Debt Management

I. Purpose

This Debt Management Policy is designed to provide a useful framework by which decisions will be made concerning the use and management of debt but is not intended to bind the Board of Trustees in the proper exercise of its fiduciary discretion.

This policy and its underlying strategies are subject to reevaluation and change over time and shall be reviewed as needed but no less frequently than every three years. The Finance, Budget and Audit Committee of the Board of Trustees shall be responsible for monitoring this policy and the Vice President for Finance and Administration and Treasurer shall be responsible for implementing this policy.

It is recognized that debt may be used prudently to finance capital projects that enable Dickinson College (the “College”) to achieve its mission and strategic objectives. Decisions regarding the use of appropriate financial leverage should be balanced to ensure the financial health of the College both in present terms as well as in terms of the effect of present decisions on future costs of capital. Debt, as the term is generally used herein, includes all short- and long-term obligations, guarantees, and instruments that have the effect of committing the College to future payments, but excludes unsecured trade credit payable less than 90 days, short-term operating leases and financing leases in immaterial amounts. For purposes of calculating the ratios described in Article VII and defined in Appendix A, its meaning and usage is intended to follow industry standards as applied by applicable rating agencies. Any assumption of debt in excess of $2 million shall be subject to approval by the College’s Board of Trustees.

II. Objectives

A) To provide funds to support the College’s capital needs while providing for the current and future financial health of the College.

B) To support and fulfill the debt management fiduciary oversight responsibilities of the Trustees by providing structure and guidance for College administrators.

C) To maintain an acceptable credit rating, given its other institutional priorities and goals, that will permit the College to continue to issue debt and finance projects at favorable rates and fulfill the College’s mission but with a view to optimizing institutional credit worthiness over the long term.

D) To provide a suggested methodology for determining the feasibility of certain types of projects and matching project costs with available funding to meet the College’s strategic objectives.
E) To allow for financial flexibility.

F) To manage debt in compliance with applicable laws and regulations.

III. Debt Operating Guidelines

The following are designed as general guidelines for borrowing decisions, but are not intended to be all-inclusive:

A) The College will generally 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. An exception to this matching principle would be in the case of interim financing for a capital project where debt financing, not operating funds, would be used to bridge any gap between the timing of cash flows for the project’s funding and its construction. In circumstances where bridge financing is utilized, it is expected that there be a clearly identified and reliable source of payment.

B) The allocation and use of debt financing within the College will include prioritization among all uses: academic, student life projects and real property, plant and equipment. Projects that relate to the strategic objectives are core mission of the College will be given priority for debt financing, but projects that present a related revenue stream or can create budgetary savings will also receive priority consideration. For these projects, the use of debt should be supported by an achievable finance plan that includes servicing the debt and meeting any new or increased operating costs.

C) Annual debt interest and principal amortization payments will be budgeted for in the annual operating budget or in a specified or designated restricted fund.

D) Projects proposed to be funded with bonded debt should include a pro forma of future operating expense up to a five-year period and establish a long-term replacement reserve fund for capital replacement (e.g. roof, mechanical system and special equipment).

E) The College will consider the use of call options to reduce its overall cost of capital and to provide for maximum flexibility of its debt portfolio. The College will actively consider calling and/or refinancing a single outstanding debt issue when net savings for that calling/refinancing, measured on a net present value basis, are at least 2% or $500,000.

F) The College will consider other reasonable options to reduce its overall cost of capital and to provide for maximum flexibility of its debt portfolio.

G) To provide an appropriate and prudent balance between interest rate risk and the cost of capital, the College will consider a mix of variable and fixed rate debt in structuring its overall debt portfolio.
H) In issuing tax-exempt debt, the College will adhere to all requirements of law, including without limitation requirements of the federal tax law which, inter alia, impose restrictions on the average life of the bonds, use of proceeds for private use purposes, and timing of expenditures. The College will also comply with post-issuance requirements including record-keeping and continuing disclosure. The College may consider taxable debt as an alternative to tax-exempt debt as specified in Article IV.

I) In negotiating bond documents, care should be taken to avoid any covenants that could impede the financial flexibility of the College. All existing and anticipated bond covenants must be fulfilled after reviewing three-year projections, which assume the new debt has been incurred, before proceeding with new debt.

J) The College may be subject to certain risk related to non-traditional transactions (e.g. private/public partnerships, sale-leaseback, off-balance sheet transactions), and therefore, commitment of resources to such transactions will not be permitted absent specific Board direction.

K) Long-term debt will not be incurred to fund operations.

IV. Capital Project Planning, Funding and Approval Criteria

All projects in excess of $2 million must be presented by the College’s Administrative Officers to the Committee on Facilities and on Finance, Budget and Audit of the Board and approved by the Board of Trustees or the Executive Committee of the Board of Trustees, even if the project will not be funded by debt, in accordance with applicable Board policy.

The College’s goal is for at least 50% of the expected non-debt funding proceeds to be received, or pledged and anticipated to be received, within three-years as of the date of commencement of construction.

Project team selection for project development may proceed in advance of formal approval; this includes engagement of design and engineering professionals and consultants, programming schematic design through final construction documentation, independent cost estimates and issuance of bid documents for contractor selection. However, final award and execution of construction contractor’s agreement will not proceed until the relevant committee of the College has formally reviewed and approved:

1. An executive summary project cost analysis, including the potential impact on operations (one-time costs, incremental maintenance costs, incremental direct revenue) and the potential impact on cash flows;
2. A plan of debt financing and/or funding plan that may include debt funding and non-debt funding has been formally reviewed and approved by the relevant committee(s) and the Board of Trustees of the College;
3. An analysis of the ability of the College to service any additional debt associated with the project has been formally reviewed and approved by the relevant committee(s) and the Board of Trustees of the College;
4. Satisfactory progress has been made in obtaining expected non-debt funding, and the amount of proceeds on deposit in the form of cash and/or short-term investments in connection with the proposed project equals or exceeds the goals for the project;
5. Satisfactory progress has been made regarding gift intentions, pledges and anticipated payments to date for the project;
6. The ability of the College to fulfill all existing and anticipated bond covenants and evaluation of the impact on the College’s key financial ratios (Appendix A) has been formally reviewed and approved by the respective committee(s) and the Board of Trustees of the College.

The debt discussion and analysis referenced above will take place within the Committee on Finance, Budget and Audit and/or Ad Hoc Committee on Financing Strategies and will be supported by the Advancement Division. Additionally, the Committee on Facilities and Ad Hoc Committee on Real Estate will be consulted on the impact of any debt undertaking on their current or proposed activities.

V. Measurement of Acceptable Debt Levels

The College’s debt capacity will be evaluated and determined by a number of factors including: legal authorizations and limitations, current and pro forma operating performance, credit considerations (including the College’s credit rating) and targeted financial ratios.

A. As part of the Debt Management Policy, the College will seek to maintain a long-term bond rating in the “A” category to assure continued access to the capital markets at competitive rates.

B. To ensure that the College operates within an appropriate financial framework and maintains an adequate level of flexibility to respond to major market shifts or competitive disruptions, the key financial measures in Appendix A will be used as a basis for performing a financial evaluation for all potential debt issues. The administration will report annually to the Committee on Finance, Budget and Audit concerning the College’s performance on key financial ratios.

VI. Debt Structure

When issuing debt, the following options related to debt structure should be considered:

A. Taxable vs. Tax-Exempt
   Tax-exempt debt should be secured when possible as it typically represents the lowest cost of funds. However, it is possible that the nature of a future need or a tax law change could result in taxable debt representing the most appropriate or only solution. The
College may consider taxable debt as an alternative, where market conditions and debt flexibility make it appropriate.

B. Fixed vs. Variable Rate
Consideration should be given to both historic and current market rates for fixed and variable rate debt, the structure of the College’s existing debt, and the nature of investments in the College’s investment portfolio (long- vs. short-term and type). Variable rate debt usually carries significant additional risks compared with traditional fixed rate financing. These risks include changes in interest costs, the ability to remarket the debt consistently, and the ability to secure the necessary bank liquidity support for the transactions. These risks will be carefully considered in comparing fixed and variable rate debt.

C. Use of Credit Enhancement
Issuers of public debt often secure a third party to guarantee payment to bondholders in the event that the borrower defaults. Such action lowers the yield rate on the bonds by reducing risk. The College should not use credit enhancement if the resulting financial covenants significantly compromise the College’s future plans and operations.

D. Amortization Type (level, staggered or bullet debt service amortization)
The College will determine the appropriate duration and the specific amortization schedule of each debt issue by evaluating its overall debt portfolio.

E. Use of Interest Rate Derivative Products
Interest rate derivative products may be utilized in appropriate circumstances, on either a current or forward basis, for the purpose of lowering the College’s cost of borrowing and/or interest rate risk. Based on current market interest rates, any limiting features associated with potential derivative products, the structure of the College’s existing debt portfolio and the composition of its investment portfolio, the advantages and disadvantages of certain interest rate derivative products (such as an interest rate swap) will be reviewed. Use of any interest rate derivative products would require Committee on Finance, Budget and Audit review and recommendation, followed by Board approval.

F. Other financing sources and non-traditional financing structures including guarantees of third-party debt, utilization or service agreements can be considered providing the economic impact on the College’s debt capacity, operating budget and credit has been evaluated. Such transactions may include but are not limited to leases, sale-leaseback or long-term leases or operating agreements.

VII. Ratios
The ratios included in Appendix A will be monitored and reported to the Finance, Budget and Audit Committee of the Board of Trustees at least annually, and prior to the incurrence of any debt of the College. In particular, the following three ratios will be examined closely with the goal of maintaining certain levels. The specific thresholds are not intended as absolute levels,
but to guide discussion and decisions. For example, if the College falls below the specified levels, management will discuss the reasons and implications of such event and take this into consideration in making capital and debt decisions. In addition to the College’s ratios and any medians published by the rating agencies for its rating category, the College will also compare its ratios relative to its financial peers, as indicated in Appendix A.

A. Debt Service to Operations
B. Debt Service Coverage
C. Expendable Resources to Debt
APPENDIX A

Ratio #1:  Debt Service to Operations

Definition - The debt burden is measured by comparing debt service to operating expenses. A high percentage of debt service to operations suggests that current students have been unfairly burdened with debt, not allowing their tuition dollars to be used for other resources, such as faculty and student services, to which they are entitled. In addition, a high proportion of debt relative to the College’s operations can reduce budget flexibility to address other needs. The College will seek to maintain a ratio below 7%

Reference: Standard & Poor’s has publicly stated that a ratio under 5% is considered good, between 5% and 8%, moderate, and in excess of 8%, a potential concern

Monitors: Actual Annual Debt Service
Ratio Calculation: Annual Debt Service / Annual Operating Expenses (including financial aid as an operating expense per S&P’s methodology)

Maximum: 7.0%
Future Goal: 5.0% - 6.0%

Ratio #2: Debt Service Coverage

Definition - This formula largely measures the College’s ability to service debt from operating performance and rewards those institutions that generate a substantial surplus, thus resulting in a higher ratio. This ratio can vary greatly from year to year based on operating performance and changes in debt service. The desired goal is for the College to maintain a 2.75x debt service coverage ratio.

Monitors: Ability to make debt service payments from operating cash flow
Ratio Calculation: [Operating surplus (deficit) + interest expense + depreciation] / principal and interest payments

Reference: Operating surplus to be defined based on S&P’s methodology, which is based on the change in unrestricted net assets before other gains/losses and excludes investment income other than those funds appropriated for current operations.

Ratio #3:  Expendable Resources to Debt

Definition - This formula, widely used by rating agencies and other credit analysts, measures the amount of debt relative to an institution’s financial resources and can be viewed as the inverse of
the debt-to-capitalization ratio used in the corporate sector. Expendable Resources includes unrestricted and temporarily restricted net assets that are available for expenditure but excludes both unrestricted and temporarily restricted net investment in plant. The College’s desired goal is 200%, although fluctuations in investment markets may lead to circumstances where temporarily falling below this goal is appropriate.

Monitors: Coverage of direct debt by financial resources that are not permanently restricted
Ratio Calculation: Unrestricted and temporarily restricted net assets less net investment in plant / direct debt

### Related Information

- Fixed Asset Management
- Project Management Policy
- Tax-Exempt Bond Compliance

### History/Revision Information

**Responsible Office/Division:** Financial Operations

**Effective Date:** January 2006

**Last Amended Date:** January 2014

**Next Review Date:** Periodic review by the Trustee Committee on Finance, Budget and Audit and the Trustee Committee on Facilities

**Also Found In:** Minutes of the Trustee Committee on Finance, Budget and Audit