University of Vermont
Debt Policy
As Adopted by the Board of Trustees
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OVERVIEW

Purpose

1. Articulate the role of UVM’s debt policy within the strategic planning process.

UVM’s Mission

Strategic Financial Plan

Other Initiatives

Capital planning and management policies

Debt Policy

The University of Vermont’s strategic planning is a long-term process that establishes University-wide priorities as well as University and divisional programmatic objectives to guide principles and practices. The University’s strategic plan identifies specific goals and initiatives, including capital plans that identify necessary and desired University facility investments. To fund its plan, the University will continue to utilize a mix of financing sources including State and Federal sources, philanthropy, internal reserves, and external University-supported debt.

As the University continues to balance the significant need for both current and future facilities investment, research, teaching, student, and other important needs and competing initiatives for capital from limited resources, the University is implementing this debt policy. This policy, in conjunction with the Strategic Financial Plan and capital planning, will aid management in ensuring that an appropriate mix and types of funding sources are utilized and that the University’s debt capacity is allocated strategically. A UVM-specific debt policy is appropriate to ensure adequate financial strength to service existing and proposed debt, maintain leverage within an acceptable risk tolerance while investing in priority capital projects, maintain a strong financial profile to ensure a competitive position relative to its peers, and maintain the budgetary capacity to invest in other initiatives. Additionally, this policy will provide the foundation for internal procedures to ensure that appropriate reporting and management requirements are in place in order to meet objectives outlined in this policy, and to provide a more efficient process for the ongoing external and internal management of debt in order to optimize its utilization on campus.

Management and the Board of Trustees, acting through the Trustee Debt Subcommittee, will assess this policy on an ongoing basis to ensure that it remains responsive to UVM’s evolving academic, research and strategic priorities and financial position. Additionally, a set of operating procedures will be established in order to implement the objectives set forth in this policy. The procedures will outline management roles and responsibilities including internal operating controls and fiduciary responsibilities consistent with the long-term objectives of this policy.

The University believes that financial discipline is a critical component of long-term debt management and that the Board and management, operating through the Trustee Debt Subcommittee should establish a limited number of financial ratios and limits in order to manage debt within acceptable ranges consistent with UVM’s objectives. These measures will be monitored and reported on in light of UVM’s evolving strategic initiatives and capital needs.
INTRODUCTION AND OBJECTIVES

Purpose

1. Articulate UVM’s philosophy regarding debt.
2. Establish objectives for debt policy.
3. Provide for regular review and potential update of policy to reflect evolving needs.

Over time, appropriate financial leverage serves an important role in funding the University’s capital investments and should be considered a long-term component of UVM’s balance sheet. Just as investments represent an integral component of assets, debt is viewed to be a long-term component of liabilities that therefore should be managed on a long-term portfolio-basis consistent with the institution’s policy objectives. Debt, especially tax-exempt debt, provides a limited low cost source of funding for capital projects in order to achieve the University’s mission and strategic objectives, and, together with other limited resources, should be utilized and allocated appropriately, strategically, judiciously, and equitably.

This objectives of the policy are to:

(i) Maintain the University’s access to capital. Management will utilize and issue debt in order to provide timely access to capital to fund project priorities that have been approved by the Board;

(ii) Manage the University’s credit to meet its long-term strategic objectives while maintaining creditworthiness consistent with the most favorable relative cost of capital and borrowing terms. Maintaining the highest acceptable credit rating will permit the University to continue to issue debt and finance capital projects at favorable interest rates while meeting its strategic objectives;

(iii) Limit risk of the University’s debt portfolio. Debt will be managed on a portfolio, rather than a transactional or project-specific, basis. Management’s continuing objective of incurring the lowest achievable long-term risk-adjusted cost of capital will be balanced with the goal of appropriately limiting exposure to market shifts within acceptable budgetary parameters. Various types of debt structures and financial instruments will be considered, monitored, and managed within the framework established in this policy and according to internal management procedures; and

(iv) Permit the optimization of the investment of the University’s working capital and cash balances. Management will explore various options and alternatives to internal cash holdings regarding the optimal funding mechanism for short-term equipment needs, bridge financing and cash requirements. Management recognizes that working capital requirements, debt management, and the investment of cash should be viewed comprehensively in order to optimize overall funding and investment return strategies.

In addition to establishing a framework relating to the administration of debt, the policy provides for periodic updates pertaining to UVM’s debt capacity and financial management to both internal and external parties.
OVERSIGHT

Purpose
1. Provide mechanism for oversight and review on periodic basis.
2. Provide management flexibility to make ongoing financing decisions within the framework of the policy.

By adopting this policy and regularly reviewing its results and appropriateness with the Trustee Debt Subcommittee, management will follow and report on guidelines and requirements regarding debt utilization. With appropriate authorizations consistent with the policy, management will have flexibility to implement specific financial transactions and utilize approved financing vehicles (e.g. commercial paper) in accordance with stated procedures.

The Office of the Vice President for Finance and Administration and Treasurer will manage all funding sources, including debt, for capital projects authorized by the Board. The structure of any individual transaction (e.g., maturity, interest rate mode, use of derivative products, other financing structures) will be based upon overall University needs to ensure that (i) long-term costs to the University and its operating units are minimized consistent within the context of other strategic objectives and (ii) overall risk does not exceed acceptable levels as defined in this policy.

Because this debt policy is a living document, the Trustee Debt Subcommittee will review this policy on an annual basis and report any recommended changes or revisions to the Finance Committee. This review process is necessary to ensure that the policy remains consistent with the University’s objectives and responsive to evolving practices, competitive pressures in the external environment, and financial indicators.

In addition, the Trustee Debt Subcommittee will hold regular meetings in order to review short and intermediate term financing needs, market opportunities, and financial performance. This regular review will help the University determine appropriate financial decisions as well as review capital investments and the timing of financing plans responsive to market conditions.

POLICY RATIOS

Purpose
1. Identify core ratios.
2. Clearly communicate with key parties such as rating agencies the University’s philosophy regarding debt and management’s ongoing assessment of debt capacity and affordability.

This policy establishes limits to measure the total amount of outstanding debt compared to University balance-sheet resources and the annual operating budget. These ratios can be derived from the financial statements and are subject to review periodically.

The policy identifies ratios that (i) are based on current GAAP requirements, including the GASB 34/35 reporting format and (ii) are consistent with ratios utilized in the higher education industry to permit benchmarking.

In addition to the two policy ratios below, the University may consider tracking other ratios in addition to the policy ratios. Listed below are the policy ratios and limits that will be followed.

Ratio 1 – Debt Burden Ratio

This ratio measures the University’s ability to repay debt service associated with all outstanding debt and the impact on the overall budget and includes all activities of the University. The defined limit for this ratio is intended to maintain the University’s long-term operating flexibility to
fund existing requirements and new initiatives, although the University may target a desired ratio below this limit.

\[
\frac{\text{ANNUAL DEBT SERVICE}}{\text{TOTAL EXPENSES}} < 5\%.
\]

The measure is based on aggregate operating expenses as opposed to operating revenues because expenses typically are more stable (e.g., no one-time operating gifts, investment return, variability of State funding) and better reflect the operating base of the University. Management recognizes that a growing expense base would make this ratio appear more attractive. The limit for this ratio is not to be greater than 5.0%. If more than 5.0% of the University’s annual budget were committed to debt service expense, flexibility to devote resources to fund other objectives could be diminished. This ratio will be adjusted to include the impact of non-amortizing or non-traditional debt structures that could result in significant single year fluctuations, as well as an assumption of an appropriate variable rate.

\textit{Ratio 2 - Viability Ratio}

This ratio indicates one of the most basic determinants of financial health by measuring the availability of liquid and expendable net assets compared to aggregate debt. The ratio measures the medium to long-term health of the University’s balance sheet and debt capacity and is a critical component of universities with the highest credit quality.

Many factors influence the viability ratio, affecting both the assets (e.g., investment performance, philanthropy) and liabilities (e.g., timing of bond issues), and therefore the ratio is best examined in the context of changing market conditions so that it accurately reflects relative financial strength. For example, a viability ratio that is acceptable and entirely appropriate in one market condition may be relatively stronger or weaker in other market environments.

This policy establishes a debt policy limit (floor) for this ratio of 1.0x to ensure that sufficient balance sheet strength is maintained at all times.

\[
\frac{\text{UNRESTRICTED NET ASSETS + TEMPORARILY RESTRICTED NET ASSETS – EQUITY IN PLANT}}{\text{AGGREGATE DEBT}} > 1.0x
\]

This ratio will include any financings that impact the University credit, including guarantees of third-party debt.

The 1.0x limit is recognized as a limit, and not a long-term objective. Over time, to remain competitive and retain the flexibility to invest in future strategic initiatives, UVM will want to target and maintain a ratio above 1.0x

\textit{Ratios as a Credit Factor}

The University has established its ratios and associated ratio limits based on internally-established guidelines. The ratios and limits are not intended to provide a long-term target or track a specific rating, but rather will enable the maintenance of the University’s competitive financial profile and complement the capital planning process.
The debt policy will be shared with external credit analysts and other third parties in order to provide them with the context regarding UVM’s assessment of self-determined debt capacity and affordability, which is subject to ongoing review.

**TYPES OF FINANCINGS**

<table>
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<th>Purpose</th>
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<td>1. Review of all potential funding sources for projects.</td>
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<td>2. Maximize tax-exempt University-issued debt.</td>
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<td>3. Commercial Paper program.</td>
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<td>a. Provide bridge funding.</td>
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<td>b. Provide continual access to capital.</td>
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<td>c. Issuance on a taxable or tax-exempt basis.</td>
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<td>4. Manage derivative products, including swaps.</td>
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<td>5. Consider other financing sources.</td>
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<td>a. Management will explore securitizations, joint ventures and other financial structures to provide for the optimal funding for any project.</td>
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The University recognizes that there are numerous types of financing structures and funding sources available, each with specific benefits, risks, and costs. All potential funding sources will be reviewed by management within the context of the debt policy and the overall portfolio to ensure that any financial product or structure is consistent with UVM’s objectives. Regardless of what financing structure(s) is(are) utilized, a full understanding of the transaction, including (i) quantification of potential risks and benefits, and (ii) analysis of the impact on University creditworthiness and debt capacity, will be required. Any financial transaction which, in management’s opinion, utilizes the University’s credit, will be subject to the limits set forth in this policy regardless of source.

**Tax-Exempt Debt**

The University recognizes that debt will remain a long-term component of the University’s capitalization over the foreseeable future due in part to its continued need for capital and the substantial economic benefits associated with tax-exempt debt. Therefore, financial transactions will be managed on a portfolio basis with a long-term perspective. Management will manage the debt portfolio to maximize its utilization of tax-exempt debt relative to taxable debt whenever possible. (In all circumstances, however, individual projects must continue to be identified and tracked to ensure compliance with all tax and reimbursement requirements).

Recognizing the inherent benefit provided by tax-exempt borrowing, the University will prefer to consider maximizing the external maturity of any tax-exempt bond issue, subject to prevailing market conditions and opportunities, budgetary constraints, the useful life of projects being financed, and other considerations. Although debt will be structured to meet the University’s comprehensive long-term objectives, each project being financed will be required to provide a sound business plan, including the source of repayment for the debt and appropriate and realistic repayment terms. Among other things, the repayment terms will require that the loan term is no greater than the expected componentized useful life of the asset financed. Additionally, the financed project will be required to budget and fund principal payments on a fully amortized basis.

**Taxable Debt**

While all of the University’s capital projects may not qualify for tax-exempt debt, taxable debt should only be used in appropriate cases as it generally represents a more expensive source of capital relative to tax-exempt issuance. Issuing taxable debt reduces the University’s overall debt affordability due to higher associated interest expense.

When utilized, taxable debt will be structured to provide maximum repayment flexibility and rapid external principal amortization.
Commercial Paper

The University is establishing a commercial paper program, which will include both a tax-exempt and taxable series. The CP program can provide substantial financial flexibility to the University including the ability to manage and optimize cash balances, provide an alternative to lease transactions, and other purposes. At this time, however, the University is limiting the use of the program to providing the University with interim financing for capital projects in anticipation of the receipt of funding either in the form of future philanthropy or the issuance of long-term debt for permanent financing, providing greater flexibility regarding the timing and structuring of individual bond transactions. It is expected that the University may consider expanding the permitted use of the CP program at some point in the future.

The University recognizes that the amount of project-related commercial paper is limited by the ratios established by this debt policy, and the University’s available liquidity support however, the University will not include outstanding CP in the variable rate debts exposure, given the expected short-term nature of the CP. The existence and utilization of the commercial paper program has influenced the decision to limit variable rate exposure to no more than 35% of the long-term debt portfolio.

Derivative Products

Management recognizes that derivative products may enable more opportunistic and flexible management of the debt portfolio. Derivative products, including interest rate swaps, may be employed primarily to manage or hedge the University’s interest rate exposure for a specific period of time. The University will utilize a framework to evaluate potential derivative instruments through consideration of (i) its variable rate allocation, (ii) market and interest rate conditions, (iii) impact on future financing flexibility, and (iv) the compensation for assuming risks, or the costs for eliminating certain risks and exposure. In addition, the University will analyze and quantify the cost/benefit of any derivative instrument relative to achieving desirable long-term capital structure objectives. Under no circumstances will a derivative transaction be utilized that is not understood fully by management or that imposes inappropriate risk on the University. Risks include but are not limited to tax risk, interest rate risk, liquidity risk, counterparty credit risk, basis risk, and any other potential risks either imposed or removed through the execution of any transaction. In addition, management will consider and disclose the potential impact of any derivative product on the University’s financial statements and the appropriate treatment in calculating the debt policy ratios. The University will regularly report on the status and performance of its derivative products, if any, to the Trustee Debt Subcommittee.

Given the risks and complexity associated with derivative products, they will be considered more seriously only when: (i) conventional financing sources are relatively more expensive (e.g. exceed the portfolio blended interest rate, and (ii) can achieve desired financial objectives more efficiently or at a significantly lower risk-adjusted cost than traditional structures. Management is required to present any recommended derivative product to the Trustee Debt Subcommittee and must receive the Subcommittee’s recommendation and Board approval prior to execution.
Other Financing Sources

The University recognizes that a variety of transactions, not limited to debt insured directly by UVM, may impact the University’s credit while the University’s limited debt capacity and substantial capital needs require the consideration of various financing alternatives, including possible opportunities for alternative and non-traditional transaction structures. The University recognizes these types of transactions may also impact the University’s credit and also often can be more expensive than traditional University debt structures. Therefore all non-traditional financing structures including guarantees and third party debt can only be considered once the economic benefit and the likely impact on the University’s debt capacity and credit has been determined. Specifically, for any third-party or developer based financing, management will ensure the full credit impact of the structure is evaluated and quantified to the extent possible prior to execution and the analysis must be presented to the Trustee Debt Subcommittee and must receive the Subcommittee’s recommendation and Board approval prior to execution.

PORTFOLIO MANAGEMENT OF DEBT

Purpose

1. Permit decisions regarding debt issuance and structure to be made on a portfolio basis, rather than on a per-project basis.
2. Manage variable rate exposure of the debt portfolio.
   a. Limit variable rate exposure.
   b. Manage the overall liquidity requirements associated with outstanding debt.
   c. Target overall variable rate debt exposure.
3. Evaluate exposure to other financing vehicles and third parties on a portfolio-wide basis.

The University considers its debt portfolio holistically; that is, it optimizes the portfolio of debt for the entire University rather than on a project-by-project basis, and takes into account the University’s cash and investments. Therefore, management will make decisions regarding project prioritization, variable rate allocation, and financing structures within the context of the overall needs and circumstances of the University.

Variable Rate Debt

It is recognized that a degree of exposure to variable interest rates within the University’s debt portfolio may be desirable in order to:

(i) take advantage of repayment/restructuring flexibility;

(ii) benefit from historically lower average interest costs; and

(iii) diversify the debt portfolio; and,

(iv) provide a hedge to short-term working capital balances

Management will monitor overall interest rate exposure, analyze and quantify potential risks, and coordinate appropriate fixed/variable allocation strategies. The portfolio allocation to variable rate debt may be managed or adjusted through (i) the issuance of debt (potentially new issues and refunding), (ii) and the use of interest rate swaps and other derivative products. While the utilization of commercial paper impacts the University’s variable rate exposure, outstanding CP will not be included in the ratio, given the expected interim financing purpose.

Recognizing the desire to manage interest rate risk, the amount of variable rate debt outstanding shall not exceed 35% of the University’s outstanding debt. This limit is based on (i) the University’s desire to limit annual variances in its debt portfolio, (ii) provide sufficient structuring flexibility
to management, (iii) keep the University’s variable rate allocation within acceptable external parameters, (iv) utilize variable rate debt (and/or swaps) to optimize debt portfolio allocation and minimize costs, and (v) consideration of the commercial paper program.

\[
\text{VARIABLE RATE AND LIQUIDITY EXPOSURE} \quad \frac{<35\%}{\text{TOTAL LONG-TERM DEBT OUTSTANDING}}
\]

The University will exclude from this calculation project-related commercial paper used in advance of expected long-term financing since this commercial paper is used for interim purposes and should not be included in the University’s desired long-term variable rate allocation calculation. The numerator, Variable Rate and Liquidity Exposure, is defined as including all variable rate debt, not adjusted for any floating to fixed swaps, if any, and plus any fixed to floating swaps, if any. Thus, any variable rate debt that is affected by floating-to-fixed interest rate swaps will be considered variable rate debt for the purposes of this calculation since it impacts the University’s liquidity requirements and exposes the institution to counterparty credit exposure.

**Overall Exposure**

The University recognizes that it may be exposed to short-term interest rates, third-party credit, and other potential risks in areas other than direct University debt (e.g., non-traditional transactions, exposure in the investment portfolio, etc.) and, therefore, exposure will be considered on a comprehensive University-wide basis.

The University recognizes that during some periods it may be desirable to maintain a lower variable-rate allocation within its 35% limit, depending on prevailing long-term rates and/or opportunities in the short-term market.
GLOSSARY

Annual Debt Service – refers to the principal and interest due on long-term debt in a fiscal year.

Bridge Financing – refers to any type of financing used to “bridge” a period of time. For universities, it generally refers to financings that provide funding in advance of a long-term bond issue or the receipt of gift funding.

Capital Project – refers to physical facilities or equipment or software that may be capitalized.

Commercial Paper – an alternative to bank line for stronger rated borrowers, commercial paper is short-term promissory notes issued on the open market as an obligation of the borrower. The maturity of commercial paper is less than 270 days, and for most universities, the average maturity of all paper is between 30-50 days. Registration and disclosure for commercial paper is significantly less than traditional university bonds.

Derivative Products – generally referred to transactions which are an exchange of specified cash flows for a period of time. The most common types of derivatives are floating-rate-to-fixed-rate or fixed-rate-to-floating-rate swaps.

GAAP – refers to Generally Accepted Accounting Principles.

GASB 34/35 – Government Accounting Standards Board Statement Nos. 34 and 35. These statements dramatically changed the reporting format for the University effective Fiscal 2002 by consolidating fund balances into net assets and consolidating university-wide activity instead of distinct fund groups. The Statements also require a statement of cash flows and a change in representation of state appropriation and investment income.

Leverage – long-term debt as a component of the total assets of the University. “High leverage” indicates an institution that has a considerable portion of its assets that are debt financed.