Debt Management Guideline
West Virginia University

Goals and Objectives

This Guideline outlines the use of debt to finance capital projects and provides the framework within which WVU will manage its debt. The Guideline is intended to be used in tandem with the Debt Policy, the Strategic Plan and the Master Plan. Although the Guideline is intended to guide management decision-making, it is only a guide and Management reserves the option to temporarily deviate from the Guidelines in order to address strategic priorities.

The Debt Policy approves a variety of debt instruments for WVU management to use to maintain timely and favorable access to the capital markets. These include:

- Tax-exempt debt
- Taxable debt
- Fixed and variable rate debt
- Derivative products and
- Other financing sources.

WVU's goals are to:

- Manage debt to meet long term strategic objectives while maintaining the highest possible rating to achieve favorable relative cost of capital and borrowing terms,
- Manage risk on a portfolio basis rather than a transactional process,
- Balance lowest cost of capital goal with goal of limiting exposure to market fluctuations,
- Limit impact on future debt issuance,
- Manage interest rate risk through methods such as the use of derivative instruments,
- Coordinate debt management with asset and liquidity management decisions and portfolio management decisions,
- Coordinate bond issues to the extent possible so that multiple projects can be accommodated in a single borrowing to reduce the overall cost per dollar of debt issued, and
- Maximize the rate of return on capital investments through the strategic use of debt.

The Vice President for Administration and Finance will be responsible for updating and reviewing these Guidelines annually with the Investment Committee of the University.

Use of Ratios in Monitoring Debt Affordability, Debt Capacity and Resource Sufficiency

The list of ratios described in this section has been established as appropriate at the time of original drafting of the Guideline (see below and Appendix B). However, this list is created as a guideline and not meant to remain unchanged. Management may use different ratios than those described in this section to monitor WVU's debt structure.

The use of ratios allows the University to manage its debt on a portfolio basis and focus more broadly on WVU debt affordability and allocate debt to projects in relation to their priority to the mission, strategic and master plans. The use of ratios also allows WVU to maintain a competitive financial profile, adequate funding capacity and resource sufficiency for current and future facilities needs and/or reserves.

The ratios used by WVU are intended to address the following:

1. Are resources sufficient and flexible enough to support the mission?
2. Are resources, including debt, managed strategically to advance the mission?
3. Does asset performance and management support the strategic direction?
4. Do operating results indicate that the University is living within available resources?

The specific ratios are:

1. Viability
2. Debt Burden
3. Debt Service Coverage
4. Return on Net Assets
5. Primary Reserve
6. Net Operating Revenue and
7. Expendable Financial Resources to Operations

The use of these ratios is part of the strategy WVU employs to review its operations as part of a strategic framework resulting in a Core Financial Index (CFI)[1]. The CFI is a methodology for creating one overall financial measurement of the health of WVU based

[1] Source - Strategic Financial Analysis for Higher Education by KPMG, Prager, Sealy & Co. LLC and Bearing Point.

on four of the above ratios. The four ratios in the CFI are the Primary Reserve, Viability, Return on Net Assets and Net Operating Revenues ratios. Using ratios from the CFI as well as others in this Guideline will allow WVU to link the Debt Policy and strategic financial review process with the mission and strategic and master plans.

Debt Affordability

Debt Affordability can be defined as the impact issuing more debt will have on WVU's operating budget. Debt affordability takes into consideration the incremental costs associated with maintaining new facilities; not simply the future debt service payments. As these costs may be more of a constraint into future periods, WVU will use the Debt Burden, Debt Service Coverage and Net Operating Revenue ratios to assess debt affordability.

Debt Capacity

Debt Capacity focuses solely on the balance sheet and is important not only to WVU but to rating agencies. WVU will assess debt capacity using the Viability and Return on Net Assets ratios.

Resource Sufficiency

WVU recognizes that an appropriate level of resources is needed to enable it to achieve its long-term strategic objectives and therefore must be monitored. The Primary Reserve and Expendable Resources to Operations ratios will be used by WVU to measure financial soundness and ability to achieve and sustain a level of resources sufficient to realize our strategic goals.

See Appendix B – for ratio calculations and definitions

Variable Rate Debt and Allocation to the Portfolio

Management is responsible for monitoring overall interest rate exposure, analyzing and quantifying potential risks, and determining appropriate fixed/variable allocation strategies. The portfolio allocation to variable-rate debt may be managed or adjusted through – (i) the issuance, conversion or redemption of debt (potentially new issues and refunding) and (ii) the use of interest rate swaps and other derivative products as deemed appropriate and allowable.

The amount of unhedged variable-rate debt outstanding (adjusted for derivatives including the effect of any outstanding options being exercised) shall not exceed 30% of WVU's outstanding debt. This limit is based on the desire to: (i) limit annual variances in its debt portfolio, (ii) provide sufficient structuring flexibility to management, (iii) keep WVU's variable-rate debt allocation within acceptable external parameters, and (iv) utilize variable-rate debt (and/or derivatives) to optimize debt portfolio allocation and minimize costs.

Additionally, WVU will use a tax exposure ratio to manage its exposure to marginal personal income tax rates. This ratio measures the amount of tax exposure WVU is willing to maintain at any given time. Under current tax regulations, WVU receives a benefit by issuing tax-exempt debt in the form of a lower interest rate. Tax exempt debt is attractive to investors because the interest income is exempt from Federal (and sometimes State) taxation. If the benefit of tax-exemption was to end due to changes in tax laws WVU's floating rate tax-exempt obligations could be negatively impacted.

Derivative Products

Management recognizes that derivative products may enable more opportunistic and flexible management of the debt portfolio. Derivative products, including interest rate swaps and rate locks, may be employed primarily to manage or hedge WVU's interest rate exposure. WVU utilizes a framework to evaluate potential derivative instruments by considering (i) its current variable-rate debt allocation and tax exposure, (ii) existing market interest rate conditions, (iii) the impact on future financing flexibility, and (iv) the compensation for assuming risks or the costs for eliminating certain risks and exposure.

Risks of derivative products include, but are not limited to,

- tax risk,
- interest rate risk,

- counterparty risk,
- basis risk,
- liquidity/remarketing risk
- Termination risk, and
- Any other potential risks either imposed or removed through the execution of any transaction.

(See Glossary of Terms in Appendix A)

WVU analyzes and quantifies the cost/benefit of any derivative instrument relative to achieving desirable long-term capital structure objectives. In addition, management discloses the impact of any derivative products on its financial statements per GASB requirements and includes their effects in calculating the Debt Policy ratios and portfolio composition.

WVU recognizes that a variety of derivative products are available that can assist in reducing the expected interest expense related to the debt portfolio. WVU will consider the utilization of such products provided that:

- The transaction does not impose unacceptable risk;
- WVU is appropriately compensated for the assumption of any risk;
- Management understands the risks and benefits of any transaction that is considered;
- Management presents the expected benefits and risks associated with any proposed transaction to the Board of Governors, and
- WVU receives independent legal and financial advice concerning the legality and merits of the prospective derivative transactions.

Specifically, management will address the following issues and provide the following information to the Board of Governors with respect to any proposed transaction:

- A discussion of how the transaction relates to potential exposure in other areas of WVU;
- A review of various risks inherent in the transaction. The risks will be discussed for the individual transaction, as well as in the context of the overall debt portfolio;
- The expected economic benefit of the transaction, as well as sensitivity analysis highlighting potential exposure in various interest rate environments; and
- That all legal requirements are met.

At a minimum, the legal documentation for any transaction will require:

- Full collateralization of exposure in the event that the counterparty's credit falls below "A".

- The ability for WVU to terminate the transaction at any time, at market value, with no greater than five days notice to the counterparty.

WVU will retain an independent pricing advisor for all derivative transactions.

Other Financing Sources

All structures can only be considered once the economic benefit and the likely impact on WVU's debt affordability and credit has been determined. Specifically, for any third-party or developer-based financing, management ensures the full credit impact of the structure is evaluated and quantified. WVU will prepare long-term cash flow projections for projects to be financed with other financing sources to demonstrate the project's affordability considering sufficiency of revenue sources to cover total cost of issuance and incremental operating costs including long term maintenance costs. The project's projected impact on the ratios contained in Appendix B will be taken into consideration in the approval process. Additionally, when considering internal bridge-financing WVU will obtain a reimbursement resolution from the Board of Governors to reimburse itself from the external debt when issued.

Refunding Opportunities

In evaluating current or advance refunding opportunities, WVU will consider the value of the call option to be exercised, including the amount of time to the call date and the amount of time from the call date to maturity. Based on these and other factors, WVU will determine the minimum savings threshold for any particular refunding transaction. In general, WVU will consider positive net present value savings of 3%-5% as a criterion for executing either a current or advance refunding. Refundings that do not produce savings may be considered under certain circumstances, such as eliminating restrictive bond covenants or situations that create greater benefit to WVU.

Appendix A: GLOSSARY OF TERMS

Basis Risk	The risk that the price of a derivative instrument will vary from that of the underlying commodity. Risk that variable swap rate does not fully offset variable bond rate
Bond Market Association (BMA)	Index of weekly reset of high grade, non -AMT floaters adjusted based upon historical analysis.
Counterparty risk	The risk that a counterparty to a contract defaults and does not fulfill its obligations.
Credit	Credit is the ability to repay a financial obligation.
Credit Rating	A measure of the credit quality and safety of a bond the university has issued, based on the university's financial condition. More specifically, an evaluation from a rating agency indicating the relative likelihood that the university will be able to meet scheduled interest and principal repayments to bondholders.
Debt	All short- and long-term obligations, guarantees, and instruments that have the effect of committing the university to future payments and therefore impacting its credit.
Debt capacity	The amount of debt the university can take on under specified criteria. Internal criteria include financial ratios. External criteria include credit ratings from rating agencies.
Derivative	A financial tool that 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 reduce risk and/or reduce cost.
Direct debt	The amount of long-term debt recognized in the university's audited statement of financial position (balance sheet).
Financial ratios	One value divided by another, which are used to study and interpret relationships between financial variables.

Interest rate cap An options contract which puts an upper limit on a variable interest rate. The writer of the cap has to pay the holder of the cap the difference between the variable rate and the reference rate when that reference rate is breached. There is a premium to be paid by the buyer of such a contract in order to gain the certainty of a maximum payout.

Interest rate collar A security which combines the purchase of a cap and the sale of a floor to specify a range in which an interest rate will fluctuate. The security insulates the buyer against the risk of a significant rise in a floating rate, but limits the benefits of a drop in that floating rate.

Interest rate risk The risk that short-term interest rates will increase above the fixed rate that otherwise could have been locked-in.

Interest rate swap An exchange of interest payments on a specific principal amount. This is a counterparty agreement, and so can be standardized to the requirements of the parties involved. An interest rate swap usually involves just two parties, but occasionally involves more. Often, an interest rate swap involves exchanging a fixed amount per payment period for a payment that is not fixed (the floating side of the swap would usually be linked to another interest rate, such as LIBOR or BMA). In an interest rate swap, the principal amount is never exchanged, it is just a notional principal amount. Also, on a payment date, it is normally the case that only the difference between the two payment amounts is turned over to the party that is entitled to it, as opposed to exchanging the full interest amounts. Thus, an interest rate swap usually involves very little cash outlay. However, basis risk can also cause a need for a cash outlay.

Leverage The degree to which the university is utilizing borrowed money versus revenues or net assets to finance projects.

LIBOR London Inter-Bank Offer Rate. Interest rate that banks charge each other for loans (usually in Eurodollars). This rate is applicable to the short-term international inter-bank market, and applies to very large loans borrowed for anywhere from one day to five years. This market allows banks with liquidity requirements to borrow quickly from other banks with surpluses, enabling banks to avoid holding excessively large amounts of their asset base as liquid assets. The LIBOR is officially fixed by a small group of large London banks each day at 11:00 a.m. GMT, for periods of from one day to up to 12 months.

Liquidity/remarketing risk	The possibility that buyers in the market would not be willing to buy the bonds being sold by current investors during the regular remarketing schedule and as a result the university would have to purchase those bonds when presented for sale on the market.
Net investment in campus facilities	Net campus facilities less direct debt. Also referred to as net investment in plant.
Rating agencies	Companies that publish borrowers' credit ratings, including Moody's Investors Service, Inc., Standard and Poor's and Fitch.
Swap	A type of derivative product whereby two counterparties 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.
Tax risk	The risk that the premium received from being a tax-exempt interest organization would be altered in some way by Federal tax cuts or changes in the basic tax structure. The issuer uses a swap based on a percentage of a taxable index to hedge a tax-exempt obligation. The risk is change in marginal tax rates.
Termination Risk	The risk that a swap contract could terminate by the counterparty