Debt Financing Policy

Background
Debt-financing allows the University to pay for an asset over a period of time, up to its useful life, rather than pay for it at the time of purchase. This is a financially responsible practice for certain types of investments within appropriate limitations and at appropriate interest rates. Debt-financing may be financially beneficial if borrowing rates are below investment returns or if the University invests in capital assets which provide investment returns or cost savings which are larger than the cost of borrowings.

Since debt is a limited resource, an approach for securing debt as cost-effectively as possible is wise. The University can improve the effective use of debt-financing resources by its approaches to structuring debt-financing.

The effective use of debt requires both a financial analysis and opinion and a legal analysis and opinion.

Part I: Principles for Structuring Debt-Financings. Since debt is limited and our demand for debt may exceed the supply at some point in time, it is imperative that borrowings are structured to effectively utilize this resource. Guidelines will assure that the University stretches these resources as far as possible and the financings are executed at the lowest all-in cost. Such guidelines for the Treasurer's Office to utilize in structuring external borrowings follow.

1. When issuing debt, the University will seek the lowest-cost source of financing available. Due to differences in security, revenue bonds are typically less costly than, and preferable to, certificates of participation.
2. External borrowings will be for the minimum required portion of project cost. Projects with alternative restricted or unrestricted funding sources may only use debt financing for the unfunded portion.
3. A financed project must have an identifiable and accurately predictable repayment source, and, where possible, a back-up guarantee from an unrestricted resource in case some portion of the intended repayment sources is delayed or not available as planned.
4. Undedicated reserves and unrestricted gift balances will be examined and may be utilized up to a reasonable level to support the project investment prior to accessing external debt. These contributions will be limited to levels which do not jeopardize the maintenance of appropriate operating reserves to protect a unit from cash flow deficits and unexpected costs. We should plan and strive for equity contributions, where appropriate, so that debt financing does not exceed 80% of the project costs.
5. External borrowings will not fund debt service reserve requirements unless it is more cost-effective to do so. Debt service reserve requirements will be met with surety bonds rather than yield-restricted reserve funds when this is cost-effective. This conserves debt capacity for project costs.
6. External borrowings will be coordinated to the extent practical so that multiple project needs can be accommodated in a single borrowing, reducing issuance costs. Since many issuance costs do not vary with the size of a borrowing, increasing size reduces the amount of debt capacity used to support issuance costs.
7. The timing of borrowings will be structured to minimize the effect of negative arbitrage on the size of the borrowing. When the investment earnings on borrowed proceeds are below the cost of borrowing, borrowed capital is increased to provide sufficient funds to pay project expenses. Since this practice increases the cost of borrowing and limits the productivity of borrowed capital, it should be minimized.
8. Internal loans may provide interim financing until debt is placed externally. The lending of internal capital for interim financing reduces negative arbitrage on borrowings and facilitate cost-effective groupings of projects under a single debt financing. It will also allow the University to determine the timing of a borrowing transaction, which provides opportunities for greater control of the cost of borrowings.
9. An external borrowing may be used for interim financing of projects and, upon repayment, redirected to other projects in need of long-term debt financing. This approach may increase the productivity of a borrowing by enabling the University to draw down borrowed resources more quickly. This reduces negative arbitrage on a borrowing and allows internal resources to continue to be invested at unrestricted investment returns.
10. Additional staff resources will be needed to implement this broadly.
11. Variable rate debt will be actively considered as an option for financing capital assets when sufficient internally held assets are available to protect against the effect of large swings in interest rates or an interest rate stabilization reserve is financially feasible. Since the interest cost on a dollar of variable rate debt may be less than the cost of a dollar of fixed rate, debt, the University can support more variable rate debt within the established ratios and guidelines. Prudent use of variable rate debt should increase the University's debt capacity.
12. The University will actively consider refinancing a single outstanding debt issue when net savings for that refinancing, measured on a net present value basis, are positive. To the extent possible, refinancings will be

combined into single transactions. Since there are legal limitations on the number of allowable refinancings, it is important to use refinancing opportunities wisely. It is also wise to combine multiple refinancings into a single issuance to reduce costs and effort.

13. Choices regarding the timing and distribution of savings realized from refinancings will be presented to University and campus Administration. The preferred use of savings is to shorten the repayment period by providing for a borrowing to be repaid in a shorter timeframe than originally planned. This relieves debt capacity for new projects more quickly and reduces the University's cost of capital. A higher-priority capital use is the second consideration, with preferred use of savings being those projects with safety implications, or cost-savings (self-liquidating) projects. In some cases, University administration and Campus administration may prioritize the use of savings from a refinancing to support a program beyond the initial borrower. The University administration and the affected Campuses will make decisions regarding timing and use of savings.
14. Call options on outstanding borrowings will be exercised when this offers net present value savings when compared to the alternative investment opportunities for these funds. Called debt may be converted to internal debt when financially beneficial for the borrower and the University Treasury.
15. The maturity on a tax-exempt bond issue should be as short as economically feasible for the project, generally should not exceed the useful life of the financed asset, and may never exceed the federally mandated limit (currently 125%) of the useful life of the financed asset. Since debt is a limited resource, it should be viewed as a facilitator for the acquisition of assets. Repayment should be made as quickly as financially feasible to free up these resources for other worthy projects.
16. Substantial benefits could be realized by the University by pooling debt and borrowing rates. To the extent possible and allowable by law, it is usually beneficial to pool debt and average borrowing rates to internal units so that projects aren't charged widely-varying rates, higher or lower than average long-term interest rates, based upon the market driven interest rate yield curve at the time of the borrowing.

Part 2: Implementing Procedures of Refinancing and New Borrowings Background

C.R.S 23-20-129.5 requires the Regents to establish policies and procedures to determine and monitor the ability of the University of Colorado to support its debt (Control 17). According to the statute, these policies and procedures shall be established no later than January 1, 1995, and shall apply to any revenue bonds issued pursuant to C.R.S. 23-5-102 on or after such date. These procedures enable the Regents to meet the statutory requirements.

Part 2A: Procedures for Refinancing Outstanding Revenue Bonds & Certificates of Participation (COP), and Converting from a COP to a Revenue Bond

Financial Analysis Procedure

The University Treasurer will determine that C.R.S. 23-20-129.5 (a) through (d) are met, specifically that, the underlying revenues, and/or annual appropriations for COP's continue to be in place, the required reserves meet covenant requirements, the costs of operation and maintenance are paid, and all covenants and agreements set forth in issuing documents are satisfied, if:

- debt service and/or lease payments are up-to-date;
- the most recent issue of the annual bond fund reports which has completed the audit cycle indicates that covenants have been met and any exceptions have been reviewed and approved by the administration and the Regents;
- annual debt servicing budget plans are in place for each operation to pay previously scheduled debt service and the 125% coverage ratio requirements are met unless waived by the Regents; and, if appropriate, annual appropriations have been authorized by the Regents to meet COP payment schedules

The annual bond fund reports are audited statements which meet the test required tin C.R.S. 23-20-129.5 (2) (a) (b) (c) (e) and (f).

The Regents annually approve the debt servicing budget plans for outstanding revenue bonds, and this approval meets the Regents' approval requirements in C.R.S. 23-20-129.5 (2) (b) because it demonstrates that revenues expected to be annually available will be sufficient to pay at least 125% of the annual principal and

interest on the revenue bonds (Control 18). When revenue bonds are refunded, the state auditor will approve the assumptions for the financial analysis in these same debt service budget plans.

When a certificate of participation is converted to a revenue bond, revenue streams to repay the debt are identified and the debt coverage ratio calculated. Since existing COP's are not subject to the 125% coverage ratio test, it is possible that the test may not be met in the first years of conversion to revenue bonds. If the 125% coverage ratio is not achieved, a transition plan will be developed so that these operations achieve the 125% coverage ratio at a future time. Reducing the interest rate for these borrowings should allow an operation to become fiscally stronger and meet the coverage test earlier than otherwise.

These assumptions will be used by the University for the financial analysis to determine the ability of the operation's revenue coverage ratio for debt.

The Board approves the financial assumptions inherent in these plans by approving the financing plan and the financing parameters.

The official statement prepared for the bond buyers will include a statement which identifies the revenues and other moneys pledged for payment of principal and interest on the revenue bonds;

The University Treasurer will review the underwriters' analysis and determine that the interest rate projections for the refinancing will produce the expected savings to assure that the savings are sufficient to cover the costs of the refinancing and provide net present value savings to the University. The Treasurer will monitor the timing of the transaction to assure that sufficient to cover the costs of the refinancing and provide net present value savings to the University. The Treasurer will monitor the timing of the transaction to assure that sufficient savings are realized.

Notwithstanding these procedures, it is impossible to predict the exact savings from a financing transaction since the savings are dependent upon market conditions at the time of the sale of the borrowing, and interest rates are not known until the sale is completed.

Legal Analysis Procedures

The Regents will receive favorable opinions from the University's Bond Counsel and from University Counsel regarding the Regents' authority under Colorado State Law for the planned transaction.

Part 2B: Procedures For Issuing New University Debt General Procedure

Approvals of state agencies will be secured as required by processes and procedures in place at the time of the borrowing (Control 19). C.R.S. 23-1-106 proscribes that "the Commission shall review plans for capital construction projects and consider recommendations from the capital development committee and the join budget committee prior to approving any plan for a capital construction project to be constructed operated and maintained solely from student fess, auxiliary facility funds, wholly endowed gifts and bequests, research building revolving funds or a combination of such sources."

Financial Analysis Procedures

The University will perform a financial analysis for the new project and determine the coverage ratios and the ability of a project to meet the 125% coverage requirements in C.R.S. 23-20-129.5 (2), from the primary revenues.

Assumptions for the financial analysis will be provided to the State Auditor for consideration and approval as required by the referenced statute.

These assumptions will be used by the University for the financial analysis to determine the ability of the operation's revenue coverage ratio for debt.

The Board approves the financial assumptions inherent in these plans by approving the financing plan and the financing parameter. The Board approves the financing plan and the financing parameter (Control 20).

The official statement prepared for the bond buyers will include a statement identifying the moneys pledged for payment of principal and interest on the revenue bonds;

The University Treasurer will report to the Regents, prior to the issuance of new debt, the effect that the new debt will have on the University's debt capacity ratio, in contrast to the 7% limit, currently established by the Regents. The ratio is calculated as maximum annual debt service as a percentage of the University's unrestricted current fund expenditures plus mandatory transfers. State statute sets the maximum for this ratio at 10% in C.R.S. 23-5-129.5 (2)(d).

Legal Analysis Procedures

The Regents will receive favorable opinions from the University's Bond Counsel and from University Counsel regarding the Regent's statutory authority for the planned transaction.

Part 3: Annual Monitoring for Compliance of University Debt with State Statute and Bond Covenants

Operations with outstanding revenue bonds will provide annual bond fund reports to the Regents to demonstrate compliance with State Statutes, Federal guidelines and Bond Covenants (Control 21).

The Secretary of the Bond shall provide annually to the State Auditor a copy of the reports provided to the Board of Regents, which will demonstrate compliance with C.R.S. 23-20-129.5 Section 1 & 2. These reports include:

Annual Debt Servicing Budget Plans presented in June by operations with outstanding revenues bonds;
Annual Bond Fund Reports; and
Annual Debt Capacity ratio calculation for the University.