

Debt Management Policy

Policy/Procedure

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 prohibit the Board of Trustees from taking actions 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 Trustee Committee on Resources 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 sustainable financial health of the College both in present terms as well as for future generations. 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 payables 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 more than \$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, terms, and security packages and fulfill the College’s mission 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 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 repayment.
- 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 and 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 long-term debt should include pro-forma of future operating expense up to a five-year period and ensure sufficient resources to maintain the facility over its useful life (e.g., roof, mechanical system, and special equipment).
- E) The College will consider the use of call options and other structuring tools to reduce its overall cost of capital and to provide for maximum flexibility within 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% of refunded par after considering the cost of the refunding transaction.
- F) To provide an appropriate and prudent balance between interest rate risk and the cost of capital, the College will evaluate a mix of variable and fixed rate debt in structuring its overall debt portfolio.

- G) 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, 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.
- H) In negotiating bond documents, care should be taken to avoid any covenants or security packages that could impede the financial flexibility of the College. All existing and anticipated bond covenants should be reviewed for reasonableness of maintaining future compliance before proceeding with new debt.
- I) Long-term debt will not be incurred to fund operations.

IV. Capital Project Planning, Funding and Approval Criteria

All projects more than \$2 million must be presented by the College's administrative officers to the Trustee Committee on Resources 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 the construction contractor's agreement will not proceed until the relevant committee of the Board of Trustees of the College has formally reviewed and approved:

1. A 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.
3. An analysis of the ability of the College to service any additional debt associated with the project.
4. Evidence that 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. Evidence that 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).

The debt discussion and analyses referenced above will take place within the Trustee Committee on Resources and will be supported by the Advancement Division. Additionally, the Trustee Committee on Resources will be consulted on the impact of any debt undertaking on 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.

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.

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 Resources 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 evaluated and 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 legal 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/or 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) which may serve to offset some or all the interest rate risk from variable rate debt. Variable rate debt usually carries significant additional risks compared with traditional fixed rate debt, including changes in interest costs, the necessity to remarket the debt consistently, and the need 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 occasionally secure a third party to guarantee (or “insure”) payment to bondholders if the borrower defaults. Such insurance lowers the yield required on the bonds but requires an upfront payment by the borrower. The College will not use credit enhancement if the resulting financial covenants significantly compromise the College’s future plans and operations and/or if the cost is not justifiable.

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 the life of the asset being financed as well as the 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 reducing risks within the debt portfolio. The College will evaluate the potential benefits and risks of any interest rate derivative product (including interest rate swaps, options, caps, and floors) in the context of the current market environment, the transaction at hand, and the College’s existing debt and investment portfolios. Use of any interest rate derivative products would require Trustee Committee on Resources 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 structures and long-term leases or operating agreements.

VII. Ratios

The three ratios included in Appendix A will be monitored and reported to the Trustee Committee on Resources at least on an annual basis and prior to the incurrence of any debt of the College. While the College seeks to maintain certain minimum levels for these ratios, the specific thresholds are not intended to be absolute limits, 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 will use that when making capital and debt related 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. Total Cash and Investments 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% and ideally in the 4% - 6% range.

Monitors: The portion of the operating budget dedicated to debt service
Ratio Calculation: $\text{Annual debt service} / \text{operating expenses (including financial aid per S\&P's methodology)}$

Ratio #2: Three-Year Average Debt Service Coverage

Definition - This formula measures the College’s ability to service debt from operating performance and rewards those institutions that generate a substantial surplus. This ratio can vary greatly from year to year based on operating performance and changes in debt service, particularly for institutions that have non-level debt service profiles. Averaging the ratio over a three-year period serves to reduce some of the volatility. The College will seek to maintain a ratio above 2.0x.

Monitors: Ability to make debt service payments from operating cash flow
Ratio Calculation: $\text{Three-year average adjusted operating income [operating income} + \text{interest expense} + \text{depreciation]} / \text{annual debt service}$

Reference: Operating income to be defined based on S&P’s methodology, which is based on the change in net assets without donor restrictions before other gains/losses and excludes investment income other than those funds appropriated for current operations.

Ratio #3: Total Cash and Investments 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. Notably, the move by rating agencies to use a numerator of total cash and investments no longer distinguishes the impact of donor restrictions on their primary balance sheet leverage metrics. The College’s desired goal is to maintain a ratio above 3.0x, although fluctuations in investment markets may lead to circumstances where temporarily falling below this goal is appropriate.

Monitors: Coverage of direct debt by total cash and investments
Ratio Calculation: $\text{Cash} + \text{investments} / \text{debt (at par, including leases)}$

Related Information

Fixed Asset Management
Project Management Policy
Tax-Exempt Bond Compliance
Authorization to Engage in Financial Services Transactions

History/Revision Information

Responsible Office/Division:	Financial Operations
Effective Date:	January 2006
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Next Review Date:	Periodic review by the Trustee Committee on Resources
Also Found In:	Minutes of the Trustee Committee on Resources (and prior minutes from the Committee on Finance, Budget and Audit and the Committee on Facilities)