Ohio Administrative Code

Rule 3341-6-19 Debt policy.

Effective: March 17, 2015

(A) Policy statement and purpose

It is the policy of Bowling Green state university to utilize various forms of debt financing to fund the acquisition and construction of capital assets and to provide for university liquidity and cash flow requirements. The following debt policy sets forth guidelines applicable to issuance of debt, subject in all cases to approval of the universitys board of trustees.

(B) Policy

(1) Debt administration and oversight

No debt (including all short and long-term obligations, guarantees, and other debt instruments) shall be incurred except as approved by the universitys board of trustees. The board shall be advised by the financial affairs/facilities committee on all debt related topics.

(2) Principles governing use of debt

Unless otherwise determined by the board of trustees:

(a) The university may incur long-term debt to acquire and construct capital assets.

(b) Debt shall not be used to finance current operations.

(c) Debt shall not be incurred unless projected debt service requirements (principal and interest payments) and operating costs associated with any new capital improvements financed by the debt can be accommodated within the universitys operating budget.

(d) The university shall seek to maintain a long term credit rating in the A category or higher.

(e) The university shall seek to maintain a debt portfolio that balances interest rate risk and the long-term cost of capital given market conditions and overall university financing objectives.

(f) The university shall maintain debt capacity ratios in excess of the minimum acceptable composite score as outlined by the state of Ohio (see appendix A to this rule) and seek to achieve its credit rating, cost of capital and long-term viability objectives.

(g) The universitys debt portfolio shall be evaluated in the context of all of its assets and liabilities. Diversification within the debt portfolio may be used to balance risk and liquidity.

(h) Capital and operating leases are financing tools that may be utilized, where appropriate, to help achieve the universitys objectives concerning the use of debt. Consideration shall be given to the accounting impact of lease financing.

(3) Debt capacity

Bowling Green state universitys debt capacity can be defined as:

(a) A level of outstanding debt at which the university can maintain its high credit ratings and a low cost of borrowing.

(b) A practical level of annual debt service payments that the university can comfortably cover from predictable sources of repayment.

In general, the universitys debt capacity shall be evaluated and determined by the consideration of the following factors:

(i) Legal authorizations and limitations

(ii) Current and pro forma financial operating performance

(iii) Credit considerations, including the universitys credit rating(s)

The universitys legal debt capacity as specified in applicable debt covenants and statutory restrictions shall be the starting point for evaluating the appropriate level of new and total indebtedness.

The universitys debt capacity is in part a function of current and pro forma operations. While a target range shall be established, annual debt service (principal and interest payments) as a percentage of the operating budget are expected to vary over time as the university makes judgments about its highest priorities and needed investments.

Credit considerations encompass a broad array of factors that affect how the university is viewed by the financial and capital markets. Many of these factors will be analyzed by the credit rating agencies in the determination of the universitys credit rating, which is an important reflection of the universitys operating, management and financial strengths, and a significant determinant of both its access to and cost of capital.

Debt capacity is generally measured through ratio analysis. Ratios provide a consistent measure of the debt level carried by an institution in relation to its balance sheet, revenues and expenses. Ratio analysis provides insight into the debt capacity from two perspectives: by monitoring trends over time and in comparison to benchmarks. It is the intent of the university to maintain a strong financial position that will support a favorable ratio analysis measured against national standards, peer and in-state comparisons, and credit rating agency medians. Some of the key ratios currently utilized for evaluating debt capacity are contained in appendix A to this rule.

(4) Projects that may be considered for debt financing

The university shall utilize long-term debt financing solely for capital projects. In general, this will include:

(a) Capital projects where it is unlikely that sufficient donor funding for the project will be secured.

(b) Capital projects where all or the majority of the project is to be funded through gifts and contributions; however, the timing of payment of those gifts and pledges may extend beyond the construction period.

(c) Capital projects which are projected to generate sufficient cash flow to cover operating expenses and contribute in full or substantially in-full to the costs of debt service.

(5) Other considerations regarding the use of debt

(a) Term of debt

The university shall determine the appropriate duration and the specific amortization schedule of a proposed debt issue by evaluating the overall debt portfolio. Considerations shall include the life of the assets being financed, interest rate costs, risk assessment, general market conditions, and the universitys future financial plans. If and when bullet or balloon payments are used, the university shall establish and fund reserves over the life of the debt issue to assure that the bullet or balloon maturity payments will not unduly impact any one fiscal year. In cases where the project is intended to generate revenues that will fund the underlying debt, bullet or balloon payment structures shall not be used.

(b) Refinancing and restructuring of debt

The administration shall periodically review all outstanding debt to determine if refinancing opportunities exist. Refinancing or restructuring of current debt may be used to reduce debt service payments or to change covenants in order to benefit the universitys financial or operating position.

(c) Use of tax-exempt versus taxable debt

The university may use tax exempt and taxable debt as market conditions, tax laws and other considerations allow. For example, the university may utilize taxable debt in certain situations where Federal tax law limits the use of tax-exempt debt for particular projects, such as those where use of the project includes both private and not-for-profit purposes. The university may also consider taxable debt under other circumstances where market conditions, speed and flexibility make it an appropriate alternative.

(d) Use of call options

The university shall consider the use of call options to reduce the universitys overall cost of capital and to provide maximum flexibility in its debt portfolio. The use of non-callable debt beyond ten years is generally to be avoided because of the potential constraints such an issuance may place upon the universitys future financing plans.

(e) Use of alternative borrowing strategies

The university may consider the use of alternative borrowing strategies such as; subordinated general receipts, project revenue alternatives and privatized options as market conditions and university financing objectives warrant.

(6) Acceptable approaches for debt structure

(a) Mix of fixed and variable rate debt

The university may structure its overall debt portfolio, using a combination of fixed and variable rate debt, to provide an appropriate and prudent balance between interest rate risk and the cost of capital as well as to integrate asset-liability management.

Variable rate debt is an appropriate tool that the university may use to manage its assets and liabilities. Variable rate debt allows the university greater diversification in its debt portfolio and may reduce its overall interest costs. In addition, variable rate debt typically can be called more readily which would provide greater flexibility to debt management especially when pledge payments toward a project are expected. However, the use of variable rate debt increases interest rate risk as a result of market fluctuations and potential tax law changes.

The amount of variable rate debt maintained by the university can vary depending on market conditions. When financings are being considered in a low interest rate environment, it may be prudent to secure fixed-rate financing. In high interest rate environments, variable rate financings may be preferable because: (i) variable rate debt is generally lower in rate than fixed rate debt; and (ii) variable rates can be expected to decrease as interest rate levels decrease.

Likewise, fixed rate debt provides a different set of advantages for the university. Fixed rate debt ensures a known and set obligation for the university which assists management in planning and budgeting. In low interest rate environments, fixed rate debt can secure significant financings at relatively low costs for extended periods.

(b) Interest rate swaps and other derivative products

Interest rate swaps and other derivative products can be appropriate interest rate management tools that can help the university meet important financial objectives. Properly used, these instruments can increase the universitys financial flexibility, provide opportunities for interest rate savings or enhanced investment yields, and help the university manage its balance sheet through better matching of assets and liabilities. Swaps may be integrated into the universitys overall debt and investment management guidelines and should not be used for speculation or leverage.

(c) Rationale for utilizing interest rate swaps and other derivative products

The university may use interest rate swaps and other derivative products if it is reasonably determined that the proposed transaction will:

(i) Optimize capital structure, including the schedule of debt service payments and/or fixed vs. variable rate allocations.

(ii) Achieve appropriate asset/liability match.

(iii) Reduce risk, including:

(a) Interest rate risk

(b) Tax risk

(c) Liquidity renewal risk

(iv) Provide greater financial flexibility.

(v) Generate interest rate savings.

(vi) Enhance investment yields.

(vii) Manage exposure to changing markets in advance of anticipated debt issuances (through the use of anticipatory hedging instruments).

(d) Permitted instruments

The university may utilize the following financial products on a current or forward basis, after identifying the objective(s) to be realized and assessing the attendant risks.

(i) Interest rate swaps, including fixed, floating and/or basis swaps.

(ii) Interest rate caps/floors/collars.

(iii) Options, including swaptions, caps, floors, collars, and/or cancellation or index based features.

The instruments outlined above are only intended to be examples of various interest rate hedging products. They are not intended to be a limitation on other derivative products that the university may consider.

(e) Authorization

The vice president for finance and administration shall receive approval from the board of trustees prior to entering into any swap or derivative product arrangement related to the universitys debt. The financial affairs/facilities committee shall evaluate the recommendation for the use of such products and shall evaluate the appropriateness of the instrument in meeting the universitys financial objectives before making a recommendation to the board of trustees for approval.

(7) Payment of debt service

The university typically relies on the operating budget for payment of debt service on long-term debt. Other sources may include permitted endowment revenue and pledge payments.

Where the university identifies a capital project to be funded through the issuance of long-term debt and funded entirely through operations, such debt shall be included in financial modeling as an operational item sufficient to support debt service.

Where the university identifies a capital project to be funded through the issuance of long-term debt and funded by revenues to be generated by the project, the projected revenues shall flow through the operating budget. In evaluating debt on a new revenue generating project, special attention shall be given to projects that are replacing an existing debt-free revenue generating project that is planned to be decommissioned. The revenue generated on the new project should be evaluated to determine if it can replace revenue generated from the decommissioned facility as well as satisfy the debt service on the new project.

(8) Reporting requirements

The vice president for finance and administration shall present to the financial affairs/facilities committee of the board of trustees periodically the following information:

(a) An overall review of the university debt portfolio, balance sheet and debt issuance plans.

(b) A comprehensive schedule of long-term debt issues and underlying structure of debt.

(c) A schedule of each issuance that has an associated derivative product and review of its purpose in line with university objectives. The schedule shall include, but not be limited to, information on the counterparty risk, termination risk, basis risk, and liquidity and remarketing risk.

(9) Debt policy

Through the 1997 enactment of Senate Bill 6, a standardized method for monitoring the financial health of Ohios state-assisted college and universities was established. Key ratios monitored by the

Ohio board of regents (OBOR) are:

(a) Viability ratio: expendable net assets divided by total debt. This ratio is a measure of an institutions ability to retire its long-term debt using available current resources. A viability ratio in excess of one hundred percent indicates that the institution has expendable fund balances in excess of its plant debt. A viability ratio above sixty percent is considered good, while a ratio below thirty percent may be a cause for concern.

(b) Primary reserve ratio: expendable net assets divided by total operating expenses. This ratio is a measure of an institutions ability to continue operating at current levels without future revenues. A primary reserve ratio of ten percent or greater is considered good, while a ratio below five percent may be a cause for concern.

(c) Net income ratio: change in total assets divided by total revenues. This ratio measures an institutions financial status in terms of current year operations. A negative net income ratio results when an institutions current year expenses exceed its current year revenues. A positive ratio indicates the institution experienced a net increase in current year fund balances.

(d) Composite score: weighted summary statistic of the above three ratios. Each ratio is assigned a score of one to five based on predetermined ranges and then weighted, with thirty per cent to the viability ratio, fifty per cent to the primary reserve ratio, and twenty percent to the net income ratio. The scoring process emphasizes the need for campuses to have strong expendable fund balances, manageable plant debt, and a positive operating balance. The highest possible composite score is five and zero tenths. The minimum acceptable composite score is one and seventy-five hundredths. A score at or below this minimum level for two consecutive years will result in being placed on fiscal watch by OBOR.

In addition to the above ratios, the major rating agencies such as Moodys and Standard and Poors track a series of financial indicators. The university will regularly provide a discussion of these indicators and trends.

Date: December 6, 2013