

UNIVERSITY OF SAN DIEGO

DEBT POLICY

Adopted September 27, 2009

Amended ⁽¹⁾ – September 29, 2013

University of San Diego

Debt Policy

General Information

The University of San Diego (the “university”) is a Roman Catholic institution committed to advancing academic excellence, expanding liberal and professional knowledge, creating a diverse and inclusive community, and preparing leaders dedicated to ethical conduct and compassionate service. Chartered in 1949, the university offers bachelor’s, master’s, and doctoral degrees, as well as continuing education programs.

To fulfill its mission, the university will make capital investments which will in turn impact the university’s credit profile and capital structure. Appropriate financial leverage serves a useful role and allows the university to strengthen both its balance sheet and credit profile. As such, the use of debt can be fiscally prudent when employed within appropriate limitations.

Introduction

Debt, especially tax-exempt debt, provides a low-cost source of capital to fund capital investments whose purpose is to further the university’s mission and strategic objectives. Since debt capacity and institutional resources are limited, it is imperative that borrowings are effectively structured and prudently managed. This policy provides the framework by which decisions will be made regarding the university’s use of debt to ensure that appropriate discipline is in place regarding debt portfolio composition, debt servicing, and debt authorization.

Debt may generally be used as follows:

- To provide cost-effective, long-term or bridge funding for capital construction, renovation or an acquisition (a “project”) considered critical to the core mission of the university;
- To appropriately match the costs of the project to the associated asset’s estimated useful life; and
- To acquire an asset under a capital lease transaction.

Debt Policy Objectives

The objectives of this debt policy are:

- To define the guidelines for the strategic use of leverage in funding mission critical projects;
- To define the principles of structuring and managing the university’s debt portfolio in the course of maintaining the most suitable credit rating, thus permitting access to capital markets at an appropriate borrowing cost.
- To provide parameters for the use of synthetic or derivative financial products;
- To outline the process by which debt will be monitored and serviced, thus enabling the university to operate within the appropriate financial parameters; and
- To define the process by which financing professionals will be selected in connection with debt transactions.

Debt Utilization, Structure and Credit Management

Debt Utilization

The university will strive to identify and secure funding for 100% of all projects as outlined in the university's Construction Funding Guidelines. For projects where 100% of funding cannot be secured, or where the timing of the receipt of the funding does not match the timing of the capital expenditures, the university may authorize the issuance of debt. Philanthropy, project-generating revenues, Federal and State grants, and other sources are expected to finance portions of the project to the extent feasible. Debt is to be used conservatively and strategically. The Board of Trustees, after receiving a recommendation from the Finance Committee of the Board of Trustees (the "Finance Committee"), will decide whether to authorize new debt issuances or changes to existing debt issuances. However, the Vice President for Finance shall be authorized to approve capital leases and the associated debt without the prior approval of the Board of Trustees in either of the following circumstances: (1) where a capital lease is entered into for the purpose of acquiring or utilizing information technology equipment and the total outstanding debt for all such capital leases does not exceed \$3 million; or (2) where a capital lease is entered into for the purpose of acquiring or utilizing an item whose value is less than \$500,000. Any capital leases approved by the Vice President for Finance shall be reported to the Finance Committee.

A project's priority for the use of debt funding will primarily be determined by the criticalness of the project to fulfilling the university's core mission. Any revenue stream or budgetary cost savings generated by the project also will be considered. Projects funded through the use of debt must be supported by an achievable financial plan that includes servicing the debt and meeting new or increased operating costs, which could include the funding of a replacement and renovation reserve. For projects that can create budgetary savings, the budget savings are expected to contribute to funding the debt service.

Structure

The sale of debt should be conducted and structured around four primary parameters: 1) the interest rate; 2) the amortization term; 3) the provisions for early redemption or prepayment; and 4) the cost of placement.

Interest Rate – A balance between *fixed rate debt* that supplies the certainty of future debt service payments and *variable rate debt* that provides a lower immediate cost of funds should be maintained.

Term – The amortization term should generally reflect the associated asset's useful life and be no more than forty years.

Prepayment – The goal of the university is to permit debt to be redeemed at par with a no-call period as short as possible to increase debt management flexibility and to reduce the long-term cost.

Cost of Placement – The cost of placement shall be reasonable and competitive with the market.

Credit Management

Credit rating reports generated by Moody's Investor Services or other independent credit rating agencies provide the university with an independent affirmation of the financial health of the institution. Maintaining the highest acceptable credit rating permits the university to continue to issue debt and finance capital projects at favorable interest rates in the course of meeting its strategic objectives. From time to time, short term reductions in the credit rating may be necessary to position the university for long-term success. As such, the university will manage its overall debt to a level that maintains the most suitable credit rating in the course of meeting its strategic objectives.

Synthetic or Derivative Financial Products

It is recognized that in managing a debt portfolio, the use of synthetic or derivative products can be appropriate for the purpose of reducing borrowing costs or limiting interest rate risk. When appropriate, the university will consider the use of synthetic or derivative products, such as interest rate swap agreements and interest rate caps, in conjunction with new or existing bond issuances. The use of interest rate swap agreements must be carefully assessed by the Finance Committee and university counsel, and must be tied directly to university debt instruments.

Debt, whose interest rate nature is changed through the use of a derivative product, should be viewed as possessing the type of interest rate consistent with the derivative product used to hedge the debt. The Board of Trustees, after receiving a recommendation from the Finance Committee, will authorize the use of new synthetic or derivative products or changes to existing products.

Methods of Soliciting and Procuring Swap Transactions

Swap transactions can be procured via competitive bids or on a negotiated basis. The competitive bid should include a minimum of three firms with counterparty credit ratings of “AA-“ or “Aa3” or better from Standard & Poor’s and Moody’s Investor Services, respectively, or equivalent ratings from other independent credit rating agencies. The Vice President for Finance, as approved by the Finance Committee, may procure swaps by negotiated methods if the determination is made that a negotiated bid would result in the most favorable structure and pricing.

Management of Swap Transaction Risk

Certain risks are created when the university enters into any swap transaction. In order to manage the associated risks, guidelines and parameters for each risk category are:

Counterparty Credit Risk – To limit and diversify the university’s counterparty risk and to monitor credit exposure to each counterparty, the university will consider the following prior to entering into a new swap transaction: 1) the counterparty’s long-term debt rating as reported by Standard & Poor’s, Moody’s Investor Services, or other independent credit rating agencies; and 2) the cumulative sum of all mark-to-market values owed to the university by the counterparty (and its unconditional guarantor, if applicable).

Termination Risk – The university shall consider the merits of including a provision that permits it to optionally terminate a swap agreement at any time over the term of the agreement. Generally speaking, exercising the right to optionally terminate an agreement should produce a benefit to the university, either through receipt of a payment from termination, or if a termination payment is made by the university, a conversion to a more beneficial debt instrument or credit relationship. If no other remedies are available, it is possible that termination payment by the university may be required in the event of termination of a swap agreement due to a counterparty default or due to a counterparty’s decrease in credit rating.

Amortization Risk – The amortization schedules of the debt and associated swap transaction should be closely matched for the duration of the swap. Mismatched amortization schedules can result in a less than satisfactory hedge and can create unnecessary risk. In no circumstance may the term of a swap transaction extend beyond the final maturity date of the affected debt instrument, or in the case of a refunding transaction, beyond the final maturity of the refunding bonds.

Basis (Index) Risk – Basis Risk arises as a result of movement in the underlying variable rate indices that may not be in tandem, creating a cost differential that could result in a net cash outflow for the university. Basis risk can also result from the use of floating, but different, indices. To mitigate basis risk, any index used as part of an interest rate swap agreement shall be a recognized market index, including but not limited to the Securities Industry and Financial Market Association Municipal Swap Index (SIFMA) or the London Interbank Offered Rate (LIBOR).

Swap Agreement Updates

Periodically but no less than annually, the Finance Committee will receive a report detailing the status of all interest rate swaps. The report shall include a list of all swaps with notional values and interest rates, a list of counterparties and their respective credit ratings, and other key information.

Monitoring and Servicing Debt

The university will periodically review the structure of the debt portfolio to identify opportunities to refinance existing debt or to reposition the fixed versus variable rate debt composition. The Finance Office will provide an annual report to the Finance Committee which will include updates on key financial ratios, debt outstanding, annual debt service, synthetic or derivative products, and the university’s credit rating.

Selection of Financing Professionals

Adoption of all new debt documents or modifications to existing debt documents may only be considered with the approval of the Board of Trustees, after receiving a recommendation from the Finance Committee. The selection of financing professionals for the issuance or modification of debt will be made as follows:

Legal Counsel

The Vice President for Finance and General Counsel will review and select law firms to serve as bond counsel and university counsel. The Vice President for Finance and General Counsel will coordinate and negotiate the related legal fees in advance of engaging either law firm.

Underwriter

The Vice President for Finance will periodically solicit information from qualified investment banking firms to serve as underwriter for university financing transactions. The Request for Proposal (the "RFP") will be distributed at times and intervals deemed appropriate by the Vice President for Finance. The final selection of an underwriter may be approved by the Vice President for Finance. An underwriter may be selected without a formal RFP process with approval of the President if it has been determined that due to the complexity of a particular transaction, negotiations with one underwriter would result in the most favorable structure and pricing.

Credit Bank

In the case of debt issued where a bank credit facility will result in a lower cost of funds, the Vice President for Finance will solicit an RFP from qualified credit providers to provide the requested credit support for the transaction at hand. The final selection of a credit bank may be approved by the Vice President for Finance. A credit bank may be selected without a formal RFP process with approval of the President if it has been determined that due to the complexity of a particular transaction, negotiations with one credit bank would result in the most favorable structure and pricing.

Other Financing Professionals

The Vice President for Finance may at his/her discretion appoint such other financing professionals as needed.

All fees and expenses for parties retained will be negotiated and agreed to by the Vice President for Finance prior to each party's appointment, and reported to the Finance Committee. In the event the university stipulates that the fees or expenses cannot be reasonably determined in advance, a good faith estimate will be prepared. Upon completion of the transaction, the reconciliation of the final fees and expenses against the estimate will be prepared and reported to the Finance Committee.

Debt Policy Revisions

The Debt Policy will be reviewed and revised as needed to reflect changing conditions. Revisions to the Debt Policy will be approved by the Board of Trustees, after receiving a recommendation from the Finance Committee.