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DEBT MANAGEMENT POLICY

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The University of Montana

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Table of Contents

The University of Montana
Debt Management Policy

A. Purpose

The University of Montana (the "University") recognizes that a comprehensive debt management policy is the foundation of any well-managed debt program. This debt management policy sets forth the parameters for issuing debt and managing the outstanding debt portfolio. It provides guidance to the Administration and the Board of Regents regarding the purposes for which debt may be issued, types of and amounts of permissible debt, timing and method of sale that may be used, and structural features that may be incorporated. Adherence to a debt management policy serves to ensure that the University maintains a sound debt position and that credit quality is protected.

It is the intent of the University to establish a debt management policy to:

- Ensure high quality debt management decisions;
- Impose order and discipline on the debt issuance process;
- Demonstrate a commitment to long-term financial planning objectives;
- Keep the average borrowing costs to the University as low as possible;
- Ensure that debt management decisions are viewed positively by rating agencies and the investment community.

B. Guiding Principles

The following guiding principles will be used for managing the University's existing debt and for the planning of capital improvements to be funded with new debt:

- Full and timely payment of principal and interest on all outstanding debt;
- Debt incurred only for those purposes as provided by State Statute;
- Payment of debt secured by the pledge of specified, limited University, special facility, or fee revenues of the University;
- Principal and interest retirement schedules structured to: (1) achieve a low borrowing cost for the University, 2) accommodate debt service payments of existing debt, and (3) respond to perceptions of market demand;
- Debt generally limited to obligations with serial and term maturities but may be sold in the form of capital appreciation bonds or other structures if circumstances warrant;
- The average life of the debt incurred to be no greater than the average life used by the University for depreciating similar assets;
- The University maintain good communications with bond rating agencies and insurers to ensure complete and clear understanding of the credit worthiness of the University;

- Every financial report and bond “official statement” will follow a policy of full, complete and accurate disclosure of financial conditions and operating results. All reports will conform to the necessary guidelines to meet the disclosure needs of rating agencies, underwriters, and investors;
- Although the Master Indenture requires a 1.15 coverage ratio, the University to continue to target a 1.25 coverage ratio when evaluating the issuance of new debt;
- Revenue bonds issued with fixed interest rates to include a call option which can be exercised beginning ten years from the date of issuance. Call options give the University flexibility and opportunity to take advantage of refunding or re-structuring debt in the future;
- An evaluation as part of the debt issuance process to determine whether a formal rating by a nationally recognized rating agency (i.e. Standard and Poor, Moody, Fitch) or the purchase of bond insurance is appropriate based on current conditions;
- Bond proceeds invested to match, to the extent possible, the restrictive yield on the bonds.

C. Debt Management Multi-Campus Oversight Committee

It is the role of the Debt Management Oversight Committee to develop and maintain a debt management policy that will be subject to the approval of the President of the University and the Board of Regents; and to review and structure the plans for all capital financings.

The responsibilities of the Debt Management Oversight Committee are to:

- Develop and maintain comprehensive debt management guidelines in accordance with the University’s Debt Management Policy.
- Review and evaluate results of debt-financing operations including the issuance of long-term debt obligations and the selection of bond type, structure, and methods of sale.
- Review expenditures of bond proceeds and the status of various projects being financed for timeliness of spent bond proceeds.
- Review and evaluate services provided by Bond Counsel, Swap Counsel, Underwriters, Trustee, and other service providers in bond transactions for effectiveness and quality of service.
- Review and revise annually, the Debt Management Policy based upon the review of operations and market conditions.

Membership

The Debt Management Oversight Committee is composed of the Vice President of Administration and Finance-Missoula; Associate Vice President of Administration and Finance-Missoula; Vice Chancellor for Administration and Finance-Dillon; Assistant Dean, Fiscal and Plant Operations-Helena; Controller-Butte; Accounting Manager-Missoula; and Assistant to Vice President for Student Affairs-Missoula. The Associate Vice President for Administration and Finance-Missoula will chair the Committee.

D. Use of Debt –Related Swap and Derivative Products

The use of derivative products has become more prevalent in university, as well as state and local government, debt management programs. Derivatives may take the form of interest rate swaps, options on swaps and other hedging mechanisms such as caps, floors, collars and rate locks. Derivative products can be an important interest rate management tool which when used properly can increase the University's financial flexibility, provide opportunities for interest rate savings, alter the pattern of debt service payments, create variable rate exposure, and limit or hedge variable rate payments. It is essential that the risk associated with these transactions be evaluated and clearly understood prior to entering into a debt-related derivative. In connection with the use of swaps and derivative products, the University will consider the following parameters:

Term: In connection with the issuance or carrying of bonds, the term of the derivative product agreement shall not extend beyond the final maturity date of the related bonds.

Notional amount: The total "net notional amount" of all derivative products related to a bond issue may not exceed the amount of the outstanding bonds. For purposes of calculating the net notional amount, credit shall be given to any fixed versus variable rate derivative products that offset for a specific bond transaction.

Liquidity: The University shall consider the impact on the availability and cost of liquidity of any variable rate bonds issued in combination with an interest rate swap.

Call Option Value: When considering the relative advantage of a derivative product to fixed rate bonds, the University will consider the value of the call option on fixed rate bonds. All value derived from the ability to call bonds at a future date may be forgone when executing a swap transaction.

Risk Limits: The amount and term of all swap transactions executed by the University must be in accord with these guidelines, periodically adjusted. In the context of balancing risk and efficiencies related to fixed rate vs. other debt management methods, at least 75% (65% including swap transactions) of the University's debt issuance activities in cumulative aggregate shall continue in the practice of fixed rate issuance. This exposure may vary over time, dependent upon risk tolerance, credit strength, market conditions, and other factors that may evolve.

Derivative Agreements: Derivative agreements will use terms and conditions as set forth in the International Swaps and Derivatives Association, Inc. (ISDA) Master Agreement. Any Agreement between the Issuer and each counterparty shall include payment, term, security, collateral, default, remedy, terminations, and other terms, conditions, provisions and safeguards as the Issuer, in consultation with Legal Counsel and Swap Advisor, deems necessary or desirable.

Prohibited Interest Rate Swap Features: The University will not use derivative products that:

a. Are speculative or create extraordinary leverage or risk;
b. Lack adequate liquidity to terminate without incurring a significant bid/ask spread;
c. Provide insufficient price transparency to allow reasonable valuation; or
d. Are used as investments.

E. Evaluation and Management of Derivative Product Risks

Prior to the execution of any derivative product transaction, the University and its Underwriter, Swap Counsel, and Bond Counsel will evaluate the proposed transaction and report the findings to the Board of Regents. Such a review will include the identification of the proposed benefit, potential risks, and mitigations, if any.

The University will review the following areas of potential risk for new and existing interest rate swaps:

Basis Risk	This risk refers to having insufficient receipts from a floating receiver exchange contract to pay interest due on the underlying variable rate issued by the University. The mismatch of receipts and payments can also occur to the University's net benefit.
Remarketing Risk	The risk that floating rates will rise due to difficulty in remarketing the underlying debt.
Tax Risk	Tax risk is the risk that change in the U.S. tax code will cause tax-exempt interest to change. If tax rates rise, tax-exempt interest is more valuable and tax-exempt interest rates will fall; and vice versa.
Counterparty Risk	Swaps create bilateral credit agreements between an issuer and a swap provider. Counterparty risk is the risk that the swap provider doesn't perform.
Non-callable Issues	Synthetic rate debt issuers are typically issued as non-callable. Termination costs for breaking the swap effectively work like a call premium which may prevent refinancing.
Liquidity Risk	The inability to continue or renew a liquidity facility.
Termination Risk	Also known as issuer default risk, this is the risk that the issuer fails to perform its swap obligations and may owe a termination penalty if it defaults.
Credit Risk	The occurrence of an event modifying the credit rating of the issuer or its counterparty.

F. Counterparty Selection

The University may utilize a competitive bidding process to select a counterparty and price a swap when that process will provide the lowest financing cost. The University may also use a negotiated process to select counterparty and process a swap when it believes market or competitive conditions justify such a process. The conditions under which a negotiated process may be best used:

a. Market of the swap will require complex explanation about the security for repayment or credit quality.
b. Demand is weak among swap counterparties.
c. Market timing is important, such as for refunding.
d. Coordination of multiple components of the financing is required.
e. The swap has non-standard feature, such as forward starting swap.
f. Bond insurance is neither available nor offered.
g. The par amount for the transaction is significantly larger than normal.

In the event a negotiated process is used for the counterparty selection, the University will document, to the greatest extent possible, that the pricing of the swap or other derivative is reflective of comparable instruments' pricing

G. Review and Reporting

Quarterly Review

The University will review, at a minimum, quarterly, any and all derivative products including interest rate swaps, etc. This review will include the Vice President of Administration and Finance, other University Finance Officers, Underwriter, and Swap Advisor. The review will include an evaluation of all outstanding interest rate swaps and any pending options, an assessment of continued credit worthiness of all counterparties with whom the University has agreements, and an analysis of received interest payments from counterparties with the actual associated bond debt service paid by the University. The review will also assess any risks associated with the outstanding derivatives as well as current market trends, particularly with regard to institutions similar to the University.

Annual Reporting

On an annual basis, The University will report to the Board of Regents any recommended changes to The University of Montana Debt Management Policy. The reporting also will include the current status of all derivative products held by the University, credit rating of each swap counterparty, and information concerning any material event involving outstanding swap agreements or derivative products.