

NUMBER: 1640

TITLE: Debt Management Policy

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Overview

Old Dominion University ("ODU" or the "University") utilizes a long-term strategic plan to establish institutional priorities and objectives. Within this strategic plan is a capital funding plan, which sets out the projects to be undertaken and the method of funding for each project. The University incorporates debt as part of its capital plan to help it achieve its goals. The proper use of debt is critical in meeting the goals of the strategic and capital plans.

Objectives

This Debt Management Policy (the "Policy") establishes a control framework to ensure that appropriate discipline is in place regarding capital allocation, debt portfolio composition, debt servicing and debt authorization. It establishes guidelines to ensure that existing and future debt issues are consistent with financial resources to maintain the proper leverage, a strong financial profile and credit rating. It is the intention of ODU to use debt in a manner consistent with an investment grade borrower with a goal of obtaining and maintaining a minimum credit rating in the "A" rating category from one or more of the nationally recognized credit rating agencies. It is the policy of the University to meet periodically with the credit rating agency(s) to review debt strategy and determine positive refinements to the Policy. A more long-term rating goal is the achievement of a rating in the "AA" credit rating category.

Oversight

The Vice President for Finance has overall responsibility for implementing this policy and any debt financing activities of the University. The University's Board of Visitors (the "Board") must approve this policy, and any subsequent, material changes made to it. The Board is also required to approve each debt issuance. The Vice President for Finance will be responsible for monitoring compliance with the guidelines and regularly reporting his findings to the Board.

Debt Management Guidelines

These debt management guidelines apply to all forms of debt including long-term, short-term, fixed-rate, and variable-rate debt.

Amortization - The amortization of debt will be based on the types of assets financed, the expected availability of cash flows to meet debt service requirements, and tax regulations. In general, the amortization tax-exempt debt should not exceed the useful life of the financed asset and may never exceed the IRS limit of 120% of the useful life of the financed asset

Debt Service should be structured to meet the financial and strategic management goals of the University. The structures may include, but are not limited to, level annual debt service, level annual principal, accelerated principal, deferred principal, and bullet maturities.

Fixed and Variable Rate Bonds - When issuing fixed rate bonds, the University will analyze the slope of the yield curve and tend to issue bonds for new real estate-related projects with long-term final maturities because most of the assets financed have useful lives in excess of 30 years. If the University is concerned that interest rates may trend lower, then the University should explore shortening the non-redemption period to less than the traditional 10-year term. Bonds without an optional redemption feature should be limited in the University's debt portfolio and should be issued only when investors are willing to pay a substantial premium. Credit enhancements will be used only when necessary for cost effectiveness and/or marketability.

The University will consider utilizing variable rate debt to lessen the potential interest costs over the life of a debt issue and to provide greater flexibility in its debt management. In considering variable rate debt, the University will evaluate the risks involved, which include liquidity risk and short- and long-term interest rate risk. The University may utilize different forms of variable rate debt including variable rate demand bonds, auction rate securities and commercial paper.

The University will utilize variable rate debt when deemed appropriate for the following purposes:

- Asset/Liability Management - for matching debt to useful life of the financed asset or to match debt with investment portfolio
- Achieve interest rate savings as compared to other alternatives
- Provide flexibility in principal repayment
- Diversify investor base
- Utilize a portfolio approach to debt to diversify exposure

Bank liquidity facilities may be used to offset liquidity risk of variable rate securities and, in addition to the long-term rating assigned to the bank letter of credit or liquidity facility, such facilities should also carry a minimum short-term rating of MIG 1 or VMIG 1 from Moody's and/or A-1 or SP-1 from Standard & Poor's. (The short-term rating portion of the overall rating reflects the rating agency's view of the liquidity facility provider's ability to make timely payments of debt service on a short-term bond or variable rate demand obligation).

When the University decides to issue variable rate debt, it will generally limit net variable rate debt to not more than 30% of its capital structure. The specific amount of variable rate exposure would depend on market conditions and the type of facility to be financed. Before issuing variable rate bonds, the University will determine the assumed variable rate for budget purposes, and its plans to address positive and negative variances from the assumed rate. Additionally, unrestricted endowment assets, interest rate caps and swaps, and rate stabilization reserve funds can all help to manage the variable rate exposure.

The level of variable rate debt will also be managed in conjunction with the University's levels of cash and short-term investments, which serve as a natural hedge against rising interest rates. The actual percentage for outstanding variable rate debt will vary due to financing needs, asset/liability management goals, interim financing structures, and prevailing interest rates at the time of each borrowing.

Tax-exempt and Taxable - Tax-exempt debt will be the preferred method of financing projects. However, in instances where the capital projects do not qualify for tax-exempt financing, the University will consider taxable alternatives.

University-issued vs. Commonwealth-issued debt - In determining the most cost-effective means of issuing debt, the University will evaluate the merits of issuing debt directly as compared to Commonwealth issuance, either directly by the Commonwealth or through one of its issuing entities (such as the Virginia College Building Authority). This analysis will include an evaluation of cost, timing, and future management flexibility.

Alternative Financing Sources - There are alternative financing sources that may be considered, such as off-balance sheet financings. These financings may be more costly than traditional structures and will be used only when the economic benefit and likely impact on the University's debt capacity and credit quality are fully understood. Specifically, for any third party or developer-based financing, management will determine and quantify the full credit impact of the structure.

Debt Capacity & Affordability Measures - The University will utilize the following ratio as guidelines for issuing new debt.

$$\begin{aligned} &\text{Debt Burden no greater than 7\%} \\ &(\text{Debt Burden Ratio} = \text{Annual debt service} / \text{Total operating expenses}) \end{aligned}$$

This ratio is adjusted to reflect any non-amortizing or non-traditional debt structures that could result in significant single year fluctuations. The debt burden ratio may exceed 7% in instances involving debt of revenue producing projects when the debt used to finance the project is secured by income from the operation of the project.

Refinancings - The University will consider refinancing existing debt when net present value savings are positive. Federal tax law limits advance refunding of tax-exempt bonds. Consequently, it is vitally important to use these opportunities wisely. The Vice President for Administration and Finance will evaluate refinancing opportunities considering the value of the call option to be exercised, including the time period to the call date and the time period from the call date to final maturity. Based on this analysis, the Vice President of Administration and Finance will establish the minimum savings threshold for each refinancing. There are cases where refundings that do not produce savings will be considered, including eliminating restrictive bond covenants.

Capital Funding Source

- *Debt Service Funding* - Prior to the issuance of any amount of debt, the Vice President for Administration and Finance or designee will identify and analyze the funding source(s) for the debt repayment. Sources may include but are not limited to:

- State appropriations
 - The general revenue pledge of the University
 - Revenues from the specific project being financed
 - Indirect cost recoveries from sponsored programs
 - Gifts and bequests
 - University affiliated foundations
 - Unaffiliated third parties including joint ventures with private sector entities and grants from private foundations
- *Capital Maintenance Funding* - The University will determine how to fund the ongoing capital maintenance cost for each capital financed project prior to issuing the debt. If it is anticipated that additional borrowing will be required to fund the capital maintenance for a project, then the amount of additional borrowing will be taken into account in its debt capacity analysis.

Statement of Effect on Student Costs

The Vice President for Finance or designee will determine if the proposed debt will result in additional cost to University students. A Statement of Effect on Student Costs will be included in the material presented to the Board any time the Board is asked to approve a debt issuance.

Interest Rate Risk Management Guidelines

The University will consider the use of interest rate swaps and other interest rate risk management tools after carefully evaluating the risks and benefits of any proposed transactions. These tools will be employed primarily to manage the University's variable rate debt exposure. The use of these instruments in conjunction with variable interest rate exposure will be evaluated within prudent guidelines to achieve more flexibility in meeting the University's overall financial objectives. Interest rate swaps will be evaluated in light of existing market and interest rate conditions, the savings that can be achieved as compared to other debt structures available in the bond market, and the overall asset/liability management practices of the University.

Risk management strategies will not be utilized unless the contract or structure is fully understood, can be monitored and managed, and the risk imposed has been evaluated and concluded to be appropriate for the University. Prior to entering into any risk management agreement, the University will have received evidence of legal authorization to enter into such agreement. The Vice President for Finance, in consultation with the Administration & Finance Committee of the Board, is authorized to enter into any risk management contract or agreement that is determined to be necessary or appropriate. Interest rate management tools shall not be used for speculative purposes or in cases involving Financial Instruments that create extraordinary leverage or financial risk.

Financial Instruments - The University may utilize the following Financial Instruments after identifying the specific financial objective to be realized and the assessment of associated risks:

- Interest Rate Swaps - Spot or forward starting interest rate swaps may be utilized to capture current market rates, eliminate variable rate exposure, or create incremental variable interest rate exposure.
- Interest Rate Caps or Collars - Interest Rate Caps, Collars and Floors may be utilized to limit or bound exposure to interest rate volatility.
- Swap Options - The sale or purchase of options may be utilized to commence or cancel interest rate swaps. Potential option structures can range from vanilla to more exotic but must meet Transaction Approval guidelines as outlined in this policy.
- Basis Swaps - May be utilized to manage basis or tax risk and manipulate the basis on which cash flows are determined.
- Rate-locks - May be utilized to hedge interest rate exposure on anticipated bond issuances.
- Constant Maturity Swaps
- Total Return Swaps

Other Financial Instruments may be utilized provided the requirements for a transaction approval are met.

Financial Instruments Risk Analysis

Risk Type	Description	Evaluation
Basis Risk	The mismatch between two variable rate indices.	Review historical differentials between the indices.
Tax Risk	The risk created by certain tax events that could impact swap cash flows.	Review the potential impact of tax events & perform cash flow sensitivity analysis.
Counterparty Risk	The risk of default by the University's swap counterparty.	Monitor exposure levels, ratings thresholds & collateralization requirements.
Termination Risk	The need or requirement to terminate a swap transaction prior to maturity in a market dictating a termination payment to the swap counterparty.	Analyze its potential termination exposure upon entrance into a transaction and perform termination sensitivity analysis.
Rollover Risk	The mismatch of the maturity of a swap transaction and the credit enhancement on underlying variable rate debt.	Review its capacity to maintain variable rate debt.
Liquidity Risk	The inability to continue or renew a liquidity facility.	Evaluate the expected viability of liquidity support.

The University will not enter into agreements involving Financial Instruments for speculative purposes or involving Financial Instruments that create extraordinary leverage or financial risk.

Procurement and Execution - The University has authority to enter into Financial Instrument transactions either through a competitive bid or a negotiated process. The University must take reasonable steps, such as hiring a qualified advisor, to ensure that the economics involved in a negotiated transaction represent a fair market price taking into consideration the terms of the agreement and the University's current financial status.

Swap Counterparties Policy - The University will execute Financial Instrument transactions with counterparties with credit ratings in the "A" category or above as of the transaction date.

The University may seek credit enhancement in the form of collateral, guarantees, and/or termination events in the agreement for counterparty downgrades below the "A" category. The University will seek to maintain voluntary termination rights in all transactions it undertakes.

Swap Documentation - The University will utilize standard International Swap Dealers Association swap documentation, including the Schedule to Master Agreement and Credit Support Annex (if applicable).

Active Management - The University will seek to maximize the benefits it accrues and minimize the risks it bears by actively managing its interest rate risk management program. This will entail monitoring of market conditions (such as current interest rates, counterparty credit ratings and other relevant factors) in conjunction with the swap counterparty and the University's advisors for potential opportunities and risks. Active management may entail modifications of existing transactions including:

- Early termination;
- Shortening or lengthening the term of the agreement;
- Sale or purchase of options; and
- Application of basis swaps.

Each proposed modification must be consistent with this policy and should be expected to further the goals of the University interest rate risk management program.

Rating Agencies - The University will seek Rating Agency review to determine materiality of any financial instrument transaction on the credit quality of the University as part of its overall rating agency strategy.

Financial Instrument Analysis - The University will undertake a financial risk analysis of the application of Financial Instruments prior to entering any proposed transaction. Utilizing Financial Instruments requires an ongoing commitment for the University's management. Therefore, to help ensure understanding and knowledge of considered transactions, a specific approach will be developed for each potential transaction evaluating the risks, rewards and exit strategies. The approach will include, but not necessarily be limited to the following:

- The goals the University is trying to achieve by implementation.
- The swap counterparty's rating and the University's credit exposure to the counterparty.
- Cash flow projections and sensitivity analysis.
- An evaluation of potential risks, including basis risk, tax risk, rollover risk, termination risk and counterparty risk.
- Events that may trigger an early termination under the agreement.
- A sensitivity analysis of potential market valuations in various market conditions.
- A discussion or example of how the University plans to report and monitor the transaction in the future.

Disclosure & Reporting Requirements

Disclosure - The University will provide updated financial information and operation data and timely notice of specified material events to each nationally recognized municipal securities information repository and any State information depository, pursuant to its continuing disclosure undertakings with respect to SEC Rule 15c2-12.

Reporting Requirements - On an annual basis the Vice President for Finance will prepare a report for the Board that will include the following items:

- Composite debt service schedule
- Financial ratio analysis
- Debt use and purpose
- Current and future debt as it relates to the strategic plan and debt strategy
- Financial instrument review