

FAYETTEVILLE STATE UNIVERSITY

Debt Policy

INTRODUCTION

Fayetteville State University's ("the University") strategic and capital planning is a long-term process requiring continuously re-evaluation. The University recognizes the need for campus facilities to keep pace with programmatic expansion. To accomplish strategic and capital plans, the University will utilize a mix of funding sources including State funds (bonds and appropriations), University bonds, internal reserves, and philanthropy.

To ensure the appropriate mix of funding sources is utilized, the University's Debt Policy has been developed. The Debt Policy will be continuously used by management as a tool to evaluate the University's capital structure, the appropriate use of leverage, and internal lending mechanisms. Maintaining the Debt Policy is a long-term process, occasionally involving the issuance of debt.

Depending on the facilities needs, the Debt Policy addresses the following questions relating to University debt:

- How much debt is appropriate?
- What type of debt is needed?
- How should debt be handled internally and externally to optimize University borrowings?

Approach

The debt objectives listed below, combined with management judgment, provide the framework by which decisions will be made regarding the use and management of debt. The debt policy and objectives are subject to re-evaluation and change over time.

Objectives

1. **Identify projects eligible for debt financing.** Using debt to fund mission critical projects will ensure that debt capacity is optimally utilized to fulfill the University's mission. Projects that relate to the core mission will be given priority for debt financing; projects with associated revenues will receive priority consideration as well.
2. **Maintain the University's favorable access to capital.** Management's determination of the timing of capital projects will not be compromised by the University's access to capital sources, including debt. Management will utilize and issue debt in order to ensure timely access to capital.
3. **Limit risk of the University's debt.** The University will manage debt on a transactional or project-specific, basis. The University's continuing objective to achieve the lowest cost of capital will be balanced with the goal of limiting exposure to market shifts.
4. **Manage the University's credit to maintain the highest acceptable credit rating.** Maintaining the highest acceptable credit rating will permit the

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University to continue to issue debt and finance capital projects at favorable interest rates while meeting its strategic objectives.

Debt Strategies

For the University to achieve the above objectives, it will adopt debt strategies and procedures relating to both the external and internal management of debt and interest. It is intended for these strategies to be reviewed and reassessed periodically by management.

1. **Mission Based Capital Planning.** Provide framework with link to mission to evaluate and prioritize projects eligible for debt financing.
2. **Core Ratios.** Adopt a set of core financial ratios to guide capital planning and ensure central oversight of University-wide leverage levels.
3. **Financial Instruments.** Provide the University with access to appropriate financing sources, including debt and liability management strategies debt based on borrowing needs.

To support its objectives and in addition to the debt strategies, the University will also incorporate debt management practices as listed on Page 6. These practices will be updated periodically and are intended to be a resource for management in determining structuring, marketing, and administrative elements of the debt program.

DEBT STRATEGIES

Mission Based Capital Planning – Management will allocate the use of debt financing within the University to include the prioritization of debt resources among all uses, including plant and equipment financing, academic projects, and projects with University-wide impact. Generally, the following guidelines will be used, although they are not intended to be all-inclusive.

1. Only projects that relate to the mission of the University, directly or indirectly, will be considered for debt financing.
2. A project that has a related revenue stream or can create budgetary savings will receive priority consideration. Every project considered for financing must have a defined, supportable plan of costs approved by management.
3. State funding is expected to remain major sources of financing for the University's plant investments. In assessing the possible use of debt, all other financing and revenue sources will be considered. State appropriations/bonds, philanthropy, project-generating revenues, research facilities and administration cost reimbursement, expendable reserves, and other sources are expected to finance a portion of the cost of a project. Debt is to be used conservatively and strategically.
4. The University will consider other funding opportunities (e.g., joint ventures, real estate development, etc.) when appropriate and advantageous to the University.

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Opportunities and financing sources will be evaluated within the context of the Debt Policy.

5. Federal research projects will receive priority consideration for external debt financing due to partial reimbursement of operating expenses (including the interest component of applicable debt service) of research facilities.

Core Ratios – The University will establish guidelines for overall debt using a select number of financial ratios. These ratios will be derived from the financial statements, and should be consistent with some of the measures used by the marketplace. Following are the ratios that will be calculated and reported annually. Also these ratios will be calculated when new debt is issued and will be revised to reflect any changes in accounting standards.

1. Total Financial Resources to Direct Debt Ratio:

This ratio indicates one of the key determinants of near to medium term financial health by measuring the availability of the University to cover its debt as of the Statement of Net Assets date, should the University need to do so. A positive ratio of greater than 1:1 denotes strength.

$$\frac{\text{Unrestricted, Nonexpendable Restricted, \& Expendable Restricted Net Assets}}{\text{Total University Debt}}$$

Example for Fiscal Year Ended June 30, 2003:

Unrestricted Net Assets	\$ 3,344,782.36
Nonexpendable Restricted Net Assets	2,936,665.71
Expendable Restricted Net Assets	<u>11,173,463.78</u>
Total Financial Resources	<u>\$17,454,911.85</u>
Total University Debt (Notes & Bonds Pay.)	\$ 7,422,000.00
Ratio	2.4x

2. Direct Debt to Adjusted Cash Flow Ratio:

This ratio measures the financial strength of the University by indicating how long the University would take to repay the debt using cash provided by its operations. A decreasing ratio over time denotes strength.

$$\frac{\text{Total University Debt}}{\text{Adjusted Cash Flow from Operations}}$$

Example for Fiscal Year Ended June 30, 2003:

Net Cash Used by Operating Activities	\$42,121,640.62
State Appropriations	31,797,116.00
Grants for Other than Capital Purposes	8,438,023.18
Noncapital Gifts	<u>\$ 407,675.61</u>
Adjusted Cash Flow from Operations	<u>\$82,764,455.41</u>
Total University Debt (Notes & Bonds Pay.)	<u>\$ 7,422,000.00</u>

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Adjusted Cash Flow from Operations	\$82,764,455.41
Ratio	9.0x

3. **Debt Burden Ratio:**

The Debt Burden Ratio measures the financial strength of the University by indicating how long the University could function using its expendable reserves to cover operations should additional net assets not be available. A positive ratio and an increasing amount over time denote strength.

$$\frac{\text{Debt Service}}{\text{Total Expenditures}}$$

Example for Fiscal Year Ended June 30, 2003:

Interest & Fees Paid on Capital Debt and Leases	\$ 412,586.63
Principal Paid on Capital Debt and Leases	<u>1,593,535.52</u>
Debt Service	\$ 2,006,122.15
Operating Expenses	\$63,581,502.52
Interest and Fees on Capital Asset-related Debt	442,718.15
Other Nonoperating Revenues (Expenses)	-
Less: Depreciation Expense	(1,789,678.33)
Plus: Principal Paid on Capital Debt and Leases	<u>1,593,535.52</u>
Total Expenditures	\$63,828,077.86
Debt Service	<u>\$ 2,006,122.15</u>
Total Expenditures	\$63,828,077.86
Ratio	3.2%

Debt Instruments:

Tax-Exempt Debt – The University recognizes the benefits associated with tax-exempt debt and therefore will maximize the reporting of tax-exempt debt outstanding under the Debt Policy.

Commercial Paper – The University recognizes that a commercial paper program can provide low-cost working capital and provide bridge financing for projects. However, as with other debt structures, the level of commercial paper outstanding impacts the University's overall debt capacity. Commercial paper will be treated as any other form of debt and subject to the Debt Policy guidelines.

Taxable Debt – The University will manage its debt to minimize the use of taxable debt. Taxable debt will not be considered a perpetual component of the University's liabilities. Taxable debt will be utilized to fund projects ineligible for tax-exempt financing.

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Interest Rate Swaps – The use of swaps will be employed primarily to manage the University’s variable rate exposure. The University will utilize a framework to evaluate potential derivative instruments through evaluation of its variable rate allocation, market and interest rate conditions, and the compensation for undertaking counter-party exposure. In addition, the University will incorporate the cost/benefit of any derivative instrument. Under no circumstances will a derivative transaction be utilized that is not fully understood by the University or that imposes inappropriate risk on the University.

Fixed versus Variable Allocation – Due to the financing flexibility and typically low interest cost associated with variable rate debt, it is desirable to maintain a portion of the University’s aggregate debt on a variable rate basis. However, variable rate debt also introduces volatility to the University’s debt service obligations. Therefore, the University will balance the mix of variable and fixed rate debt according to a target guideline of up to 50% variable, although the actual percentage for debt outstanding will fluctuate from time-to-time due in part to financing needs, utilization of commercial paper, and prevailing market interest rates.

DEBT MANAGEMENT PRACTICES

General Revenue Pledge – The University will utilize general revenue secured debt for all financing needs, unless for certain projects management desires to structure specific revenue pledges independent of general revenue projects. The general revenue pledge provides a strong, flexible security which captures the strengths of auxiliary and student related revenues. General revenue bonds price better than corresponding auxiliary or indirect cost recovery bonds. In addition, on general revenue debt the University is not subject to operating or financial covenants and coverage levels imposed by the market and external constituents.

Structure (Maturity, etc.) – The University will employ maturity structures that correspond with the life of the facilities financed, subject to UNC System and State limitations. As market dynamics change, maturity structures should be re-evaluated. Call features should be structured to provide the highest degree of flexibility relative to cost.

Methods of Sale – The University will consider any method of sale. Negotiated and competitive bond offerings will be considered on an individual transaction basis. For those transactions that represent a new or non-traditional pledge of University revenues, the University generally will consider negotiated methods of sale over competitive sales.

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Refunding Targets – The University will continuously monitor its outstanding tax-exempt debt for refunding and/or restructuring opportunities.

For a stand-alone refunding, the University will enter into a transaction that produces at least 3-5% present value savings (based on refunded bonds), with this threshold higher for those transactions with a long escrow.

The University also will consider refinancing if it relieves the University of certain limitations, covenants, payment obligations or reserve requirements that reduce flexibility. The University will also consider refinancing certain obligations within a new money offering even if savings levels are minimal in order to consolidate debt into the general revenue pledge, and /or reduce the administrative burden and cost of managing many small outstanding obligations.

Disclosure – The University will continue to meet its ongoing disclosure requirements by submitting financial reports, statistical data, and any other material events as required under outstanding bond indentures.

Arbitrage – The University will comply with arbitrage requirements on any invested bond funds.

Bond Proceed Investment – The University will invest bond proceeds appropriately to achieve the highest return available under arbitrage limitations.

Internal Controls – the University will adhere to the following internal controls relating to debt:

- All debt transactions are initiated by authorized individuals and approved by the general assembly or by officials to whom this authority has been delegated.
- All documents relating to notes and other debt instruments are subject to effective custodial controls and physical safeguards.
- Adequate detail accounting records are maintained and appropriate reports issued.
- All transactions are properly accumulated, classified and summarized in the accounts.