

THE BOARD OF REGENTS OF THE UNIVERSITY OF HOUSTON SYSTEM

DEBT POLICY

Purpose

This policy governs the use of debt to finance capital projects within The University of Houston System (System). The prudent use of debt can help the System achieve its strategic objectives while maintaining a credit rating that appropriately balances financial flexibility with cost of capital.

Financing Programs

The System issues debt through two primary programs: the Consolidated Revenue Financing Program (CRFP) and the Higher Education Assistance Fund (HEAF). This policy will govern the issuance of all System debt.

Consolidated Revenue Financing Program – This program was created by the Board of Regents of The University of Houston System (Board) through the adoption of a Master Resolution on April 15, 1990. The Board established this program for the System for the purpose of assembling the System’s revenue-supported debt capacity into a single financing program in order to provide a cost-effective debt program to component institutions of the System and to maximize the financing options available to the Board.

Higher Education Assistance Fund (HEAF) - Article VII, Section 17 of the Texas Constitution authorizes the Board to issue bonds and notes secured by pledged revenues consisting of up to 50% of the money allocated annually to the Board. Bonds issued under this authority are typically referred to as HEAF bonds or constitutional appropriation bonds. The proceeds from the sale of HEAF bonds or notes may only be used to finance eligible projects as described in Article VII, Section 17 of the Texas Constitution including (i) acquiring land, constructing and equipping permanent improvements, major repair and rehabilitation of permanent improvements, acquiring capital equipment, library books and library materials, and refunding previously issued HEAF indebtedness; and (ii) major repair and rehabilitation of leased buildings or other permanent improvements, provided there is clean and adequate consideration to the System in the overall transaction, such as the existence of a lease of sufficient length to provide expected benefits which would justify the expenditure. The Texas Constitution prohibits the issuance of HEAF debt for maintenance, minor repairs, operating expenses, student housing, intercollegiate athletics, or auxiliary projects, except to the extent of a project’s use for educational and general activities. HEAF bonds must be competitively bid. HEAF notes do not require competitive bidding.

Authority

All debt incurred by the System will be issued or incurred pursuant to resolutions approved by the Board and in accordance with the general laws of the State of Texas, including particularly Article VII, Sections 17 of the Texas Constitution, Chapter 55 of the *Texas Education Code*, and Chapters 1207 and 1371 of the *Texas Government Code*. Before any debt can be issued, the System must obtain an opinion from nationally recognized bond counsel to the effect that the debt is a valid and legally binding obligation of the issuer, payable from the security described therein. The System must also receive the necessary approval from the Texas Bond Review Board and the approving opinion of the Texas Attorney General.

To the extent required by law, Coordinating Board approval will be obtained if project costs exceed the then existing thresholds for new construction or for rehabilitation. Debt will not be issued for a project prior to receiving Coordinating Board approval, if required.

Debt Guidelines

Any debt must be issued in strict compliance with applicable law. The following debt guidelines will apply:

Project Funding - The System will borrow money, through the issuance of debt, to finance only those projects that have been approved for financing by the Board. Capital projects are generally evaluated and prioritized through the System's Capital Improvement Program. For construction projects that require debt financing, bond proceeds will be provided only after design development approval and appropriation of funds by the Board.

Interest Rate Exposure - The Treasurer will evaluate and recommend to the Vice Chancellor for Administration and Finance the appropriate amount of its interest rate exposure, defined as the possible increase in capital costs resulting from rising short-term interest rates. The System will limit its variable rate debt in accordance with rating agency guidelines for assessing the debt structure of peer institutions of higher education with comparable credit ratings. In determining the amount of variable rate debt, the Treasurer will evaluate the level of variable rate assets that may be available to provide a natural hedge to interest rate fluctuations. The System will seek to minimize its cost of capital within a prudent level of exposure to interest rate volatility. The System shall broadly target variable rate debt of 20-30% of total outstanding debt.

Amortization - The amortization of tax-exempt debt will be based on the types of assets financed, the expected availability of cash flows to meet debt service requirements, and tax regulations. Generally, the amortization of tax-exempt debt should not exceed the useful life of the financed asset and may never exceed the Internal Revenue Service limit of 120% of the useful life of the financed asset. The maximum maturity of CRFP debt is limited to 30 years from the projected completion of the projects being financed. The

maximum maturity of HEAF debt is limited to 10 years by Article VII, Section 17 of the Texas Constitution.

Financial Ratios - The System will use selected actual and pro forma financial ratios, consistent with major credit rating agency criteria, to ensure the System is operating within appropriate financial bounds. Although other ratios may also be evaluated, the primary financial ratios to be analyzed include the debt service coverage ratio, the debt burden ratio, and the leverage ratio.

Individual revenue streams considered for proposed debt service must meet a 1.15 debt coverage ratio test, unless the debt is being issued as "tuition revenue" debt, in which case it must meet a 1.00 debt coverage ratio test. Debt coverage is defined as Net Operating Income divided by Maximum Annual Debt Service.

Economies of Scale - Debt financings will be coordinated to the extent practical so that multiple project needs can be accommodated in a single borrowing, thereby increasing the efficiency of the debt issuance. Since many issuance costs do not vary with the size of a borrowing, a large bond issue increases the efficiency of the financing by spreading fixed costs over a greater number of projects.

Refunding Opportunities - The Treasurer will consider refinancing of outstanding debt issues when net savings for that refinancing measured on a net present value basis are positive. Since there are limitations on the number of allowable refinancings, it is important to use refinancing opportunities wisely. In evaluating refunding opportunities, the Treasurer will consider the value of the call option to be exercised, including the amount of time to the call date and the amount of time from the call date to maturity. The System will generally use 5% net present value savings as its minimum threshold for determining the viability of a refunding under consideration. Refundings that do not produce savings or meet the minimum net present value savings threshold may be considered under certain circumstances, such as eliminating restrictive bond covenants or other situations that produce a greater benefit to the System.

Disclosure - The Treasurer will provide updated financial information and operating data and timely notice of specified material events to each nationally recognized municipal securities information repository and any State information depository, pursuant to the System's continuing disclosure undertakings with respect to Rule 15c2-12 promulgated by the Securities and Exchange Commission.

Tax Compliance - The Treasurer will monitor the System's ongoing responsibilities for tax compliance including monitoring funds for yield restriction and arbitrage rebate calculations.

Hedging Instruments - The Treasurer will consider and recommend to the Vice Chancellor for Administration and Finance the use of interest rate swaps and other interest rate risk management tools after carefully evaluating the risks and benefits of any proposed transaction in accordance with the System's Interest Rate Swap Policy. By

using swaps in a prudent manner, the System can take advantage of market opportunities to minimize expected costs and manage interest rate risk. As outlined in the System's Interest Rate Swap Policy, the use of swaps must be tied directly to System debt instruments. The System will not enter into swap transactions for speculative purposes.

Project Financing - The Treasurer will consider and recommend to the Vice Chancellor for Administration and Finance the use of project financing in those limited circumstances where the benefits of such a transaction exceed the increased costs. Project financing can be a useful financing technique in certain circumstances; however, these transactions are typically less efficient and more costly than traditional financing due to lower credit ratings, fewer economies of scale, the funding of a reserve fund, and the cost of bond insurance. Project financing does not preserve or increase debt capacity relative to traditional financing. The credit rating agencies and the System include project debt when assessing the System's debt capacity.

Taxable Debt - The System may use taxable debt for those projects that have an intended use or other characteristics that preclude the use of tax-exempt debt. The System will strive to allocate its available resources, including equity capital, among its various capital projects to minimize or eliminate the need to issue taxable debt, thereby minimizing the System's cost of capital. Any use of taxable debt would require separate Board approval and be subject to the same statutory requirements as tax-exempt debt.

Reporting Requirements - The Annual Financial Report (AFR), prepared by the System and presented to the Board, will discuss the status of all outstanding bond and note indebtedness. The AFR presented to the Board provides detailed information on the System's outstanding bonds and notes including, by series, the amount outstanding, interest rates, maturity dates, a summary of the changes in outstanding indebtedness, and the associated debt service requirements.

Commercial Paper - The System's commercial paper program is a short-term debt program used to purchase equipment and to provide interim financing for capital projects during construction. The Vice Chancellor for Administration and Finance will prioritize requests for the use of commercial paper to fund equipment and capital projects. The minimum aggregate amount of equipment value to be financed under the commercial paper program is \$100,000 for each System component. Several smaller equipment purchases may be commingled to achieve the minimum amount. Each piece of equipment must have a useful life of not less than three years. The equipment will be purchased from the vendor by System components, and commercial paper will be issued on any business day for direct acquisition or to reimburse the institution for the equipment purchases. The commercial paper will be amortized and paid to the System (by the System components) as directed by the System and will be fully amortized up to the lesser of its project useful life or 10 years. Commercial paper does not require competitive bidding. The System will be responsible for making timely payments to the paying agent as required by the commercial paper dealer in accordance with the related bond resolution. All conversions of commercial paper notes to long-term indebtedness will be approved by the Board. The long term debt will be amortized and paid to the

System as directed by the System. The System will be responsible for making timely payments to the paying agent as required by the related bond resolution and paying agent agreement.

Failed Remarketing Procedures – The Failed Remarketing Plan procedures as adopted by the Board and administered by the Treasurer will be used in the event of a failed remarketing of commercial paper or variable rate demand bonds.

Miscellaneous

- A. The Vice Chancellor for Administration and Finance, or authorized representative of the System, is delegated the authority to designate a financing team consisting of System staff, bond counsel, financial advisor and underwriters. The Vice Chancellor for Administration and Finance, or authorized representative of the System, is responsible for assuring that all bond covenants are in compliance and that all necessary approvals, certifications and authorizations are fully documented and made available to the Board and to all bondholders. The Chair of the Committee is authorized to price bond issues.
- B. The Treasurer will take steps to effect the timely transfer of System funds for debt service payments.
- C. Debt service funding is the responsibility of each System component participating in the Consolidated Revenue Financing Program and the Higher Education Assistance Fund Program.
- D. The Treasurer will take steps to effect Board approval of Reimbursement Certificates as required by U.S. Treasury Regulations, Section 1.150-2, in connection with projects the Board intends to debt finance.

Approved: November 15, 2007