

**STANDING COMMITTEES**

Finance and Asset Management Committee

Annual Debt Management Report

INFORMATION

This item is for information only.

BACKGROUND

The Board of Regents is charged with oversight of the University's external and internal debt portfolios.

Oversight of the University's external debt portfolio is accomplished by adopting the University's Debt Management Policy, guiding credit standards, authorizing the issuance of external debt, and ensuring compliance with bond covenants and Internal Revenue Service (IRS) regulations.

Internally, the Board approves the use of financing programs to fund projects, monitors internal loans, and approves Financial Stability Plans (or, this year, Quarterly Borrower Risk Reports in their place). The Board also approves changes to the Internal Lending Program (ILP) rate and authorizes withdrawals other than those described in the Debt Management Policy.

The Debt Management Annual Report provides the Board with a broad overview of the external and internal debt portfolios, macro challenges, and how the University is managing those challenges. Its purpose is to provide the Board with information and context to inform decisions about the University's external borrowing and internal lending activities. This report does not require Regental action.

The Annual Internal Lending Program Report, presented to the Board each spring, contains information on outstanding ILP loans, internal borrower performance and an overview of other lending programs. This report does not require Regental action.

*Attachments*

1. University of Washington 2021 Debt Management Annual Report
2. Annual ILP Report as of March 31, 2021



# **UNIVERSITY OF WASHINGTON**

## **Debt Management Annual Report**

**Board of Regents Finance and Asset Management  
Committee**

**April 7, 2021**

# AGENDA

---

- > Portfolio Overview
  - External Borrowing and Internal Lending Overview
  - Why issue debt?
  - Institutional Credit Overview
- > Debt Capacity Estimate
  - 5-year Debt Capacity
  - Debt History and Future
- > Internal Lending Rate (ILP) Assessment
  - Why have an ILP?
  - University Lending Overview
  - ILP Sufficiency
  - Target Sufficiency
  - 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<sup>(1)</sup> / Quarterly Borrower Risk Reports<sup>(2)</sup>
- > Annual ILP Report<sup>(3)</sup>
- > Debt Management Annual Report
- > Annual ILP Audit

<sup>(1)</sup> Formerly known as the "Semi-Annual Borrower's Report"

<sup>(2)</sup> Provided through June 30, 2021, or until otherwise determined

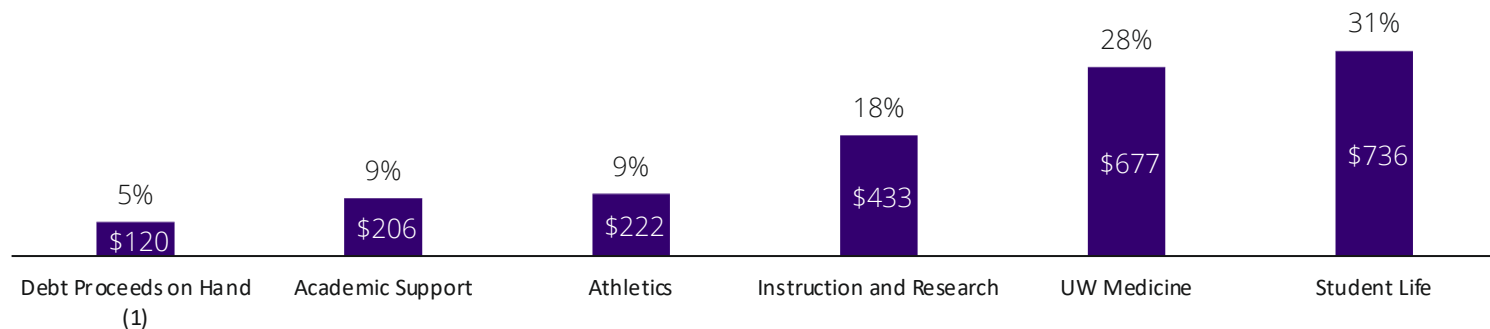
<sup>(3)</sup> Formerly known as the "Semi-Annual ILP Report"

# WHY ISSUE DEBT?

## The University utilizes bonds 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



(1) "Debt Proceeds on Hand" represents proceeds from commercial paper issuance for funding Finance Transformation and 2021 bond sale for funding Destination One, Childbirth Center, Kincaid Hall, and other University projects. External debt balances shown as of 2/28/21.

# INSTITUTIONAL CREDIT OVERVIEW

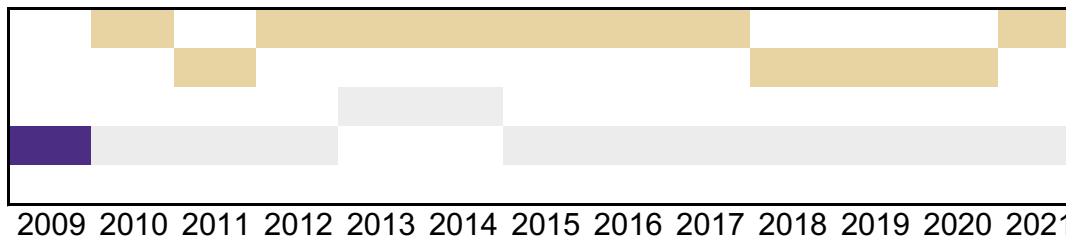
## UW is one of the highest rated public universities in the US

- > An institutional credit rating is 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
  - Moody's revised outlook to stable from negative, where it had been since 2018
- > The following factors could lead to a rating downgrade:
  - Sustained weakening of operating performance, or revenue pressures on major revenue streams
  - Material debt plans beyond those outlined
  - Reduction in same day liquidity or increased calls on liquidity
  - Weakening of debt and treasury management

**University's Credit Rating by Year and Agency**

**Moody's Scale**

Aaa Stable  
Aaa Negative  
Aa1 Positive  
Aa1 Stable  
Aa1 Negative



**S&P's Scale**

AAA Stable  
AAA Negative  
AA+ Positive  
AA+ Stable  
AA+ Negative

**Moody's and S&P**

**Moody's Only**

**S&P Only**

# 5-YEAR DEBT CAPACITY IS \$600M

FY22 – FY26 debt capacity represents a \$125 million increase over 2020

- > For FY22 the University included an affordability metric in its analysis
- > Debt capacity is evaluated annually based on institutional financial performance (audit), updated forecast, peer behaviors, and long-term capital plan
  - Institutional Total Cash and Investments forecasted to grow at nominal levels (~1%)
  - 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

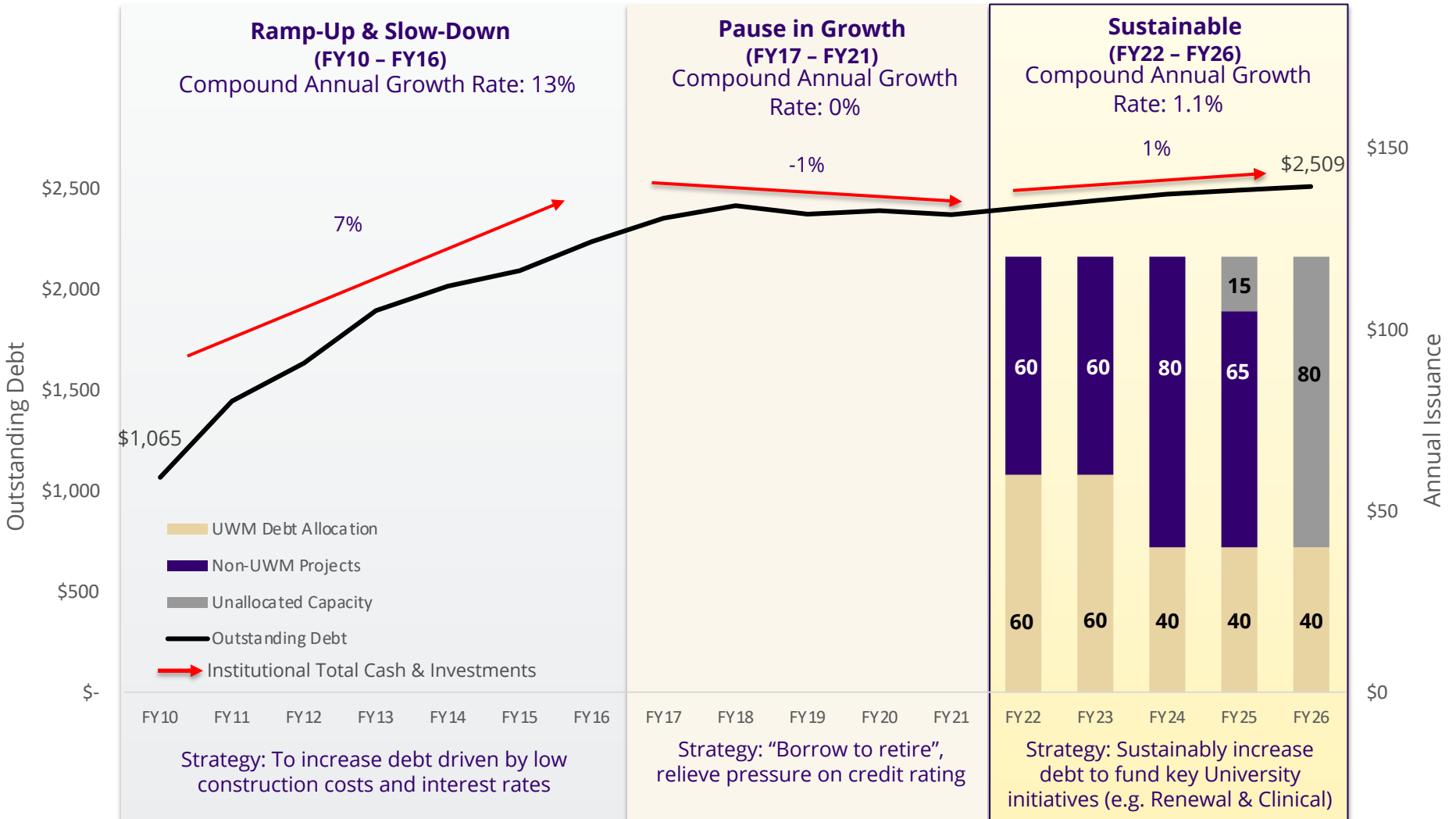
Projected Debt Balances FY22-FY26 (\$ in millions)							
Fiscal Year	Beginning Balance	– Debt Retired	+ Non-UWM Projects <sup>(1)</sup>	+ UWM Debt Allocation <sup>(2)</sup>	+ Unallocated Capacity	= Ending Balance	
FY22	2,369	(84)	60	60	0	2,405	
FY23	2,405	(86)	60	60	0	2,439	
FY24	2,439	(87)	80	40	0	2,472	
FY25	2,472	(101)	65	40	15	2,491	
FY26	2,491	(102)	0	40	80	2,509	
<b>Totals</b>		<b>(461)</b>	<b>265</b>	<b>240</b>	<b>95</b>		
<b>FY22 – FY26 Total Debt Capacity:</b>					<b>600</b>		

<sup>(1)</sup> Includes approved projects and projects pending approval on preliminary five-year capital budget

<sup>(2)</sup> Includes approved debt for Medicine and preliminary five-year capital budget estimate

# DEBT HISTORY AND FUTURE

(\$ in millions)





# WHY HAVE AN INTERNAL LENDING PROGRAM (ILP)?

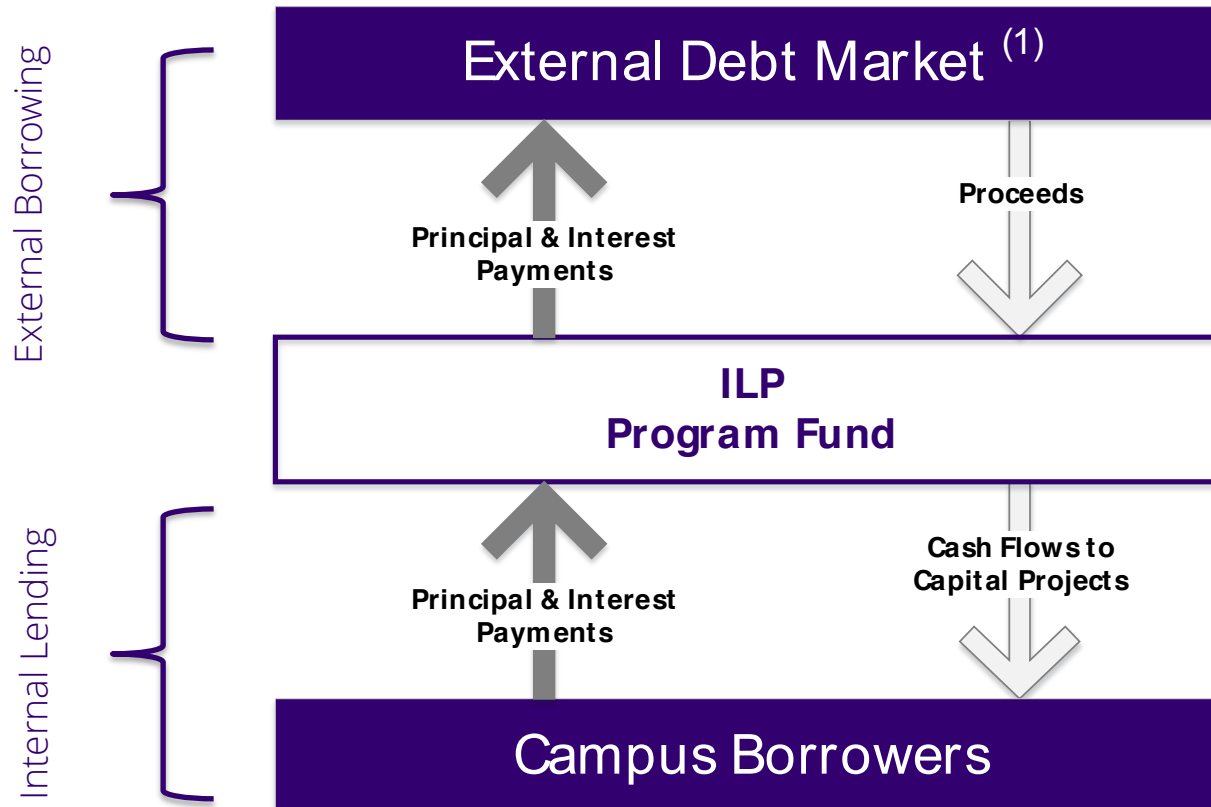
---

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

- > There are numerous additional benefits of the ILP:
  - Substantial flexibility in structuring internal loans, including more favorable internal loan covenants
  - 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 (ICA debt service deferral), and supports institutional projects (FT contribution)



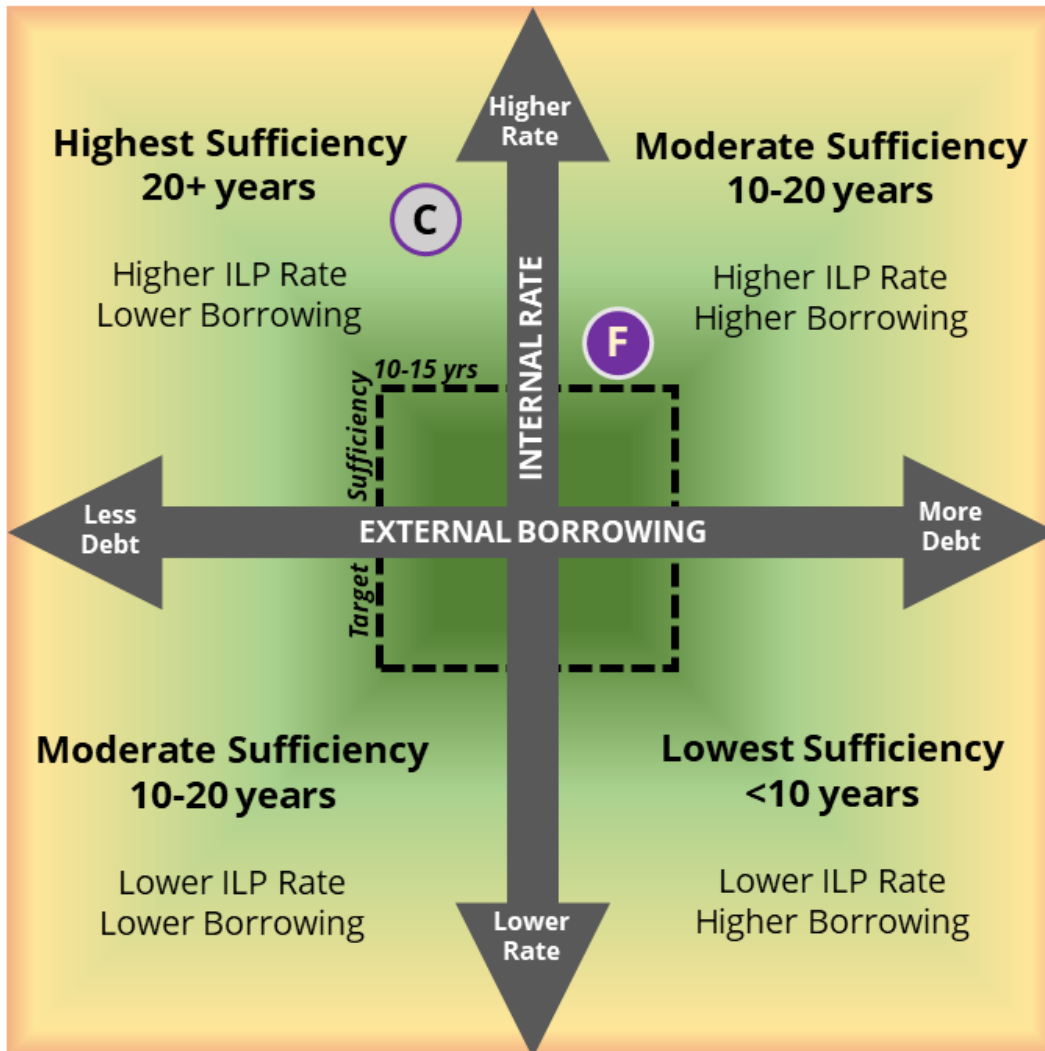
(1) The Capital Assets Pool (CAP) program is also a funding source to the ILP

# ILP SUFFICIENCY INCREASED BY LOW RATES AND REFUNDING SAVINGS

---

- > Sufficiency represents the number of years the ILP rate can be held stable for internal borrowers as external rates increase
- > The current ILP rate of 4.25% is:
  - Close to historic average external borrowing rates
  - In range for similar programs at higher education peer institutions, although several schools are evaluating further rate reductions
- > As of FY20, the ILP had a cash balance of \$99.8 million<sup>(1)</sup>, which includes:
  - Funding for future principal payments
  - 19-21 years of rate sufficiency
  - \$17 million remaining authorized distribution for Finance Transformation in FY21
  - Minimum balance to support ILP programs
- > The Board must approve any changes to the ILP rate or distributions from the ILP

# TARGET SUFFICIENCY OF 10-15 YEARS



- > Sufficiency impacted by:
  - ILP interest rates
  - External borrowing rates <sup>(1)</sup>
  - Future borrowing amount
  - Program distributions

**C** Current sufficiency 19-21 years

**F** Future sufficiency 17 years

# RATE RECOMMENDATION

---

## Treasury recommends lowering the ILP rate from 4.25% to 4.00%

- > Rate change would be effective as of July 1, 2021
  - Rate resets for all outstanding and future ILP loans<sup>(1)</sup>
  - After the January 2021 issuance and recent bond refundings, the University's weighted average cost of capital is 3.33%
  - 0.25% of ILP rate is used for Credit Support Fee and related program costs
  - A 4.00% ILP rate provides
    - Sufficiency of 17 years (reduction of two years)
    - A potential distribution of up to \$25 million for institutional priorities
    - FY22 interest savings of \$3.2 million and total savings of \$67.9 million over the remaining life of the loans
    - Closer alignment with peer interest rates
- > Next Steps
  - Notify internal borrowers of rate reduction and provide updated amortization schedules

<sup>(1)</sup>Excludes "legacy" loans and 63-20 loans (South Lake Union Properties)

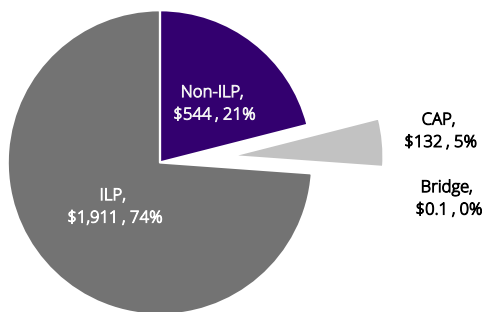
# Annual ILP Report

As of 3/31/2021  
(dollars in millions)

- As a result of recent bond refinancings, the University will pay \$49 million less in debt service payments over the life of the bonds (2021-2042). Additionally, the portfolio weighted-average cost of funds decreased by 0.28% to 3.33%.
- The 2021 General Revenue Bond proceeds paid off \$25 million in outstanding tax-exempt commercial paper and will fund construction of the Childbirth Center at the UW Medical Center Northwest campus, Destination One, Kincaid Hall, and other Board-approved projects.
- The Treasury Office is working with ILP borrowers to assess COVID-19 financial impacts and develop strategies to assist them as their revenues are disrupted and temporarily impaired. Treasury has implemented specific mitigation strategies to assist ILP borrowers:
  - Reduced ILP rate to 4.25% in FY20 and reducing to 3.75% in FY22 (subject to Board approval)
  - FY21 debt service deferral (ICA)
  - Short-term borrowing to preserve unit reserves (HFS)
  - Ongoing assessment via the Quarterly Borrower Risk Report (ICA, HFS, UWM CCE, UWT)
  - Establishment of a \$200 million line of credit program
- \$73.6 million** of project expenses were funded between 7/1/2020 and 2/28/2021 for the Childbirth Center at the UW Medical Center Northwest campus, Destination One, and Kincaid Hall. These project costs were funded from 2019 and 2020 General Revenue Bond proceeds and commercial paper.
- In March 2021, Treasury issued \$25 million in tax-exempt commercial paper for funding of Finance Transformation project expenditures.

## Internal Debt Summary

**Total Outstanding Balance: \$2.59 billion**  
**Internal Borrowing Rate: 4.25%**



### ILP (including CAP)

- The Internal Lending Program (ILP) outstanding balance as of 12/31/2020 totaled \$2.04 billion. This total includes the Capital Assets Pool Program (CAP).
- The ILP currently consists of 74 individual loans.
- Loans are funded through a combination of external debt and internal reserves (see Overview of Reserve Programs).

### Non-ILP

Non-ILP debt includes (but is not limited to):

- South Lake Union (\$315 million)
- MolE Interdisciplinary Academic Building (\$54 million)
- Dempsey Hall (\$34 million)
- Cobb Building (\$29 million)
- HR/Payroll Modernization (\$25 million)

## Capital Assets Pool (CAP)

Invested Funds (IF) Balance (as of 12/31/2020)	\$3,139.0
Target Allocation (10%)	\$313.9
Current Outstanding CAP Balance	\$132.4
<b>Allocation Remaining</b>	<b>\$181.5</b>

- Capacity is recalculated as the value of the Invested Funds changes and principal is repaid. Target allocation is 10% of the Invested Funds balance, less outstanding CAP loans as of 12/31/2020.
- Funds are borrowed through the ILP.
- As of January 2019, the Supplemental Retirement Funds was removed from the IF, reducing future CAP balances by \$31 million.

Note: Internal (due to the ILP) and external (due to the IF) CAP balances may differ slightly due to timing differences.

## ILP Borrowers

Department	Loan Balance	Compliance as of 12/31/20 <sup>(1)</sup>	Risk Assessment <sup>(4)</sup>
Housing and Food Services <sup>(1)</sup>	\$688.1	No	High Risk
Central	\$505.0	N/A	N/A
Clinical Enterprise <sup>(1)</sup>	\$410.4	FSP <sup>(2)</sup>	High Risk
Intercollegiate Athletics <sup>(1)</sup>	\$242.5	No	High Risk
Student Life	\$143.4	Yes	Low Risk
UW Tacoma	\$34.2	No	High Risk
UW Bothell	\$10.6	Yes <sup>(3)</sup>	Low Risk
School of Dentistry	\$9.4	N/A	N/A
<b>Total at 12/31/2020:</b>	<b>\$2,043.6</b>		

(1) Financial covenants are currently suspended.

(2) FSP indicates unit in Financial Stability Plan.

(3) UWB Husky Village to be redeveloped beginning in Fall 2021; currently below 1.25x DS coverage and the minimum reserve requirement due to transition to new project.

(4) Risk assessment as detailed and defined in the unit Quarterly Borrower Risk Reports.

● Low Risk    ● Medium Risk    ● High Risk

## Other Lending Programs

Program Name	Total Capacity	Committed	
		Capacity	Remaining Capacity
Bridge Program <sup>(1)</sup>	\$60.0	\$47.2	\$12.8
FAST Program 2014 <sup>(2)</sup>	-	\$0.7	N/A
FAST Program 2017 <sup>(2)</sup>	-	\$21.7	N/A
FAST Program 2020 <sup>(2)</sup>	\$40.0	\$7.9	\$32.1
FASTER	\$10.0	\$2.0	\$8.0
Line of Credit	\$200.0	-	\$200.0
UHAP <sup>(3)</sup>	\$3.0	\$2.5	\$0.5

(1) The Bridge Program provides funding to manage timing differences between gift and project cash flows. Approved Bridge projects include: Bill & Melinda Gates Center for Computer and Engineering, Parrington Hall, ICA Performance Center, Mackenzie Hall, and Founders Hall. Bridge is funded using balance in the CAP program.

(2) Financing Assets in the Short Term (FAST) provides short term borrowing at market-based rates. Approved projects include HFS Oak Hall, School of Medicine MRI, SAF IMA Pool, and Sandpoint Library.

(3) University Housing Assistance Program (UHAP) is a three year pilot program that offers down payment assistance to faculty seeking homes.