Debt Management Policy

History:
Approved by the Colorado School of Mines Board of Trustees, October 24, 2008

1.0 STATEMENT OF AUTHORITY AND PURPOSE

This policy is promulgated by the Board of Trustees pursuant to the authority conferred upon it by §23-41-104(1), C.R.S. (2008). The primary objective of this policy is to establish a strategy for when and how the School will utilize debt financing for its capital program needs. This covers all debt issued by the School for any use; academic, administrative, auxiliary, other. The policy addresses the need to diligently manage debt from both an operating and overall balance sheet perspective. The policy is intended to provide guidance for the prudent use of debt to finance capital projects that enable the School to fulfill its mission and achieve its strategic objectives. This policy shall supersede any previously promulgated CSM policy that is in conflict herewith.

2.0 OVERVIEW

Debt financing allows the School to fund capital assets over a period of time typically related to the useful life of the asset. This can be a financially prudent practice for certain types of capital investments when executed within appropriate loan covenant limitations and at favorable interest rates.

Since debt capacity is limited and the demand for debt may from time-to-time exceed available capacity, it is imperative that borrowings focus primarily on those projects that support the vision, mission, and values of the School and its strategic plan. The School will issue debt to finance only those projects that have been evaluated and prioritized by the Executive Committee and then approved by the President and the Board of Trustees.

Decisions regarding the appropriate use of financial leverage should be balanced to ensure the School's current financial health, while also considering the financial impact of present decisions on future costs of capital and operating budgets.

2.1 Policy Scope

This policy provides guidance for the execution and management of debt financing conducted by the School for any purpose consisting of but not limited to academic, administrative and auxiliary. The policy also provides a framework for decision-making related to the School's debt management processes, including maintaining compliance with all debt-related covenants and reporting requirements.

2.2 Overall Debt Policy

It is the responsibility of the Finance and Administration division to negotiate, execute, and manage any and all long or short-term debt required for the School (short-term debt may include, but is not limited to, revolving lines of credit, overdraft facilities, commercial paper, letters of credit and liquidity facilities). This includes non-traditional debt such as loans from banks or other entities including the CSM Foundation.

In this regard, Finance and Administration will seek the lowest possible financing cost commensurate with the most favorable financial terms, conditions and risks, and that are consistent with the School's capital structure and financing requirements.

2.3 Policy Updates and Revisions

Finance and Administration shall review this debt management policy annually and recommend any changes necessary to ensure that it continues to meet the School's objectives. The policy should also be reviewed as soon as practicable in the event of a major School reorganization, shift in the strategic plan or following any material changes in the School's credit rating.

3.0 DEBT MANAGEMENT GUIDELINES

In developing a debt management strategy there are three primary guidelines to consider:

<u>Affordability</u> - Analysis of the cost of capital, cash flow forecasts and rationale to instill budget discipline and help ensure, if appropriate, the linking of the beneficiaries and users of the debt financed capital projects with the actual payment of the principal and interest on the debt used to finance the facilities.

<u>Risk Management</u> – Addresses the appropriate mix between fixed and variable rate debt, managing liquidity risks and exposures, and establishing a rationale for matching assets to liabilities.

<u>Financial Structure & Balance Sheet Management</u>- Includes the goal of establishing and maintaining the highest credit/bond rating possible while supporting the mission and strategic plan, a rationale for the appropriate level of debt versus pay-as-you-go capital financing and proactive monitoring of the capital markets to manage unplanned inefficiencies or disequilibriums in both debt and investment markets.

3.1 Affordability

- When issuing debt, the School will seek the lowest-cost source of funding available within the risk parameters established for a particular financing.

- External borrowings will be coordinated to the extent practical so that multiple project needs can be accomplished in a single borrowing, thereby reducing issuance costs.

- The School will consider credit enhancement such as insurance or a letter of credit when it is cost beneficial to do so and/or results in a more favorable financing outcome.

- The cost of debt-financed capital acquisitions will be charged over the asset's useful life.

3.2 Risk Management

- The School will consider refinancing outstanding debt targeting net savings for the refinancing, measured on a net present value basis, greater than 2%. Present value savings targets may increase dependent upon risk associated with any given mode. Refundings generating lower than 2% present value savings will be considered if they achieve some other critically important financing objective.

- The exercising of call options on outstanding debt may be considered so long as: (1) they offer net present value savings when compared to alternative investment opportunities for utilized funds, (2) more favorable covenants can be obtained, and/or (3) the School desires to reshape the amortization pattern of its debt.

- Guidelines surrounding the mix of fixed and variable rate debt are: 1) liquidity risks need to be covered; and 2) costs of capital should be budgeted higher than actual expected short-term interest rates.

- In practice, schools with larger endowments and schools with strong unrestricted net assets typically have a higher percentage of variable rate debt due to the hedge provided by the unrestricted reserves. Accordingly, the mix of fixed versus variable rate debt shall have a long-range target of 70% fixed and 30% variable. In the short-term if prudent and advantageous given market conditions, the School may operate for a period of time within the tactical ranges of 0-50% variable and 50-100% fixed. The Senior Vice President for Finance and Administration will be Colorado School of Mines responsible for monitoring the debt markets and recommending the appropriate tactical strategy depending on the interest rate environment, the School's liquidity position, current tax regulations, and market dynamics.

- In taking on all debt, the School shall adhere to the principle of matching the term of the debt to the expected useful life of the project or to the purpose of the program being funded with that debt. Long-term debt will not be incurred to fund Administration, while the use of recurring operating funds to fund major capital projects and to maintain debt funded projects is to be carefully considered in the context of other available funding sources, including state appropriations, grants, and gifts.

- Where financially feasible, debt will be retired as soon as possible to recapture debt capacity for future use. The maturity on a tax-exempt bond issue should be as short as economically feasible for the project, and will not exceed the useful life of the financed asset unless extenuating circumstances necessitate a longer maturity.

- In order to hedge interest rate risk and take advantage of the competitive nature of the derivatives market, the School may execute one or more swaps, swaptions, or other derivative transactions, as appropriate, in relation to debt financing activities pursuant to the authorization contained in the specific resolution relating to the associated debt financing transaction.

3.3 Financial Structure/Balance Sheet Management

- In order to preserve debt capacity, external borrowings will not be used to fund any debt reserve requirements (if any) unless it is more cost effective than purchasing a surety bond or other third party stand-by commitment. If a debt reserve must be fully funded due to market conditions, Finance and Administration will monitor the availability of surety bonds or stand-by commitments and when available on a cost effective basis, substitute such alternatives for the funded debt reserve.

- The School will take an institution-wide approach to capital allocation and wherever practical, will seek to consolidate debt in order to benefit from potential lower cost of borrowing, reduced administrative costs, and improved flexibility.

- It is the general intent of the School to utilize debt as a cost effective financing vehicle rather than simply a funding source. To the extent possible, state capital appropriations, auxiliary proceeds, external gifts, grants, etc. will be used to "fund" capital projects, with debt utilized primarily as either a temporary financing source or "lowest cost of capital" alternative.

- Borrowing will generally be for the minimum required portion of the project cost. Projects with alternative restricted or unrestricted funding sources should only use debt financing for the unfunded portion and to bridge the timing of secured cash payments on secured gifts and pledges.

- The School will seek to utilize tax exempt financing versus taxable financing wherever practical. If taxable financing is desired or required, the analysis for affordability, risk and structure will be in line with tax exempt debt.
- Compliance with debt reporting and financial covenants will be closely monitored and adhered to by Finance and Administration with validation by external auditors, with compliance efforts reported regularly to the Senior Vice President for Finance and Administration. Colorado School of Mines

- Where possible, and when market conditions create an opportunity for substantial positive arbitrage, we should seek to structure and time debt such that the School meets the required federal spend down tests thereby enabling it to retain project fund earnings in excess of the arbitrage yield.

- We will monitor the School's rebatable arbitrage earnings for tax purposes on an annual basis and evaluate compliance with IRS private use rules at issuance and periodically thereafter.

- The School's debt capacity will be determined from time to time, based on the evaluation of bond rating agency and related bond insurance guidelines, with the goal of maintaining a minimum rating of A2/A, and preferably, a rating of A1/A+ or higher.

4.0 LINES OF CREDIT

For specified purposes, the School may from time-to-time determine that it is prudent to execute short-term borrowing for cash flow purposes. Such a strategy may be utilized under the following scenarios and conditions:

- To bridge finance contractual committed third party payments, such as government grants that have been appropriated or corporate research contracts that have been formally executed.

- The Senior Vice President for Finance and Administration shall annually report to the President and to the Finance and Audit Committee of the Board of Trustees regarding the use, and net costs, of lines of credit during the previous fiscal year.

5.0 KEY FINANCIAL RATIOS

Based on the three main objectives previously identified, the following financial ratios are used to guide debt capacity evaluations and debt decision making, although they are not intended to be all-inclusive in this regard. These ratios are used to measure operating and balance sheet debt capacity and are managed in order to maintain a close correlation with the credit rating agency median level for large “A” rated colleges and universities.

The following description of each of the ratios is based on a three year (2009-2011) average medians for an A1 school annually published by Moody’s.

Capital Ratio #1 = *Unrestricted financial resources to outstanding debt*

This ratio measures the coverage of outstanding debt by the most liquid resource, and offers one of the most basic indicators of clear financial health. The current median target for this ratio is **.41**

Capital Ratio #2 = *Expendable financial resources to outstanding debt*

This ratio measures the availability of expendable net assets to cover debt should the School need to settle its obligations as of the balance sheet date and incorporates net unrestricted and temporarily restricted net assets of the CSM Foundation. The current median target for this ratio is **.65**

Capital Ratio #3 = *Total Financial Resources to outstanding debt*

This ratio measures the availability of total net assets to cover debt should the School need to settle its obligations as of the balance sheet date and incorporates total net assets of the CSM Foundation. The current median target for this ratio is **.87**

Balance Sheet Ratio #1 = *Unrestricted financial resources to total operating expenses*

This ratio measures the coverage of annual operating expenses by the most liquid financial resource. The current median target for this ratio is **.24**

Balance Sheet Ratio #2 = *Expendable financial resources to total operating expenses*

This ratio measures the coverage of annual operating expenses by the financial resources that are expendable in the long run and incorporates net unrestricted and temporarily restricted net assets of the CSM Foundation. The current median target for this ratio is **.39**

Debt Service Coverage = *Excess revenue over additional debt capacity*

The ratio measures the coverage of new debt service projected new revenue generated from the issue. The current median target for this ration is **1.2X.**

6.0 DEBT APPROVAL PROCEDURES

Whenever short or long-term debt is required or whenever there are transactions that would contingently obligate the School for any amount, the Finance and Audit committee will alert the Board of Trustees to the proposed plan of finance. Subsequent to the notification to the Board of Trustees, the following approval procedures are required:

- Finance and Administration shall be solely responsible for negotiating all debt and debt-related terms, conditions and financial covenants. Finance and Administration will seek approval from the President on all debt related matters.

- General Counsel must approve the legal form on all instruments, documents or agreements relating to financing, indebtedness and contingent obligations.

- Finance and Administration shall prepare any direct debt financing resolutions requiring Finance and Audit Committee and Board of Trustees approval.

- Finance and Administration, and as appropriate together with General Counsel, shall be responsible for reviewing and preparing for execution by the School's "Authorized Officers" (the Senior Vice President for Finance and Administration), any instrument, document or agreement which will cause the School to become directly indebted pursuant to Board approval or to become contingently obligated to an unrelated third party (e.g. loan guarantee).

7.0 POLICY ADHERENCE AND COMPLIANCE

The debt strategy and procedures outlined in this policy are designed to provide discipline to capital financing and operating budget decisions (affordability), manage interest rate and liquidity risk (risk management) and provide a "discipline" and a mechanism to ensure appropriate capital structure balance is achieved between debt, endowment equity and cost of capital minimization (financial structure/balance sheet management). Finance and Administration will evidence compliance with these policies and report annually to the Finance and Audit committee on such compliance pursuant to Section 2.3 of this policy.

8.0 APPENDIX A - DEFINITIONS

Bridge Financing – Refers to any type of financing used to "bridge" a period of time. For colleges and universities, it generally refers to financings that provide funding in advance of a long-term bond issue or the receipt of gift or grant funding.

Credit - Credit is the ability to repay a financial obligation.

Credit Rating - A measure of the School's overall financial sustainability and specific ability and willingness to repay its debts on time, based in part on the School's financial condition, debt load, and management capabilities.

Debt - All short and long term obligations, guarantees, and instruments that have the effect of committing the School to future payments and therefore impacting its credit.

Debt Capacity - The amount of debt the School can accommodate under specified criteria. Internal criteria include capital and balance sheet ratios. External criteria include credit ratings from rating agencies.

Derivative - A financial tool which derives its value from another more fundamental financial instrument, such as a commitment to buy a bond for a certain sum on a certain date, or a hedge against a change in interest rates. The purpose of derivatives is to manage or reduce risk and/or reduce cost.

Financial Ratios - One value divided by another which are used to study and interpret relationships between financial variables.

Leverage – Long term debt as a component of the total assets of the School. A highly leveraged university is one in which a high percentage of its assets are debt financed.

Net Investment in Plant - Total plant, property and equipment assets less long-term debt and accumulated depreciation.

Rating Agencies - Companies that publish borrowers' credit ratings, such as Moody's and Standard & Poor's.

Swap - A type of derivative product whereby two parties enter into a transaction under which they exchange streams of payments over time according to specified terms. The most common type is an interest rate swap, in which one party agrees to exchange a fixed interest rate for an adjustable rate (or vice-versa) with another party.