Doc. T09-050, as amended
Passed by the Board of Trustees
September 30, 2009
Revised: 6/18/14

UNIVERSITY OF MASSACHUSETTS
DEBT POLICY

PURPOSE

To fulfill its mission, the University must make ongoing strategic capital investments in academic, student life, research, and other plant facilities using an appropriate mix of funding sources including state bonds and appropriations, University bonds, capital leases, internal reserves, operating funds, grants, and private gifts.

The purpose of the Debt Policy is to ensure the appropriate mix of funding sources is utilized and to provide guidance on the strategic use of debt (external and internal). Debt is a valuable source of capital project financing but should be limited to projects that relate to the mission and strategic objectives of the University consistent with its capital planning process. The amount of debt incurred has an impact on the financial health of the University and its credit rating.

This Policy provides a discipline and framework to be used by senior administration to evaluate the appropriate use of debt in capital financing plans.

I. INTRODUCTION

This policy will assist University management in the evaluation of internal and external debt while seeking to maintain an acceptable credit rating and sufficient liquidity. Although the attainment or maintenance of a specific rating is not the main objective of this policy, maintaining an acceptable credit rating that is the same or better than current rating levels will permit the University to continue to issue debt and finance capital investments at favorable interest rates. The University, consistent with its capital objectives, will limit its external debt to a level that will maintain an acceptable credit rating with bond rating agencies.

Management will use quantitative tests to evaluate the University's overall financial health, liquidity, present and future debt capacity. In addition, project-specific analysis, as appropriate, will be used to determine the financial feasibility of an individual project.

II. POLICY STATEMENT

A. The University will only incur debt in strict compliance with applicable state and federal law and with debt-related contractual covenants.

B. The University may incur debt to refinance existing debt or to fund capital projects that are consistent with the University's mission and strategic priorities and/or the University's capital plan.

C. The University will incur external debt only with the prior approval of the Board of Trustees and the Commonwealth of Massachusetts as required.

D. The ratio of debt service to operating expenses should be no greater than 8% for the University or a campus. An individual campus may exceed 8% if so authorized by a vote of the Board of Trustees, but may at no time exceed 10%.

E. Management will promote the integration of long-term financial planning with long-term capital planning while incorporating sound financial practices and proactive resource management.

F. Management shall seek the best possible national credit ratings based on an analysis of economic and market conditions and the University’s capital plan.

G. The University may incur debt bearing interest at variable rates when advantageous based on market conditions and will limit debt portfolio risk to appropriate levels as determined by the Senior Vice President for Administration & Finance in consultation with the President and Board of Trustees.

H. The University shall not enter into debt-related derivative transactions for speculative purposes, but rather may use debt-related derivatives to limit risks and to provide appropriate protection.

III. STANDARDS

The President, in consultation with the Vice President(s) and Chancellors, will issue administrative standards to implement this policy.

UNIVERSITY OF MASSACHUSETTS
ADMINISTRATIVE STANDARDS FOR THE DEBT POLICY
(Doc. T09-050, as amended)

I. INTRODUCTION

This policy will assist University management in the evaluation of external and internal debt while seeking to maintain an acceptable credit rating and sufficient liquidity. The University, consistent with its capital objectives, will limit its external debt to a level that will maintain an acceptable credit rating with bond rating agencies. Maintaining a credit rating that is the same or better that current levels will permit the University to continue to issue debt and finance capital investments at favorable interest rates, although the attainment or maintenance of a specific rating is not an objective of this policy.

Management will use quantitative tests to evaluate the University's overall financial health, liquidity, and present and future debt capacity. In addition, project-specific quantitative tests, as appropriate, will be used to determine the financial feasibility of an individual project.

II. POLICY STATEMENT

A. The University will only incur debt in strict compliance with applicable state and federal law and with debt-related contractual covenants.

B. The University may incur debt to fund capital projects that are consistent with the University's mission and strategic priorities and/or the University's master plan, or to refinance existing outstanding debt.

C. The University will incur debt only with the prior approval of the Board of Trustees and the Commonwealth of Massachusetts as required.

D. The ratio of debt service to operating expenses should be no greater than 8% for the University or a campus. An individual campus may exceed 8% if so authorized by a vote of the Board of Trustees, but may at no time exceed 10%.

E. Management will promote the integration of long-term financial planning with long-term capital planning while incorporating sound financial practices and proactive resource management.

F. Management shall seek the highest possible national credit ratings given economic and market conditions.

G. The University may incur debt bearing interest at variable rates when advantageous in light of market conditions and will limit debt portfolio risk to appropriate levels as determined by the Senior Vice President for Administration & Finance in consultation with the President and Board of Trustees.

H. The University shall not enter into debt-related derivative transactions for speculative purposes, but rather may use debt-related derivatives to limit risks and to provide appropriate protection.

III. STANDARDS STATEMENT

The University will establish standards for overall debt management using a select number of financial ratios calculated and reported annually and when new debt is issued; and revised periodically to reflect any changes in accounting standards.

By maintaining an appropriate proportion of debt service to total expenses, other critical and strategic needs can be met as part of the expense base. The ratio of debt service to operating expenses should be no greater than 8% for the University or a campus. An individual campus may exceed 8% if so authorized by a vote of the Board of Trustees, but may at no time exceed 10%.

Financial ratios will serve as indicators of the University's financial health and capacity to incur debt. Calculation of these ratios will be calculated annually based on the audited financial statement on a University-wide and campus basis and campus basis and using operating budgets and other projections for years not yet closed and audited.

A. Ratios

The following strategic financial ratios, when considered together and over time, will help to provide a clear, high level, assessment of the overall financial health of the University.

1. **Debt Service Ratio:** Measures the share of the University's operating budget that is going to pay principal and interest on debt.

   Annual Principal & Interest Expense on Debt/Operating Expenses & Interest on Indebtedness.

2. **Primary Reserve Ratio:** Measures the financial strength by comparing expendable net assets to total expenses. This ratio provides a snapshot of financial strength and flexibility by indicating how long the University could function using its expendable resources without relying on additional net assets generated by operations. A negative ratio or decreasing trend over time indicates a weakening financial condition.

   Unrestricted Net Position/Operating Expenses & Interest on Indebtedness.

3. **Operating Margin:** Indicates whether total operating activities resulted in either a surplus or deficit as a percentage of the budget.

   Operating Revenue (Operating Revenue & State Appropriation & Federal Appropriation & Gifts & Endowment Income & Non-Operating Federal Grants & Contracts & Investment Income net of Unrealized Gains/(Losses)) less Operating Expenses (Operating Expenses & Interest on Indebtedness/ Operating Revenue (Operating Revenue & State Appropriation & Federal Appropriation & Gifts & Endowment Income & Non-Operating Federal Grants & Contracts & Investment Income net of Unrealized Gains/Losses)).

4. **Viability Ratio:** Measures the availability of expendable net assets to cover debt. As this ratio falls below 1:1, the University's ability to respond to adverse conditions, to attract capital from external sources, and its flexibility to fund new objectives is diminished. This ratio is regarded as an important indicator of the ability to assume new debt.

Restricted Expendable & Unrestricted Net Positions/Capital Lease Obligations and Bonds Payable.

B. Synthetic Products Considerations

The University will consider the use of interest rate swaps and other synthetic financial products primarily to manage the University's variable rate debt exposure. They will not be used unless the contract or structure is understood and has been fully evaluated, can be monitored and managed, and the risk imposed has been evaluated and concluded to be appropriate for the University. Swaps and other synthetic financial products shall not be used for speculative purposes.

<u>Procurement and Execution</u> – The University has authority to enter into synthetic financial product transactions either through a competitive bid or a negotiated process. The University must take reasonable steps, such as hiring a qualified advisor, to ensure that the economics involved in a negotiated transaction represent a fair market price while taking into consideration the terms of the agreement and the University's current financial status.

<u>Swap Counterparties</u> – The University will execute synthetic financial product transactions with counterparties with credit ratings in the "A" category or above as of the transaction date. The University may seek credit enhancement in the form of collateral, guarantees, and/or termination event triggers should the counterparty's credit rating be downgraded below the "A" category. The University's ability to procure counterparty credit enhancement and termination event triggers will be subject to then current market standards and the University's then current financial status. The University will seek to maintain voluntary termination rights in all of its swap or synthetic financial product transactions.

<u>Swap Documentation</u> – The University will utilize standard International Swap Dealers Association swap documentation, including the Schedule to Master Agreement and Credit Support Annex (if applicable).

<u>Rating Agencies</u> – The University will seek a Rating Agency review to determine the effect of any synthetic financial product transaction on the credit quality of the University.

C. Disclosure And Reporting Requirements

The University will provide updated financial information operation data, and a timely notice of specified material events to each nationally recognized municipal securities information repository and any State information depository, pursuant to its continuing disclosure undertakings with respect to SEC Rule 15c2-12 (17 CFR 240.15c2-12).

Reporting Requirements – The University will prepare a report for the Board of Trustees on an annual basis which provides an update of the University's current debt structure and status and outlines the proposed future financing plans.

D. Definitions

Direct Debt: Financing that is assigned to and supported by the University of Massachusetts.

Present Value: The value at the current time of a cash payment or stream of payments which is expected to be received in the future, allowing for the fact that an amount received today could be invested to earn interest until the future date(s).

Present Value Savings: A method of calculating the aggregate amount of savings on a refinancing transaction. In each semi-annual period, the present value of the debt service on the Refunding Bonds is subtracted from the present value of the debt service on the refunded Bonds using the arbitrage yield on the refunding bonds as the discount rate. The present value savings in each year are added together to result in the aggregate Present Value Savings.

Rating Agency: One of the three (Fitch Investors Service, Moody's Investors Service or Standard & Poor's Corporation) nationally-recognized credit rating agencies.

Refinancing: A procedure whereby an issuer issues new bonds to replace outstanding bonds. The newly issued bonds are called the "refunding bonds," while the bonds being refinanced are called the "refunded bonds."

Synthetic Financial Products: Financial products (i.e., interest rate swaps, caps, collars, etc.) that are primarily used to manage interest rate risk or asset/liability balance.

Terms and Structure: Terms and Structure shall have the same meaning as provided by the Treasury Board Debt Structuring and Issuance Guidelines, as amended.

Variable Rate Debt: Debt with interest payment requirements which change based on market conditions during the term of the debt.

E. Related Procedures, Forms, And Other Resources