

UNIVERSITY OF KENTUCKY AND AFFILIATED CORPORATIONS

DEBT POLICY

Amended December 12, 2022

**University of Kentucky
University of Kentucky Research Foundation
University of Kentucky Gluck Equine Research Foundation, Inc.
University of Kentucky Humanities Foundation, Inc.
University of Kentucky Mining Engineering Foundation, Inc.
Central Kentucky Management Services, Inc.
Beyond Blue Corporation**

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I. Overview and Objectives of the Debt Policy

To fulfill its mission, the University of Kentucky must make ongoing strategic capital investments in academic, student life, healthcare, and other plant facilities using an appropriate mix of funding sources including state bonds and appropriations, philanthropy, University bonds, capital leases and agency funds (internal reserves).

The purpose of the Debt Policy is to provide guidance on the strategic use of debt (external and internal) and to ensure the appropriate mix of funding sources are considered and utilized. Debt is a valuable source of capital project financing but should be limited to projects that relate to the mission and strategic objectives of the University. The amount of debt incurred has an impact on the financial health of the University and its credit rating.

This Policy provides a discipline and framework to be used by senior administration to evaluate the appropriate use of debt in capital financing plans.

Objectives of the Debt Policy

The objectives stated below provide the framework for decisions regarding the use and management of traditional and non-traditional external debt. The Debt Policy and objectives are subject to ongoing evaluation and may change over time.

Objectives:

1. Outline a process for identifying and prioritizing capital projects considered eligible for debt financing and assure debt-financed projects have a clear and feasible plan of repayment. Overall leverage of the University will be considered when evaluating the issuance of external debt to finance a capital project. Projects relating to the core mission and having associated revenues will generally be given higher priority for debt financing.
2. Define the process, qualitative considerations and quantitative tests to be used to evaluate the University's overall financial health, liquidity, and present and future debt capacity and affordability.
3. Establish guidelines to manage the risk of the total external debt portfolio. The University will manage debt on a portfolio basis, rather than on a transactional or project specific basis; will use an appropriate mix of fixed and variable rate debt (as permitted by State Law) to achieve the lowest cost of capital while limiting exposure to market interest rate shifts; and protect the operational liquidity of the University.
4. Establish guidelines for communication with rating agencies, investors and other market participants to ensure appropriate communication of the University's creditworthiness and strategy.
5. Assign responsibilities for the implementation and management of the University's Debt Policy.

II. Roles and Responsibilities

The Executive Vice President for Finance and Administration (“EVPFA”) is directly responsible for all debt management. Debt capacity and affordability guidelines shall be set annually by the Debt Management Committee and monitored on a regular basis by the EVPFA and the Treasurer. The Treasurer will report regularly to the University’s Debt Management Committee on the University’s debt position and plans. Specific debt management practices are provided in **Appendix 1**.

Debt Management Committee

A Debt Management Committee consisting of the following members and any other individual designated by the EVPFA will meet on a regular basis to review the University’s internal and external debt capacity, liquidity measures and projects requested to be funded in whole or in part with debt.

- Executive Vice President for Finance and Administration
- Provost
- Senior Vice President for Health Affairs and Chief Financial Officer
- Treasurer
- Vice President for Facilities Management and Chief Facilities Officer
- Vice President for Financial Planning and Chief Budget Officer

Requests for debt authority must be submitted by the Provost or the appropriate executive vice president to the EVPFA for review. The EVPFA will present the request to the Debt Management Committee and convey the Committee’s recommendations to the President. Any public-private partnership will be reviewed and approved by the Debt Management Committee if the following three conditions are met: (i) the project is primarily intended for use by University constituents; (ii) the project is located on land owned by the University and falls under a long-term contract; and (iii) ownership of the project reverts to the University at the conclusion of the contractual agreement. See **Appendix 2** for more information regarding the guidelines that the Debt Management Committee is responsible for setting annually.

Financial Planning and Facilities Management

The Vice President for Facilities Management and Chief Facilities Officer is responsible for estimating and defining capital project costs and maintaining a list of potential projects under consideration. The Vice President for Financial Planning and Chief Budget Officer is responsible for developing university-wide capital planning documents for the current year, current biennium and the six-year capital plan.

Treasury Management

The Treasurer shall regularly monitor the debt capacity and affordability guidelines set by the Debt Management Committee. The Treasurer will also maintain a schedule of current and forecasted debt (external and internal) and associated payment of principal, interest and fees. The Treasurer is responsible for the administration of all aspects of debt financing, including accounting, reporting and coordination with financial advisors, underwriters, bond counsel and rating agencies to issue new debt or refinance existing debt.

Board of Trustees

In accordance with the Governing and Administrative Regulations, the Board of Trustees will approve all capital projects over \$1,000,000 and all external debt financing transactions except federal aid loans as outlined in Kentucky Revised Statute §164.288 which may be authorized by the President. A resolution, which may include a reimbursement resolution, must be passed by the Board of Trustees prior to the issuance of debt.

III. External Debt Utilization and Management

Prioritizing Capital Projects Requiring Debt

The University has significant capital needs and recognizes that external debt is a strategic, but limited, resource that can be used as part of a multi-pronged strategy for funding those needs. Additionally, the University must compete with all other state agencies for capital projects bonding authority, as the Commonwealth of Kentucky has imposed limits on the aggregate amount of outstanding debt attributable to the State. Therefore, it is essential that the University appropriately prioritize capital projects requiring debt. Projects to be considered for debt financing must relate, directly or indirectly, to the mission of the University.

In assessing the possible use of debt, all financing and revenue sources will be considered. The University shall maximize the use of philanthropy, grants, agency funds (internal reserves), state appropriations and state bonds to fund capital projects, strategically using taxable and tax-exempt debt to provide additional resources to support mission-critical investments. The University will consider other funding opportunities when appropriate and advantageous to the University. An evaluation of such financing strategies will include a comprehensive assessment of the risks, costs and benefits specific to the project, the University resources at-large and the overall debt portfolio.

Project Specific Quantitative Tests

Every project considered for debt financing must have a management-approved plan of project costs, including incremental operating expenses and revenues. The Provost or appropriate executive vice president must approve these plans. Incremental revenues include revenue increases directly associated with the project (e.g., usage fees) that can only be realized if the project is undertaken. Similarly, incremental expenses include any increase in expected operating costs associated with the project. Revenues and costs savings should be estimated conservatively, especially for high-risk projects. The net present value of each project will be calculated by summing the discounted value of the annual net project cash flows over the life of the project.

Financial Ratios/Institutional Quantitative Tests

There are multiple factors affecting overall institutional debt capacity and debt affordability. These include both internal factors and external factors. Before undertaking any new borrowing, the University will assess its broad institutional health, both at the current point in time and forward looking, to determine its ability to absorb additional fixed capital costs while maintaining its overall financial health. Among the areas to be considered are:

1. **Scale** – success in attracting students, donors and faculty, as well as resilience to shocks, such as sudden shifts in demand or rapid cost increases;

2. **Market Profile** – ability to compete effectively for and realize tuition revenue, private gifts, research grants, faculty and staff, and government support;
3. **Operating Performance** – ability to repay debt from operating revenues as well as invest in academic programs and facilities to advance strategic objectives;
4. **Financial Resources and Liquidity** – ability to withstand periods of volatility in the operating and competitive landscape;
5. **Leverage and Coverage** – ability to pay annual fixed costs, including debt service obligations, while still fulfilling the mission;
6. **Financial Policy and Strategy**– institution’s risk appetite, risk management capabilities and ability to execute strategic plans that foster long-term financial viability. Also, management’s ability to manage risks with regard to operating assumptions, asset and treasury management, capital structure, and the broader enterprise.

To support the evaluation of the institution’s debt capacity and affordability, the University will utilize the Moody’s Investors Service higher education scorecard (see **Appendix 3**). The scorecard should not be considered a hard limitation on issuing additional debt or entering into a public-private partnership, as it is a tool to provide one view of credit strength. The University will also compare itself to peer institutions and assess its relative strength among its benchmarks. These approaches are to be evaluated in conjunction with each other, as each approach provides different information to be considered within the overall context of the University’s operations and financial profile.

The Debt Management Committee shall review the Moody’s scorecard data annually based on the most recent fiscal year-end audited financial statements. The Committee will utilize the scorecard to assist in setting debt capacity and affordability guidelines for the University. Prior to the approval of any new debt issues or public-private partnership, projected sensitivity scores shall be reviewed in order to provide a measure of the University’s debt capacity and affordability. The sensitivity scorecard will analyze the impact of the anticipated debt or public-private partnership on the University by evaluating the most recent fiscal year-end audited financial statements and incorporating the proposal. For more information regarding the guidelines to be set annually by the Debt Management Committee, see **Appendix 2**.

Managing External Debt

The University recognizes that there are numerous types of financing structures for external debt, each with specific benefits, risks and costs. These will be reviewed by management within the context of the Debt Policy and the overall portfolio to ensure that any financial product or structure is consistent with the University’s objectives. Regardless of what financing structure(s) is utilized, a full understanding of the transaction, including quantification of potential risks and benefits, and analysis of the impact on the University’s creditworthiness and debt capacity, will be required. The maturity, average life and duration, and taxability of the debt issue should be commensurate with the project financed.

Mix of Fixed and Variable Debt

Due to the financing flexibility and lower interest cost typically associated with variable rate debt, it may be desirable, depending on market conditions, to maintain a portion of the University's aggregate debt on a floating (variable) rate basis. However, variable rate debt also introduces cash flow and fair value volatility to the debt service obligations. Therefore, the mix of variable and fixed-rate debt will be balanced appropriately.

When considering the use of variable rate debt, the University will consider the liquidity profile of the institution and the overall risk associated with variable rate debt prior to entering into a transaction. Such risks include the frequency and mechanics of the rate setting, the demand frequency and mechanics (as applicable), the market and investor base supporting the bond demand, the third-party market facilitators (e.g., remarking agents, bank facility providers), credit demands impacting rate/price performance, the structure and diversification relative to the overall portfolio, etc.

Use of Derivative Products

Derivative products provide another tool for managing the University's overall debt portfolio. The University is permitted to use derivative products but must conduct a thorough assessment of the risks and benefits, both short and long-term, for doing so. All derivative activity must be intrinsically understood from both a liquidity and operational perspective.

The University will undertake to have a diversified set of counterparties as appropriate to provide financial and debt related services, including provision of liquidity instruments and derivative instruments.

IV. Credit Rating and Investor Relations

The University will maintain ongoing communication and interaction with the rating agencies to inform the agencies about the general credit structure and financial performance of the University in order to maintain an acceptable credit rating. Maintaining an acceptable credit rating will ensure capital markets access and permit the University to continue to issue debt and finance capital investments at favorable interest rates; however, the attainment or maintenance of a specific rating is not an objective of this policy.

The University will also, at the time of sale and on an ongoing basis, keep investors in the University's bonds informed regarding the University's financial condition through appropriate means, such as timely posting of financial statements and other continuing disclosure documents.

V. Internal Loan Program

Units needing to finance certain projects or operations may borrow funds from the University's operating funds investment pool through an internal loan, cash advance, or a working capital line of credit, based on the intended use of funds. Units wishing to borrow funds should refer to the [Internal Loan Program Policy](#) for more information.

VI. Review of Debt Policy and Approval of Exceptions

This Debt Policy should be reviewed annually by the Debt Management Committee designated above and changed only when it no longer reflects the debt philosophy of the University. Consistent application of the University's Debt Policy provides evidence of debt management discipline over the long term. The Board of Trustees will be apprised of any significant changes to the Policy.

Exceptions to this policy must be approved by the President based on a recommendation from the Debt Management Committee.

VII. Policy History

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|-----------|----------------|
| Revised: | December 2022 |
| Revised: | December 2021 |
| Revised: | April 2019 |
| Revised: | March 2017 |
| Revised: | May 2011 |
| Revised: | April 2010 |
| Original: | September 2005 |

APPENDIX 1
Debt Management Practices

Debt Management Practices

Structure and Maturity

The University will issue bonds to finance capital projects under the provisions of trust indentures approved by the Board of Trustees.

Debt in the form of capitalized lease obligations will be approved by the Board of Trustees and issued on behalf of the University by the Commonwealth of Kentucky's Asset Liability Commission, the State Property and Buildings Commission, or other financing entities.

The University will employ maturity structures that correspond to the life of the facilities financed, are complementary to the overall portfolio structure and subject to limitations imposed by the State. As market dynamics change, maturity structures should be reevaluated. Call features should be structured to provide the highest degree of flexibility relative to cost.

Methods of Sale

The University will use the method of sale which will achieve the lowest cost of capital considering the complexity of the transaction. Generally, this can be achieved utilizing a competitive sales method for the placement of bond offerings. However, there may be certain transactions where a negotiated sales method would be more appropriate. To utilize this sales method, the University will need to request legislative approval.

Refunding Targets

The University will continuously monitor its outstanding debt portfolio for refunding and/or restructuring opportunities. In analyzing possible refunding candidates, the University will consider the net present value savings as a percentage of refunded debt as well as the potential cash flow savings from the refunding.

A refunding may also be considered if it relieves the University of certain limitations, covenants, payment obligations, or reserve requirements. Existing provisions of outstanding debt, such as call features, may also be considered when analyzing a debt for potential refunding, weighing the refunding benefit with the cost and any future restrictions imposed. The University also will consider refinancing certain obligations within a new money offering, even if savings levels are minimal, in order to reduce the administrative burden and cost of managing many small outstanding obligations.

Office of Financial Management

The Commonwealth of Kentucky's Office of Financial Management, in accordance with Kentucky Revised Statute 42.400, shall review and approve all proposed bond issues, bond anticipation notes, or interim external debt financings prior to the issuance.

Selection of Financial Advisors, Underwriters and Bond Counsel

The University will, in accordance with Kentucky Revised Statute 45A.840, utilize a Request for Proposal process to select financial advisors, underwriters and bond counsel. Multiple firms may

be selected to provide financial advisory, underwriting and bond counsel services for a specific contract period of time. The firms utilized on an individual transaction will be selected based upon expertise related to the specific transaction. Additionally, the University may utilize financial advisors, underwriters and bond counsel selected by the Commonwealth of Kentucky's Office of Financial Management through their own similar competitive process.

Post Issuance Compliance

The University understands the importance of complying with federal and institutional requirements regarding the issuance and ongoing management of its debt. The University will monitor its debt portfolio to remain within compliance of federal and state law to maintain the tax-exempt status, if applicable. All required continuing disclosures shall be timely filed.

APPENDIX 2

Debt Management Committee Operating Guidelines

Debt Management Committee Operating Guidelines

Purpose

The Debt Management Committee (“Committee”) was formed to review the University’s internal and external debt capacity, liquidity measures and projects requested to be funded in whole or in part with debt. The purpose of this policy is to establish guidelines to be set annually by the Committee to aid in the oversight and management related to the functions outlined above.

Guidelines

Monthly Days Cash on Hand

On or about April 1st of each year, the Committee will establish the preliminary monthly days cash on hand target range for the upcoming fiscal year for investment Tiers I, II, and III as defined by the [Operating Fund Investment Policy](#). On or about November 1st of each year, the Committee will establish the final monthly days cash on hand target range for the current fiscal year.

To assist the Committee in its determinations, University Financial Services will provide the Committee with the following information.

- 1) The completed Moody’s Investors Service higher education scorecard (“Moody’s scorecard”) and a sensitivity scorecard to analyze the impact of anticipated debt, or public-private partnership arrangements. The scorecards will be based on the most recent fiscal year’s audited financial statements.
- 2) A days cash on hand calculation for investment Tiers I, II, and III and a total cash and investments to operating expenses calculation. For the April meeting the calculations will be based both on the most recent fiscal year’s audited financial statements and the current fiscal year to date unaudited results. For the November 1st meeting, the calculations will be based on the most recent fiscal year’s audited financial statements.
- 3) Benchmark data related to the Moody’s scorecard for selected benchmark institutions and median scores for schools which are rated the same or higher by Moody’s.

Utilizing this data, the Committee shall provide a preliminary targeted range of days cash on hand for the investment Tiers I, II and III for the upcoming fiscal year at the April meeting and a final targeted range of days cash on hand for the current fiscal year at the November meeting. When considering the preliminary and final days cash on hand target ranges for investment Tiers I, II and III the Committee may elect to exclude the daily expenditures of University affiliates whose cash and investments are not included in investment Tiers I, II and III.

Internal Loans

On or about April 1st of each year, the Committee will establish the preliminary maximum days or percentage of days cash on hand which shall be allocated to be used for internal loans. On or about November 1st of each year, the Committee will establish the final maximum days or percentage of days cash on hand which shall be allocated to be used for internal loans. When

deciding these allocations, the Committee shall consider all the strategic demands for cash and the various funding mechanisms for meeting those demands facing the University.

In addition to setting the maximum internal loan capacity of the University, the Committee will also set the internal loan interest rates each fiscal year. For more information on the Committee's responsibilities concerning internal loans, refer to the [Internal Loan Program Policy](#).

Refunding Parameters

Annually at the June Board of Trustees meeting, the Executive Vice President for Finance and Administration will recommend through the Finance Committee a resolution providing for the authorization, issuance and sale of refunding obligations. The approval will be sought for all prior obligations eligible to be refunded during the upcoming fiscal year. University Financial Services will provide the Committee with a net present value savings analysis for each refunding candidate. Using this analysis, the Committee will set refunding parameters and use the parameters to approve any refundings during the fiscal year.

Monitoring

At each Committee meeting, and with each new internal loan, debt financing or public-private partnership arrangement, or upon request, University Financial Services shall report to the Committee a current and sensitivity Moody's scorecard along with a dashboard report for the purpose of monitoring the internal loan portfolio and the days cash on hand targets discussed above. In the event the established targets set by the Committee are not being met, the Committee may choose to alter the targets or establish a plan to achieve the desired targets, as necessary.

APPENDIX 3
Moody's Investors Service Higher Education Scorecard

Enter Obligor Name Here ▶

Enter Fiscal Year-End/Pro-Forma Date Here ▶

Select Institution Type ▶

| | | Sub Factor | Scorecard-Indicated Outcome | Numerical Equiv | Base Weight | Score |
|-----------------------------------|---|------------|-----------------------------|-----------------|-------------|-------|
| SCALE | Adjusted Operating Revenue (USD Million) | | | | 15% | |
| MARKET PROFILE | Brand and Strategic Positioning | | | | 10% | |
| | Operating Environment | | | | 10% | |
| OPERATING PERFORMANCE | EBIDA Margin | | | | 10% | |
| FINANCIAL RESOURCES AND LIQUIDITY | Total Cash and Investments (USD Million) | | | | 10% | |
| | Total Cash and Investments to Operating Expenses | | | | 15% | |
| LEVERAGE AND COVERAGE | Total Cash and Investments to Total Adjusted Debt | | | | 10% | |
| | Annual Debt Service Coverage | | | | 10% | |
| FINANCIAL POLICY AND STRATEGY | Financial Policy and Strategy | | | | 10% | |
| | | | N/A | | 100% | N/A |

Sub-factor: Brand and Strategy Positioning - Rationale

Sub-factor: Operating Environment - Rationale

Sub-factor: Financial Policy and Strategy - Rationale