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DEBT CAPACITY STUDY

UNC Board of Governors

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# Overview of 2016 Debt Capacity Study

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## UNC System Report

- SL 2015-241 (H97) requires the Board to advise stakeholders “on the **estimated debt capacity of The University of North Carolina for the upcoming five fiscal years**”
- Because the UNC System itself has no aggregate debt capacity, the System report instead focuses on the following elements:
  - Educating stakeholders on the System’s current approach to evaluating debt and the complexity of the credit rating process
  - Assessing each Campus’s estimated debt capacity over a five year period
  - Making recommendations for the use of the Study and suggestions for future improvement

## Campus Reports

- Each Campus report provides context for the Campus’s financial model and addresses H97’s legislative requirements
- Campus reports contain the following components:
  - Overview of **recent enrollment trends** and other general performance metrics
  - Explanation of **factors considered in setting growth factors**
  - Summary of **projected results** for the financial model’s **four financial ratios**
  - Current **debt and credit profiles**, including details on financed projects, sources of repayment and recommendations for maintaining or improving the Campus’s credit rating
  - Copy of any **existing debt management policy**

# Study Methodology & Development

- State law mandates that the Campuses evaluate **debt to obligated resources** and a **five-year payout ratio**, but the task force also elected to track **debt service to operations** and **expendable resources to debt** to enhance the value of the Study
- Financial model assumes growth in Available Funds, expendable financial resources and operating expenses
- Each Campus was tasked with developing its own tailored policies and growth assumptions **to accommodate institutional diversity** across the UNC System and **to avoid distortions** created by a “one-size-fits-all” approach

## Statutory Ratios

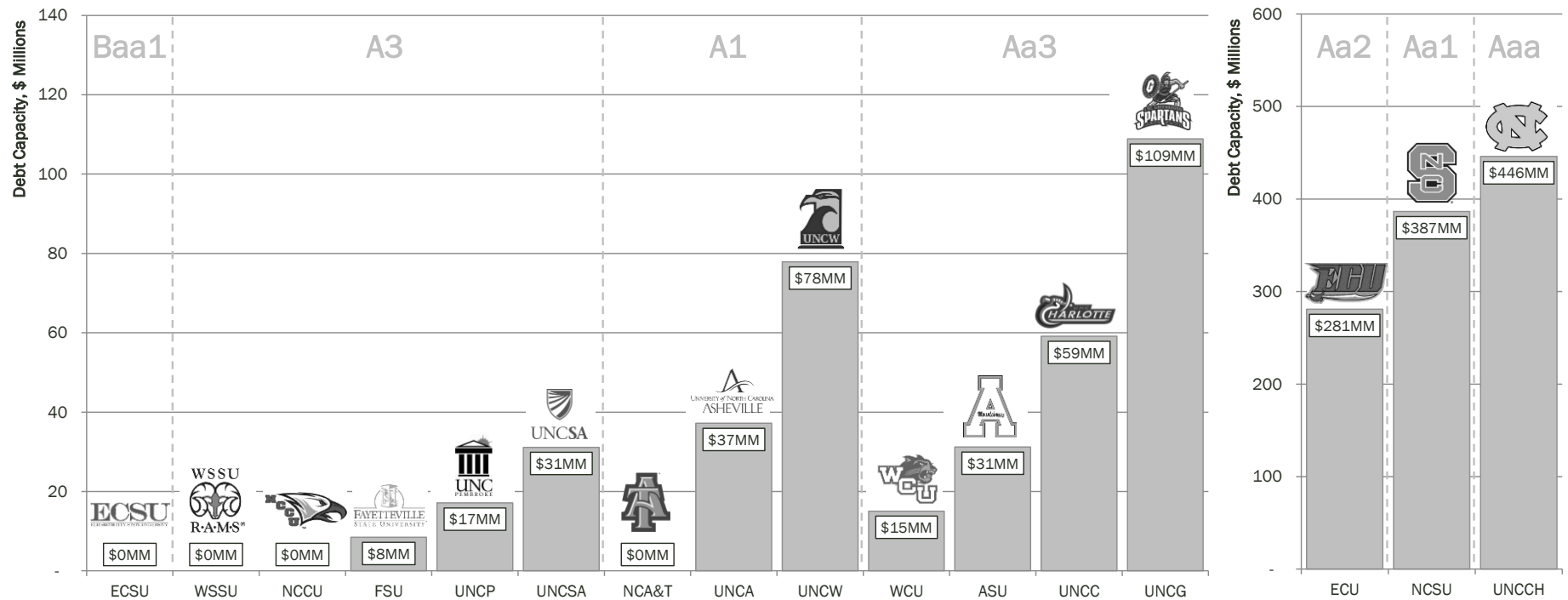
Ratio	Explanation	Commentary
<b>Debt to Obligated Resources</b>	Compares each Campus's outstanding debt to the funds legally available to service its debt	<ul style="list-style-type: none"><li>■ Provides a general indication of a Campus's ability to repay debt from wealth that can be accessed over time</li><li>■ Tied to the statutory framework for Campus debt, so ratio is not used outside the State</li></ul>
<b>Five-Year Payout</b>	Measures the percentage of each Campus's debt to be retired within the subsequent five year period	<ul style="list-style-type: none"><li>■ Indicates how rapidly a Campus's debt is amortizing and how much additional debt capacity may be created in the near term</li><li>■ Five year horizon is not widely used</li></ul>

## Supplementary Ratios

Ratio	Explanation	Commentary
<b>Debt Service to Operations</b>	Measures debt service burden as a percentage of each Campus's total operating expenses	<ul style="list-style-type: none"><li>■ Indicates a Campus's operating flexibility to finance existing requirements and new initiatives</li><li>■ Uses expenses rather than revenues because expenses tend to be more stable year-over-year</li></ul>
<b>Expendable Resources to Debt</b>	Measures the number of times each Campus's liquid and expendable net assets covers its aggregate debt	<ul style="list-style-type: none"><li>■ Provides a general indication of a Campus's ability to repay debt from wealth that can be accessed over time</li><li>■ Permits comparisons to peers outside the State</li></ul>

# Current Estimated Debt Capacity for 2016

## Estimated Debt Capacity Across the System (2016)

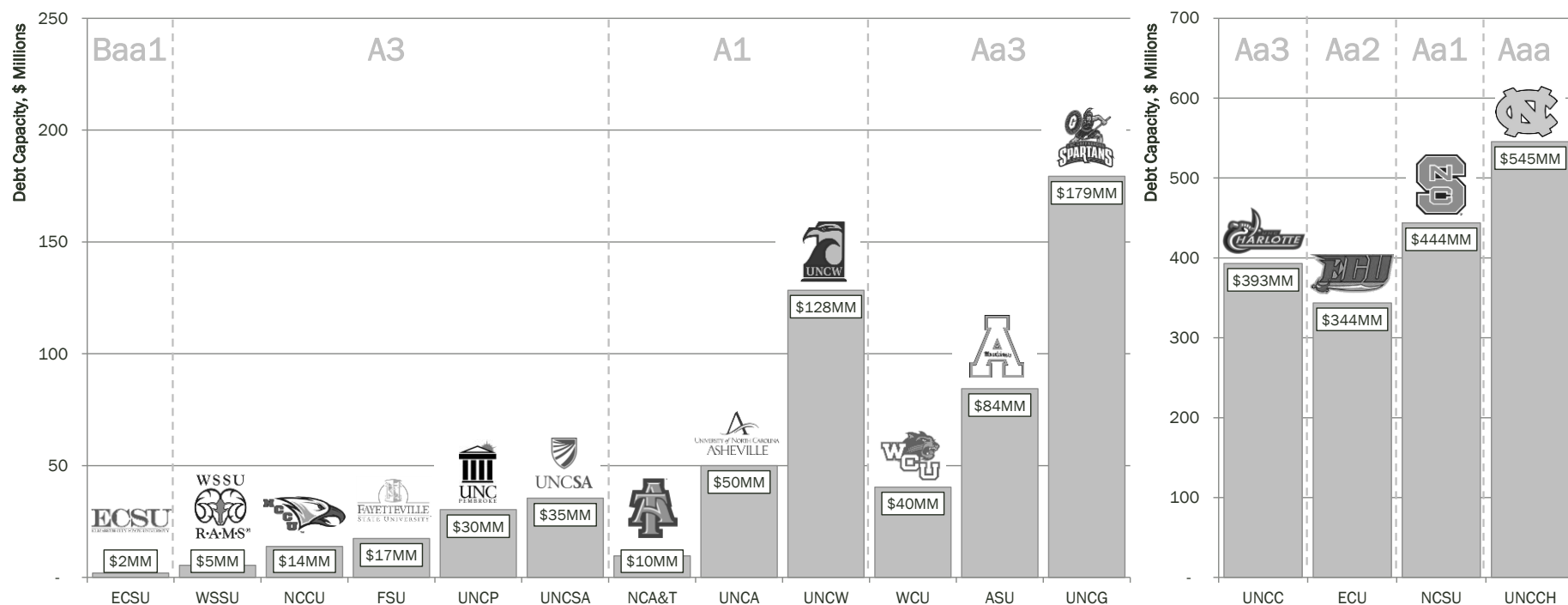


### General Observations

- Estimated debt capacity reflects the **maximum amount of debt each Campus could issue in 2016** without violating its ceiling ratio for **debt to obligated resources** during any year of the Study Period
- Results **take into account any legislatively-approved projects** to be financed during the Study Period
- Capacity should be evaluated through the lens of a Campus's "life cycle" (i.e., recent investments, future needs, etc.)
- Underlying financial model used to calculate capacity **does not** consider:
  - New revenue streams** that will support self-liquidating projects (new student fees, increased enterprise revenues, etc.)
  - Other "**affordability**" factors such as mission criticality or the potential consequences of foregoing the project

# Projected Debt Capacity for 2020

## Estimated Debt Capacity Across the System (2020)



## General Observations

- Projected debt capacity reflects the **maximum amount of debt** each Campus could issue in 2020 if each Campus waited until the end of the Study Period to issue any additional debt
- Projected results **take into account** any legislatively-approved projects to be financed during the Study Period, which are already factored into the model
- Capacity **grows over the Study Period** for two reasons:
  - Amortization of existing debt
  - Projected growth in Available Funds

# Summary of Study Recommendations

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## Campus Debt Policies

Each Campus without a formal debt management policy should develop a policy tailored to its particular mission, size and financial condition. Policy should address specific criteria for evaluating (and, if applicable, recommending) critical infrastructure projects in the face of limited debt capacity.

## Scorecard Approach

Incorporate into the Study methodology and financial model more rating agency “scorecard” elements to clarify relationship between estimated debt capacity and the amount of debt each Campus could issue debt without negatively impacting its credit rating.

## Report Due Dates

Legislators should consider shifting the due date for Campus reports from November 1 of each year to January or February of the following year to provide stakeholders with more current and meaningful data. System report would then be due within a month of the Campus reports.

# Integration of Debt Capacity Study into Debt Approval Processes

## Annual Debt Capacity Study

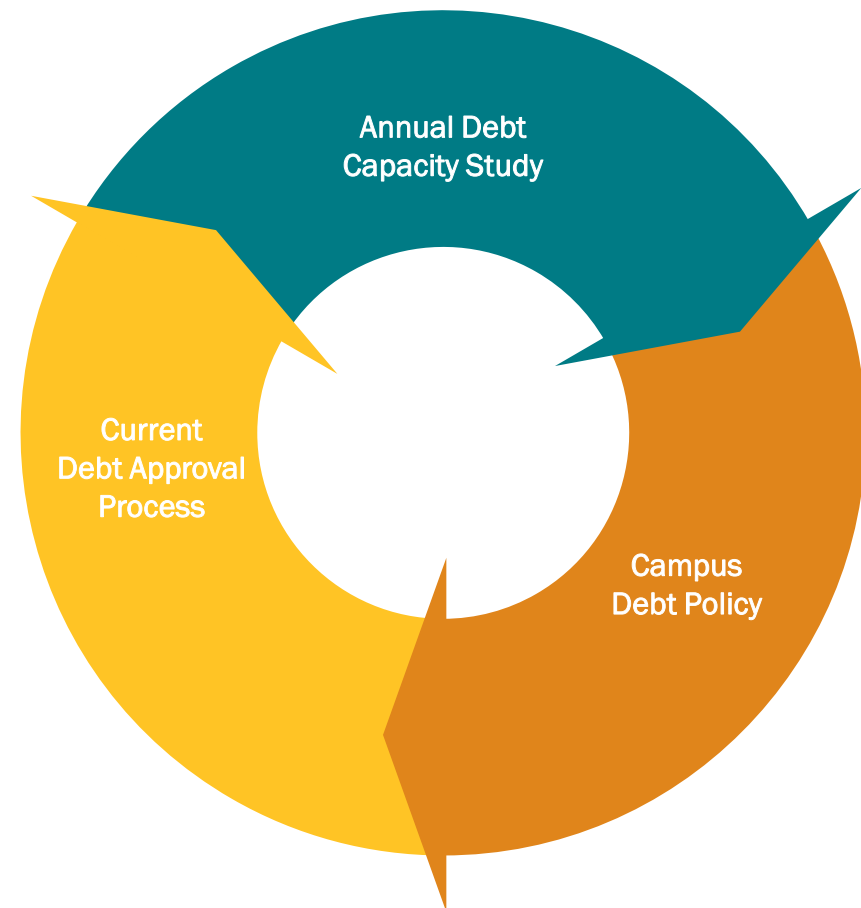
- Provides snapshot of each Campus's current estimated debt capacity
- May indicate when a proposed project requires heightened scrutiny
- Updated annually to reflect (1) newly approved debt, (2) any relevant changes to the Campuses' strategic debt policies and (3) updated Campus financial results and projections

## Campus Debt Policy

- Clarifies each Campus's strategic approach to debt and its capital investment needs
- Establishes criteria for evaluating projects and approving debt, including benchmarks to measure prudent debt levels
- Sets guidelines for pursuing strategic exceptions to stated policies, including specific criteria for approving debt in excess of estimated capacity

## Current Debt Approval Process

- Evaluates each proposed project's affordability based on identified sources of repayment and projected impact on student cost
- Uses estimated debt capacity results to assess strategic value of proposed project in light of a Campus's overall debt burden, mission and needs
- May request and consider additional evaluation criteria when a Campus's estimated debt capacity is limited



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