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Debt Policy

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I. Policy Statement

The University's use of debt plays a critical role in ensuring adequate and cost-effective funding for the acquisition, construction and renovation of capital assets. Since debt is a limited resource, it must be managed strategically in order to best support the University's priorities. The following Debt Policy sets forth the guiding principles for the issuance of debt and provides a framework by which decisions will be made regarding the use and management of debt.

The University's debt management goals are to:

- Use debt as a means to fund mission-critical projects.
- Strategically manage debt in order to maintain continued access to capital markets and maintain an acceptable credit rating.
- Manage risk within the University's debt portfolio.
- Achieve lowest cost of capital possible consistent with the first three goals.

The objectives of this policy are to:

- Outline the legal and regulatory authority by which the University can issue debt.
- Establish a framework for prioritizing projects and approving debt issuance.
- Establish guidance for debt capacity parameters.
- Outline debt compliance and reporting requirements.
- Provide a framework for the University's debt management strategies.

II. Legal & Regulatory Authority

All debt issued by the Southern Illinois University System will be issued under the provisions of the legal and regulatory authority described below.

1. *Constitutional Authority*

   Article IX, Section 9 of the Constitution of the State of Illinois permits State colleges and universities to issue bonds or other evidence of indebtedness for such purposes and in such amounts as may be authorized by law, but such debt may not be secured by the full faith and credit or tax revenue of the State and cannot be repaid, directly or indirectly, from tax revenue.

2. *Revenue Bonds*

   The Board is authorized to issue revenue bonds pursuant to the Southern Illinois University Revenue Bond Act (110 ILCS 525/1 et seq.) (the "Revenue Bond Act") for the purpose of acquiring "projects" as defined in Section 525/2(5) and to refund bonds as provided in Section 525/4 (B) and (C). The sources of payment of such revenue bonds, as provided by the Revenue Bond Act and as authorized by resolution of the Board of Trustees, are net revenues of the project or any group of projects. The Revenue Bond Act authorizes the pledge of tuition and fees as additional security for revenue bonds.

In general, revenue bonds may be utilized for the purpose of acquiring, constructing, and equipping revenue-generating projects or for refunding previously issued revenue bonds.

3. *Certificates of Participation*

Between June 2009 and December 2014, the University issued certificates of participation pursuant to the authority granted in the State University Certificates of Participation Act (110 ILCS 73) (the "COPS Act"). Following the expiration of the COPs Act on December 31, 2014, authority to issue certificates of participation defaulted to authority granted by the Southern Illinois University Management Act (110 ILCS 520/0.01 et seq.) (the "Management Act"). Under the provisions of the Management Act, the Board may enter into installment contracts providing for the acquisition of various improvements by the Board paid for from the proceeds of certificates of participation representing interests in the payments to be made over time by the Board as consideration for such improvements. The certificates of participation are issued by a trustee under an indenture, which provides security for the certificates of participation.

In general, certificates of participation are used for acquiring, constructing, and equipping non-revenue producing projects, such as infrastructure, administrative or academic projects.

4. *Public University Energy Conservation Financing*

The Public University Energy Conservation Act (110 ILCS 62/1 et seq.) (the "Energy Conservation Act") authorizes the Board to enter into a "guaranteed energy savings contract" with a "qualified provider" to provide "energy conservation measures" (as such terms are defined in the Energy Conservation Act). The Energy Conservation Act contains the methods for obtaining and evaluating proposals and awarding the contract. Under the guaranteed contract, the provider guarantees the University that the savings under the contract will meet or exceed the costs of the conservation measures within twenty years of the date of final installation of the measures.

Section 110 ILCS 62/25 provides that the University may issue debt certificates to finance an installment payment contract or lease purchase agreement for the purchase and installation of the energy conservation measures.

5. *Illinois Procurement Code*

   The Illinois Procurement Code (30 ILCS 500) contains limitation provisions which apply both to the issuance of revenue bonds and to the issuance of installment contract certificates of participation. Service providers instrumental in the issuance of debt must be approved through a competitive request for proposal (RFP) process. Certain participants may be exempt from the procurement process. In addition, certificates of participation installment contracts are limited to a maximum duration of 10 years per the Illinois Procurement Code.

6. *Illinois Board of Higher Education*

   The Board of Higher Education Act (110 ILCS 205/0.01 et seq.) requires that the University submit its plan for capital improvement of non-instructional facilities to the Illinois Board of Higher Education (the "IBHE") for approval before final commitments are made if the total cost of the project, as approved by the Board, is in excess of $2 million. Non-instructional facilities include, but are not limited to, residence halls, stadiums, student centers, recreational facilities, and parking lots. The IBHE shall determine whether or not any project submitted for approval is consistent with the master plan for higher education and with instructional buildings that are provided for therein.

7. *Legislative Audit Commission Guidelines*

   The Legislative Audit Guidelines describe the purpose for which revenue bonds may be issued, the uses of funds, the sources of payment and the accumulation of excess reserves.

III. Establish Framework for Prioritizing Projects and Approving Debt Issuance

The University seeks to optimize its debt capacity by prioritizing projects and financing those projects that are critical to the mission and advance the strategic objectives of the University. Listed below are the processes established for prioritizing projects and approving the use of debt:

1. *Identify & Prioritize Projects*

   Debt financed projects will be identified as early as possible. All potential debt financed projects under consideration for the next several years are discussed as to their budget, timeline, and priority. Projects should be prioritized based on their relationship to the University's mission and strategic objectives.

2. *Internal Approval Process*

   Project details are reviewed by key administrative staff to assure there is demand for the project, a reliable source of revenue is identified for debt repayment and that the financial analysis assumptions are reasonable. Projects are reviewed and approved by the Chancellor and brought forward to the President on a campus-by-campus and programmatic basis. The President recommends project financing and brings forward to the Board of Trustees for project financing approval.

3. *Authorization to Issue Debt*

   Bonds and Certificates of Participation are authorized by resolution of the Board of Trustees prior to issuance. The Board has delegated to the Board Treasurer the responsibility for overseeing the issuance of revenue bonds and other forms of external financing.

IV. Establish Guidance for Debt Capacity Parameters

Debt capacity is generally measured through ratio analysis. Ratios provide a consistent measure of the debt level carried by an institution in relation to its balance sheet, revenues and expenses. Ratio analysis provides insight into the debt capacity from two perspectives: by monitoring trends over time and in comparison to benchmarks. It is the intent of the university to maintain a strong financial position that will support a favorable ratio analysis measured against national standards, peer and in-state comparisons, and credit rating agency medians.

Below are four key quantitative ratios used by the University to evaluate its level of debt affordability and debt capacity.

- *Spendable Cash & Investments to Total Debt*– Measures the ability of the University to repay bondholders from wealth that can be accessed over time or for a specific purpose.
- *Total Debt to Earnings Before Interest, Depreciation and Amortization (EBIDA)*– Measures the ability of the University to repay its debt from the profitability of its operations.
- *EBIDA Margin*– Measures net income, before non-cash expenses, relative to operating revenue to indicate the amount of cash the University generates to support its strategic and capital investments.
- *Maximum Annual Debt Service (MADS) Coverage*– Measures the margin of protection for the maximum debt service payments from annual operations.

The University recognizes that its strategy and mission must be the primary drivers of its capital investment and use of debt. External credit ratings provide a view on debt capacity and affordability, and will be used to help maintain a strong financial profile.

V. Debt Compliance and Reporting Requirements

In order to have continued access to the capital financing markets, the University must comply with Securities and Exchange Commission (SEC) laws, various Internal Revenue Service rules and regulations, and covenant requirements. Compliance and reporting are required both upon the issuance of debt and during the post-issuance phase which extends through and beyond the life of the debt obligation. The Board Treasurer is responsible for ensuring these compliance and reporting requirements are maintained.

1. *Compliance with the SEC Laws*

   The University will meet its ongoing disclosure requirements in accordance with the Securities Exchange Commission Rule 15c2-12, by submitting financial reports, statistical data, and any other material events as required.

2. *Compliance with IRS Regulations*

   In order to access tax-exempt financing, the University must comply with all applicable IRS regulations including, but not limited to, regulations relating to the use of bond proceeds, the use of bond financed facilities, and arbitrage in order to maintain the debt instrument's tax-exempt status.

3. *Compliance with Covenants*

   Debt issuance often comes with covenants, which are legally enforceable commitments made by the issuer. These covenants include the Interest Sinking Fund, Debt Service Reserve and Repair & Replacement Reserve funding requirements and distribution of financial reports. In fulfilling such covenants, the Board hereby establishes that the minimum annual deposit to the HAFS Repair & Replacement Reserve will be an amount equal to 10% of the Maximum Annual Debt Service or such other lesser amount as may be determined by the Board Treasurer.

4. *Debt Compliance Policy*

   The Board Treasurer has established a Debt Compliance Policy, which includes, but is not limited to, the following procedures and processes used to assist in monitoring these compliance and reporting requirements.

   - Responsibility for Maintaining Compliance
   - Private Business Use
   - Arbitrage Rebate
   - Investment of Debt Proceeds
   - Expenditure of Debt Proceeds
   - Record Retention
   - Continuing Disclosure

VI. Debt Management Strategies

When selecting a debt management strategy, all options will be evaluated within the context of balancing the goals of managing risk and achieving the lowest cost of capital possible. In order to manage the University's debt portfolio risk, debt will be assessed on a portfolio, rather than a transactional or project specific basis.

Described below are some of the key debt management strategies and tools that can be utilized to achieve the University's goals:

1. *Methods of Sale*

   The University will consider various methods of sale. Negotiated, competitive, private placement, and bank qualified sales will be considered on an individual transaction basis. Issue size and complexity will be factors in determining which method of sale to pursue.

2. *Fixed versus Variable Rate Allocation*

   Variable rate debt can provide a lower cost of capital, but introduces additional risks. The University will carefully examine the risks and rewards of variable rate exposure. Variable rate debt should only be used as an integral part of a long-term strategy and should not exceed twenty percent of the total debt portfolio.

3. *Purchase of Insurance or Credit Enhancement*

   The University will evaluate insurance and credit enhancement opportunities and utilize them if they are deemed cost effective.

4. *Call Features*

   The University may use call provisions when issuing debt. Call features should be structured to provide maximum flexibility relative to cost.

5. *Refunding Opportunities*

   The University will monitor its debt portfolio for refunding and/or restructuring opportunities. For a stand-alone refunding for savings, the University will generally enter into a transaction that produces at least a 3% present value savings (based upon the amount of callable bonds or certificates). The University may also seek to refinance debt for legal reasons, such as to ensure compliance with IRS regulations or to address any bond document related issues, including eliminating restrictive covenants, payment obligations, reserve and/or security requirements or other obligations, or from consolidation into larger, more cost-effective transactions. Advance refunding[1] transactions must weigh the current opportunity against possible future refunding opportunities.

6. *Selection of Underwriters and Participants on the Selling Team*

   The members of the selling team, including the senior and co-managing underwriters, bond counsel, financial advisor and other service providers, will be selected in compliance with the Illinois Procurement Code. The selling team members assembled should complement the specific needs of the particular transaction. The University will reserve the right to utilize a competitive process for any single debt issue.

7. *Public-Private Partnerships*

   Third parties may provide other types of funding for capital investments and other needs. When considering public-private partnerships, the University will assess the direct or indirect impact on the University's debt position or overall credit profile.

8. *Taxable Debt*

The University will manage its debt portfolio to minimize its taxable component in order to keep its cost of borrowing as low as possible. The University may utilize taxable debt for projects ineligible for tax-exempt financing or when compliance with tax-exempt financing rules is an administrative burden. Taxable debt would be issued pursuant to the same legal and regulatory authority as tax-exempt debt.

VII. Debt Policy Monitoring

The Board Treasurer is responsible for implementing this Debt Policy and will periodically review the policy to ensure it remains consistent with the University's objectives and industry standards. Any recommendations for changes to the policy will be brought to the Board of Trustees.

Footnotes

[1] The Tax Cuts and Jobs Act of 2017 eliminated the ability of governmental issuers and issuers of qualified 501(c)(3) bonds to issue advance refunded bonds on a tax-exempt basis after December 31, 2017. IRC Section 149(d) places limits on advance refundings which it defines as a bond issued to advance refund another bond more than 90 days before the redemption of the refunded bond.

Attribution

This policy was developed, in part, or incorporates language, based upon the debt policies of the University of Illinois, University of North Carolina and Oregon State University. Because legal structure and debt issuance are governed by state and federal laws and statues, this policy may look very similar to other institutions.