System-wide Policy: BT0026 - Debt Management	
Version: 2	Effective Date: 06/21/2019

BOARD OF TRUSTEES
DEBT MANAGEMENT POLICY

INTRODUCTION

The Board of Trustees of The University of Tennessee ("Board"), hereby adopts the following policies and procedures concerning debt management.

When the Board seeks to borrow money for any purpose, the Board must first obtain the approval of the Tennessee State School Bond Authority (the "Authority"), created in 1965 under the Tennessee State School Bond Authority Act, Tennessee Code Annotated §§ 49-3-1201 *et seq*. ("Act") (see also University of Tennessee Fiscal Policy FI0620, paragraph 8d). The Authority is a corporate governmental agency and instrumentality of the State of Tennessee whose purpose is to finance capital projects for public institutions of higher education located in Tennessee by issuing its bonds and notes. The Board has entered into a Second Program Financing Agreement dated as of November 1, 1997, as amended and restated as of May 9, 2013 (the "Financing Agreement") with the Authority for the financing of projects for institutions under the jurisdiction of the Board.[1] Terms not defined in this Policy have the same definition as in the Financing Agreement.

At this time, the Board chooses to finance over time all borrowing needs through the Authority with the exception of limited special situation borrowings that will be approved by the Authority but privately placed (e.g., specialized equipment with obsolescence risk for which the equipment manufacturers provide financing; interest rate subsidy programs usually offered through federal agencies).

The Authority has financed for the Board a variety of higher education projects including dormitories, athletic facilities, parking facilities, student activities/recreation centers, research laboratories, and major equipment purchases. These projects could be contrasted with capital projects for basic academic and instructional needs such as classrooms, laboratories, and libraries that are funded from the proceeds of the State's general obligation bonds issued by the State Funding Board and for which the Board is not obligated to pay the debt service.

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[1] A copy of the Financing Agreement is Attachment B to this Policy. There are no First Program Bonds outstanding, and thus the Amended and Restated Financing Agreement dated as of September 17, 1996 is of no effect.

PURPOSE

Debt management policies provide written guidance about the amount and type of debt issued by governments, the issuance process, and the management of the debt portfolio. A debt management policy tailored to the needs of the Board: (1) identifies policy goals and demonstrates a commitment to long-term financial planning; (2) improves the quality of decisions; and (3) provides justification for the structure of debt issuance. Adherence to its debt management policy signals to rating agencies and the capital markets that the Board is well-managed and should meet its obligations in a timely manner.

Debt levels and their related annual costs are important long-term obligations that must be managed within available resources. An effective debt management policy provides guidelines for the Board to manage its debt programs in line with those resources.

GOALS AND OBJECTIVES

The Board is establishing a debt policy as a tool to ensure that financial resources are adequate to meet the Board's long-term debt program and financial planning. In addition, the Debt Management Policy (the "Policy") helps to ensure that financings undertaken by the Board satisfy certain clear objective standards designed to protect the Board's financial resources and to meet its long-term capital needs. This Policy coordinates with other policies of the Board, including but not limited to the fiscal policies identified in Attachment A.

The goals of this policy are:

1. To document responsibility for the oversight and management of debt related transactions;
2. To define the criteria for the issuance of debt;
3. To define the types of debt approved for use within the constraints established by the General Assembly;
4. To define the appropriate uses of debt; and
5. To minimize the cost of debt.

The objectives of this policy are:

1. To establish clear criteria and promote prudent financial management for the issuance of all debt obligations;
2. To identify legal and administrative limitations on the issuance of debt;
3. To ensure the legal use of the Board's direct debt issuance authority;

4. To maintain appropriate resources and funding capacity for present and future capital needs;
5. To evaluate debt issuance options;
6. To promote cooperation and coordination with other stakeholders in the financing and delivery of services;
7. To manage interest rate exposure and other risks; and
8. To comply with Federal Regulations and Generally Accepted Accounting Principles ("GAAP").

DEBT MANAGEMENT

A. Purpose and Use of Debt Issuance

1. Debt may be used to finance capital projects identified by the campuses/institutes comprising The University of Tennessee. Most often, projects are identified and included in the University's capital plan submitted to the Tennessee Higher Education Commission annually for incorporation into the State of Tennessee annual budget ("disclosed projects"). Occasionally, justified mission critical projects will be brought to the Tennessee Higher Education Commission intra-year for financing.
2. Debt may be used to finance project costs which include all direct capital costs and indirect capital costs of projects, including but not limited to costs of construction and acquisition, costs of issuance of debt, funded interest on debt, and amounts to fund or replenish reserves, if and to the extent approved by the Authority. In compliance with Article II, Section 24, of the Tennessee Constitution, no budgeted operational expenditures (including internal employee labor) shall be reimbursed with debt proceeds unless such debt is retired/repaid within the fiscal year of issuance.

B. Debt Capacity Assessment

1. The debt capacity of the Board is partially reliant on the debt capacity of each institution under its jurisdiction. Due to this reliance, this Policy requires the assessment of the debt capacity on a project by project basis as each project is considered. Debt capacity of each project is based on debt service coverage, which measures the actual margin of protection for annual debt service payments from the annual pledged revenue. The pledged revenue plus the pledge of Legislative Appropriations must meet a two times coverage test for the project to be approved for debt funding.

2. The Commercial Paper Program is limited to the amount stated in the Commercial Paper Resolution as amended and by the amount allowed in the Credit Agreement.

C. **Federal Tax Status**

1. **Tax-Exempt Debt** – The Board will use its best efforts to have projects eligible for financing with tax-exempt debt based on the assumptions that tax-exempt interest rates are lower than taxable rates and that the interest savings outweigh the administrative costs, restrictions on use of financed projects, and investment constraints.
2. **Taxable Debt** – The Board will agree to financing of projects with taxable debt when projects are not eligible to be financed with tax-exempt debt or when the administrative costs, restrictions on use of financed projects, and investment constraints outweigh the benefit of tax-exempt rates.

D. **Legal Limitations on the Use of Debt**

1. Pursuant to Tennessee Code Annotated § 47-3-1207(d)(4), limitations on the purpose to which the proceeds of sale of bonds or notes may be applied are contained in the resolution or resolutions authorizing the bonds or notes (commercial paper).
2. No debt may be issued for a period longer than the useful life of the capital project it is funding.

TYPES OF DEBT

Pursuant to Tennessee Code Annotated § 49-3-1207, the Authority is authorized from time to time to issue its negotiable bonds and notes. The Board (through the University Treasurer) will work with the Authority concerning the type of debt used to fund the Board's projects. The Board will request funding through short term debt, from time to time as needed to fund projects during their construction phase and to fund projects with an average useful life of ten years or less.

DEBT STRUCTURE

The Board, when requesting financing for a project, shall request the Authority to structure the funding:

A. Term

All capital projects financed through the issuance of debt will be financed for a period not to exceed the useful life of the projects, but in no event will the term exceed thirty (30) years.

B. Capitalized Interest

From time to time certain projects may require the use of capitalized interest from the issuance date until the Board has beneficial use or occupancy of the financed project. Interest may be financed (capitalized) through a period permitted by federal law and the Authority's Second Program General Bond Resolution if it is determined that doing so is beneficial.

C. Debt Service

Debt issuance shall be planned to achieve relatively net level debt service. The Board shall not use bullet or balloon maturities, absent sinking fund requirements, except in those instances where these maturities serve to make existing overall debt service level or to match a specific income stream.

No request shall be made to the Authority for debt to be structured with deferred repayment of principal unless such structure is specifically approved by affirmative vote of the members of the Board.

REFUNDING OUTSTANDING DEBT

At least semiannually, Authority staff with assistance from the Authority's Financial Advisor analyzes outstanding bond issues for refunding opportunities, whether for economic, tax-status, or project reasons. Consideration is to be given to anticipated costs and administrative implementation and management. The Board shall report to the Authority a need for refunding when:

1. The refunding of the debt is necessary due to a change in the use of a project that would require a change to the tax status of the debt.
2. The project is to be sold or no longer in service while still in its amortization period.
3. Restrictive Covenants prevent the issuance of other debt or create other restrictions on the financial management of the project and revenue producing activities.

The Board will request the refunding term to be no longer than the term of the originally issued debt.

RESERVE FUNDS

A. Debt Service Reserve Fund

The Authority's Second Program General Bond Resolution establishes a Debt Service Reserve Fund to be set up for each bond that is issued. If future Authority bond resolutions do not require such a reserve fund, this provision will not apply.

B. Interest Rate Reserve Fund

The Authority establishes an interest reserve fund for the Commercial Paper Program for each project. The interest reserve fund provides security for interest due on the commercial paper as it matures between billings. The Board will pay on a monthly basis based on the amount of commercial paper that was used. When a project is either repaid or taken to bonds, the amount invested in the reserve fund will be credited back to the Board.

RISK ASSESSMENT

The University Treasurer will evaluate each transaction to assess the types and amounts of risk associated with that transaction, considering all available means to mitigate those risks. The University Treasurer will evaluate all proposed transactions for consistency with the objectives and constraints defined in this Policy. The following risks should be assessed before issuing debt:

A. **Change in Public/Private Use.** The change in the public/private use of a project that is funded by tax-exempt funds could potentially cause a debt issue to become taxable.

B. **Default Risk.** The risk that revenues for debt service payments are not all received by the due date.

C. **Liquidity Risk.** For variable rate debt, the risk of having to pay a higher rate to the Authority for the liquidity provider in the event of a failed remarketing.

D. **Interest Rate Risk.** For variable rate debt, the risk that interest rates will rise, on a sustained basis, above levels that would have been set if the issue had been fixed.

E. **Rollover Risk.** For variable rate debt, the risk of the inability to obtain a suitable liquidity facility at an acceptable price to replace a facility upon termination or expiration of the contract period.

Transparency

The Board shall comply with the Tennessee Open Meetings Act, providing adequate public notice of meetings and specifying on the agenda when matters related to debt issuance will be considered. Additionally, in complying with U.S. Securities and Exchange Commission Rule 15c2-12, the Board will assist the Authority to provide certain financial information and operating data by specified dates, and to provide notice of certain enumerated events with respect to the bonds, if material.

Professional Services

The Board uses its General Counsel as its Issuer's Counsel; no engagement letter is required since General Counsel is an employee of the Board.

Potential Conflicts of Interest

If the Board were to hire professionals to assist the Board in a debt transaction, the professionals shall be required to disclose to the Board existing client and business relationships between and among the professionals to a transaction (including but not limited to financial advisor), as well as the Authority. This disclosure shall include that information reasonably sufficient to allow the Board to appreciate the significance of the relationships.

Debt Administration

A. **Planning for Sale –** The Board (through the University Treasurer) will provide all requisite information to the Authority to facilitate the compilation of data necessary for the Official Statement related to the bond issuance and bond underwriting.

B. **Post-Sale –** The Board will ascertain that University fees and charges are established at levels sufficient to meet the two times debt coverage when combined with legislative appropriations. The Board will provide for timely transmission of requisite debt service payments as billed by the Authority.

C. **Continuing Administration –** The Board (through the campus/institute administration) will ascertain that facilities financed with tax exempt debt will be used in a manner such as to not jeopardize the exempt status of the issued debt. The Board (through the campus/institute administration) will maintain the financed facilities in a prudent manner establishing maintenance reserves when necessary to preserve the viability of the facilities.

Federal Regulatory Compliance and Continuing Disclosure

A. Arbitrage

The Board (through the University Treasurer) will work with the Office of State and Local Finance to comply with arbitrage requirements on invested tax-exempt bond funds consistent with representations made in the relevant Tax Certificate. The Board will also retain all records relating to debt transactions for as long as the debt is outstanding, plus three years after the final redemption date of the transaction.

B. Generally Accepted Accounting Principles (GAAP)

The Board will comply with the standard accounting practices adopted by the Financial Accounting Standards Board and the Governmental Accounting Standards Board when applicable.

Review of the Policy

The debt policy guidelines outlined in this Policy are intended to provide direction regarding the future use and execution of debt. The Board maintains the right to modify these guidelines in a manner similar to the original adoption of the Policy.

History:

Adopted	6/21/2012
Revised	6/21/2019 (technical revisions)

Attachment A - Relevant UT Fiscal Policies

FI0620 - Capital Outlay

FI0605 - Equipment

FI0405 - Procurement

FI0625 - Lease of Real Property by or to the University

FI0420 - Contracts

FI0330 - Unrelated Business Taxable Income (UBTI)

FI0120 - Records Management

FI0125 - Conflict of Interests [Replaced by GE0002]

Attachment B - Second Program Financing Agreement (November 1, 1997, as amended and restated as of May 9, 2013)