F–11

VII. STANDING COMMITTEES

B. Finance, Audit and Facilities Committee

Debt Management Annual Report

INFORMATION

There will be an oral report for information only.

Attachment
Debt Management Annual Report

UNIVERSITY OF WASHINGTON
DEBT MANAGEMENT ANNUAL REPORT

BOARD OF REGENTS

FINANCE, AUDIT AND FACILITIES COMMITTEE

June 7, 2012

ATTACHMENT

F-11.1/206-12
6/7/12

Discussion Outline

Overview and Outlook

Debt Management Outlook

- The University has an aggressive capital plan – about $5.3 billion through 2023 – with $2.0 billion coming from debt.

- Challenges to the UW's revenues include declining state funds, uncertainties around federal research funding, and potential changes to Medicare and Medicaid reimbursements and Pell Grant support.

- Increasing amount of leverage puts pressure on university credit ratings and could increase borrowing cost.

- The University has been able to lock in very low rates on recent debt issuances, however $519 million in unfunded authorizations creates some rate risk in the future.

- Interest rates continue to be attractive for high grade issuers like UW:
  - Short and long term rates are at historical lows
  - The spread between taxable and tax-exempt debt is narrow, making taxable debt more appealing in shorter maturities
  - The addition of taxable debt to the portfolio can increase flexibility with a minimal increase in interest cost

Accomplishments

- **Maintain Cost Effective Access to the Debt Markets**
  - Aaa Stable rating reaffirmed by Moody's in December 2011
  - Competitively sold $211 million of General Revenue Bonds in July 2011 at 3.88%
  - Sold $268 million of General Revenue Bonds in March 2012 at 3.67%
  - Launched investor outreach program

- **Seek Opportunities to Reduce Long Term Institutional Borrowing Costs**
  - Realized savings of $14 million by refinancing lease-backed bonds as General Revenue Bonds in July 2011 and March 2012
  - Funded project cash flows with short term commercial paper prior to long term takeout at an average rate of 0.2%

- **Improve Communications and Operations**
  - Led Moody's visit to UW campus for institutional credit review
  - Presented best practices for internal banks at national higher education treasury symposium (invited back!)
  - Created PAC-12 Finance Officers Group and hosted inaugural meeting
  - Hosted higher education treasury leadership group summit at UW in May

Initiatives

- **Enterprise financial forecasting and analysis**
  - UW-wide stress tests

- **Portfolio structuring**
  - Variable rate
  - Non-amortizing
  - Taxable

- **Ongoing due diligence**
  - Internal Loans
  - Semi annual reporting to regents on large borrowers
  - Formalizing internal review of loan covenants
  - Institutional Risks

- **Investor Outreach**
  - Direct visits
  - Investor conferences
  - Phone calls prior to bond sale
  - Internet “road shows”
  - Retail investor participation

- **Rate stabilization account**
  - Projected balances
  - Operating target

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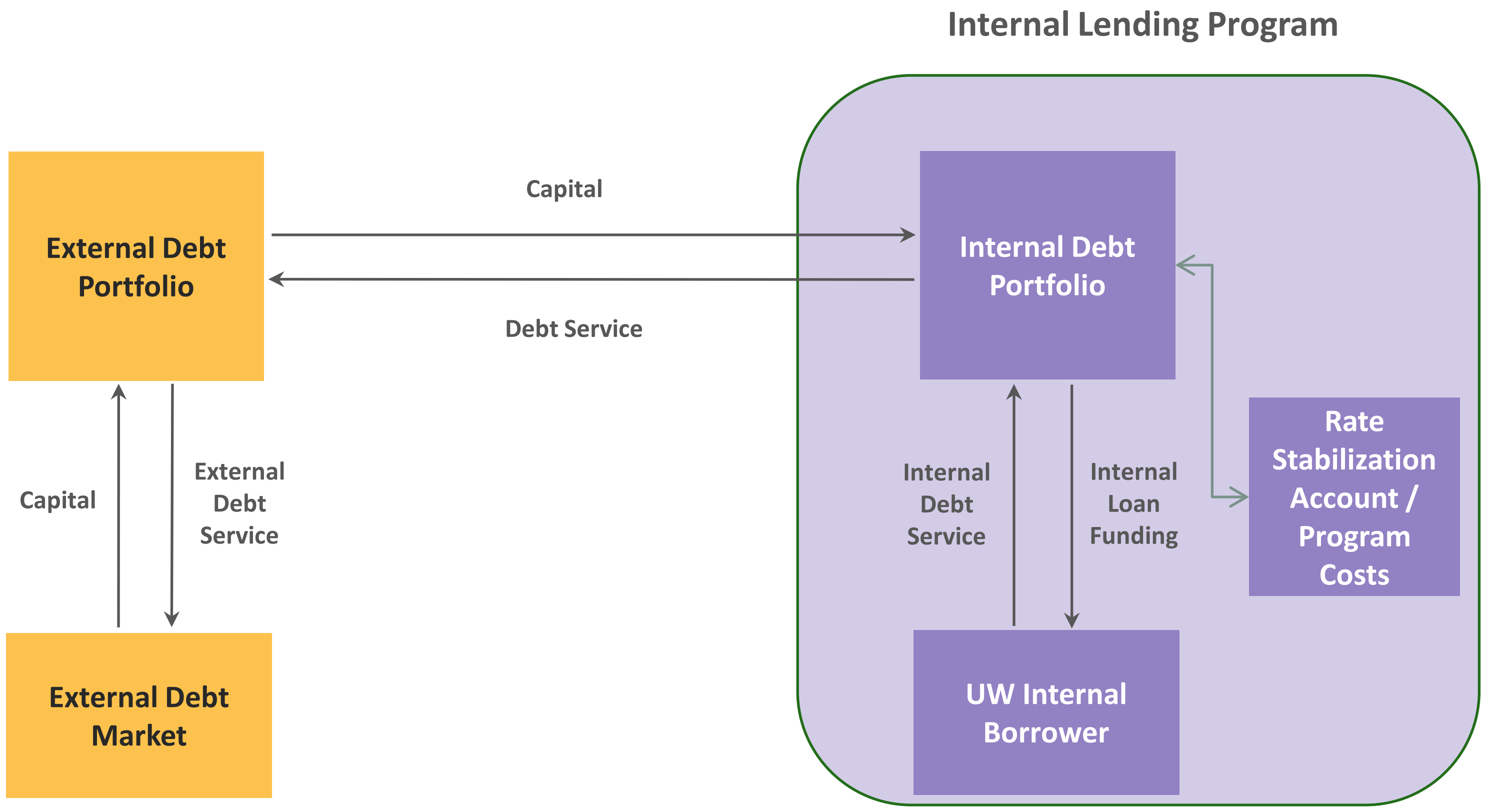
Debt Portfolio Diagram



- Maintain cost effective access to the debt markets
- Seek opportunities to reduce long term institutional borrowing costs
- Provide quality underwriting and monitoring of new and outstanding obligations
- Fund rate stabilization account to minimize increases in the internal lending rate

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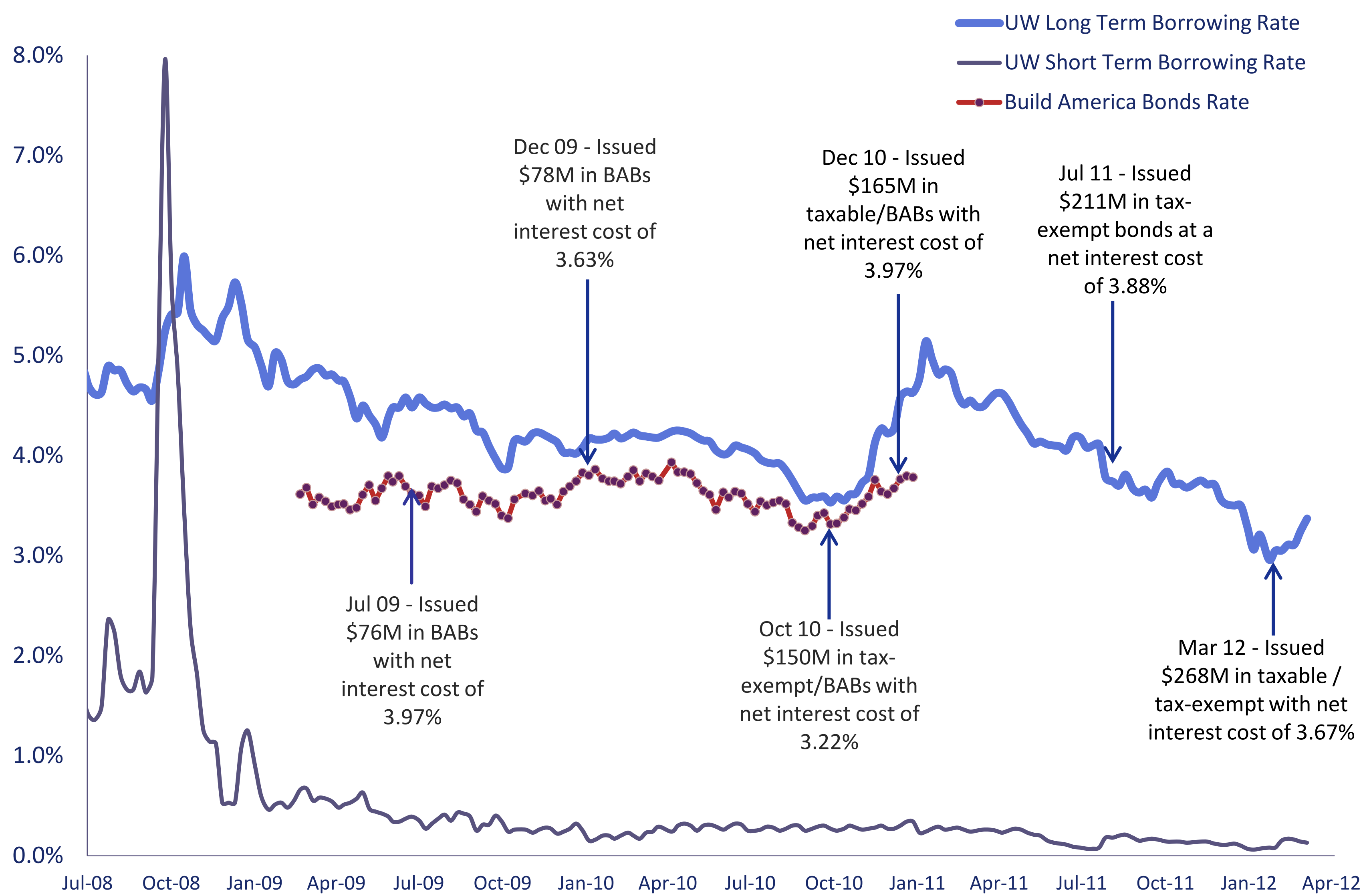
External Debt Portfolio

Interest Rates and Issuances July 2008 – April 2012



Source: Seattle Northwest Securities

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External Debt Portfolio – June 2012

Type of Debt	Issued FY2012	Total Outstanding	Weighted Average Rate	Weighted Average Maturity (yrs)
Commercial Paper	$0	$25	0.1%	0.08
Other Variable Rate	0	0	n/a	n/a
Fixed Rate	503	1,134	3.9%	16.4
ILP Total	**503**	**1,159**	**3.8%**	**16.0**
Non-ILP Debt	12	921	4.9%	14.6
Total	**$515**	**$2,080**	**4.3%**	**15.4**

(Dollars in Millions)

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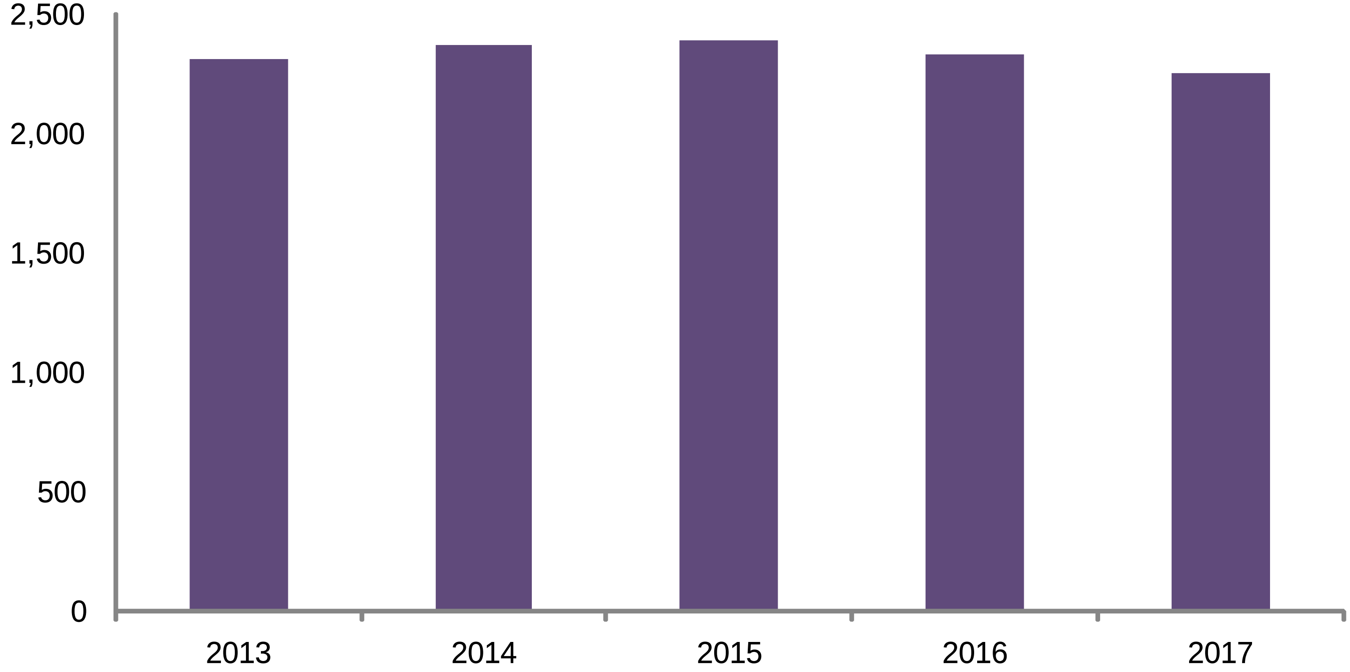
Outstanding Debt 2013 – 2017

(in millions)	**2013**	**2014**	**2015**	**2016**	**2017**
Annual Borrowing [1]	281	134	86	16	2
Outstanding Debt [2] [3]	2,309	2,371	2,388	2,330	2,252



(1) Based on expected cash flows for projects authorized by the Board of Regents

(2) Assumes that all future debt is 30 year amortizing bonds at 5.5%. Structure of actual issuance will vary

(3) Includes Northwest Hospital & Valley Medical Center debt

Policy Limits on Variable Rate Debt Exposure

- **There are no current plans to issue variable rate debt**
  - Policy amendment in July 2012 to limit the amount of variable rate exposure to 20% of the portfolio; there is currently no policy maximum
  - Variable rate debt could make sense in an environment of increasing long term rates
  - In a historically low fixed rate environment, locking in low long term rates is most important

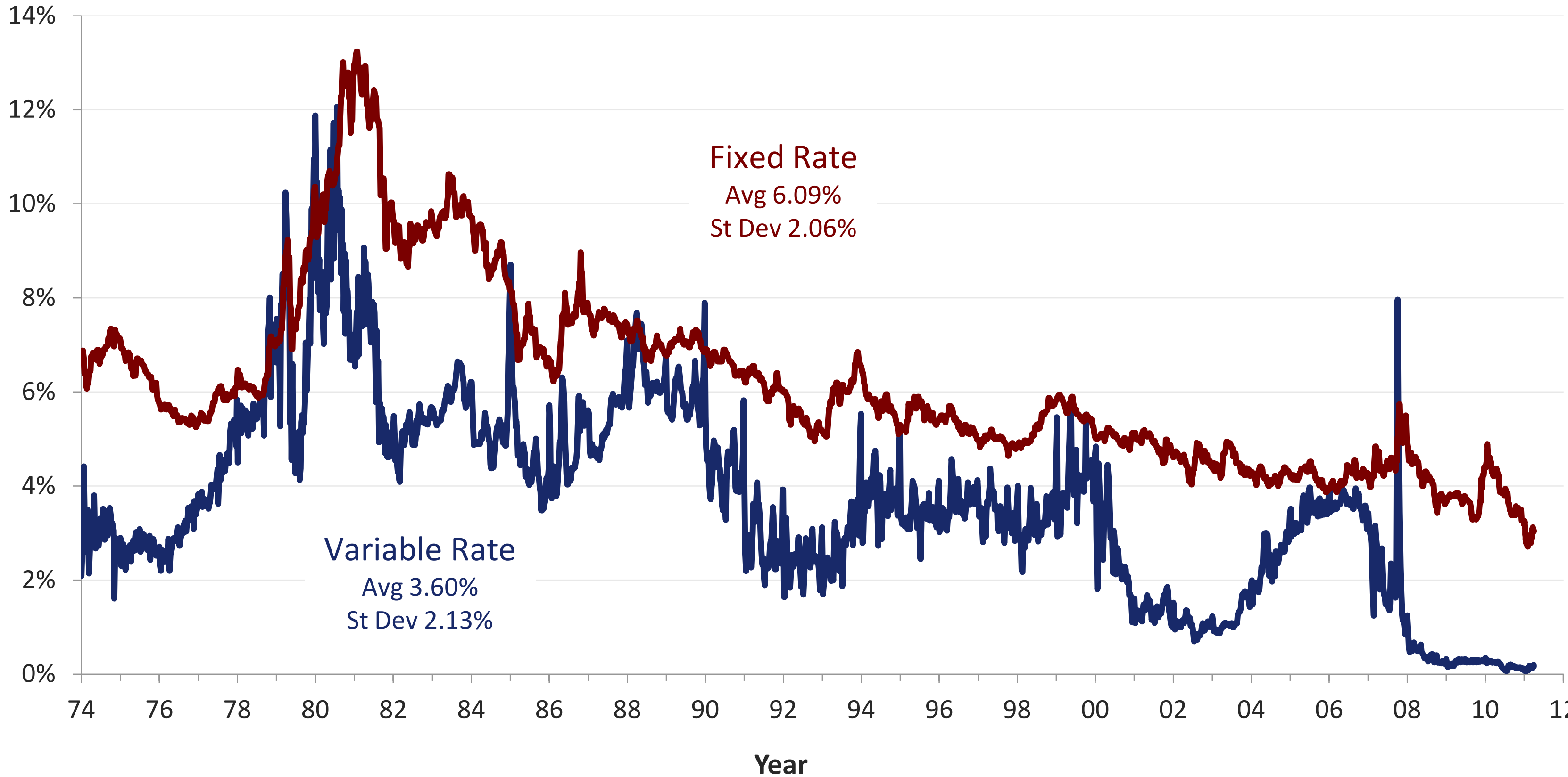
- **Approach to adding variable rate debt to the portfolio**
  - Conversation with Regents before adding variable rate debt to the portfolio
  - Existing commercial paper program is an easy way to get variable rate exposure, currently used only to manage cash flows
  - Regular reporting to senior management and Board of Regents on status of variable rate debt portfolio

- **Benefits of variable rate debt**
  - Achieve lower cost
  - Easy to refinance

- **Risks of variable rate debt**
  - Rate risk continues over the life of the debt
  - Liquidity risk impacts cash that UW holds in operating funds

Historical Interest Rates: 1974 - 2012

Since 1974, fixed rates have been higher than variable rates with an average spread of 2.50%.



Internal Debt Portfolio

Internal Rate Assessment

The ILP rate will remain at 5.5% for the next 12 months

- External rates and the portfolio average are lower than the ILP rate
- Recent $268 million issuance locked in an all-in net rate of 3.67%
- Weighted average cost of funds of the ILP portfolio as of June 2012 is 4.3%
- Between July 2011 – June 2012 the ILP added $7 million to the rate stabilization account (RSA) bringing the balance to $16.2 million
- Unfunded authorizations of $519 million through 2017 create some risk to the ILP rate
- Paying external debt service for projects not yet making internal loan payments will create a draw on the RSA in 2013

Internal Loan Portfolio – June 2012

	University Mission			
	Education	Research	Service	**Total**
Beginning Balance Jul-11	**$113**	**$111**	**$609**	**$833**
Additions	10	26	316	352
Reductions	(16)	(11)	(20)	(47)
Annual Activity thru Jun-12	**(6)**	**15**	**296**	**305**
Total Internal Loans	**$107**	**$126**	**$905**	**$1,138**

(Dollars in Millions)

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Source: Treasury Office Projections

Estimated Construction Draws and Issuance

Approved Project	Remaining Draws
Husky Stadium Renovation	$175
Housing, Phase 2	154
Housing, Phase 3	133
Student Life Projects	30
Bothell, Phase 3	30
UWMC Expansion, Phase 1	23
Housing, Phase 1	10
Molecular Engineering – ILP only	8
Tacoma Phase 3 – ILP only	6
Total	**$569**

Debt Proceeds on Hand	$50
Estimated size of FY2013 Bond Resolution	$281
Estimated size of FY2014-FY2017 Bond Resolutions (total)	$238

(Dollars in Millions)

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Source: Capital Projects Office Cash Flows, 3/12

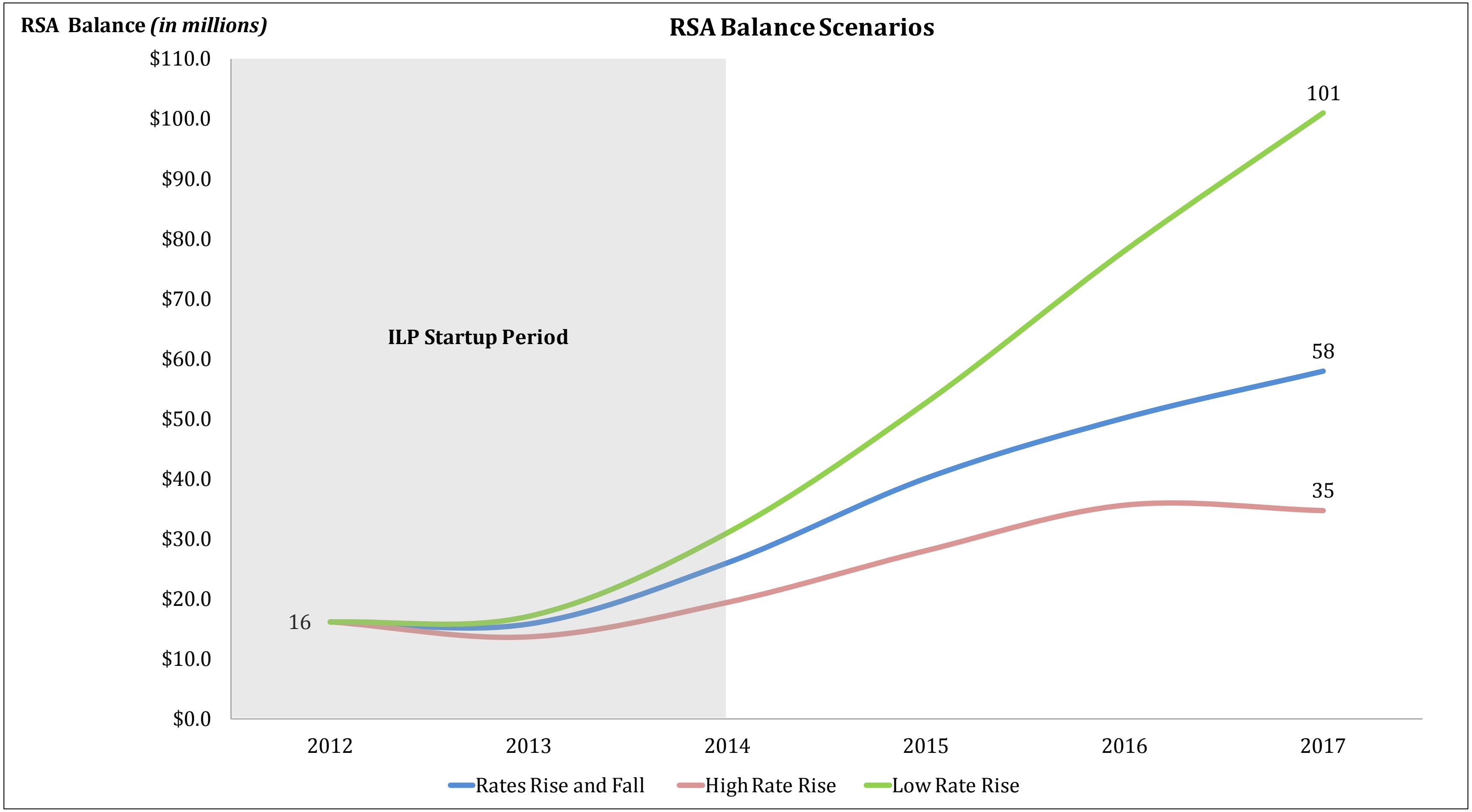
Future Projects from One Capital Plan (not yet approved)

Project Name	Estimated Borrowing Amount through 2023
Research Buildings	$548
South Lake Union 3, Phases 2-3	308
Student Housing, Phase 4-5	274
Metropolitan Tract Recapitalization	200
Education Buildings	144
Enterprise Information System	110
UWMC Building Expansion, Phase 2	71
Major Infrastructure Upgrade Projects	70
Strategic Real Estate Investment	65
UW Bothell Student Activity Center	28
UW Tacoma Projects	8
Other Projects	27
Total	**$1,853**

(Dollars in Millions)

Source: "One Capital Plan", 4/12

Projected Rate Stabilization Account Balances



RSA RATE SCENARIOS	2012	2013	2014	2015	2016	2017
Low Rate Rise	3.68%	3.50%	4.10%	4.60%	4.85%	5.10%
Rates Rise and Fall	3.68%	3.95%	5.00%	6.10%	7.20%	6.10%
High Rate Rise	3.68%	4.60%	5.85%	6.70%	6.70%	7.20%

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RSA Solvency

Sensitivity to Increasing External Rates

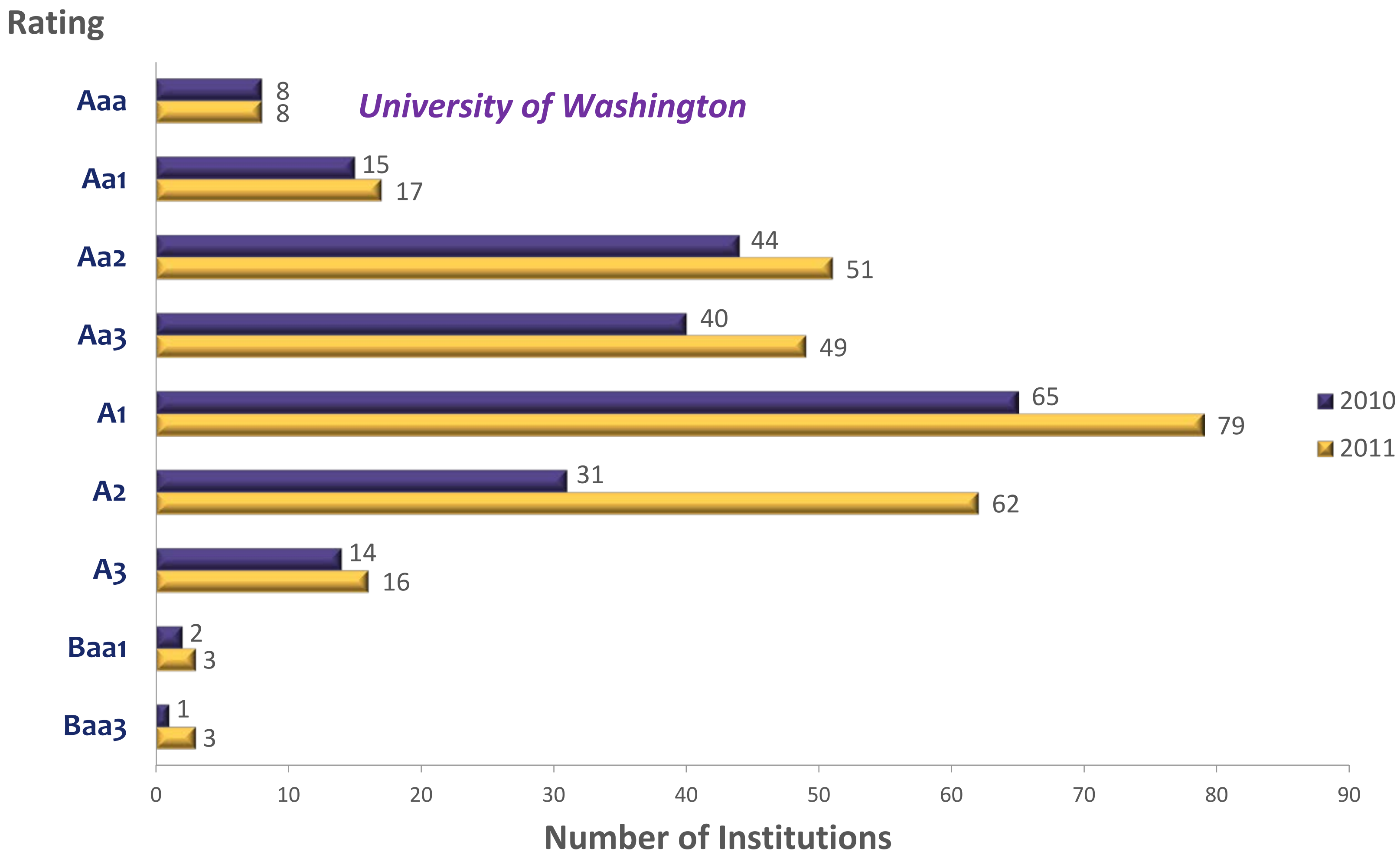
RSA Ending Balances (Authorized + One Capital Plan)

Fixed Rate	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
5.50%	16.2	10.8	15.1	25.7	38.2	47.2	56.5	65.9	74.9	84.0	92.5	100.9
5.75%	16.2	10.1	13.0	21.7	31.6	37.4	42.9	47.9	51.5	54.5	56.3	57.4
6.00%	16.2	9.4	10.9	17.7	25.1	27.6	29.2	29.6	27.9	24.7	19.5	13.1
6.25%	16.2	8.7	8.8	13.8	18.5	17.7	15.4	11.2	4.1			
6.50%	16.2	8.3	7.6	10.6	12.7	8.6	2.2					
6.75%	16.2	8.4	7.7	8.8	8.3	0.8						
7.00%	16.2	8.5	7.9	7.4	4.2				*RSA Insolvent*			
7.25%	16.2	8.7	8.1	5.9	0.1							
7.50%	16.2	8.8	8.1	3.9								

- Ending balances reflect impacts of a sustained increase in external borrowing rates
- All issuances are 30 year amortizing fixed rate debt
- Interest earnings assumed to be borrowing rate less 50 basis points
- Beginning in 2013, rates would have to increase 275 basis points above today's rates for the RSA to become insolvent in 2021

Institutional Metrics and Debt Capacity

Public Higher Education Credit Ratings



Source: Moody's rating distribution for fiscal year 2011
Note: Baa3 Ratings as of Fiscal Year 2010
Institutions in Aaa rating category: Indiana University; Purdue University; Texas A&M University System; University of Michigan; University of North Carolina-Chapel Hill; University of Texas System; University of Virginia; University of Washington

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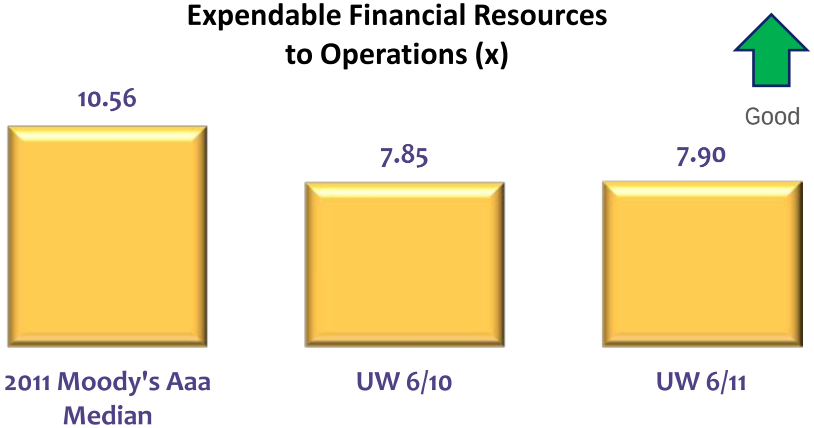
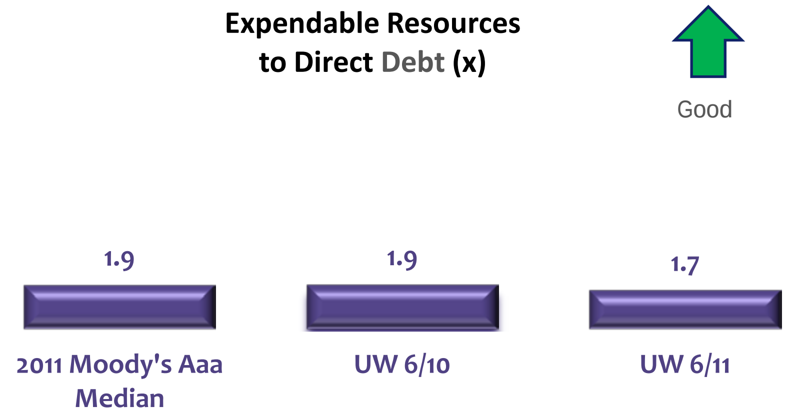
Financial Ratios Comparison

Expendable Financial Resources to Operations (x)



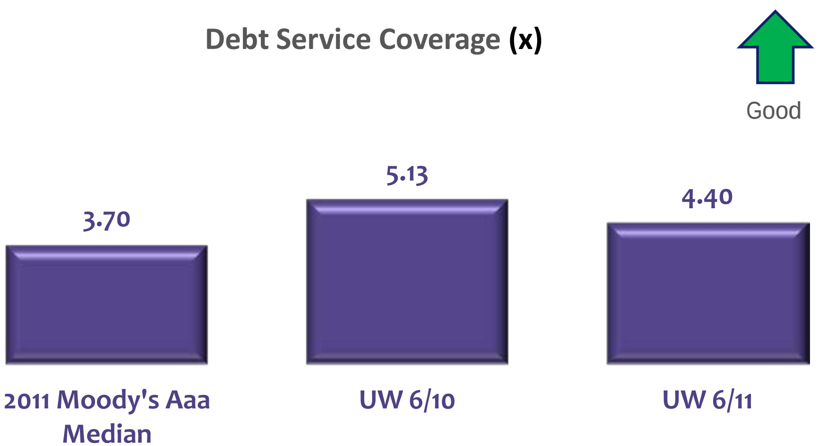
UW has nearly 8 months of expendable resources on hand to fund operations.

Expendable Resources to Direct Debt (x)



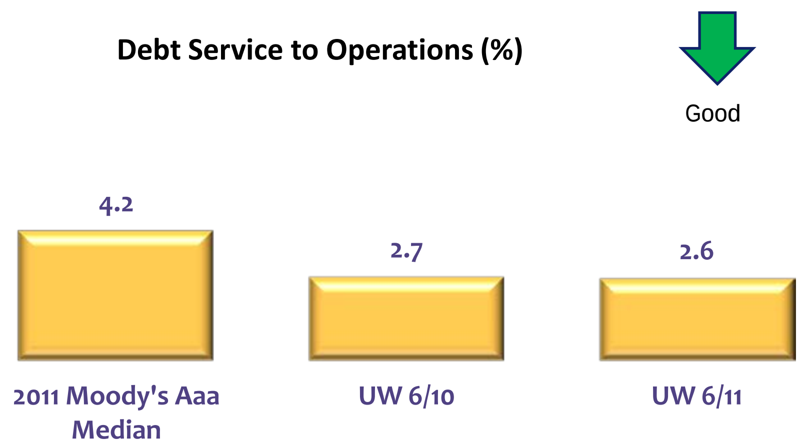
Ratio has declined slightly as outstanding debt has grown faster than reserve levels.

Debt Service Coverage (x)



Debt service coverage has declined as external debt service payments come on line before new revenues from financed projects.

Debt Service to Operations (%)



Ratio has remained stable and below the median for the last two years.

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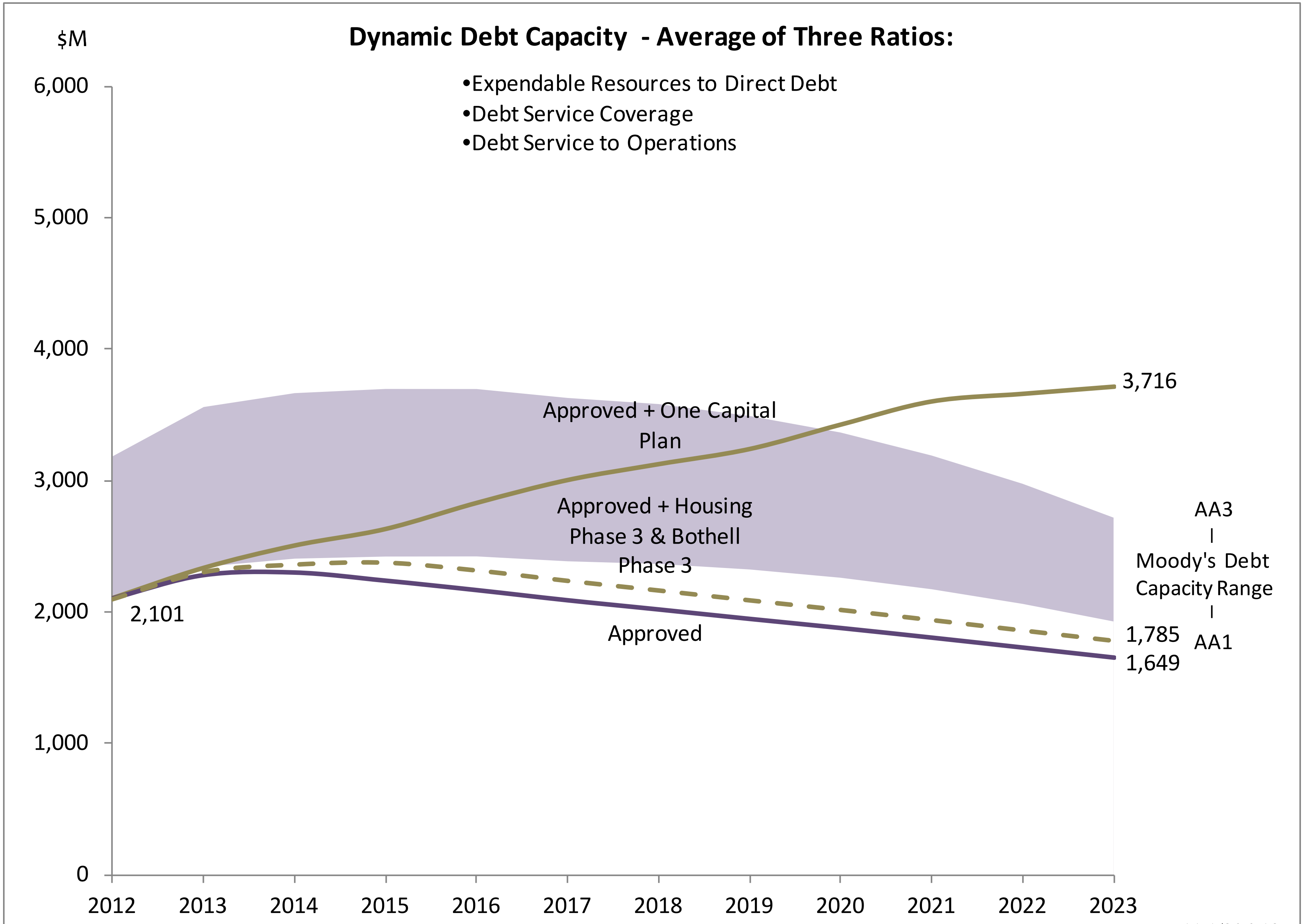
Source: Moody's MFRA database as of March 2012

Approach to Debt Capacity

- **The University does not have a defined debt capacity**
  - Capacity is the ability to service the debt
  - Capacity is the ability to access the capital markets at reasonable rates
  - Credit ratings play a major role in the cost of capital for the UW
- **Ratio analysis to project future debt capacity**
  - Identify three most important financial ratios:
    - Expendable resources to debt
    - Debt service coverage
    - Debt service as a percentage of total operating expenses
  - Project financial statements and future debt
  - Compare projected financial ratios to Moody's medians

Projected Debt Capacity 2012-2023



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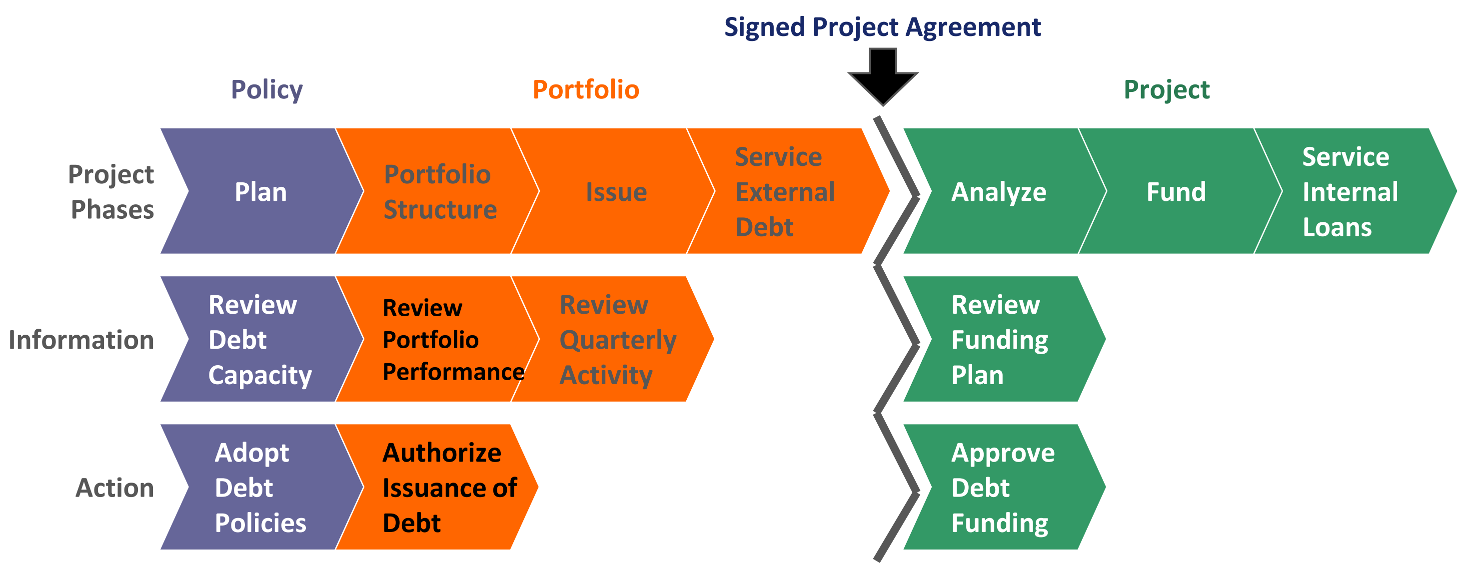
Additional Materials

Regent Roles

- Adopt debt management policy
- Establish University credit standards ("A" category rating or better)
- Oversee debt outstanding, credit ratings, and compliance with bond covenants and IRS regulations
- Adopt bond resolutions to allow for issuance of external debt
- Approve use of Internal Lending Program to fund capital projects



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ILP Audited Financial Statements – June 30, 2011

Income Statement (Dollars in Millions)	
Operating revenues	$37.3
Operating expenses	34.1
Operating income (loss)	3.2
Non-operating revenue	3.6
Change in net assets	**$6.8**
Net assets at beginning of year	**$3.7**
Net assets at end of year	**$10.5**

Balance Sheet (Dollars in Millions)	
Assets	
Cash & short-term investments	$59.7
Current receivables	34.9
Current assets	94.6
Noncurrent receivables	773.6
Long-term investments	2.5
Total assets	**$870.7**
Liabilities & Net Assets (equity)	
Current liabilities	$96.6
Noncurrent liabilities	763.6
Total liabilities	860.2
Net assets	10.5
Total liabilities & net assets	**$870.7**

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Source: FY2011 ILP audited financial statements

Overview of Variable Rate Alternatives

There are a variety of variable rate products available to issuers in the current market

	Forms of Liquidity/Credit Support		
Variable Rate Instruments	**Self-Support**	**External Support (e.g. Bank LC)**	**No Support**
Variable Rate Demand Bonds	X	X	
Commercial Paper	X	X	
Floating Rate Notes			X
Interest Rate Swaps			X
Bank Loans			X

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Rate Stabilization Account Scenario Analysis

Low Rate Rise Scenario

ILP Rate Stabilization Account Projections *(Auth, One Cap Plan, & $25M Additional Borrowing Per Year)*						
	2012	**2013**	**2014**	**2015**	**2016**	**2017**
Fixed Rate	3.68%	4.00%	4.50%	5.00%	5.25%	5.50%
Variable Rate	0.00%	1.50%	2.50%	3.00%	3.25%	3.50%
(in millions)						
Total Debt Issued (New Money)	254.1	332.4	283.7	189.2	266.5	266.5
Interest Received	26.4	37.5	65.0	81.6	95.6	108.5
Interest Paid	(21.1)	(43.4)	(57.5)	(66.3)	(78.8)	(91.8)
Net Interest Margin	5.3	(5.9)	7.5	15.3	16.8	16.7
RSA Beginning Balance	9.8	16.2	17.1	31.0	52.7	77.9
+Adjusted Net Interest Margin	5.3	0.0	7.5	15.3	16.8	16.7
-RSA Balance Used	0.0	(5.9)	0.0	0.0	0.0	0.0
+Interest Earned Less Expenses**	0.3	1.0	1.6	2.4	3.5	5.0
+Savings from Refundings	0.8	5.8	4.8	4.0	4.9	1.2
RSA Balance	**16.2**	**17.1**	**31.0**	**52.7**	**77.9**	**100.8**
Weighted Average Cost of Debt (%)	3.66%	3.61%	3.75%	3.96%	4.22%	4.46%

*** Earnings rate assumed to be current external borrowing rate minus 50 basis points*

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Rate Stabilization Account Scenario Analysis

Rates Rise and Fall Scenario

ILP Rate Stabilization Account Projections *(Auth, One Cap Plan, & $25M Additional Borrowing Per Year)*						
	2012	**2013**	**2014**	**2015**	**2016**	**2017**
Fixed Rate	3.68%	4.50%	5.50%	6.50%	7.50%	6.50%
Variable Rate	0.00%	1.75%	3.00%	4.50%	6.00%	4.50%
(in millions)						
Total Debt Issued (New Money)	254.1	332.4	283.7	189.2	266.5	266.5
Interest Received	26.4	37.5	65.0	81.6	95.6	108.5
Interest Paid	(21.1)	(44.9)	(61.8)	(74.9)	(95.8)	(107.4)
Net Interest Margin	5.3	(7.5)	3.2	6.7	(0.2)	1.1
RSA Beginning Balance	9.8	16.2	15.8	26.0	40.1	50.1
+Adjusted Net Interest Margin	5.3	0.0	3.2	6.7	0.0	1.1
-RSA Balance Used	0.0	(7.5)	0.0	0.0	(0.2)	0.0
+Interest Earned Less Expenses**	0.3	1.3	2.2	3.4	5.3	5.4
+Savings from Refundings	0.8	5.8	4.8	4.0	4.9	1.2
RSA Balance	**16.2**	**15.8**	**26.0**	**40.1**	**50.1**	**57.8**
Weighted Average Cost of Debt (%)	3.66%	3.75%	4.14%	4.69%	5.44%	5.65%

*** Earnings rate assumed to be current external borrowing rate minus 50 basis points*

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Rate Stabilization Account Scenario Analysis

High Rate Rise Scenario

ILP Rate Stabilization Account Projections *(Auth, One Cap Plan, & $25M Additional Borrowing Per Year)*						
	2012	**2013**	**2014**	**2015**	**2016**	**2017**
Fixed Rate	3.68%	5.00%	6.25%	7.00%	7.00%	7.50%
Variable Rate	0.00%	3.00%	4.25%	5.50%	5.50%	6.00%
(in millions)						
Total Debt Issued (New Money)	254.1	332.4	283.7	189.2	266.5	266.5
Interest Received	26.4	37.5	65.0	81.6	95.6	108.5
Interest Paid	(21.1)	(47.4)	(66.7)	(80.5)	(97.4)	(116.4)
Net Interest Margin	5.3	(9.9)	(1.7)	1.1	(1.8)	(7.9)
RSA Beginning Balance	9.8	16.2	13.7	19.4	28.1	35.6
+Adjusted Net Interest Margin	5.3	0.0	0.0	1.1	0.0	0.0
-RSA Balance Used	0.0	(9.9)	(1.7)	0.0	(1.8)	(7.9)
+Interest Earned Less Expenses**	0.3	1.6	2.6	3.6	4.4	5.8
+Savings from Refundings	0.8	5.8	4.8	4.0	4.9	1.2
RSA Balance	**16.2**	**13.7**	**19.4**	**28.1**	**35.6**	**34.7**
Weighted Average Cost of Debt (%)	3.66%	3.95%	4.59%	5.26%	5.76%	6.19%

*** Earnings rate assumed to be current external borrowing rate minus 50 basis points*

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Key Statistics and Ratios

	UW (Aaa)		Moody's 2011 Medians	
	2010	2011	Aaa	Aa1
Key Financial Statistics				
Total Direct Debt ($, in millions)	1,174	1,581	1,441	
Comprehensive Debt ($, in millions)	1,337	1,750	1,600	
Unrestricted Financial Resources ($, in millions)	1,163	1,405	1,285	
Expendable Financial Resources ($, in millions)	2,252	2,633	2,619	
Total Financial Resources ($, in millions)	3,212	3,710	3,443	
Total Cash & Investments ($, in millions)	3,266	4,028	3,868	
Total Revenues ($, in millions)	3,599	4,153	3,280	
Total Expenses ($, in millions)	3,442	4,002	3,079	
Student Enrollment and Ratios				
Total Enrollment FTE (#)	49,294	50,527	57,026	
Freshman Matriculation (%)	42%	40%	44%	
Freshman Selectivity (%)	57%	58 %	63%	
Net tuition per student ($)	9,869	10,905		10,325
State appropriation per student ($)	6,344	6,020	6,750	
Educational expenses per student ($)	37,631	43,956	39,353	
Capital Ratios				
Expendable financial resources-to-direct debt (x)	1.9	1.7	1.9	
Debt Service to Operations (%)	2.7%	2.6%		3.1%
Direct debt to total revenues (x)	0.3	0.4		0.4
Balance Sheet Ratios				
Expendable financial resources-to-operations (x)	0.65	0.66		0.67
Operating Ratios				
Actual debt service coverage (x)	5.1	4.4		4.5
Average actual debt service coverage (x)	4.3	4.0	3.8	

Source: Moody's median data for fiscal year 2011 for Aaa and Aa1 rated public institutions of higher education. (MFRA database as of March 2012)
Ratios for fiscal year 2010 exclude NW Hospital information

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