Policy Title:	Debt

Governing Body:	Southern Oregon University	Policy Number:	FAD.051
Policy Contact:	Vice President for Finance & Administration	Date Revised:	July 2016
Custodial Office:	Finance & Administration	Date Approved:	July 2016
Approved By:	President	Next Review:	July 2019
Related Policy:			

Revision History

Revision Number:	Change:	Date:
-	Initial version	July 2015
1	Revision	July 2016

A. Purpose

This policy codifies and revises as Southern Oregon University Policy the rule previously adopted by the State Board of Higher Education concerning this topic and transferred to SOU by operation of law on July 1, 2015.

B. Policy Statement

1. Overview

In support of its mission, Southern Oregon University (SOU) maintains a long-term strategic plan. This strategic plan establishes university-wide priorities as well as university-wide and divisional programmatic objectives. SOU develops a capital plan to support these priorities and objectives.

The university's use of debt plays a critical role in ensuring adequate and cost-effective funding for its capital plans. By linking the objectives of its Debt Policy to its strategic objectives, the university ultimately increases the likelihood of achieving its mission.

2. Scope

The Debt Policy covers all forms of debt including long-term, short-term, fixed-rate, and variable-rate debt. It also covers other forms of financing including both on-balance sheet and other forms of financing that effectively operate as capital debt instruments even when not classified as such for financial statement purposes, such as certain operating leases and other structured products used with the intent of funding capital projects.

The use of derivatives is considered when managing the debt portfolio and structuring transactions. Conditions guiding the use of derivatives are addressed in a separate Interest Rate Risk Management Policy.

3. Objectives

The objectives of this policy are to:

A. Outline SOU's philosophy on debt
B. Establish a control framework for approving and managing debt
C. Define reporting guidelines
D. Establish debt management guidelines

The Debt Policy formalizes the link between the University's Strategic Plans and the issuance of debt. Debt is a limited resource that must be managed strategically in order to best support university priorities.

The policy establishes a control framework to ensure that appropriate discipline is in place regarding capital rationing, reporting requirements, debt portfolio composition, debt servicing, and debt authorization. It establishes guidelines to ensure that existing and proposed debt issues are consistent with financial resources to maintain an optimal amount of leverage, a strong financial profile, and a strategically optimal credit rating.

Under this policy, debt is being managed to achieve the following goals:

A. Maintaining access to financial markets: capital, money, and bank markets;
B. Managing the university's credit rating (if applicable) to meet its strategic objectives while maintaining the highest possible creditworthiness that provides the most favorable cost of capital and borrowing terms;
C. Optimizing the university's debt mix (i.e. short-term and long-term, fixed-rate and floating- rate, traditional and synthetic) for its debt portfolio;
D. Managing the structure and maturity profile of debt to meet liquidity objectives and to make funds available to support future capital projects and strategic initiatives;
E. Coordinating debt management decisions with asset management decisions to optimize overall funding and portfolio management strategies; and
F. Coordinating debt management decisions to maximize overall access to resources, including consideration of strategic opportunity costs, potential lost revenue, and interest and inflation rate tradeoffs.

SOU may use debt to accomplish critical priorities by prudently using debt financing to accelerate the initiation or completion of certain projects. As part of its review of each project, the university will evaluate all funding sources to determine the optimal funding structure to achieve the most beneficial cost of capital.

4. Oversight

The Vice President for Finance and Administration is responsible for implementing this policy and for all debt financing activities of the university. This policy provides the framework under which debt management decisions are made.

The exposure limits listed in the policy are monitored on a regular basis by the Vice President for Finance and Administration. The Vice President for Finance and Administration reports regularly to the President, the Board of Trustees, and the Internal Bank Oversight Committee on the university's debt position and plans.

PRINCIPLES/GUIDELINES/PROCEDURES

5. Debt Affordability and Capacity

Project Viability:

All projects using self-generated revenues to repay the debt will be carefully reviewed to ensure that they are financially viable based on reasonable and prudent estimates of the revenues and expenses associated with each project or combination of similar projects. When determining whether a project meets the self-supporting requirements, the Board of Trustees may take into consideration the total available unobligated revenues of the university. This review process will include an analysis of the total cost of the project, including site preparation, environmental assessment/remediation, architectural and engineering costs, and construction, renovation or purchase costs. A financial pro-forma will be prepared by the university that estimates the revenues and expenses associated with the operations, maintenance and debt service of the project over the life of the bonds. Projected operating revenues will provide coverage of operating expenses, maintenance, and debt service. Sources and uses of funds should be identified as part of this analysis. The financial pro-forma will be reviewed by the Vice President for Finance and Administration prior to recommendation of projects to the Board of Trustees.

Institutional Concerns:
Institutional financial viability will also be considered as part of the debt approval process. The institution must demonstrate that there is sufficient enrollment or research demand or other compelling needs or strategic opportunities to justify the investment in the project and to generate the resources for debt repayment. Three years of trend data will be considered as part of this analysis in order to demonstrate institutional financial viability over a series of years.

The following financial statement ratios will be considered in order to determine institutional financial viability as part of this analysis:

Primary reserve ratio — unrestricted net assets / operating expenses

Current ratio — current assets / current liabilities

Debt burden ratio — annual debt service (principal + interest) / total operating expenses, with a guideline maximum debt burden ratio of 7 percent, as established by the Board of Trustees

In addition to presenting the actual ratios computed for the prior three fiscal years, the university will be responsible for calculating pro-forma ratios to incorporate additional debt allocated during the current fiscal year as well as for other future proposed projects and to analyze this information together to determine financial viability.

The ratios and limits are intended to help the university maintain a competitive financial profile, funding for facilities needs and reserves, and compliance with debt service to budget guidelines.

The Debt Policy is shared with external credit analysts and other parties to provide them background on the university's philosophy on debt and management's assessment of debt capacity and affordability.

6. Real Property Financed by Third Parties

In computing financial ratios, universities need to identify and incorporate information related to real property financed by third parties when by written agreement the university is obligated to provide payments toward the property financing or to take over the financial obligation at a specified future date. Examples include agreements with an affiliated foundation and long-term capital leases. In determining whether long-term leases should be included when computing financial ratios, the institution must distinguish between capital and operating leases. Capital leases are considered debt, and must therefore be included in the ratios. Operating leases are not considered debt, and are therefore excluded from the ratio calculations.

Third-party financings may not include annual appropriation pledges of the State's general fund, and long-term leases must comply with DAS administrative rules. In addition, third-party financings may not use the State's credit or view the State as the underlying guarantor.

7. Financing Sources

There are numerous types of financing structures and funding sources available, each with specific benefits, risks, and costs. All potential funding sources are 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 the university's objectives. Regardless of what financing structure(s) is utilized, due-diligence review must be performed for each transaction, including (i) quantification of potential risks and benefits, and (ii) analysis of the impact on the university's creditworthiness and debt affordability and capacity.

Tax-Exempt Debt

Tax-exempt debt is a significant component of the university's capitalization due in part to its substantial cost benefits; therefore, tax-exempt debt is managed as a portfolio of obligations designed to meet long-term financial objectives rather than as a series of discrete financings tied to specific projects. The university manages the debt portfolio to maximize its utilization of tax-exempt debt relative to taxable debt whenever possible, keeping in mind potential issues related to the restrictions on the use of facilities financed with tax-exempt debt and the potential future uses of the facility(ies) being financed by the debt. In all circumstances, however, individual projects continue to be identified and tracked to ensure compliance with all tax and reimbursement regulations.

For tax-exempt debt, the university will consider maximizing the external maturity of any tax- exempt bond issue, subject to prevailing market conditions and opportunities and other considerations, including the useful life of financed facilities, future debt capacity of the university, applicable regulations, and the State Treasurer's statewide debt portfolio management goals and policies.

Taxable Debt

In instances where certain of the university's capital projects do not qualify for tax-exempt debt, the use of taxable debt may be considered. The taxable debt market offers certain advantages in terms of liquidity, marketing efficiency, and flexibility in the use of proceeds; such advantages will be considered when evaluating the costs and benefits of a taxable debt issuance.

Build America Bond Program

The American Recovery and Reinvestment Act (ARRA) of 2009 included provisions authorizing state governments to issue taxable bonds and receive an interest rate rebate in the amount of 35 percent of the interest paid from the Federal government (Build America Bond Program or BAB). This program opens up the taxable debt market to the university, which may prove to reduce borrowing costs. Bonds issued under this program must be treated in the same manner as tax-exempt debt with respect to the use of the bond proceeds (must be used for exempt purposes and follow the same private use rules as tax-exempt bond proceeds) and with respect to arbitrage rules. Accordingly, the System will manage debt issued under the BAB program as a part of the tax-exempt debt portfolio.

Commercial Paper

Commercial paper provides interim financing for projects in anticipation of philanthropy, planned issuance of long-term debt or from other sources of funds. The use of commercial paper also provides greater flexibility on the timing and structuring of individual bond transactions. This flexibility may also make commercial paper appropriate for financing equipment and as a tool to help manage the university's short-term liquidity position. The amount of commercial paper is limited by the Debt Policy ratios, the university's variable-rate debt allocation limit, and the university's available liquidity support.

System-issued vs. Other State-issued Debt
In determining the most cost effective means of issuing debt, the university evaluates the merits of issuing debt "directly" (e.g., under Articles XI-G or XI-F(1) of the Oregon Constitution) vs. "issuing" debt through a State-issuing entity (e.g., The Oregon Lottery, Certificates of Participation, or the State Energy Loan Program.)

When "issuing" debt through a State-issuing entity, the Legislature may appropriate funds to the university to repay the debt, or may appropriate funds to the State-issuing entity to repay the debt. Debt issued through a State-issuing entity will not be managed as a part of the debt portfolio, but will be managed discretely. Debt issued through a State-issuing entity is normally only available if authorized by the Legislature and is not available as an option unless so authorized.

University-issued debt under Article XI-G of the Oregon Constitution is repaid by Legislative appropriation to SOU and is not managed as a part of the debt portfolio, but will be managed discretely.

In the case of debt that will be repaid by university-generated revenues, the university performs a cost benefit analysis between this financing option and others available and takes into consideration the comparative funding costs and the flexibility in market timing of each alternative. The university also takes into consideration the future administrative flexibility and financial options of each issue, such as the ability to call and/or refund issues at a later date, as well as the administrative flexibility to structure and manage the debt in a manner that the university believes to be appropriate.

Derivative Products
Derivative products may enable more opportunistic and flexible management of the debt portfolio. Derivative products, including interest rate swaps and locks, may be employed primarily to manage or hedge the university's interest rate exposure. The university, in consultation with the State Treasurer and in compliance with the State's Interest Rate Swap Policy, utilizes a framework to evaluate potential derivative instruments by considering (i) its current variable- rate debt allocation, (ii) existing market and interest rate conditions, (iii) the impact on future financing flexibility, and (iv) the compensation for assuming risks or the costs for eliminating certain risks and exposure. 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.

The university analyzes and quantifies 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. In addition, management discloses the impact of any derivative product on the university's financial statements per GASB (Governmental Accounting Standards Board) requirements and includes their effects in calculating the Debt Policy ratios.

Other Financing Sources
Given limited debt capacity and substantial capital needs, opportunities for alternative and non-traditional transaction structures may be considered, including off-balance sheet financings. The university recognizes these types of transactions often can be more expensive than traditional debt structures; therefore, the benefits of any potential transaction must outweigh any potential costs.

All structures can be considered only when the economic benefit and the likely impact on the university's debt capacity and credit have been determined. Specifically, for any third-party or developer-based financing, management ensures the full credit impact of the structure is evaluated and quantified.

8. Compliance with IRS Regulations

When tax-exempt governmental-purpose bonds are issued, the university must comply with all applicable IRS regulations including, but not limited to, regulations relating to the use of bond proceeds, the use of bond-financed facilities, and arbitrage in order to maintain the bonds' tax-exempt status.

9. Portfolio Management of Debt

For purposes of this section, the university's debt portfolio is defined as debt issued under Article XI-F(1) of the Oregon Constitution (XI-F debt). 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 while taking into account the university's cash and investment portfolio. Therefore, management makes decisions regarding project prioritization, debt portfolio optimization, and financing structures within the context of the overall needs and circumstances of the university.

Variable-Rate Debt
Exposure to variable interest rates within the university's debt portfolio may be desirable in order to: take advantage of repayment/restructuring flexibility; benefit from historically lower average interest costs; reduce financial interest rate risk by providing a "match" between debt service requirements and the projected cash flows from the university's assets; and diversify its pool of potential investors and gain additional access to the capital markets.

Management monitors overall interest rate exposure, analyzes and quantifies potential risks, including interest rate, liquidity and rollover risks, and coordinates appropriate fixed/variable allocation strategies. The portfolio allocation to variable-rate debt may be managed or adjusted through (i) the issuance or redemption of debt in the conventional debt market (e.g., new issues and refundings) and (ii) the use of interest rate derivative products including swaps.

The amount of variable-rate debt outstanding (adjusted for any derivatives) shall not exceed 20 percent of the university's outstanding XI-F debt. This limit is based on the university's desire to: (i) limit annual variances in its interest payments, (ii) provide sufficient structuring flexibility to management, (iii) keep the university's variable-rate allocation within acceptable external parameters, and (iv) utilize variable-rate debt (including derivatives) to optimize debt portfolio allocation and minimize costs.

$$\frac{\text{VARIABLE-RATE DEBT (INCLUDING SYNTHETIC)}}{\text{TOTAL XI-F DEBT OUTSTANDING}} \le 20\%$$

Refinancing Outstanding Debt
The university monitors its debt portfolio on a continual basis to assure portfolio management objectives are being met and to identify opportunities to lower its cost of funding, primarily through refinancing outstanding debt.

The university monitors the prices and yields of its outstanding debt and attempts to identify potential refunding candidates by examining refunding rates and calculating the net present value of any refunding savings after taking into account all transaction costs. The university may choose to pursue refundings for economic and/or legal reasons. The university currently adheres to the State of Oregon's refunding thresholds. Net Present Value (NPV) savings of 3 percent or otherwise as permitted by the State Treasurer.

Liquidity Requirements
The university's portfolio of variable-rate debt and commercial paper require liquidity support in the event of variable rate demand bonds being put back to the university or the Commercial Paper maturing without new investors. Generally, the university can purchase liquidity support externally from a bank in the form of a standby bond purchase agreement or line of credit. In addition, the university can also use its own capital or the capital available to the State Treasurer (if approved) in lieu of or to supplement external facilities. Alternatively, it can utilize variable-rate structures that do not require liquidity support (e.g., resetting variable rate term loans).

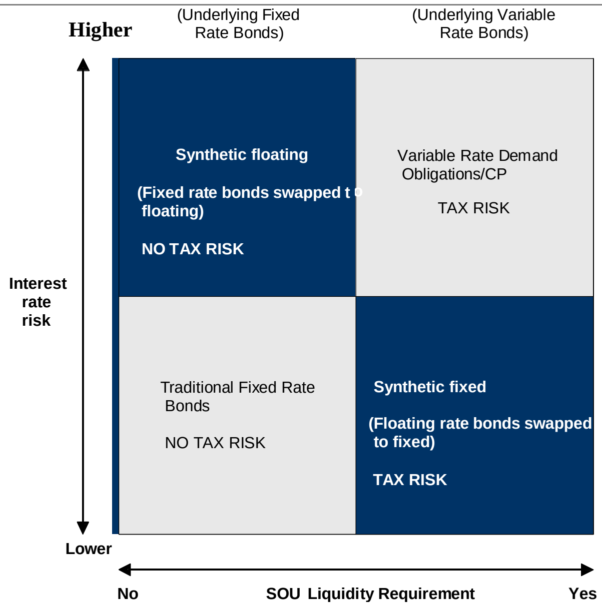
Just as the university manages its debt on a portfolio basis, it also manages its liquidity needs by considering its entire asset and debt portfolio, rather than managing liquidity solely on an issue-specific basis. This approach permits university-wide evaluation of desired liquidity exposure, provides administrative flexibility, and reduces total liquidity costs.

A balanced approach is used to provide liquidity support to enhance credit for variable-rate debt, through a combination of external bank liquidity, self-liquidity, and other financial tools. Using a variety of approaches limits dependence on an individual type or source of credit; it also increases access to different types of investors. The university must balance liquidity requirements with its investment objectives and its cost and renewal risk of third-party liquidity providers and internal capacity.

Further, a portfolio-approach to liquidity can enhance investment flexibility, reduce administrative requirements, lower total interest costs, and reduce the need for external bank liquidity.

Overall Exposure
The university may be exposed to interest rate, third-party credit, tax (the risk that the tax code may change in future periods and impact the cost or financial result of certain debt instruments), and other potential risks in areas other than direct university debt (e.g., off-balance sheet transactions, counterparty exposure in the investment portfolio, etc.) and, therefore, exposure will be measured and monitored on a comprehensive university-wide basis.

The chart below attempts to visually display the interplay of risks that may be present depending on the types of debt instruments employed. For instance, when using variable rate debt, interest rate risk increases for obvious reasons. For less obvious reasons, if the university utilizes third-party liquidity to support its variable rate debt, the risk of the credit-worthiness of the liquidity provider comes into play. Additionally, income tax risk is interjected when variable rate bonds are remarketed as the tax laws may change and impact the cost of carrying the variable rate debt. If the university were to convert that variable rate debt to fixed via an interest rate swap agreement, the interest rate risks would be mitigated, but the risk of the credit-worthiness of the third-party liquidity provider would not.



This blended interest rate may change periodically to reflect changes in the System's average aggregate expected long-term cost of borrowing. The blended interest rate may also include a reserve for interest rate stabilization purposes.

In addition to charging borrowers interest, the central loan program collects amounts to pay for costs of administering the debt portfolio. These costs are clearly articulated to institutions, and are passed on to borrowers in the form of a rate surcharge and an upfront fee for loan origination. These charges may be reviewed and adjusted from time-to-time.

10. Approval Process

The university, through the Oregon State Treasury, issues debt under Articles XI-F(1) and XI-G of the Oregon Constitution. The university may also enter into other financing agreements (e.g., capital leases) with external entities for amounts in excess of $100,000 with the approval of the State Treasurer. Should the university be granted authority in the future to establish a revenue bond program, it is anticipated that such debt would be issued through the Oregon State Treasury as well.

All debt issued by the university must be authorized through a board resolution (or the Finance and Administration Committee as authorized by the board). When the university issues debt under Article XI-F(1) of the Oregon Constitution, the board's authorizing resolution must include its finding, based on the analysis of debt affordability and capacity delineated in section IV above, that the XI-F(1) debt financed projects are both self-liquidating and self-supporting.

The Board delegates the authority to approve the pricing of System-issued debt to the Vice President for Finance and Administration.

Other State-issued debt is approved as follows:

- The Oregon Lottery issues Lottery bonds on behalf of the System.
- The Oregon Department of Energy loans money to System institutions for energy savings projects.

When the System participates in debt programs that are administered by other State agencies, such bonds are issued by the State Treasurer who also possesses the authority to price such bonds.

11. Policy Conflicts

The provisions of this policy will supersede conflicting policy provisions in other Internal Management Directives, board policies, and/or other fiscal policies.

This policy may be revised at any time without notice. All revisions supersede prior policy and are effective immediately upon approval.

C. Policy Consultation

This policy was transferred to SOU by operation of law on July 1, 2015 from the State Board of Higher Education Board Policy Manual. Revisions to the text of the policy were posted for campus comment on June 21, 2016.

D. Other Information

The Policy Contact, defined above, will write and maintain the procedures related to this policy and these procedures will be made available within the Custodial Office.