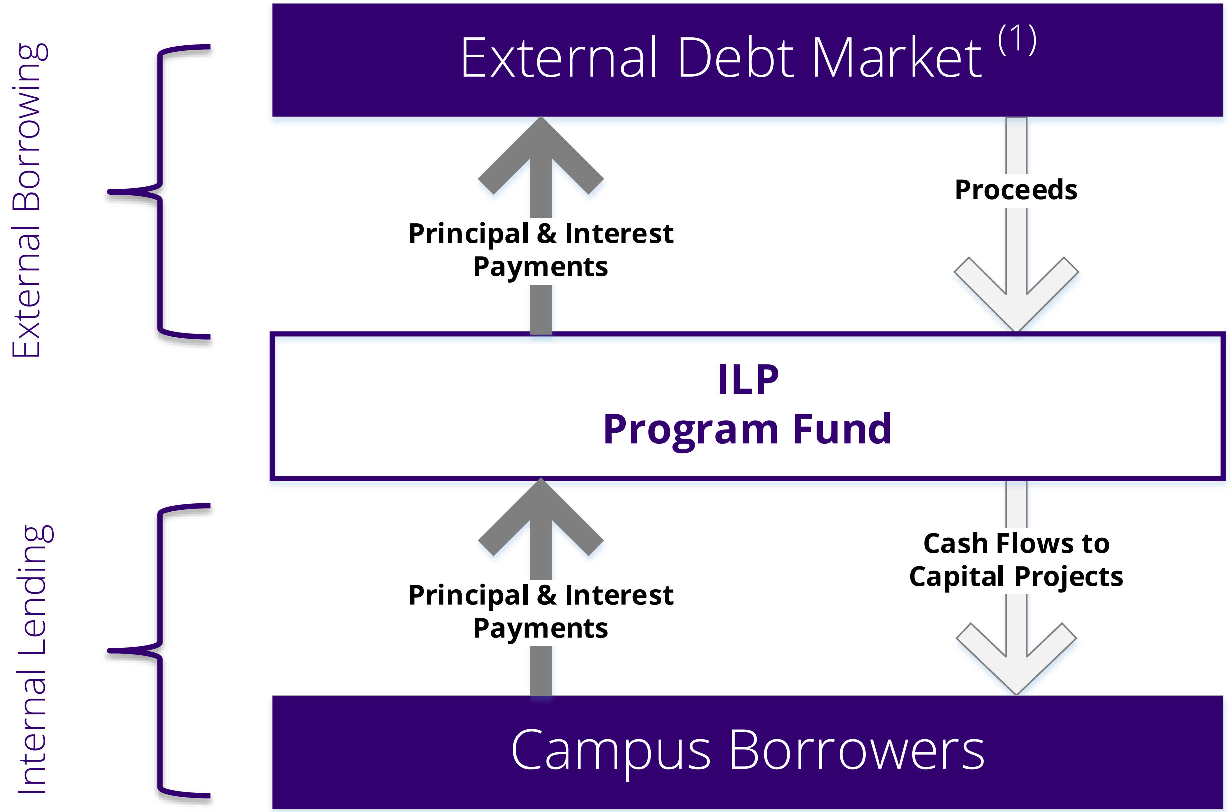
INTERNAL LENDING PROGRAM (ILP)…NOW MORE THAN EVER

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 etc.
- 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. Annual Borrower Reports), 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, Lines of Credit)
  - Annual support to University Provost to support troubled borrowers through Credit Support Fee

UNIVERSITY LENDING OVERVIEW

External borrowing and internal lending come together in the Program Fund. The Program Fund is “insurance” against future higher interest rates, assists troubled borrowers, and supports institutional projects



(1) The Capital Assets Pool (CAP) program is also a funding source to the ILP

ILP RATE RECOMMENDATION

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

- Sufficiency represents:
  - The number of years the ILP rate can be held stable for internal borrowers as external rates increase
  - The point in time when the ILP becomes insolvent
- The current ILP rate of 4.00% is:
  - Below historic average external borrowing rates and equivalent to current 30-year market rates
  - In range for similar programs at higher education peer institutions
  - As of FY21, the ILP had a cash balance of $64.2 million, which includes:
    - Funding for future principal payments
    - ~13 years of rate sufficiency
    - Minimum balance to support ILP programs
- The Board must approve any changes to the ILP rate or distributions from the ILP