

# Annual Finance Policy Reports

*Board of Trustees Finance & Audit Workgroup  
September 8, 2015*

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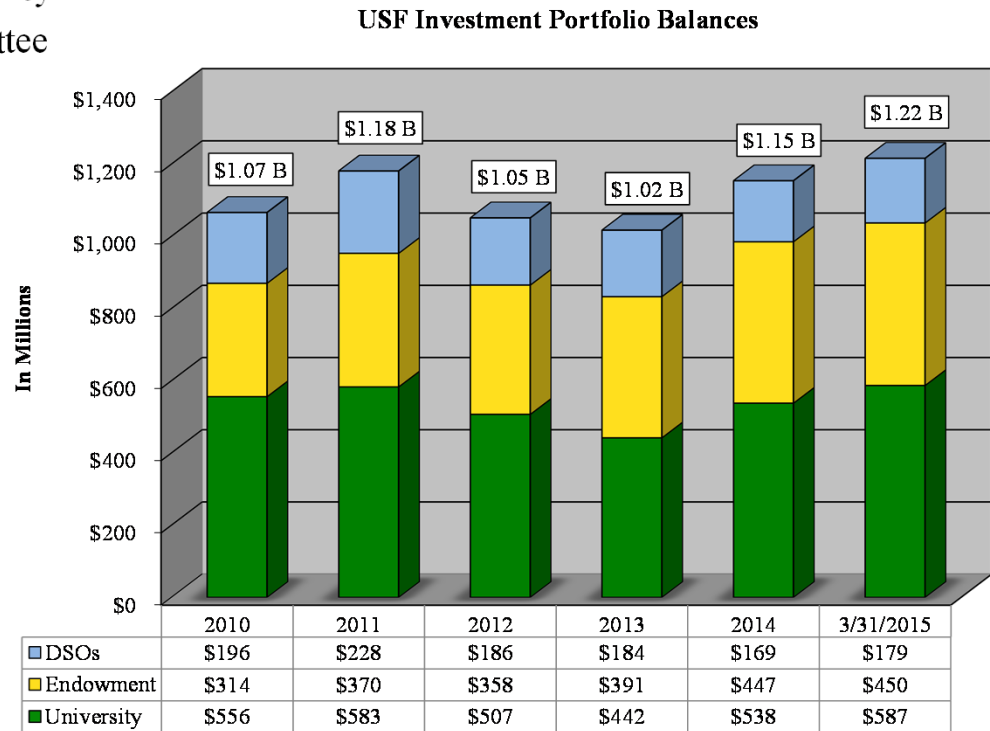
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# Annual Investment Report

*Board of Trustees Finance & Audit Workgroup  
September 8, 2015*

## GOVERNANCE AND INVESTMENT MANAGEMENT STRUCTURE

- **University Board of Trustees**
  - Adopted USF System Investment Policy
  - Established USF Investment Committee
  
- **USF Investment Committee**
  - Approves investment guidelines, asset class targets and investment direction for each asset class
  - Approves investment managers
  
- **Central Oversight of USF’s 10 Investment Portfolios**
  - All portfolios governed by active investment committees and common USF Investment Policy
  - All portfolios are in compliance with Policy



- **Combined USF System Investment Portfolio – \$1.2 Billion, Up \$59 Million over 2014**

## USF INVESTMENT PERFORMANCE

- **Combined Investment Performance**
  - 1-Year Return = 4.16%, 0.15% over benchmark
  - 3-Year Return = 5.95%, 0.21% over benchmark
  - 5-Year Return = 5.74%, 0.15% over benchmark
  
- **USF’s 10 Investment Portfolios – \$1.2 Billion, up \$59 Million**
  - University Portfolio – \$587 million, up \$45 million, due to positive net cash flow
  - Foundation Endowment – \$450 million, up \$9 million, due to positive investment returns
  - 8 Other DSO Portfolios – \$179 million, up \$5 million, due to positive net cash flow

### USF Investment Portfolios

As of March 31, 2015

Portfolio Balances (In Millions)	University Portfolio	Foundation Endowment	8 Other DSO Portfolios	USF's 10 Investment Portfolios
System Portfolio, 3/31/15	\$587	\$450	\$179	\$1,216
System Portfolio, 3/31/14	\$542	\$441	\$174	\$1,157
<b>Change in System Portfolio</b>	<b>\$45</b>	<b>\$9</b>	<b>\$5</b>	<b>\$59</b>

## UNIVERSITY PORTFOLIO – RECENT EVENTS

- **Maintain Highly Liquid Portfolio to Support Annual Cash Flow of \$1.5 Billion**
- **Manage Portfolio to Preserve Capital and Provide Reasonable Returns at an Acceptable Degree of Risk**
  - Redemption of Vanguard Prime Money Market Fund Due to Dodd-Frank Money Market Reforms
  - Continuing Redemption of Bridgeway Large Cap Index Fund – Redeploying Proceeds into S&P 500 Index Fund
  - Selective Rebalancing from High-Valuation to Attractive-Valuation Portfolio Segments
  - USF Portfolio Transactions Over the Past 12 Months
    - Total Liquidation – \$26 million – Vanguard Prime money market fund
    - Partial Liquidation – \$ 5 million – Bridgeway Mega-cap index fund
    - 1 Purchase – \$ 7 million – Vanguard S&P 500 index fund
    - 1 Purchase – \$ 2 million – Vanguard Developed markets index fund
    - 1 Purchase – \$ 1 million – Vanguard Emerging markets index fund
    - 2 Partial Liquidations – \$ 1 million – Vanguard REIT index fund
    - 2 Purchases – \$ 1 million – Vanguard Energy index fund
    - 1 Purchase – \$ 3 million – Long/short absolute return fund

## UNIVERSITY PORTFOLIO – NEAR-TERM INITIATIVES

- **Ongoing Assessment of Portfolio Exposure to Rising Interest Rates – USF Well Positioned in Short-Term, High Quality Fixed Income Funds**
- **Assess Corporate Bond Liquidity Risk due to Dodd-Frank Act Regulations – 80% Decline in Dealer Inventories**
- **Maintain Liquidity in Diversified, Well-Managed Mutual Funds – Next Day Availability**
- **Monitor Performance of Investment Managers – Strong Watch List Criteria**
- **Continue Investment of Positive Net Cash Flow Into Balanced Portfolio Structure**

## UNIVERSITY PORTFOLIO – HISTORICAL PERFORMANCE

- **University Portfolio Structure Has Lower Exposure to Market Volatility, Improving Prospects for Positive Absolute Returns**
  - U.S. Fixed Income – \$332 M – 59%
  - U.S. / Foreign Equity – \$125 M – 23%
  - Money Market Funds / Cash – \$102 M – 18%

### 8 Year Investment Performance

12-Month Performance	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015
<b><u>UNIVERSITY PORTFOLIO</u></b>								
Annual Investment Income (Loss)	\$25 M	\$23 M	\$27 M	\$21 M	\$10 M	\$14 M	\$27 M	\$8 M
Annualized Return	5.36%	4.77%	4.80%	3.30%	1.60%	2.70%	4.90%	0.70%
<i>Benchmark Return</i>	5.14%	4.51%	3.84%	3.25%	1.30%	2.40%	4.90%	0.80%
Relative Portfolio Return	0.22%	0.26%	0.96%	0.05%	0.30%	0.30%	0.00 %	(0.10)%
<b><u>COMBINED OTHER PORTFOLIOS</u></b>								
Annual Investment Income (Loss)	\$1 M	(\$78) M	\$46 M	\$78 M	\$3 M	\$50 M	\$81 M	Not Available



# Annual Debt Management Report

*Board of Trustees Finance & Audit Workgroup  
September 8, 2014*

## GOVERNANCE AND DEBT MANAGEMENT STRUCTURE

- **University Board of Trustees**
  - Adopted USF System Debt Management, Derivatives, Real Property Policies
  - Authorize all new debt and real property transactions
  
- **The University Maintains Strong, Stable Credit Ratings – “Aa2 – Stable Outlook” (Moody’s)**
  
- **USF Organized Pledged Revenue Into 5 USF Finance Systems**
  - Attract highest possible credit ratings / Obtain attractive, long-term interest rates
  - Demonstrated capability to access public and private capital markets
  
- **Central Management of New Debt, Debt Capacity and Compliance – Oversight of Leveraged Auxiliaries**
  - Financing Corporation closed \$1.4 billion transactions / Developed 1.9 million square feet of projects (2005-2015)

### USF Finance Systems

As of June 30, 2015

Outstanding Debt (In Millions)	Housing	Health	Athletics	Research	Parking	Total / Weighted
<b>Total Outstanding Debt per System</b>	\$232.7	\$78.5	\$47.3	\$33.2	\$25.1	<b>\$416.8</b>
<b>Weighted Average Interest Rate</b>	3.75%	4.19%	4.46%	4.28%	4.30%	<b>3.99%</b>
<b>Moody's / S&amp;P Rating</b>	A1 / A+	NR	NR	NR	Aa3 / AA-	

NR = Not Rated

## USF DEBT MANAGEMENT

- **University Debt Managed to Provide Low Cost, Low Risk, Long-Term Financing for Major Capital Projects**
  - Maintain USF's strong "Aa2" credit ratings – Provide access to capital markets on the best possible terms
  - Maintain strong balance sheet – Increase liquidity, manage gradual reduction in overall leverage
  - Preserve debt capacity for strategic projects
  - Maintain conservative new debt issuance standard – First year 1.3x debt service coverage ratio (exceeds BOG 1.2x requirement)

## RECENT EVENTS

- **April 2015 – Moody’s / Standard & Poor’s Affirmed USF’s “Aa2 / AA-” Credit Ratings**
  - Moody’s / S&P rated the new Marshall Student Center bonds at “Aa3 / AA-”
  - Standard & Poor’s upgraded the USF Housing System rating to “A+”
  
- **May 2015 – Restructured \$152 M Housing System Debt**
  - New Series 2015A, Series 2015 Revenue Bonds, and Series 2012A Refunding Bonds – simultaneous close May 6, 2015
    - Refunded former Series 2005A and Series 2005C
    - Converted Series 2012A from variable rate to fixed rate – Returned to public markets
  - Objectives: Lock in current low market rates and reduce risks associated with variable rate bonds
    - Reduced percentage of variable rate debt from 59% to 35%
    - Reduced amount of interest rate swaps outstanding from \$202 M to \$126 M
  
- **Highlights of Recent Compliance Efforts**
  - Successful close of onsite IRS examination of Series 2006A bonds – arbitrage and private use
  - Compliance with new Dodd-Frank Act – SEC Rules
    - “Municipalities Continuing Disclosure Cooperation Initiative” – Successful Financing Corporation self-audit of all continuing disclosures from inception
    - “Municipal Advisor Rule” – designated PFM as our independent and registered muni advisor
  
- **Rising Cost of Compliance is Affecting New USF Debt / Derivative Structures**

## NEAR-TERM INITIATIVES – NEXT 12 MONTHS

- **P3 USF Student Housing Development Project – \$133 M (\$40 M Equity, \$93 M Debt)**
  - Opportunity:
    - Develop multi-use residential village
  - Objectives:
    - Transfer risks for capital asset maintenance, construction, operations and demand
    - Accelerate delivery of housing project
    - Preserve USF credit ratings and debt capacity
  
- **Capitalize on Structured 3-5 Year Maturities of Bank Private Placements and Swaps**
  - Opportunity:
    - Convert \$40 million of variable rate debt to fixed rate (Series 2013A)
    - Advance refund prior to the July 1, 2016 expiration of the bank private placement
    - Terminate associated interest rate swap
  - Objectives:
    - Lock in current low, long-term market rates
    - Reduce exposure to variable interest rates
    - Reduce reliance on interest rate swaps

## 8-YEAR MANAGEMENT OF OUTSTANDING DEBT

Effect of New Debt Relative to Cash & Investments (In Millions)	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015 (ACTUAL)	Moody's Aa2 Medians FY 2014
<b>NEW DEBT</b>	\$96		\$10	\$52			\$20		
<b>TOTAL DEBT</b>	\$446	\$445	\$415	\$454	\$445	\$431	\$435	<b>\$417</b>	\$793
<b>CASH &amp; INVESTMENTS</b>	\$499	\$511	\$576	\$608	\$530	\$471	\$579	<b>\$626</b>	\$823

POLICY MEASURES	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015 (EST)	Moody's Aa2 Medians FY 2014
<b><u>PROFITABILITY</u></b>									
<b>Operating Margin (↑)</b>	2.6%	5.1%	0.6%	0.3%	-6.9%	-4.7%	2.4%	<b>-0.0%</b>	<b>1.4%</b>
<b><u>LEVERAGE</u></b>									
<b>Debt Service Coverage (↑)</b>	8.8x	10.2x	11.8x	11.5x	-0.6x	4.9x	20.6x	<b>15.9x</b>	<b>2.4x</b>
<b>Debt / Operating Expense (↓)</b>	1.0%	1.1%	0.6%	0.6%	0.4%	0.5%	0.4%	<b>0.4%</b>	<b>4.1%</b>
<b><u>LIQUIDITY</u></b>									
<b>Expendable Financial Resources / Debt (↑)</b>	0.88x	0.94x	1.16x	1.18x	1.01x	1.02x	1.20x	<b>0.92x *</b>	<b>1.21x</b>
<b>Total Financial Resources / Debt (↑)</b>	1.86x	1.84x	2.18x	2.21x	2.03x	2.15x	2.42x	<b>2.20x *</b>	<b>1.83x</b>
<b>Expendable Financial Resources / Operating Exp (↑)</b>	0.45x	0.49x	0.51x	0.53x	0.43x	0.42x	0.48x	<b>0.33x *</b>	<b>0.53x</b>
<b>Additional Measure: Days Cash on Hand (↑)</b>	171 days	177 days	191 days	192 days	162 days	153 days	184 days	<b>180 days</b>	<b>149 days</b>

\* USF measures affected by prior period pension adjustment (GASB 68) - All other public U.S. universities will have a similar adjustment. This adjustment is not reflected in the Moody's Medians for FY 2014.

# Annual Derivatives Report

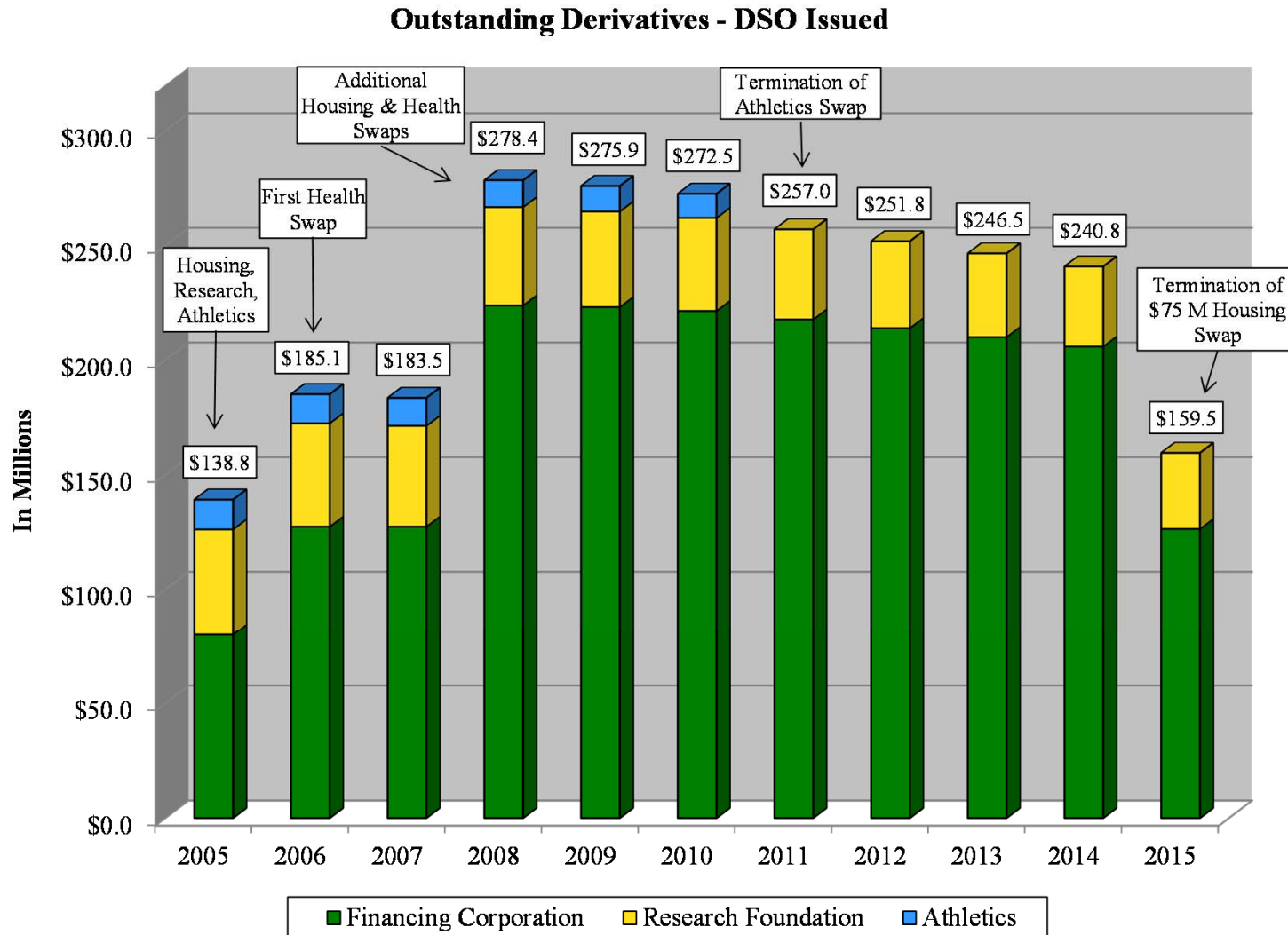
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## GOVERNANCE AND DERIVATIVES MANAGEMENT STRUCTURE

- **University Board of Trustees**
  - Adopted USF System Derivatives Policy
  - All swaps governed by this Policy – All swap counterparties carry investment grade rating
  
- **Central Management of 7 Interest Rate Swaps Outstanding - \$160 Million**
  - Negative fair value of swaps of \$18.7 million (6/30/15) (accumulated non-cash expense); As swaps approach expiration, the negative value will move to \$0
  - Change in fair value was gain of \$5.8 million (2014-2015) – non-cash gain
  - Posting \$5.6 million in cash collateral with counterparty trustee (due to downgrade of Ambac)
  - Swaps provide an effective hedge against variable interest rates
  - Swaps lock in attractive fixed interest rates for variable rate debt = 3.69%
  
- **No New Swaps Since 2007**
  
- **\$94 Million of the Remaining Swaps Will Expire over next 1-4 years**
  - Swap expirations matched with bank term debt maturities
  - Creating opportunities to convert variable rate debt to fixed rate



# 10-YEAR MANAGEMENT OF OUTSTANDING DERIVATIVES



## RECENT EVENTS

- **May 2015 – Terminated \$75 Million Swap with Conversion of \$88 Million of Variable Rate Debt to Fixed Rate Debt (Housing - Series 2012A)**
  
- **Highlights of Recent Compliance Efforts**
  - Compliance with new Dodd-Frank Act – SEC Rules
    - “Swap Data Reporting and Recordkeeping Requirements”
  
- **Cost of Compliance is Affecting USF’s Interest in New Derivatives**

## NEAR-TERM INITIATIVES – NEXT 12 MONTHS

- **Expiring 3-year Direct Bank Placements Creates Opportunity to Convert from Variable Rate Debt to Fixed Rate Debt and Eliminate Significant Amount of Interest Rate Swaps**
  - \$40 Million of Health Certificates (Series 20013A)
  - \$27 Million of Research Bonds (Series 2013B and Series 2013D)

## MANAGEMENT OF USF DERIVATIVES

- **USF Derivatives Policy – Required Strong Counterparties (At Issuance) Have Ensured Stable Derivatives Portfolio**

**USF Derivatives Portfolios**
**As of June 30, 2015**

Interest Rate Swaps	USF Financing Corporation				USF Research Foundation				TOTAL / WEIGHTED
	Royal Bank of Canada		Morgan Stanley / Royal Bank of Canada		Bank of America				
Swap Counterparties									
Counterparty Credit Rating at Issuance (Moody's)	Aa3		A2 / Aa3		A2				
Remaining Amount of Swap	\$0	\$65,500,000	\$40,450,000	\$20,315,000	\$4,600,000	\$18,455,000	\$405,000	\$9,775,000	\$159,500,000
Effective Date	5/25/2005	9/25/2007	3/16/2006	11/19/2007	6/1/2001	4/1/2006	4/1/2006	4/1/2006	
Initial Term	10 yrs	30 yrs	10 yrs	10 yrs	18 yrs	10 yrs	9 yrs	10 yrs	
Expiration Date	Terminated 4/15/2015	7/1/2037	7/1/2016	7/1/2018	12/1/2019	8/1/2016	8/1/2015	8/1/2016	
Fixed Rate	3.22%	3.55%	3.58%	3.40%	4.56%	3.62%	5.27%	5.36%	3.69%
Fair Value of Swap at 6/30/15 (w/ CVA Adj)	0	(13,164,873)	(1,996,879)	(1,814,511)	(439,472)	(705,065)	(3,542)	(544,565)	(18,668,907)
Fair Value of Swap at 6/30/14 (w/ CVA Adj)	(3,545,742)	(12,479,616)	(3,293,013)	(2,272,269)	(617,254)	(1,287,528)	(28,764)	(1,003,414)	(24,527,600)
Change in Fair Value - Income Statement	3,545,742	(685,257)	1,296,134	457,758	177,782	582,463	25,222	458,849	5,858,693
USF Optional Termination Right	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	
Collateral Posting Threshold @ A1 - A3	N/A	\$10,000,000	None	\$1,000,000	None	None	None	None	