McMaster University

Policies, Procedures and Guidelines

Complete Policy Title: **Debt Management Policy**	Policy Number (if applicable): **n/a**
Approved by: **Board of Governors**	Date of Most Recent Approval: **March 5, 2020**
Date of Original Approval(s): **December 13, 2007**	Supersedes/Amends Policy dated: **April 16, 2015** **June 7, 2012** **December 13, 2007** **December 12, 2002 (Private Placement Bond Management Policy)**
Responsible Executive: **Vice-President (Administration)**	Enquiries: **University Secretariat**
DISCLAIMER: *If there is a Discrepancy between this electronic policy and the written copy held by the policy owner, the written copy prevails.*	

TABLE OF CONTENTS

	Page
SECTION 1 – PREAMBLE	**2**
SECTION 2 – PURPOSE	**2**
SECTION 3 – ESTABLISHMENT OF POLICY RATIOS	**2**
SECTION 4 – COMPLIANCE WITH COVENANTS	**4**
SECTION 5 - PROJECT APPROVAL AND LOANS	**5**
SECTION 6 – REVIEW AND OVERSIGHT FOR THIS POLICY	**5**
APPENDIX A – MONITORING RATIOS	**6**

SECTION I - PREAMBLE

This document serves to outline the application and use of external debt by McMaster University. This policy further outlines internal methods used for the assessment of proposed projects and internal loans.

Since capital projects will require a combination of financing sources including internal reserves, external debt, gifts, future revenue streams, grants and deferred contributions, debt will be considered a perpetual component of the University's capital structure. The specific amounts, types, term, and uses of debt will be selected to help the University achieve the lowest cost of capital consistent with the University's risk tolerance profile.

SECTION II - OBJECTIVES

In order to ensure that debt and University reserves are used prudently, the University will give higher priority to projects that are considered mission-critical and/or self-supporting.

The strategic use of debt will be aligned with the University's investment policies to manage the overall cost of capital and limit the level of risk as determined through the university's enterprise wide risk management program. Bridge financing, derivative products, short and long term, fixed, and variable rate debt will all be considered to achieve this goal of risk reduction and reduced cost of capital. In determining different debt strategies, McMaster will take into account the University's assets, liabilities, unrestricted cash flow and market conditions when evaluating different debt strategies and instruments.

This policy will help guide the University's on-going relationship with the rating agencies, bond purchasers and external constituents by providing continuous communication and education.

SECTION III - ESTABLISHMENT OF POLICY RATIOS

The University has established guidelines regarding the optimal amount of outstanding debt through monitoring University-wide financial ratios. These ratios measure University balance sheet resources and annual cash flow. They can be derived from the University's financial statements and are subject to review periodically.

Ratio 1 – Viability: Expendable Net Assets-to-Debt Ratio: This ratio measures balance sheet leverage by comparing University's Expendable Net Assets[1] to outstanding debt obligations, including any debt guarantees, but excluding decommissioning obligations as these obligations have offsetting restricted assets.

$$\frac{\text{EXPENDABLE NET ASSETS}}{\text{TOTAL UNIVERSITY DEBT}} \quad > 1.0\text{ x coverage}$$

(including guarantees, and excluding decommissioning obligations)

Management has established a target of greater than one times coverage.

---

[1] Expendable Net Assets include Internal Reserves (as outlined in the University's audited financial statements), Internal endowments, and Unrestricted net assets.

Ratio 2 – Affordability: Interest Burden: This ratio indicates debt affordability as it quantifies interest expense as a percent of total expenses net of amortization. This ratio is also included in the Ministry's Financial Health Metrics.

$$\frac{\text{INTEREST EXPENSE}}{\text{OPERATING EXPENSES - AMORTIZATION}} < 4\%$$

The target for interest burden is less than four percent to ensure sufficient funding for debt interest is available.

Ratio 3 –Capacity: Debt per FTE: This ratio divides debt by the total number of full time equivalent (FTE) students registered at the university and reflects debt capacity relative to university size. While not a metric required by the Ministry, it is a key metric referenced by rating agencies. The measurement is calculated as follows:

$$\frac{\text{DEBT (same definition as Ratio 1)}}{\text{\# FTE STUDENTS}} < \$12{,}000$$

The target for debt to FTE is less than twelve thousand.

The ratios and targets above are not intended to track a specific credit rating, but rather to ensure the maintenance of the University's financial profile competitively. Other ratios, such as the additional Financial Health metrics reported annually to the Ministry of Colleges and Universities (Ministry) will be monitored in order to provide management with a more complete understanding of the University's credit and financial profile. These ratios are included in Appendix A.

SECTION IV – COMPLIANCE WITH BOND COVENANTS

At the time of review and approval of the Annual Financial Statements of the University, the Audit Committee will review a report that documents the University's compliance with all covenants and obligations associated with any outstanding bonds, including the punctual payment of debt service.

The University will ensure sufficient funding for interest payments along with annual costs (trustee fees, credit rating fees, etc.) in the multi-year financial plan approved by the Board of Governors and the Annual Consolidated Budget approved by the Board of Governors.

SECTION V – REQUIREMENT FOR DEBT AND SINKING FUNDS

Requirement for Debt: The need for external debt is reviewed annually and informed by the Capital Plan and additional strategic projects as approved by the President and Vice Presidents. External debt calls will be led by the AVP (Administration) & Chief Financial Officer, with an assembled internal team inclusive of the Treasury department, and in accordance with the Execution of Instruments policy.

Loans: The University will maintain a Central Bank Policy for internal loans, regardless of source of funding, for projects which require University debt. The Policy will include acceptable ranges for amortization, prepayment terms and a University-wide blended interest rate reflecting the University's overall cost of capital and cost of administering the loan. To the extent that internal loan payments are not needed to pay annual debt service in a given year, they will be deposited into an internally restricted fund which can be used either to fund additional loans/projects, or to pay debt service costs in the future, including principal.

Sinking Funds: Each debt instrument that requires a bullet payment is required to have a sinking fund set up designed to ensure there will be sufficient funds to repay principal on outstanding debt, when due.

Sinking funds should be invested with the objectives of:

- Maximizing investment earnings over the time horizon and to achieve a minimum annual average rate of return at least equal to the blended rate on the University's debt over the life of the fund.
- Provide appropriate diversification of asset mix to ensure prudent and effective management of the funds.

Based on the long-time horizon that exists for the sinking funds, the University has determined that the sinking funds will be invested within the McMaster University Investment Pool. As such, the Investment Pool's Statement of Investment Policies and Objectives will govern the administration and investment management of the sinking funds.

On an annual basis, the Planning and Resources Committee will review the sinking funds' value relative to projected target and consider recommendations to increase a sinking fund to ensure sufficiency of funds to repay principal.

SECTION V – REVIEW AND OVERSIGHT FOR THIS POLICY

This debt management policy will be reviewed tri-annually to remain consistent with the University's objectives and the external environment. The Planning and Resources Committee will have on-going oversight and regularly review the asset and liability structure related to this policy. Management may recommend to the Planning and Resources Committee revisions to the policy in the future if deemed desirable. The structure of any individual transaction will be based upon overall University needs to ensure that long-term costs are minimized consistent within the context of other strategic objectives and that overall risk does not exceed acceptable levels.

At a minimum, management will report the historical debt policy ratios to the Planning and Resources Committee on an annual basis. In addition, management will include a ten-year debt projection in the annual multi-year financial projections reported to the Planning and Resources Committee to monitor debt capacity, affordability, flexibility and liquidity.

Where any two of the historical or projected debt policy ratios do not meet the established targets, management will undertake a more comprehensive review and provide a report with recommendations to the Planning and Resources Committee.

Appendix A – Monitoring Ratios

The table below includes additional ratios that the Ministry uses to measure the Financial Health of universities. While the Ministry does not set targets, the university has included its targets below.

Ratio	Description	Calculation and target
Net Income/Loss	A performance measure that calculates the net income or loss as a percent of total revenues	Net income / Total expenditures >1.0%
Net Operating Revenues	A performance measure that calculates cash flow from operating activities as a percent of revenues	Cash generated from operations/Revenue > 2.0%
Primary Reserve (days)	A liquidity measure that calculates the number of days university reserves can cover operating expenses	Expendable net assets / Total expenses *365 days > 91 days
Viability	A leverage measure that calculates the number of times that long-term debt could be settled using unrestricted assets	Long term debt (including decommissioning obligations, and excluding guarantees) / Expendable net assets > 1.0