
DEBT

I. GOALS AND OBJECTIVES

The goal of this policy is to present guidelines for the management of Westfield State University's debt portfolio. For purposes of this policy, debt is defined as all short-term or long-term obligations, guarantees and instruments that commit the university to future financial obligations impacting its credit. In addition to bonds, notes and leases, debt also includes obligations that impact the university's debt capacity even if those transactions are not included in the university's financial statements or disclosed in financial notes.

The broad objectives of this policy are as follows:

- A. To strategically utilize debt to fund mission critical projects;
- B. To maintain the university's credit standing and access to capital markets that result in debt issued at favorable rates; and
- C. To maintain an appropriate balance between cash reserves and debt capacity that achieves a low, long-term cost of capital and allows for the investment of working capital.
- D. To establish guidelines to measure the total amount of outstanding debt and to assess overall financial health.

II. DEBT FUNDING SOURCES

Westfield State University, under the purview of the Board of Higher Education (BHE), receives funding for capital projects from several sources: Commonwealth General Obligation Bonds; bonds issued by both the Massachusetts Health and Educational Facilities Authority (HEFA) and the Massachusetts State University Building Authority (MSCBA); Capital Leases, Short Term Loans, and Alternative Financing.

A. *General Obligation Bonds*

General obligation bonds provide capital funding for all of state government. Portions of the funds available through this source are assigned to various agencies through debt caps determined by the Executive Office of Administration and Finance. The cost of this debt, and its availability, depend on the creditworthiness of the Commonwealth as a whole. The Commonwealth, not the university specifically, is responsible for the payment of this debt.

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B. *HEFA and MSCBA*

HEFA and MSCBA debt is issued by quasi-public authorities for specific types of capital projects and are paid for via dedicated revenue streams. HEFA states its mandate as providing financing or refinancing for any capital project related to the “primary charitable purpose” of an institution. The MSCBA issues debt to finance student activity and residential buildings. The cost and availability of HEFA and MSCBA debt depends on the creditworthiness of the individual university for which a project is being financed.

C. *Capital Leases*

Capital lease debt is primarily for equipment purchases. These purchases use the Commonwealth of Massachusetts Equipment Lease-Purchase (TELP), Massachusetts Higher Education consortium (MHEC), leases and other viable leasing mechanisms within the Commonwealth’s rules and regulations.

D. *Short-Term Loans*

Short-term loans are defined as loans with duration of five years or less and a principal balance of five million dollars or less. These funds are secured from local banks through the competitive bid process and do not purport to pledge the credit of the Commonwealth. These loans are paid with local trust funds (e.g. student fees or the like).

E. *Alternative Financing*

Alternative financing is a general category of debt financing options that allow the university to explore and develop alternative financing strategies. The University will work closely with the Board of Higher Education, state or federal agencies, and other partners in exploration and development to ensure compliance with all relevant laws and regulations.

III. GENERAL DEBT POLICY

All debt financing will be allocated with the approval of the University’s Board of Trustees. Only projects that further the mission and strategic goals of the university, either directly or indirectly, will be considered for debt financing. Specific guidelines for incurring debt include the following:

- A. Debt resources will be prioritized and include academic projects, equipment financing, major capital renewal, real estate investment, and other projects.

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- B. Consideration of debt-financed projects will include analysis and review of the impact the debt will have on operating budgets and overall financial health of the institution. Analysis should include appropriate pro forma financial calculations (including ratio analysis) and should demonstrate the university's ability to assume the debt.
- C. The use of debt for projects with a related revenue stream must be supported by an achievable financial plan that includes servicing the debt and meeting any new or increased operating costs. The plan should include contingencies in the event that the assumptions used in the plan are not realized.
- D. The useful life of the project should be taken into consideration when using long- term debt.
- E. Fundraising for capital gifts should be considered a source of financing, as well as, state and federal grants, expendable reserves, and other sources that can be expected to finance a portion of the cost of a project.
- F. Debt is to be used conservatively and strategically.
- G. 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.

IV. FINANCIAL RATIOS

The following ratios are consistent with ratios utilized in the higher education industry and should be reviewed at least annually and on a pro forma basis when considering debt financed projects.

A. Measures of Overall Financial Health

1. ***Debt Burden Ratio***

This ratio expresses annual debt service payments as a percent of total annual expenses. It measures an institution's ability to repay debt service on all outstanding debt and its impact on the institution's overall budget.

$$\text{Ratio} = \text{Annual Debt Service} / \text{Total Expenses}$$

As a general guideline, if more than 5% of an institution's budget is devoted to debt service, the institution's flexibility to devote its resources to other needs would be compromised. It is understood that rising

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expenses could make this ratio seem more attractive, though misleading, and is evaluated in conjunction with an institution's income statement.

2. **Viability Ratio**

This ratio measures the availability of expendable net assets to pay off long-term debt. A ratio of 1.0 or higher indicates an institution has sufficient net assets to satisfy debt requirements.

3. **Primary Reserve Ratio**

This ratio provides a snapshot of an institution's financial strength and flexibility. The ratio indicates how long the university could operate using expendable reserves without relying on additional new assets generated by operations. Trend analysis indicates whether an institution has increased its net worth in proportion to its rate of growth. A negative or decreasing trend indicates a weakening financial condition.

4. **Return on Net Assets Ratio**

This ratio reports whether an institution's resources are growing and if it is financially better off than in previous years. It is important to assess this ratio as a linear trend – an increasing trend indicates an increase in net assets and an increased likelihood that the institution is able to set aside financial resources to strengthen future flexibility. Single year events, like a substantial gift or extreme investment performance, can cause significant year-to-year volatility.

Ratio = Increase (Decrease) in Net Assets/Beginning of Year Net Assets

5. **Net Operating Revenues Ratio**

This ratio indicates whether operating activities resulted in a surplus or deficit. A positive ratio indicates the university experienced an operating surplus; a continuing decline or pattern of deficits indicates financial problems.

Ratio = Adjusted Net Operating Revenues/Adjusted Total Income

6. **Composite Financial Index**

This Index provides a more complete picture of the institution's financial health by combining into a single measure the strength of the primary reserve ratio, net operating revenues ratio, return on net assets ratio, and viability ratio. This score offers a stable long-term view of financial performance and it is less susceptible to year-to-year volatility. A CFI score of 3 is the threshold of institutional financial health.

B. **Bank of America's Debt Compliance Guidelines**

(Measurement dates – Annually on December 31st and June 30th)

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1. ***Debt Service Coverage Ratio***

The debt service coverage ratio is calculated by dividing the university's net income (before interest and depreciation) by the university's total debt service payments for the year. This ratio must be greater than 1.25:1 at all times.

2. ***Unrestricted Liquidity to Funded Debt***

This ratio is a measure of the university's unrestricted liquidity (cash) to its total debt outstanding. The unrestricted liquidity to funded debt ratio must be greater than .50:1 on the measurement dates.

3. ***Loan to Value of Collateral***

The loan to value of collateral ratio is used to calculate the percentage of the HEFA loan balance to the current value of the collateral pledged. The loan to value of collateral percentage cannot exceed 80% on the measurement dates.

V. REPORTING

The President or his/her designee, will report on the status of university debt and adherence to this policy to the Board of Trustees at least once per fiscal year.

VI. OVERSIGHT

The Vice President of Administration and Finance is responsible for the administration, monitoring and reporting requirements associated with debt and is responsible for adherence to this policy.

VII. REVISIONS TO POLICY

Any revisions to this policy will require approval by the University's Board of Trustees and must then be forwarded for reference purposes to the Board of Higher Education.

REVIEW

This policy shall be reviewed annually by the Vice President of Administration and Finance.