AGENDA

> External Borrowing
  - Portfolio Overview
  - Project Capacity

> Internal Lending
  - Portfolio Overview
  - Rate Recommendation

> Initiatives
The University manages two separate but related portfolios:

**External Borrowing**

**Mission**
- The mission of the external portfolio is to achieve the lowest risk adjusted cost of capital.

**Regental Roles**
- Adopt Debt Policy
- Approve annual bond resolution
- Review portfolio performance
- Guide University credit and issuance standards, including debt capacity

**Reporting**
- Bondholders Report including audits to investors
- Monthly Debt Report to Regents
- Future Debt Report to Rating Agencies
- Self-Liquidity Report Rating Agencies

**Internal Lending**

**Mission**
- The mission of the internal portfolio is to offer stable and predictable interest rates to campus borrowers and to allow for capital funding in a rising rate environment.

**Regental Roles**
- Approve and monitor ILP loans
- Approve use of Capital Assets Pool
- Approve Financial Stability Plans
- Approve ILP rate and Rate Stabilization Account (RSA) distributions

**Reporting**
- Semi-Annual Borrower Report
- Semi-Annual ILP Report
- Debt Management Annual Report
- Annual ILP Audit
External Borrowing
Since fiscal year 2012, the University has borrowed $1,819 million (including refundings of $616 million), at a rate of about 3.5%.

The University's borrowing rate is impacted by a variety of factors including term, debt type, tax status, couponing, etc.

The University issued $205 million of new money and refunding bonds in 2017 to fund Life Sciences, ARCF, Housing and Dining Phase 4a and UWMC Phase 2.
CREDIT OVERVIEW

The University’s ratings remain stable at Aaa/AA+ (Moody's/S&P)

**Credit Strengths**

- Strong market position
- Significant national research profile, good student demand with diverse enrollment, major clinical care provider for the Pacific Northwest
- Good financial flexibility with $1.6 billion of unrestricted financial resources
- Consistently favorable operations and diversified sources of revenue
- Integrated planning, active debt and project management, and very good disclosure

**Credit Weaknesses**

- Increasing leverage, debt issuance outpacing growth of financial resources and revenues
- Slowing growth in net tuition revenues with the state reassuming full tuition setting authority for in-state undergraduate tuition
- Increasingly competitive research funding environment
- Significant healthcare exposure with lower margins and liquidity
- Declining unrestricted liquidity, comparably lower than peers

**Macro challenges**

- A December 2016 Moody's sector report provided a stable outlook in higher education, however:
  - Rising pension liabilities, increasing labor costs and uncertainty around future federal policies and funding could stress the sector
  - Uncertainty in health care presents challenges to universities with a clinical enterprise
  - Budget challenges at the State level could pose financial risk
  - Increasingly competitive research funding environment with uncertainty surrounding levels of federal support for research

*Source: Moody's Investors Services*

**Institutional opportunities and challenges**

- Current and projected financial performance puts stress on Aaa rating
- Increased financial planning efforts provide management with analytical tools to make strategic decisions
The University has a large and conservative debt portfolio

- The debt portfolio consists primarily of fixed rate debt with $67 million of variable rate debt through the Commercial Paper program (CP)
- Average borrowing rate for portfolio is 3.44%
- There is approximately $230 million in authorized debt remaining to be issued over the next two years
- Approximately $80-$100 million of principal is repaid annually
- More than 70% of debt has been issued as General Revenue Bonds
Since 2014, the University has estimated project capacity by projecting institutional growth and benchmarking to peers

> What is Project Capacity?
  - Estimated annually, Project Capacity is the combination of debt and reserves that can be used to finance capital over a five-year period

> How has it been estimated?
  - Financial forecasts are used to estimate how much debt the University can issue while staying at or above peer minimums in three ratios:
    > Debt Service Coverage
    > Debt to Operating Revenue
    > Spendable Cash and Investments to Debt
  - Institutional reserves available for capital projects (Capital Assets Pool) supplement how much debt can be issued
PEER GROUP BENCHMARKS

Benchmarking criteria helps identify schools similar to the University

> Moody's rates over 500 colleges and universities
> The peer group is evaluated annually
> 13 schools meet University of Washington's peer criteria:
  - Public institutions
  - Over $1 billion annual operating revenue
  - At least 10% health care exposure
  - Aa2 or higher rating
  - Not a state system (e.g. California, Texas)

Institutions Rated by Moody's: 547
Public Institutions Only: 286
Public Institutions with >$1B in Operating Revenue: 60
Public Institutions with >10% Health Care Exposure: 23
Public Institutions rated Aa2 and higher: 20
No State-Wide Systems: 14

UW's Peers:
University of Alabama at Birmingham
University of Arkansas
University of Colorado
University of Kentucky
University of Michigan
University of Nebraska
University of New Mexico
University of North Carolina at Chapel Hill
University of Utah
University of Virginia
Ohio State University
Pennsylvania State University
State University of Iowa

UNIVERSITY of WASHINGTON
PROJECT CAPACITY DRIVERS

Many factors influence project capacity

Within the University's influence:
> **Principal repayment**: Repaying principal increases capacity
> **Project approval**: Approving projects decreases capacity
> **Growth**: Growth in net operating income improves financial ratios and increases project capacity
> **Use of institutional funds**: CAP (Capital Assets Pool) allows projects to be funded without external borrowing. The CAP limit is 10% of the Invested Funds (IF), which changes as the value of the IF changes

Outside the University's influence:
> **Changes in peer behavior**: The University estimates project capacity based on peer medians. Peer behavior can either increase or decrease project capacity
> **Interest rates**: Future increases in interest rates decrease project capacity
The University will issue $230 million in new debt over the next two fiscal years to support previously authorized projects.

- The University has outstanding debt of about $2.4 billion:
  - $410 million in principal payments between 2018-2022, averaging $82 million per year.

- In 2016, the 5-year estimated project capacity was $425 million, including $100 million from CAP:
  - Above borrowing for previously authorized projects.

- In 2017, the 5-year estimated project capacity is $95 million, generated from the CAP:
  - Reflects continued growth of expenses over revenue and state/federal funding uncertainty.

- Additional debt capacity will depend on financial performance and future expectations.

External Borrowing - Project Capacity
Internal Lending
LENDING PROGRAMS

Treasury offers a variety of loan programs to meet the needs of campus borrowers

<table>
<thead>
<tr>
<th>Program</th>
<th>Internal Lending Program (ILP)</th>
<th>Proposed Short-Term Financing Program (FASTER)</th>
<th>Bridge</th>
</tr>
</thead>
<tbody>
<tr>
<td>Purpose</td>
<td>Provide stable long-term rate to campus borrowers</td>
<td>Finance short-term assets at low cost of funds</td>
<td>Short-term loans for gift funded capital projects (up to 5 years)</td>
</tr>
<tr>
<td>Program Description</td>
<td>Loans for long-lived capital assets</td>
<td>Provide small short-term (up to 10 years) fixed rate loans to campus borrowers</td>
<td>Fund timing gap of construction cash flows and gifts</td>
</tr>
<tr>
<td>Financing Rate</td>
<td>ILP Rate, currently 4.50%</td>
<td>Short-term market rate</td>
<td>Short-term market rate</td>
</tr>
<tr>
<td>Funded by</td>
<td>Debt and CAP</td>
<td>ILP Balances</td>
<td>ILP Balances</td>
</tr>
</tbody>
</table>

Note: Debt issued by an external entity or repaid from appropriated local funds, personal property financings and credit lines reside outside these lending programs.
LENDING PROGRAMS (CONTINUED)

The purpose of the borrowing determines the lending program

- Long-term assets pay the ILP rate
- Short-term assets and gift-funded projects pay a market rate

(1) Small loans for short-term assets may be funded with Treasury assets
MECHANICS OF LENDING PROGRAMS

External borrowing and internal lending come together in the program fund. The program fund is the mechanism used to facilitate University lending.

Campus Borrowers

Interest Payments

Program Fund

Principal Payments

Rate Stabilization Account (RSA)
- Program support
- General revenue support

Rebalance

Residual Account
- Bond proceeds
- Timing differences
- Loan programs

Debt Service Payments

External Lenders and Capital Assets Pool
HOW IS THE ILP RATE EVALUATED?

Treasury recommends keeping the ILP rate at 4.50%

Treasury evaluates the ILP rate and sufficiency of the RSA and Residual Account annually

> Step 1: Evaluate the sufficiency of the Residual Account
  - The Residual Account is evaluated to ensure sufficient funding for future debt service payments and loan programs
  - Any excess funds are transferred to the RSA

> Step 2: Determine RSA sufficiency
  - The RSA represents how many years the current lending rate could be maintained in a rising external rate environment
  - Current balances in the RSA reflect 11 years of sufficiency

> Step 3: Board approves ILP rate changes or distributions, if any
Initiatives
INITIATIVES

Campus Partnerships
> Strengthen relationship with internal borrowers through dedicated Asset Liability Management credit analysts
> Partnership on deferred maintenance strategy with University Facilities and Capital Planning and Development

Industry Engagement
> Formalizing strategic investor outreach

Program Development
> Private use: Improved Policies and Procedures help ensure compliance with Federal tax-exempt guidelines. Developing workshop and better tracking system for private business use across campus
> Efficient use of Treasury balances

Debt
> Medicine disclosure/consolidating credit
> Refresh Commercial Paper disclosure document to better align with current asset reporting
> Next debt issuance expected to be in January 2018