Information

Comprehensive Debt

Effective

January 1, 2008

Applicability

This policy applies to the University Community (administrators, faculty, staff, and students).

Administrative Authority

Vice President for Finance and Chief Financial Officer

Responsible Unit

Controller's Office
Service Complex, Louisville, KY 40292
Phone: 502-852-6164
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History

Revision Date(s): October 2016; February 22, 2024

Reviewed Date(s): October 2016; February 22, 2024

Categories

Reason for Policy:

The purpose of this policy is to provide general guidance on the strategic use of debt as a funding source. The amount and type of debt incurred impacts the financial health of the University and its credit rating. In a tight fiscal environment, its use should be limited to only those projects that fulfill the mission and strategic objectives of the University. To fulfill its mission to become a preeminent metropolitan research university, the University of Louisville will need to make ongoing capital investments in facilities. These will enhance the educational experience of students and foster the pursuit of knowledge from research and scholarly activity.

Under this policy there are six primary objectives:

- Maintain a debt credit rating sufficiently high to provide the financial flexibility to access capital markets at low borrowing costs. The attainment or maintenance of a specific rating of itself is not an objective of this policy.
- Define quantitative tests that will be used to evaluate the University's overall financial operations and debt capacity.
- Assist in a process for prioritizing capital projects for debt financing with assurance the debt financed project has a viable plan of repayment.
- Consider decisions regarding term and structure of debt issuances.
- Establish guidelines for the issuance of variable rate debt and derivative products to limit risk and achieve the lowest cost of capital.
- Identify criteria used to identify refunding opportunities.

Statement:

This policy provides a discipline and framework that will be used by *leadership* management to evaluate the appropriate use of debt in capital financing plans.

Related Information:

Ratios

A. Liquidity Ratios - Measures the availability of funds to cover operating expense/debt should unexpected interruptions in cash flow occur.

- Proforma Unrestricted Net Assets

Proforma Operating Expenses

- Consolidated Unrestricted Net Assets

Consolidated Operating Expenses

- Proforma Expendable Resources

Proforma Operating Expense

- Proforma Unrestricted Net Assets

Proforma Debt

- Consolidated Unrestricted Net Assets

Consolidated Debt

- Proforma Expendable Resources

Proforma Debt

- Proforma Debt

Endowment

B. Ratio of Debt Service to Operations - Measures the availability of funds to cover operating expense/debt should unexpected interruptions in cash flow occur.

- Proforma Peak Debt Service

Proforma Operating Expense

C. Selectivity Ratio / Student Demand - Selectivity and enrollment figures reflect student demand. Lower approval rates are indicative of strong demand.

- Freshman Applications Approved

Total Freshman Applications

- Full-time Equivalent Enrollment

D. Yield Ratio - The Yield Ratio is another indication of student demand. High percentages reflect positively.

- Number Enrolled

Freshman Applications Approved

E. Operating Margin - Measures the result of operations. Consistent positive operating margins combined with strong student demand reflect positively.

- Consolidated Income Before Other Revenue, Expenses, Gains, and Losses

Consolidated Operating Expenses

Prioritizing Capital Projects Requiring Debt

When prioritizing capital projects, management should consider the relationship of the project to the mission and strategic interest of the University. Projects with a defined revenue stream or those with the greatest impact to the experience of students normally will be assigned the highest priority.

Every project considered for financing will have a defined, supportable budget for construction and operating costs. If appropriate, a written plan to fund debt service should be developed and signed by department heads to acknowledge outside funding commitments.

Terms and Structure

Method of Sale - Both negotiated and competitive bond offerings will be considered on a case by case basis.

Tax-Exempt and Taxable - The University's debt will be managed to use tax-exempt debt to the greatest extent possible while recognizing that taxable debt must be used in the case of projects that are ineligible for tax-exempt financing.

Amortization - Bond amortization will never be greater than the useful life of the assets or project being financed. Generally, a capital asset should not be financed for a term greater than 30 years.

Call Provisions - Call features should provide maximum flexibility relative to the cost of the features. Generally, call provisions should be as favorable to the University as the market will allow.

Credit Enhancements - Credit enhancements will be used only when necessary for cost effectiveness and/or marketability. Credit enhancements will only be used when the improved bond rating and corresponding reduction in borrowing costs offset the cost of the enhancement.

Variable Rate Debt

Variable rate debt can be a valuable tool providing leadership the opportunity for a lower cost of capital and increased flexibility in principal amortization. Variable rate debt exposes the University to risk not present under the fixed rate structure.

Risks Include:

- **Counterparty Risk** - The risk that the party to the swap will not be able to meet all of its financial obligations under the swap.
- **Termination Risk** - The risk that the swap will be prematurely terminated by the counterparty or that the swap agreement is not coterminous with the related bonds.
- **Basis Risk** - The risk of a mismatch between the University's receipt (or payment) on a swap and its payment (or receipt).

The University will only enter into a transaction with qualified counterparties who have demonstrated experience in successfully executing similar contracts and who hold at least an "AA" credit rating by two of the nationally recognized credit rating agencies. The swap agreement should include a provision that permits the University to optionally terminate the swap at any time over the term of the agreement.

Credit Rating

The University will maintain ongoing communications and interaction with a minimum of two bond rating agencies, striving to educate the agencies about the general credit structure and financial performance of the University in order to attain the highest credit rating possible.

Refunding

The University will monitor its outstanding debt for refunding and restructuring opportunities. Any refunding should produce a minimum net present value of saving of five percent (5%) based on the refunded bonds, unless the transaction provides relief from overly restrictive covenants, or excessive reserve requirements.

Policy Review

The policy review should take place at least every five years, but may be reviewed at any time the University's credit situation substantially changes.

Definitions:

Consolidated Debt - Bonds and notes payable, both current and non-current from the University of Louisville Consolidated Statement of Net Assets, increased by the amount of the proposed bond issuance and decreased by the amount of any refunding.

Consolidated Operating Expenses - Total operating expenses from the University of Louisville Consolidated Statement of Revenues, Expenses and Changes in Net Assets.

Consolidated Unrestricted Net Assets - Unrestricted net assets from the University of Louisville Consolidated Statement of Net Assets.

Endowment - Total University Endowment as reported by the UofL Foundation Inc. financial statements.

Proforma Debt - Consolidated debt as defined herein plus bonds payable from the University of Louisville Foundation Consolidated Statement of Net Assets, increased by the amount of the proposed bond issuance and decreased by the amount of any refunding.

Proforma Expendable Resources - Net assets of the University of Louisville Consolidated and the University of Louisville Foundation Consolidated less invested

in capital assets, net assets, nonexpendable net assets, and permanently restricted net assets.

Proforma Operating Expense - Consolidated operating expense as defined herein plus total expense of the University of Louisville Foundation consolidated financial statements.

Proforma Peak Debt Service - The maximum aggregate annual debt service for the University of Louisville and the University of Louisville Foundation and their corporate affiliates.

Proforma Unrestricted Net Assets - Consolidated unrestricted net assets as defined herein plus unrestricted net assets of the University of Louisville Foundation consolidated financial statements.

Responsibilities:

The Vice President for Finance is directly responsible for capital debt management. The Board of Trustees formally approves actions to issue debt from recommendation of the University Leadership Team, with the advice of the Vice President for Finance.