STOCKTON UNIVERSITY

POLICY

Debt Management Policy
Policy Administrator: Associate Vice President for Administration and Finance Authority: N.J.S.A. 18A:64-6 Effective Date: February 15, 2006; November 8, 2007; February 16, 2011 Index Cross-References: Policy File Number: VI-57 Approved By: Dr. Herman J. Saatkamp, Jr., President

Employees Covered

All University financing activities.

Purpose

To establish a policy for arranging and approving financing transactions that will cause the University to become indebted or contingently obligated to an outside third party. Further, to provide a basis for the prudent use of debt to finance capital projects and facilitate the achievement of strategic objectives. There are practical limits to spending and to the incurrence of debt financing; debt is therefore a resource to be managed.

This policy will be reviewed at least annually to ensure financial and operational flexibility. Management will update the Board of Trustees with an overview of the financial health of the University when proposing additional debt financing.

Introduction

Debt financing allows the University to pay for capital assets over a period of time. This is the best practice for certain types of capital investments when within appropriate limitations and at favorable rates of interest. Debt financing is desirable when the University invests in capital assets that provide investment returns or cost savings that are greater than the cost of borrowing. Decisions regarding the use of financial leverage should depend on the fiscal health of the University and the effect of today’s decisions on future costs of capital.

Authority

The Board of Trustees upon the advice of the President, the Vice President for Administration and Finance, and the Finance and Professional Services Committee will manage all funding sources, including debt, for capital projects authorized by the Board.

Criteria for Issuing Debt

The priority of a certain project, the expected use of a facility, and the likelihood that a combination of philanthropy and future budget allocations can fund a portion of the cost of a project are significant factors in determining whether issuing debt is the appropriate financing vehicle for the project. Revenue producing assets such as parking facilities and residence halls are prime candidates for debt financing due to their ability to help service the debt. Planned major debt issuance via tax-exempt bonds should relate in timing and amounts to the adopted Master Plan. Projects will be prioritized if they meet one or more of the following:

- Risk Reduction Test: The project is considered critical in terms of life/safety or is necessary to comply with environmental or legal standards.
- Core Mission: The project ties to the core mission or an academic program.
- Prudence: The project is held to be essential for maintenance and upkeep at agreed-upon levels.
- Self-sufficiency: The project can generate significant revenues to cover the capital and associated costs.
- Savings: Debt issuance can provide for budgetary savings.

Application

As a public university Stockton can issue tax-exempt debt through the New Jersey Educational Facilities Authority (EFA); this type of financing will in most cases be the lowest cost funding source for capital projects.

- To maintain access to capital funding the University will issue debt to fund priorities that have been approved by the Board of Trustees.
- The credit rating of the University will be actively managed to ensure that the University can continue to issue debt and finance capital projects at favorable interest rates.
- 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 appropriately limiting exposure to market shifts within acceptable budgetary parameters.
- Working capital requirements, debt management, and the investment of cash should be viewed comprehensively in order to optimize overall funding and investment return strategies.

The structure of any individual transaction (maturity, interest rate, use of derivative products, and other financing structuring) will be based upon overall needs to ensure that the long-term costs are minimized and that overall risk does not exceed acceptable levels.

Debt will be structured to meet the University's long-term goals and therefore each project being financed will be required to provide a comprehensive business plan, including the source of repayment for the debt and appropriate and realistic repayment terms. The repayment terms will require that the loan term is no greater than the expected useful life of the asset being financed.

Financial Ratios

Financial discipline is a critical component of long-term debt management and therefore a limited number of ratios and targets should be established. These ratios will be monitored and reported on as strategic initiatives evolve. This policy establishes guidelines to measure the total amount of debt when compared to University balance sheet resources and the annual operating budget.

- **Debt Burden Ratio**: To maintain long-term operating flexibility 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.

$$\frac{\text{ANNUAL DEBT SERVICE}}{\text{TOTAL OPERATING EXPENSES - DEPRECIATION}} < .12$$

  Total operating expenses are stable and better reflect the operating base of the University. The guideline for this ratio is not to be greater than .12.

- **Viability Ratio**: This ratio measures financial health by the availability of liquid and expendable net assets compared to aggregate debt.

$$\frac{\text{TOTAL UNRESTRICTED + TEMPORARILY RESTRICTED NET ASSETS}}{\text{AGGREGATE DEBT}} > .25$$

  To remain competitive and retain flexibility to invest in future strategic initiatives, the University will maintain a ratio of no less than .25.

In addition to the ratios described above, University management will establish and track additional ratios to enhance debt management.

Funding Sources

Each funding source available to the University has specific benefits, risks, and costs. All potential funding will be reviewed within the context of this policy and the overall portfolio to ensure that any financial product or structure is consistent with University initiatives. Most importantly, any financing structure must be fully understood as it relates to the potential risks and benefits and how they impact University creditworthiness and debt capacity.

- <u>Tax Exempt Debt</u>: The University's debt portfolio will be managed to maximize the utilization of tax exempt debt whenever possible. Depending on prevailing market conditions, opportunities, budgetary constraints, the useful life of the project being funded, and other considerations management should consider maximizing the external maturity of any tax-exempt issue.
- <u>Taxable Debt</u>: Should the University's capital projects not qualify for tax-exempt financing, taxable debt should only be used in appropriate cases as it is generally a more expensive source of capital. The issuance of taxable debt will reduce the University's overall debt affordability due to higher associated interest expense.

- Commercial Paper: The University has not utilized this method of financing (both tax-exempt and taxable series). Commercial paper 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. However, at this time the University is not contemplating the use of commercial paper but may explore this option in the future and will be subject to the ratios established by this debt policy.
- 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 its variable rate allocation, market and interest rate conditions, impact on future financing flexibility, and 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 in the University's financial statements. Management will regularly report on the status and performance of its derivative products. Given the complexity associated with derivative products, they will be considered when conventional financing sources are relatively more expensive (e.g. exceed the portfolio blended interest rate), and 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 Finance and Professional Services Committee for approval.
- Other Financing Sources: The University recognizes that various types of financing activities may also impact the University's credit and are often more expensive than traditional 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 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 this analysis must be presented to the Finance and Professional Services Committee.

The University intends to optimize 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, subject to Board approval, 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:

-take advantage of repayment/restructuring flexibility;
-benefit from historically lower average interest costs;
-diversify the debt portfolio; and,
-provide a hedge to short-term working capital balances.

Management will monitor overall interest rate exposure, analyze and quantify potential risk, and coordinate appropriate fixed/variable allocation strategies. The portfolio allocation to variable rate debt (potentially new issues and refunding) and the use of interest rate swaps and other derivative products recognizes the desire to manage interest rate risk. The amount of variable rate debt outstanding shall not exceed thirty-five percent (35%) of the University's outstanding debt. This limit is based on the University's desire to limit annual variances in its debt portfolio, provide sufficient structuring flexibility to management, keep the University variable rate allocation within acceptable external parameters, and utilize variable rate debt (and/or swaps) to optimize debt portfolio allocation and minimize costs.

$$\frac{\text{VARIABLE RATE EXPOSURE}}{\text{TOTAL LONG-TERM DEBT OUTSTANDING}} < .35$$

If and when commercial paper is utilized the University will exclude from this calculation project-related commercial paper used in advance of expected long-term financing since it is used for interim purposes and should not be included in the University's desired long-term variable rate allocation calculation. 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.

To mitigate liquidity and interest rate risk, the Vice President for Administration and Finance or designee upon the approval of the Investment Committee will invest the appropriate level of working capital funds in accordance with the Investment Policy to hedge debt interest rate exposure. The intent is not to provide a "perfect hedge" but rather to provide "reasonable" cushion to allow the University to weather unforeseen market conditions.

Refinancing of Existing Fixed Rate Debt

The University should continually monitor the markets for opportunities to refinance eligible existing fixed rate debt for savings. The University should refund fixed rate bonds in advance of their optional redemption date only if present value savings exceed 3% of the par amount to be refunded. If fixed rate bonds are within 90 days of their optional redemption date Stockton should refinance the debt if present value savings are greater than 1% of par. Alternatively, the University could refinance the fixed rate bonds with variable rate bonds within 90 days of the redemption date in an effort to adjust the mixture of fixed and variable rate bonds in the debt portfolio.

Approval History:

	Date
Board of Trustees	02/16/11