E- 2. DEBT POLICY

PURPOSE AND PHILOSOPHY

This Debt Policy serves to articulate Auburn University's philosophy regarding debt and to establish a framework to help guide decisions regarding the use and management of debt. As the University establishes institutional priorities through its strategic planning processes, including its campus master planning, the University will consider utilizing an appropriate mix of financing and funding sources, including State funding, gifts, internal reserves and investments, and external debt. This policy will help ensure that an appropriate mix of funding sources are utilized, that the University's debt capacity is allocated strategically, and that Auburn University's debt levels and types of debt are appropriate and responsible, given the University's financial strength and risk tolerance levels.

POLICY STATEMENT

Debt is a valuable source of capital project financing, and its use should be limited to projects that relate to the mission and strategic objectives of the University. The amount of debt incurred impacts the financial health of the University and its credit rating. The University will consider other funding opportunities (e.g., joint ventures, real estate development, grants, etc.) when appropriate and advantageous to the University. Opportunities and financing sources will be evaluated within the context of the Debt Policy.

OBJECTIVES

The broad objectives stated below provide the framework by which decisions will be made regarding the use and management of debt. The Debt Policy and objectives are subject to re-evaluation and change over time. This Debt Policy is set forth to:

1. Strategically use the University's credit to fund mission critical projects;

2. Manage the University's credit to maintain the highest acceptable credit rating that will permit the University to continue to issue debt at favorable rates. Use of key financial ratios provides management and the Trustees with feedback and assurances the University is not exceeding its desired use of credit capacity;

3. Optimize the debt portfolio as a whole, while also optimizing transactional and project-specific debt using an appropriate mix of fixed and variable rate debt to achieve the lowest cost of capital while limiting exposure to market interest rate shifts; and

4. Assign responsibilities for the implementation and management of the University's Debt Policy.

PROCEDURES AND GUIDELINES

Consideration is given to purpose, affordability, risk management, and financial structure (balance sheet) management in developing a framework for debt utilization and management. Generally, the following guidelines will be used, although they are not intended to be all-inclusive. Judgment by management and the Trustees ultimately will determine the use and amount of debt.

1. Only projects that further the mission and strategic goals of the University, either directly or indirectly will be considered for debt financing.

2. To the extent possible, State funding, gifts, grants, and internal reserves will be used to fund capital projects. Debt represents a valuable resource and will be used conservatively and strategically.

3. Bond financing will be coordinated to the extent possible so that multiple projects can be accommodated in a single borrowing to reduce overall issuance costs per dollar of debt issued.

4. The University will limit its overall debt to a level that, when viewed in the context of its current and future strategic objectives, is intended to optimize creditworthiness over the long term. In considering debt capacity and affordability, the University will monitor its financial condition and performance through review of (i) appropriate financial ratios (ii) public ratings; (iii) the merits and feasibility of projects being financed; and (iv) other relevant industry data such as comparison to other higher education institutions.

5. The University will seek the lowest cost source of financing when issuing debt, considered concurrently with the associated risk. It will consider the costs and benefits associated with different types of financing and liquidity options.

6. The portfolio allocation to variable rate debt will have an appropriate relationship to short-term liquid assets and will not exceed fifty percent (50%) of the debt portfolio. The allocation to variable rate debt may be managed or adjusted through the issuance of new debt or refundings and through the use of interest rate swaps and other derivative products such as caps and collars. The University will analyze costs and benefits of any derivative instrument relative to achieving its long-term capital structure objectives and will consider risk mitigation features. Under no circumstances will a derivative transaction be utilized that is not understood fully by management or that imposes inappropriate risk on the University. Certain risks to be considered include, but are not limited to, tax risk, interest rate risk, liquidity risk, counterparty risk, basis risk, and any other potential risk.

7. Annual debt interest and principal amortization payments will be provided for in the annual operating budget or in specific designated or restricted funds. Variable-rate interest will be budgeted conservatively at fixed rate levels adjusted annually.

8. The University will interact with credit rating agencies and will strive to maintain the highest acceptable credit rating.

9. The University will monitor and consider current or advanced refunding opportunities of outstanding debt when the net present value savings are positive, and the refunding will support the strategic need of the University. A refunding will also be considered if it relieves the University of certain limitations, covenants, payment obligations, or reserve requirements that reduce flexibility. The University will also consider refinancing certain obligations within a new money offering even if savings levels are minimal in order to consolidate debt into a general revenue pledge and/or reduce the administrative burden and cost of managing many small outstanding obligations.

10. The University will invest bond proceeds appropriately to achieve the highest return available under arbitrage limitations. The University will comply with arbitrage requirements on any invested bond funds.

DEBT RATIOS, PROJECT CONSIDERATION GUIDELINES, AND ONGOING REVIEW OF DEBT AND FINANCIAL PERFORMANCE

The following financial ratios, when considered together and over time, will help to provide a clear, high level assessment of the overall financial health of the University.

a. <u>Primary Reserve Ratio</u>
Expendable Net Assets/Total Expenses – This ratio provides a snapshot of financial strength and flexibility. A positive ratio or increasing trend over time may indicate increasing strength in financial condition.

b. <u>Viability Ratio</u>
Expendable Net Assets/Long Term Debt – This ratio measures the availability of expendable net assets to cover debt. A strong viability ratio is one measure of the University’s ability to respond to adverse conditions, attract capital from external sources, and maintain flexibility to fund new objectives.

c. <u>Return on Net Assets Ratio</u>
Change in Net Assets/Total Assets – This ratio measures total economic return and can be used to indicate whether the University is financially better or worse over time.

d. Net Income Ratio

Change in Unrestricted Net Assets/Total Unrestricted Revenue – This ratio measures success of financial operations for a given year.

Taken together, and in consideration of other indicators, the above ratios can represent a composite financial index which may be used to provide an overall financial measurement of the University.

The University recognizes the financial ratios noted above, and other industry measures of creditworthiness and sound financial management may change over time. The University will periodically review its debt policy to insure consideration is given to current higher education industry practices and standards.

Every project considered for financing must have a defined, supportable plan of costs (both construction and operating) approved by management. Associated revenues and cost savings should be estimated conservatively. Determination of the prioritization of individual projects to be allocated a portion of available debt capacity is a separate, internal decision that must be made before a project is initiated.

The University will monitor its debt and review financial performance on an ongoing basis. A report will be provided to the Trustees annually summarizing the University's outstanding (and proposed if applicable) debt and financial condition as indicated by appropriate industry measures, including financial ratios, public debt ratings and other relevant data.

ASSIGNMENT OF RESPONSIBILITIES

The Board of Trustees will review and consider for approval the annual capital project plan as well as each individual debt financing transaction. Additionally, the Board will review and approve the implementation of this Debt Policy and will approve any significant future changes.

The President/Executive Vice President is directly responsible for capital debt issuance and debt management.

Campus Planning and Facilities will take the lead role in estimating and defining project costs and obtaining Board of Trustee approval of the projects before debt issuances are constructed. These offices will work with the Executive Vice President, Director of Management Accounting, and the Associate Vice President for Business and Finance to explore the most advantageous funding plan for individual projects.

The Director of Management Accounting will coordinate with Campus Planning and Facilities to oversee the capital budgeting and funding plans for major projects. This office will work with the Controller, Bond Counsel, Campus Planning, Facilities, and others to help prepare and review the documents necessary for bond issuance and rating agency reviews and visits.

The Controller will maintain a schedule of current and forecasted debt and associated payment of principal, interest, and fees. The Controller will provide debt service budgets in the annual budget process and individually to all campus units which are assessed debt service. The Controller is responsible for the accounting, reporting and other disclosures, monitoring compliance with covenants, and arbitrage calculations associated with existing debt issues.

Treasury Services will invest unspent bond funds according to University investment policies to achieve the highest return available under arbitrage limitations.

APPROVED: January 31, 2008

REAFFIRMED: June 19, 2009