Annual Capital Financing and Debt Management Report
Fiscal Year 2020

Executive Summary and Highlights

The University of Minnesota enjoys a very favorable debt profile which results in low borrowing costs to finance capital projects. The University’s debt is highly rated by two rating agencies – Aa1 by Moody’s Investors Service (“Moody’s”) and AA by S&P Global Ratings (“S&P”) – which provides strong demand and competitive pricing in the marketplace for University bonds.

Key debt-related metrics at June 30, 2020 include:

- The University’s total long-term debt outstanding was approximately $1.6 billion.
- The weighted average cost of capital was approximately 2.6%.
- The ratio of tax-exempt to taxable debt was approximately 85% tax-exempt/15% taxable.
- The mix of fixed-rate and variable rate debt was approximately 81% fixed and 19% variable.
- The University’s debt is rated Aa1 by Moody’s Investors Service and AA by S&P Global.
- Debt service paid (principal and interest) has been approximately $155 million in each of the last two years, of which approximately $95 million was applied to paying down principal.
- The University has realized net present value savings of approximately $47 million since 2015 by refinancing previously-issued debt on or before optional redemption dates. In addition, another approximate $27 million is expected to be realized with the refinancing of the Special Purpose Revenue Bonds in the summer of 2021.

Fiscal 2020 debt activity included:

- Issuance of $48 million in commercial paper (CP) under the revolving CP facility to pay for certain property purchases
- Receipt of a $4.5 million loan from the Otto Bremer Trust, with interest only payments for four years and the final year’s interest plus the total principal due in year five

Long-Term Debt

Debt financing allows the University to pay for an asset over a period of time, rather than pay for it at the time of purchase. Per Board of Regents (“Board”) policy, Debt Transactions, updated in October 2020, debt shall be used to finance the purchase of land and buildings, construction of and remodeling projects to University facilities, and acquisition of and installation of equipment. Debt may not be used to fund University operating purposes without Board approval. Each debt transaction of the University is completed in the most effective and professional manner, in accordance with the highest standards of the industry, laws and governmental practices, guided by the following principles:

- Minimize borrowing costs at acceptable levels of risk over the life of the debt;
- Maintain key financial metrics to assure continued access to capital markets and manage credit-related risks;
• Exhibit a maturity profile that meets liquidity requirements and manages the balance sheet of the institution; and

• Provide financial and budgetary stability.

The majority of the University’s outstanding debt can be categorized in one of the following three designations:

• General Obligation (GO) Bonds – long-term fixed rate bonds secured by the full faith and credit of the University. Bonds have been issued as either tax-exempt or taxable with 20, 25, or 30 year maturities. Each series has been structured with approximately equal annual debt service payments over its life. The tax-exempt bonds are issued with a 10-year optional redemption at par.

• Special Purpose Revenue Bonds (State Supported Debt) – long-term fixed rate bonds that are special limited obligations of the University. These bonds were issued by the University for TCF Bank Stadium and the Biomedical Science Research Facilities, but Minnesota law provides for an annual appropriation to reimburse the University for the annual debt service on these bonds. No other revenues or assets of the University, nor the full faith and credit of the University, is pledged for the payment of the principal or interest on these bonds.

• Commercial Paper (CP) Notes – short-term obligations that are backed by the full faith and credit of the University and supported by the University’s self-liquidity. With maturities of 1 to 270 days, the CP is classified as current liabilities in the financial statements. However, the University currently treats the outstanding CP as a long-term financing vehicle by renewing the notes for extended periods as they come due, with annual required “pay-downs” established in the original offering memorandums.

In addition, long-term debt contains a small outstanding balance of State of Minnesota Infrastructure Development Bonds (IDB), a note payable, capital leases, and the unamortized premiums and discounts on the bonds.

*Debt Profile as of June 30, 2020*

$1.4 billion par outstanding; $1.2 billion University supported

- General Obligation Bonds - Fixed Rate ($872.5m) 50%
- Special Purpose Revenue Bonds Fixed Rate ($230.3m) 15%
- Commercial Paper - Variable Rate ($262.1m) 17%
- State IDB & Note Payable - Fixed Rate ($8.5m) 5%
- Capital Leases ($38.6m) 3%
- Unamortized Premium/Discount ($148.6m) 9%

Aa1 – Moody’s
AA – S&P
The table below reflects the beginning and ending fiscal year balances and fiscal 2020 activity of the various debt series summarized in major categories:

<table>
<thead>
<tr>
<th>(000s omitted)</th>
<th>Final payment due in FY</th>
<th>Beginning Balance June 30, 2019</th>
<th>Additions</th>
<th>Reductions</th>
<th>Ending Balance June 30, 2020</th>
</tr>
</thead>
<tbody>
<tr>
<td>Special Purpose Revenue Refunding Bonds – Series 2015A (State Supported Stadium Debt)</td>
<td>2032</td>
<td>75,750</td>
<td>5,245</td>
<td>70,505</td>
<td></td>
</tr>
<tr>
<td>Special Purpose Revenue Bonds – Series 2013C, 2011B, 2010A (State Supported Biomedical Science Research Facilities Funding Program)</td>
<td>2039</td>
<td>165,860</td>
<td>6,090</td>
<td>159,770</td>
<td></td>
</tr>
<tr>
<td>Commercial Paper Notes Series A, B, C, D, F, G and H (tax-exempt) and E and I (taxable)</td>
<td>2022 – 2044</td>
<td>249,920</td>
<td>48,000</td>
<td>34,825</td>
<td>263,095</td>
</tr>
<tr>
<td>Note Payable</td>
<td>2025</td>
<td>0</td>
<td>4,500</td>
<td>0</td>
<td>4,500</td>
</tr>
<tr>
<td>Obligations to the State of Minnesota pursuant to Infrastructure Development Bonds (IDB)</td>
<td>2025</td>
<td>6,142</td>
<td>2,095</td>
<td>4,047</td>
<td></td>
</tr>
<tr>
<td><strong>Balance – at par</strong></td>
<td></td>
<td><strong>1,412,367</strong></td>
<td><strong>52,500</strong></td>
<td><strong>90,000</strong></td>
<td><strong>1,374,867</strong></td>
</tr>
<tr>
<td>Unamortized premiums and discounts</td>
<td>2044</td>
<td>157,138</td>
<td>8,553</td>
<td>148,585</td>
<td></td>
</tr>
<tr>
<td>Capital leases and other</td>
<td>2025</td>
<td>43,977</td>
<td>2,091</td>
<td>7,180</td>
<td>38,888</td>
</tr>
<tr>
<td><strong>TOTAL PER FINANCIALS</strong></td>
<td></td>
<td><strong>$1,613,482</strong></td>
<td><strong>$54,591</strong></td>
<td><strong>$105,733</strong></td>
<td><strong>$1,562,340</strong></td>
</tr>
</tbody>
</table>

No hedging transactions exist in the debt portfolio at June 30, 2020.

The University’s **weighted average cost of capital** at June 30, 2020 approximates **2.6%**.
Commercial Paper Facility

On October 12, 2017, the Board authorized a revolving commercial paper facility (the “Facility”) through which the University may issue tax-exempt and taxable variable rate debt from time to time as general obligation indebtedness for the short or long-term financing of capital projects. The aggregate principal amount outstanding of the notes issued in 2005 through 2017 (Series A, B, C, D, E and F) and the additional notes to be issued (Series G, H and I) shall not exceed $400 million. Since the Facility is considered revolving in nature, CP can be issued for approved projects, paid off, and then re-issued for new approved projects, so long as the total amount of CP issued and outstanding does not exceed the Board’s maximum authorization of $400 million. The capacity to issue increases as paydowns occur.

Counter-party risk is an inherent risk in a program of this type. This is the risk that our dealer with whom the University contracts to remarket the CP will default on its obligations under that contract. We have mitigated this risk by utilizing a second dealer for the sale and remarketing of new notes to spread counter-party risk across dealers.

CP is an effective and efficient method to maintain an acceptable percentage of variable rate debt within an overall debt portfolio, with the goal of lowering overall cost of capital. It can be restructured to long-term debt quickly and efficiently since it is short-term in duration. The weighted average rate of the CP outstanding at June 30, 2020 was approximately 0.22%.

External rating agencies rate the entire CP program based on the maximum amount authorized by the Board, as opposed to previous CP financing issued under a single debt offering and rated as an individual series of CP. The current rating of the $400 million facility is P-1 by Moody’s Investors Service (“Moody’s”) and A-1+ by S&P Global Ratings (“S&P”), both the highest short-term rating possible from each rating agency.

Long-Term Bond Credit Ratings

The University’s debt is highly rated by two rating agencies – Aa1 by Moody’s and AA by S&P – which provides strong demand and competitive pricing in the marketplace for University bonds. Both rating agencies have their own methodologies that weight a number of factors to arrive at a letter rating.

Letter Ratings to Designate University Credit Quality
Moody’s uses the broad weighting factors of market profile, leverage, wealth and liquidity, and operating performance, with subsets of each. Other credit considerations include multi-year trends, governance & management, debt structure, liquidity quality, government relationship, pension and other post-employment obligations, and healthcare operations. This methodology does not include an exhaustive treatment of all factors that might be relevant when evaluating an individual university’s credit attributes. As stated in the most recent rating report for the University of Minnesota:

“The **Aa1 rating** assigned by Moody’s reflects strong student and research market positions and ample financial resources, all incorporated in the University’s excellent strategic position.

The **stable outlook** reflects Moody’s expectations that “UM will manage through challenging conditions related to the corona virus and related economic recession, mitigating fiscal impacts through appropriate budgetary responses. Over the next several years we expect continued favorable student demand, tuition revenue and sponsored research trends. The outlook also incorporates longer term stable to improving operating cash flow and debt service coverage.”

S&P’s methodology results in a convergence of a detailed analysis of a university’s “**Enterprise Profile**” and “**Financial Profile**” with qualitative adjustments for compelling factors or qualifiers. The “enterprise profile” includes market position and demand, management and governance, industry risk, and economic fundamentals. The “financial profile” includes debt and contingent liabilities, financial resources, financial performance, and financial management policies. As reported by S&P:

“The **AA rating** assigned by S&P reflects our view of the University’s, 1) position as Minnesota’s flagship research university and land-grant institution, 2) slightly declining enrollment since fall 2017, although it has been relatively stable over a longer time horizon, with some decline in freshman applicants for the past three years, 3) manageable pro forma maximum annual debt service burden, and 4) favorable philanthropic support.”

The **stable outlook** reflects S&P’s view that “over the next two years, UM’s enrollment will stabilize in fall 2021 after declining slightly in fall 2020, while other demand metrics remain firm and its adjusted full-accrual financial operating performance will improve in fiscal 2021 as the full effects of management’s cost-cutting initiatives begun in the second half of fiscal 2020 are realized, and there are no diminution in available resources relative to operations and debt, while total debt outstanding remains relatively constant.”
Debt Management Oversight

Debt management is the responsibility of the Treasurer, with day-to-day oversight assigned to the Director of Debt Management as designee. The Director, in turn, relies on various individuals in certain University departments for the expertise needed to ensure compliance with policy, laws and regulations, and to handle specific tasks. The University also utilizes a structure of three committees in its debt management oversight – the Debt Process Team (DPT), the Debt Oversight Group (DOG) and the Debt Management Advisory Committee (DMAC). Each of the committees and their respective responsibilities are summarized below:

**Debt Process Team (DPT)**
DPT acts in the capacity of the University’s trustee to approve the draws on unspent bond proceeds to reimburse expenditures incurred on eligible projects. In addition, the group establishes and ensures that appropriate accounting and compliance procedures are in place and working properly.

**Phase III - Post Issuance Compliance**

**Debt Oversight Group (DOG)**
DOG supports and advises the Treasurer and Director of Debt Management in decisions regarding policy, capital financing strategies, and debt capacity analysis. In addition, the committee periodically reviews the debt management processes to insure compliance with University and tax requirements.

**Debt Management Advisory Committee (DMAC)**
DMAC advises the Finance & Operations Committee of the Board and the University’s Treasurer on the issuance and ongoing management of debt. In doing so, the group evaluates, recommends, and monitors debt management policies, strategies, and guidelines and provides advice on their implementation so as to best serve the financial objectives of the University.

In addition, the University has retained an independent registered municipal advisor (IRMA). The University is represented by and relies on its municipal advisor, PFM Financial Advisors LLC (PFM) to provide advice on proposals from financial services firms concerning the issuance of municipal securities and transactions involving municipal financial products. PFM has represented to the University that it is an “independent registered municipal advisor” within the meaning of Section 15Ba1-1(d)(3)(vi) of the Securities Exchange Act of 1934.
**Taxable vs. Tax-Exempt Debt**

Financings generally are on a tax-exempt interest rate basis, unless there are risks that private business use ("PBU") of the financed asset may exceed the University's allowable threshold, or when other financial considerations indicate the use of taxable debt is in the best interest of the University.

Situations where taxable debt may be more advantageous than tax-exempt debt include:
- PBU limitations are expected to be exceeded;
- Unknown future use of the property;
- Longer or unknown construction time;
- Market rates for both tax-exempt and taxable debt are similar or taxable debt has a lower interest rate;
- The rate difference between taxable debt and tax-exempt debt is so small as to make the costs of post-issuance compliance on tax-exempt debt an overly burdensome requirement.

Taxable debt may take the form of CP, variable rate debt or fixed rate debt.

The ratio of tax-exempt to taxable debt outstanding as of June 30, 2020 is approximately **85%** tax-exempt/15% taxable. Included in the taxable debt is one outstanding series that was issued as Build America Bonds-Direct Payment to Issuer, whereby the University expects to receive a 35 percent annual interest subsidy from the federal government for the life of the bonds. Due to the implementation of federal sequestration effective with the subsidy payment received beginning June 2, 2013, the subsidy payments received have been reduced by 5.9% - 6.2% for fiscal 2020.
**Fixed Rate vs. Variable Rate**

Long-term fixed-rate tax-exempt debt is the most common form of debt issued by institutions of higher education, in which interest rates are fixed for a single or multiple maturities. This type of debt allows institutions to lock into certain debt service obligations at tax-advantaged interest rates over a long period of time. Long-term fixed rate debt generally includes a call option by the University within 0-10 years after the issuance date to allow for refinancing opportunities – i.e., either reduce interest rates (subject to market conditions) or restructure principal payments.

Variable rate financings can lower overall cost of capital. Financings of all maturities can carry a variable rate. Bonds are callable at any interest payment date (daily, weekly, monthly, etc.) with no premium. Risks include interest rate risk, credit risk, tax law risk and remarketing risk. All of the University’s variable rate debt is currently in the form of commercial paper.

The mix of fixed rate to variable rate as of June 30, 2020 is approximately **81% fixed** to **19% variable**.

![Pie chart showing 80.9% fixed and 19.1% variable](chart.png)

**Refinancing Savings**

The University has taken advantage of the optional par call feature that is part of the structure when tax-exempt debt is issued. This allows us to refinance the individual bond series prior to its final maturity date and defease the existing bonds.

Refunding of bonds is the issuance of a new bond for the purpose of retiring an already outstanding bond issue. Outstanding debt may be refunded to achieve interest rate savings, restructure principal and/or interest payments, or eliminate burdensome covenants with bondholders. The refunding is considered an advance refunding when done prior to the optional redemption date (call date). Until December 31, 2017, bonds could only be advance refunded once. The tax law changes enacted in December 2017 eliminated the tax-exempt advance refunding option entirely, but still allows us to do a taxable advance refunding.

A legal defeasance occurs when the proceeds of new bonds that are sufficient to pay all principal and interest on the outstanding bonds up to and including the call date are deposited in escrow at a bank. The escrow is irrevocably pledged to the retirement of such debt and thus the escrow and the refunded debt do not appear on the University’s balance sheet.
The University has realized savings of approximately $47 million on debt that has been refunded and defeased since 2015, and expects to realize savings of approximately $27 million on the planned summer 2021 refunding of the state supported revenue bonds related to the Biomedical Science Research Facilities.

**Amortization Structure**

The debt service structure for each bond issue is determined on a case-by-case basis. The University has typically structured its debt so that the annual debt service payments on each bond issue are somewhat equal. The following graph reflects the amortization structure of the bonds and commercial paper outstanding as of June 30, 2020.

The maroon bar reflects the University supported debt, the gold bar reflects the state supported bonds, and the green bar represents the debt of Gateway Corporation. Since Gateway Corporation is a component unit of the University, its debt is included as part of the University’s “total debt” for ratio calculation purposes and therefore is shown in the table below.

**Scheduled Debt Amortization, Balances at June 30, 2020-2025 (at par, in millions)**
Debt Activity Subsequent to June 30, 2020

State Capital Bonding Bill

On October 12, 2020, during the fifth special session of the 2020 Legislative year, the Minnesota Legislature passed a capital infrastructure bill that contains more than $75 million in funding for the University. Included in the bill was funding for the following projects:

- HEAPR – asset repair and maintenance across the system - $38.5 million
- Child Development Building replacement, Twin Cities – $29.2 million
- AB Anderson Hall renovation, Duluth - $4.4 million
- Chemistry Undergraduate Teaching Laboratory, Twin Cities - $3.3 million

In addition, Minnesota Statutes 137.61 through 137.65 were amended to:
1) allow the University to refinance the special purpose revenue bonds, State Supported Biomedical Science Research Facilities Funding Program Bonds, and
2) allow the University to keep the annual appropriation savings and use the savings to support additional new debt which would be issued to finance the Clinical Research Facility design phase.

The Board approved refunding of the state supported bonds in December 2019, assuming the State legislation would be amended. Refunding is expected to occur during the summer of 2021.

Issuance of GO Bonds Series 2020A and Series 2020B (Taxable)


The Series 2020A was issued in the par amount of $31.3 million with a premium of $9.1 million for total proceeds of $40.4 million and true interest cost (TIC) of 2.65%. The proceeds are being used to fund a portion of the costs of the following projects, plus finance the costs of issuance:

- Rehabilitation of Pillsbury Hall (Twin Cities);
- Renovation and space addition to the Center for Magnetic Resonance Research Building (Twin Cities);
- Expansion of the Child Development Center Lab School (Twin Cities);
- Reconfiguration of existing space in Owen Hall and Dowell Hall on the Crookston campus,
- Classroom improvements in Blakely Hall on the Morris campus;
- Purchase of a spare turbine for the Main Energy Plant (Twin Cities)

The Series 2020B was issued in the par amount of $84.7 million with a TIC of 2.31% to finance a portion of the costs of land and buildings near the Minneapolis campus to be used for University operations, including the refunding of the CP Notes Series I outstanding in the amount of $53.0 million that was originally issued for the same purposes, plus finance the costs of issuance.
Key Financial Indicators

As indicated earlier, debt capacity and credit ratings are not a function of ratios alone. However, the University annually calculates certain ratios as outlined by the ratings agencies based on the financial information contained in the audited yearend financial statements. The University uses three ratios to calculate the debt capacity of the University:

- **Total Cash & Investments to Total Debt** – measures coverage of total debt by assets that generate investment return

- **Spendable Cash & Investments to Total Debt** – measures the university’s ability to repay bondholders from wealth that can be accessed over time or for a specific purposes.

- **Debt Service to Operating Expenses** – measures annual debt service burden on the annual operating budget

Ratios calculated by the rating agencies are based on the par amount of the debt outstanding plus capital leases, but excluding the net unamortized premium or discount on the bonds.

Definitions for the numerators and denominators in these three ratios as calculated by Moody’s are provided below.

<table>
<thead>
<tr>
<th><strong>Total cash &amp; investments</strong></th>
<th>total cash and cash equivalents plus short-term investments plus noncurrent investments of the University, UMF and UMP (does not include the restricted cash and cash equivalents)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Spendable cash and investments</strong></td>
<td>total cash and investments as computed above less restricted, nonexpendable net assets of the University, less the permanently restricted net assets of UMF and UMP</td>
</tr>
<tr>
<td><strong>Total debt</strong></td>
<td>the sum of the University's outstanding debt as shown on the financials, less net unamortized premium/discount on the bonds, plus UMF bonds payable</td>
</tr>
<tr>
<td><strong>Debt service</strong></td>
<td>the sum of the principal paid and interest expense on capital debt by the University</td>
</tr>
<tr>
<td><strong>Operations</strong></td>
<td>University operating expenses less scholarships &amp; fellowships, plus interest on capital asset-related debt</td>
</tr>
</tbody>
</table>

In addition, the University performs a second calculation of the ratios modifying the Total Debt amount by subtracting out the University’s special purpose debt, and modifying the Debt Service and Operations amounts by subtracting the principal and interest on the special purpose debt.

The following graphs reflect these ratios for the last five years for the University of Minnesota, the University of Minnesota, as modified, and the median of the 14 public universities rated Aa1 by Moody’s. The blue lines on each graph represent the highest and lowest ratio as calculated for fiscal year-end 2019 for the public institutions rated Aa1.
Total Cash and Investments to Total Debt

As shown above, the University is solidly in the middle of the range for Aa1-rated public institutions and above the median for this group of institutions. In addition, when the state-supported debt is taken out of the calculations, the calculated ratio is even better.

The two blue lines represent the 2019 minimum and maximum values for this ratio for Aa-1 rated institutions reflecting the total range of values.
Spendable Cash and Investments to Total Debt

Total Cash and Investments of the University, UMF & UMP, less restricted, nonexpendable net assets of the University, less the permanently restricted net assets of UMF & UMP

Divided by Total Debt

Similar to the first ratio, the University is again solidly in the middle of the range for Aa1-rated public institutions and above the median for this group of institutions. In addition, when the state-supported debt is taken out of the calculations, the calculated ratio is even better.

The two blue lines represent the 2019 minimum and maximum values for this ratio for Aa-1 rated institutions reflecting the total range of values.
Debt Service to Operations

The University is above the median for this ratio, but is fairly consistent from year-to-year. In addition, as also shown in the previous two ratios, when the state-supported debt is removed from the calculation, the ratio improves — by decreasing — which is the desired direction for this ratio.

The two blue lines represent the 2019 minimum and maximum values for this ratio for Aa-1 rated institutions reflecting the total range of values.
Peer Analysis

The University annually compares selected financial ratios, consistent with major credit rating agency criteria, to other Big 10 institutions and to other public institutions with the same rating. This peer group consists of highly rated preeminent public research universities. The following charts provide the comparisons as of June 30, 2019, the most recent year-end that is available for all institutions. The different colors of the bars represent the University of Minnesota (maroon), Aaa-rated institutions (black), Aa1-rated institutions (gold), and one Aa2-rated institution (green).

**Total Cash and Investments ($ in Millions)**

Measures the wealth of a university and its affiliated foundation(s)

**Total Debt ($ in Millions)**

Measures direct obligations of a university and its affiliated foundation(s)
Measures coverage of total debt by assets that generate investment return. Higher percentages are more desirable.

Measures the university’s ability to repay bondholders from wealth than can be accessed over time or for a specific purpose. Higher percentages are more desirable.
Measures annual debt service burden on the annual operating budget. Lower percentages are more desirable.

Measures the extent to which a university can rely on wealth than can be accessed over time or for a specific purpose to operate without earning any additional revenue. Higher percentages are more desirable.