

Annual Finance Policy Reports

*Board of Trustees Finance & Audit Workgroup
August 28, 2014*

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Annual Investment Report

*Board of Trustees Finance & Audit Workgroup
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GOVERNANCE AND INVESTMENT MANAGEMENT STRUCTURE

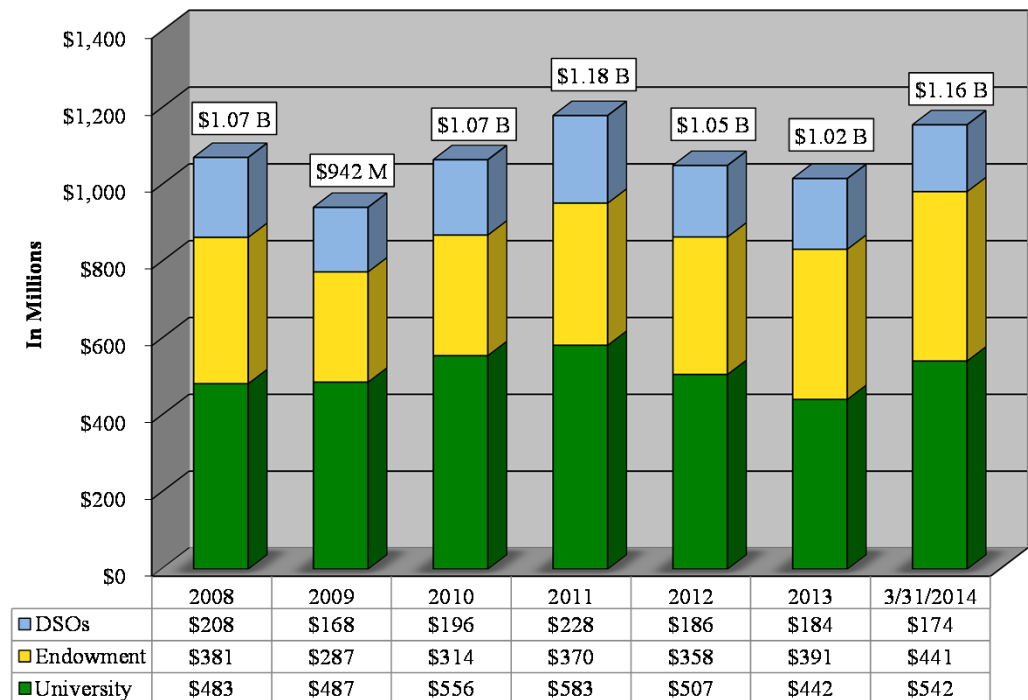
- **University Board of Trustees**
 - Adopted USF System Investment Policy
 - Established USF Investment Committee

- **USF Investment Committee**
 - Appointed investment consultant
 - 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 2014 System investment portfolio - \$1.2 billion, up \$115 million over 2013 (as of 3/31)**

USF Investment Portfolio Balances



GOVERNANCE AND INVESTMENT MANAGEMENT STRUCTURE

- **Combined Investment Performance (As of 3/31/14)**
 - 1-Year Return = 7.57%, 0.49% over benchmark
 - 3-Year Return = 5.75%, 0.25% over benchmark
 - 5-Year Return = 8.57%, 0.23% over benchmark

- **USF’s 10 Investment Portfolios – \$1.2 Billion (As of 3/31/14), up \$115 Million**
 - University Portfolio – \$542 million, up \$88 million, due to positive net cash flow
 - Foundation Endowment – \$441 million, up \$49 million, due to positive investment returns
 - 8 Other DSO Portfolios – \$174 million, down \$21 million, due to investment in fixed assets

USF Investment Portfolios

As of March 31, 2014

Portfolio Balances (In Millions)	University Portfolio	Foundation Endowment	8 Other DSO Portfolios	USF's 10 Investment Portfolios
System Portfolio, 3/31/14	\$542	\$441	\$174	\$1,157
System Portfolio, 3/31/13	\$454	\$393	\$195	\$1,042
Change in System Portfolio	\$88	\$49	(\$21)	\$115

RECENT EVENTS

- **University Replaced 3 Investment Managers and Approved 5 New in the Past 2 Years**
 - Replacement criteria: Underperformance and/or organizational issues
 - New investment managers: Approved by Investment Committee; due diligence by consultant
- **USF Positive Cash Flow Reinvested in Portfolio – Principally Short-Term Corporate Bonds**
- **Maintenance of Balanced Portfolio Structure**

USF Portfolio Transactions Over the Past 12 Months

- 1 purchase – \$50 million – Corporate bond index fund
- 3 purchases – \$12 million – S&P 500 index fund
- 3 purchases – \$ 5 million – Developed markets index fund
- 2 purchases – \$11 million – Emerging markets index fund
- 2 purchases – \$ 5 million – Energy index fund
- 1 purchase – \$ 1 million – REIT index fund
- 1 purchase – \$ 3 million – Long/short absolute return fund
- Liquidation – \$ 9 million – Emerging markets fund

NEAR-TERM INITIATIVES – NEXT 12 MONTHS

- **Ongoing Assessment of Portfolio Exposure to Interest Rate Risk – Well Positioned in Short-Term, High Quality Fixed Income**
- **Maintain Liquidity in Diversified, Well-Managed Mutual Funds – Next Day Availability**
- **Continue Investment of Positive Net Cash Flow Into Balanced Portfolio Structure**
- **Consider Changes to Asset Allocation Ranges**

MANAGEMENT OF USF INVESTMENTS AND POLICY MEASURES

- **University Portfolio Managed to Deliver Stable Returns, Preserve Capital and Maintain Liquidity**
- **University Portfolio Structure Has Lower Exposure to Market Volatility, Improving Prospects for Positive Absolute Returns**

USF 12-Month Historical Investment Performance

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

Annual Debt Management Report

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GOVERNANCE AND DEBT MANAGEMENT STRUCTURE

- **University Board of Trustees**
 - Authorizes all new debt and real property transactions
 - Adopted 3 USF System finance policies: Debt Management, Derivatives, Real Property

- **USF Organized Eligible Revenue Streams Into 5 Finance Systems**
 - Attract highest possible credit ratings / Obtain attractive, long-term interest rates

- **Central Management of New Debt Structures, Debt Capacity and Tax / Legal Compliance – Oversight of Leveraged Auxiliaries**
 - University has demonstrated capabilities, quickly responds to USF’s infrastructure needs and can access public and private capital markets
 - Closed \$1.3 billion of transactions; developed 1.9 million square feet of projects (2005-2014)

- **University Enjoys Strong, Stable Credit Ratings – “Aa2 – Stable Outlook”**

USF Finance Systems

As of June 30, 2014

Outstanding Debt (In Millions)	Housing	Health	Athletics	Research	Parking	Total / Weighted USF Issuer Credit Rating
Total Outstanding Debt per System	\$241.2	\$80.8	\$49.3	\$34.9	\$27.0	\$433.2
Weighted Average Interest Rate	4.27%	4.18%	4.40%	4.31%	4.25%	4.27%
Moody's / S&P Rating	A1 / A+	NR	NR	NR	Aa3 / AA-	Aa2 / AA-

NR = Not Rated

RECENT EVENTS

- **Moody’s and Standard & Poor’s Affirmed USF’s “Aa2 / AA-” Credit Ratings in FY 2014**
 - Standard & Poor’s raised the USF Housing System rating to “A+”

- **Restructured Debt – Health**
 - \$62.5 million – New Series 2013A and Series 2013B Refunding Bonds (closed September 2013)
 - Refunded former Series 2006A and Series 2007 Health bonds
 - New bond structure: Bank private placement; Staggered 3- and 5-year maturities
 - Matched bond maturities with expiring interest rate swaps

- **New Debt – Arena**
 - \$20 million – Series 2013 Taxable Promissory Note (closed September 2013)
 - Arena Renovation Project – Reimbursed University for portion of funds spent on the \$36 million renovation
 - New bond structure: Bank private placement; 20-year term; Taxable fixed interest rate = 4.78%

- **Highlights of Recent Compliance Efforts**
 - Compliance with new Dodd-Frank Act – SEC Rules
 - “Municipal Advisor Rule”
 - “Municipalities Continuing Disclosure Cooperation Initiative” (the MCDC Initiative)
 - Onsite compliance examination by the Internal Revenue Service

NEAR-TERM INITIATIVES – NEXT 12 MONTHS

- **Student Housing Development Project – Public Private Partnership**
 - Objective: Significantly enhance the University’s long-term competitive profile for the most attractive undergraduate students
 - Accelerate delivery of Housing Program
 - Preserve University credit ratings and debt capacity

- **Anticipated Housing System Bond Restructurings**
 - Opportunity: Convert \$88 million of variable rate debt to fixed rate (Series 2012A)
 - Opportunity: Advance refund \$28 million of fixed rate debt to reduce interest rate (Series 2005A)
 - Opportunity: Advance refund \$36 million of fixed rate debt to reduce interest rate (Series 2005C)
 - Objectives:
 - Strong “A1” Housing System rating provides access to capital markets at attractive interest rates
 - Lock in current low, long-term market rates
 - Total 3 debt series = \$152 million

MANAGEMENT OF USF DEBT AND POLICY MEASURES

- Careful, prudent management of outstanding debt over the past 6 years

Effect of New Debt Relative to Cash & Investments (In Millions)	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014 (ACTUAL)	Moody's Medians Aa2
NEW DEBT	\$96		\$10	\$52			\$20	
TOTAL DEBT	\$446	\$445	\$415	\$454	\$445	\$429	\$435	\$683
CASH & INVESTMENTS	\$499	\$511	\$576	\$608	\$530	\$471	\$579	\$750

POLICY MEASURES	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014 (EST)	Moody's Medians Aa2
<u>PROFITABILITY</u>								
Operating Margin (↑)	2.6%	5.1%	0.6%	0.3%	-6.9%	-4.7%	2.4%	2.2%
<u>LEVERAGE</u>								
Debt Service Coverage (↑)	8.8x	10.2x	11.8x	11.5x	-0.6x	4.9x	21.9x	2.9x
Debt / Operating Expense (↓)	1.0%	1.1%	0.6%	0.6%	0.4%	0.5%	0.4%	3.7%
<u>LIQUIDITY</u>								
Expendable Financial Resources / Debt (↑)	0.88x	0.94x	1.16x	1.18x	1.01x	1.02x	1.20x	1.16x
Total Financial Resources / Debt (↑)	1.86x	1.84x	2.18x	2.21x	2.03x	2.15x	2.41x	1.74x
Expendable Financial Resources / Operating Exp (↑)	0.45x	0.49x	0.51x	0.53x	0.43x	0.42x	0.48x	0.48x

Annual Derivatives Report

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GOVERNANCE AND DERIVATIVES MANAGEMENT STRUCTURE

- **University Board of Trustees**
 - Adopted USF System Derivatives Policy

- **Central Management of 8 Interest Rate Swaps Outstanding - \$241 Million**
 - Negative fair value of swaps of \$24.5 million (6/30/14) (accumulated non-cash expense); As swaps approach expiration, the negative value will move to \$0
 - Change in fair value was positive \$4.6 million (2013-2014) – non-cash gain
 - Posting \$6.9 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 = 3.55%**

- **No New Swaps Since 2007**

- **\$174 Million of the Swaps Will Expire over next 1-5 years**
 - Swap expirations now matched with bank term debt maturities
 - Creating opportunities to convert variable rate debt to fixed rate

- **All Swaps Governed by USF Derivatives Policy – All Swap Counterparties Carry Investment Grade Ratings, No Counterparty Failures**

RECENT EVENTS

- **Amending Swap Agreement to Reduce Termination Risk Prior to Maturity**
- **Highlights of Recent Compliance Efforts**
 - Compliance with new Dodd-Frank Act – SEC Rules
 - “Swap Data Reporting and Recordkeeping Requirements”

NEAR-TERM INITIATIVES – NEXT 12 MONTHS

- **Opportunity to Convert \$88 Million of Variable Rate Debt to Fixed Rate Debt (Series 2012A) – Eliminate Need for Swap Hedge of Interest Rate Risk**

MANAGEMENT OF USF DERIVATIVES AND POLICY MEASURES

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

USF Derivatives Portfolios
As of June 30, 2014

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)	Aa2		Aa3 / Aa2		Aa2				
Remaining Amount of Swap	\$76,175,000	\$67,275,000	\$41,650,000	\$20,855,000	\$5,400,000	\$18,455,000	\$1,000,000	\$10,010,000	\$240,820,000
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	7/1/2015	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%	3.55%
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)
Fair Value of Swap at 6/30/13 (w/ CVA Adj)	(5,644,385)	(12,303,146)	(4,419,131)	(2,636,749)	(818,449)	(1,801,834)	(81,233)	(1,419,396)	(29,124,323)
Change in Fair Value - Income Statement	2,098,643	(176,470)	1,126,118	364,480	201,195	514,306	52,469	415,982	4,596,723
USF Optional Termination Right	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	
Collateral Posting Threshold @ A1 - A3	\$10,000,000	\$10,000,000	None	None	None	None	None	None	