



DEBT POLICY

Last Revised May 17, 2019

Last Reviewed October 22, 2020

INTRODUCTION AND PURPOSE

This Debt Policy Statement serves to articulate Puget Sound's philosophy regarding debt and to establish a framework to help guide decisions regarding the use and management of debt. As the university establishes institutional priorities through its strategic planning processes, including its campus master planning, the university will consider utilizing a mix of financing and funding sources including gifts, internal reserves and investments, and external debt. Appropriate use of leverage will enable the university to advance its mission, achieve its strategic goals, and ensure financial health in present terms and over the long term. This policy will help ensure that an appropriate mix of funding sources is utilized, that Puget Sound's debt capacity is allocated strategically, and that Puget Sound's debt levels and types of debt are appropriate and responsible given the university's financial strength and risk tolerance levels.

This policy shall be effective until the Board of Trustees approves modifications. It is anticipated that the Finance and Facilities Committee will review this policy periodically to ensure that it remains responsive to evolving priorities, strategic initiatives, and the external environment. The Finance and Facilities Committee will recommend modifications as needed to the Board of Trustees.

SCOPE

For purposes of this policy statement, debt is defined to include all short- and long-term obligations, guarantees, and instruments that have the effect of committing the university to future payments. In addition to bonds, notes, and leases, debt includes other obligations that utilize the university's debt capacity, even if the transactions are not included in the university's financial statements or disclosed in the notes thereto.

OBJECTIVES

The broad objectives for this debt policy are to:

1. Strategically use the university's debt capacity to fund mission critical projects;

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2. Manage the university's credit to maintain the highest acceptable credit rating, that will support the university's ongoing ability to issue debt at rates commensurate with the benefits received;
3. Structure the best transactional and project-specific debt in such a way as to optimize the debt portfolio as a whole; and
4. Evaluate and manage the risk exposures associated with the debt portfolio.

GENERAL FRAMEWORK FOR DEBT UTILIZATION AND MANAGEMENT

Consideration is given to purpose, affordability, risk management, and financial structure (balance sheet) management in developing a framework for debt utilization and management:

1. Purpose includes ensuring that the debt-funded project will help the university further its mission or reach its goals.
2. Affordability includes an analysis of the cost of capital, cash flow forecasts, and rationale to instill budget discipline and ensure intergenerational equity between the beneficiaries and payers of debt.
3. Risk management includes an appropriate weighting of fixed and variable rate debt, a plan to manage liquidity risks and exposures, and rationale for matching assets to liabilities along the duration spectrum.
4. Financial structure (balance sheet) management includes a goal for establishing and maintaining the highest acceptable credit rating, a rationale for the appropriate level of debt versus gift or reserve funding, and proactive monitoring of capital markets to manage debt.

PRINCIPLES OF DEBT UTILIZATION AND MANAGEMENT

1. Only projects that further the mission and strategic goals of the university, either directly or indirectly, will be considered for debt financing.
2. To the extent possible, gifts, grants, and internal reserves will be used to fund capital projects. Debt represents a valuable and scarce resource and will be used conservatively and strategically.
3. Bond financing will be coordinated to the extent possible so that multiple projects can be accommodated in a single borrowing to reduce overall issuance costs per dollar of debt issued. Bridge financing from external or internal sources may be used for low-cost

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interim financing to facilitate best timing considering project schedules, fundraising schedules, bond financing schedules, and other variables.

4. The university will consider all methods of bond sales, including negotiated, competitive, private placement and auction.
5. The university will limit its overall debt to a level that supports its current and future strategic objectives. In considering debt capacity and affordability, the university will compare its financial ratios to other rated institutions and to its peer group. The university will also prepare long-term cash flow projections to demonstrate affordability within its budget or dedicated reserves. Decisions will be made based on the specific and unique needs of the university consistent with this debt policy.
6. The use of debt must be supported by an achievable financial plan that includes servicing the debt and meeting any new or increased operating costs associated with the project, including long-term maintenance costs. A project that generates a new revenue stream or can create budgetary savings will receive priority consideration.
7. The university will seek the overall lowest cost source of financing when issuing debt, considered concurrently with the associated risks. It will consider the costs and benefits associated with different types of financing and liquidity options, including, for example, credit enhancement via letter of credit and liquidity enhancement via internal or external liquidity support.
8. The university recognizes the desirability of having exposure to variable-rate debt as a component of its debt portfolio in order to:
 - a. take advantage of prepayment and restructuring flexibility;
 - b. benefit from historically lower average variable rate interest costs;
 - c. provide a “match” (or natural hedge) to the university’s short-term liquid investment balances;
 - d. enhance the ability to undertake optimal financial structure management;
 - e. enhance the ability to undertake risk management strategies; and
 - f. provide a potentially more attractive funding alternative than cash.

The portfolio allocation to variable rate debt will be analyzed on both a before- and after-derivative basis, will have an appropriate relationship to short-term liquid assets, and will take into consideration rating and other implications. The allocation of variable rate debt may be managed or adjusted through the issuance of new debt or refunding of outstanding debt.

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9. The allocation of variable-rate debt may also be managed through the use of interest rate swaps and other derivative products such as caps and collars. Derivative products, including swaps, will not be used for speculation. For policy purposes, speculation means taking additional risks, unrelated to the university's financing decisions, in an effort to increase returns.

Derivative products initially associated with a bond issue may be retained separately from the original underlying instrument if the costs and risks of doing so are determined to be less than retaining the original structure or terminating the derivative arrangement.

The university will analyze the costs and benefits of any derivative instrument relative to achieving its long-term capital structure objectives and will include consideration of incorporating risk-mitigation features. Under no circumstances will a derivative transaction be utilized that is not understood fully by management or that accrues inappropriate risk to the university. The risks to be considered include, but are not limited to, tax risk, interest rate risk, liquidity risk, counterparty risk, basis risk, and any other potential risk factors that are relevant to the university. The university will seek to diversify counterparty risk and will execute credit-sensitive derivative transactions only with counterparties with strong credit ratings. While the university may have a flexible credit standard, it will attempt to do business with counterparties rated in the "AA" category or above as of the transaction date. The university will structure swap and other derivative agreements to limit losses due to non-performance of its swap counterparties and to limit potential for collateral calls made on the university.

10. The university will employ maturity structures that correspond with the expected useful life of the projects to be financed. Should debt be issued with a bullet or balloon principal payment at the final maturity, optional principal payments will typically be made over the term of the debt to result in generally level annual debt (principal and interest) payments. Call features will be structured to provide the highest degree of flexibility relative to cost and consistent with market requirements.
11. Annual debt interest and principal amortization payments will be provided for in the annual operating budget or in specific designated or restricted funds. Variable-rate interest will be budgeted conservatively.
12. Debt may be secured or unsecured. Unsecured debt and debt backed by pledged revenues are preferred to the extent it is cost-effective. A "negative pledge" is preferred over secured borrowings. For secured borrowings, only campus facilities financed by the debt or unrestricted quasi-endowment investments may be pledged as

collateral. The university will seek to avoid or minimize operating or financial covenants and coverage levels consistent with credit rating and market requirements.

13. The university will interact with credit rating agencies and will strive to maintain the highest acceptable credit rating.
14. The university will monitor refunding opportunities of outstanding debt and will consider undertaking current or advance refunding of outstanding debt when the net present value savings are positive and the refunding will support the strategic goals of the university.
15. The university will invest bond proceeds appropriately to achieve the highest return available under arbitrage limitations consistent with preservation of principal. The university will comply with arbitrage requirements on any invested bond funds.

ASSIGNMENT OF RESPONSIBILITIES

Board of Trustees

The Board of Trustees is responsible for establishing and approving modifications to this Debt Policy Statement as recommended by the Finance and Facilities Committee.

The Board of Trustees has ultimate decision-making authority and responsibility for the assumption of debt, both direct and indirect. The Board of Trustees is responsible for authorizing the issuance of debt, for modifying the nature of or accelerating the repayment of existing debt, and for approving any debt-related derivative contracts.

The Board of Trustees may choose to delegate to an ad hoc committee of the Board the authority to approve terms or take actions necessary to complete the issuance or modification of debt. The Board of Trustees may delegate to the Executive Vice President and Chief Financial Officer or other Board-elected financial officers of the University, the authority to take such actions and to negotiate, review, and approve such agreements as necessary to accomplish the issuance or management of debt as authorized by the Board and/or its ad hoc committee.

The Board of Trustees delegates to management the approval of debt resulting from normal operations within approved budgets, such as trade payables, equipment leases, and other accrued liabilities.

The Board of Trustees delegates to management the negotiation and approval of an unsecured line of credit not to exceed \$10 million. The board also delegates to management the negotiation and approval of financing agreements to acquire property in

high priority zones consistent with the campus master plan, providing such financing does not exceed \$2 million in the aggregate and the university has identified an appropriate funding source for the related debt service payments.

The Board of Trustees delegates to management the negotiation and approval of financing arrangements associated with certain gifts of real estate in accordance with the authority granted in the Gift Acceptance Policy.

Finance and Facilities Committee of the Board of Trustees

The Finance and Facilities Committee is responsible for reviewing this Debt Policy Statement periodically and recommending modifications as needed to the Board of Trustees.

The Finance and Facilities Committee (or an ad hoc bond committee as noted above) is responsible for recommending to the Board of Trustees the issuance of new debt, the modification or repayment acceleration of existing debt, and the approval of any debt-related derivative contracts. The Finance and Facilities Committee (or ad hoc bond committee) will consider and act upon recommendations from the President and Executive Vice President and Chief Financial Officer.

President

The President, supported by the Executive Vice President and Chief Financial Officer, is responsible for the development of recommendations to the Board regarding the use of debt.

Executive Vice President and Chief Financial Officer and Staff

The Executive Vice President and Chief Financial Officer, in consultation with the President, is responsible for ongoing debt management, including monitoring the debt markets and recommending appropriate tactical strategies given the interest rate environment, the university's liquidity position, tax regulations, and market dynamics. The Executive Vice President and Chief Financial Officer will seek appropriate counsel from experts. The Executive Vice President and Chief Financial Officer will develop and manage relationships with credit rating agencies, investment bankers, financial advisors, Washington Higher Education Facilities Authority, financial institutions, and others in support of the objectives stated in this policy. The Executive Vice President and Chief Financial Officer is responsible for ensuring timely payment of debt service payments, monitoring debt covenant compliance, debt-related financial reporting, and regulatory compliance.

The Executive Vice President and Chief Financial Officer is responsible for reviewing and approving equipment leases and other financing arrangements in support of normal operations funded by approved budgets. The Executive Vice President and Chief Financial

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Officer is responsible for negotiating and approving an unsecured line of credit not to exceed \$10 million.

The Executive Vice President and Chief Financial Officer, in consultation with the President, is responsible for negotiating and approving financing agreements to acquire or develop property in support of the campus master plan or that is otherwise in the strategic interest of the university, including gifts of real estate, providing such financing does not exceed \$2 million in the aggregate and there is an available funding source for the related debt service.

The Executive Vice President and Chief Financial Officer may delegate the above responsibilities to senior staff reporting directly to her/him and will work closely with those senior staff on such matters.