Capital Debt Policy

Category: Financial;

Jurisdiction: Vice President, Administration and Finance; Board Audit and Risk Committee;

Approval Authority: Board of Governors;

Established on: October 17, 2008;

Amendments: February 1, 2013; September 27, 2018; September 12, 2019 (Editorial);

Reviewed with no Amendments: October 1, 2020; October 1, 2021;

PURPOSE

The purpose of the Capital Debt Policy and Capital Debt Guidelines is to define:

- Responsibilities for the approval of new University external capital debt (borrowing)
- Maximum limits on the amount of total external capital debt incurred by the University
- The system of accountability

SCOPE

The intent of this policy is to align the strategic use of debt with the University's investment policies to manage the overall cost of capital, minimize long-term costs for debt service and ensure the overall level of risk does not exceed acceptable levels. This policy provides a discipline and framework that will be used by management to evaluate the appropriate use of debt in capital financing plans and should be used in conjunction with the Use of Excess Borrowings Policy. This policy will be reviewed annually to ensure consistency with the University's objectives and the external environment.

POLICY

1.0 Capital borrowing will be undertaken by the administration only following approval of the capital project by the Board of Governors. Such approval shall include the total cost of the project, source(s) of funds for debt repayment and the period of time over which the debt is planned to be repaid.

2.0 The University will seek to borrow funds from external financial organizations in an effective and competitive manner taking into consideration factors such as term, cost of funds, security required and repayment options. Where external financing is reasonably attainable, internal funds generated from overall University cash flow not immediately required to meet their targeted purpose, may be advanced to finance projects until external financing is obtained. In these cases, any advanced funds will be charged to the project at an internal rate of interest taking into consideration the term and the costs of advancing the funds to the total University cash flow to recover lost income.

3.0 The University will manage its overall debt to maintain an acceptable credit rating to ensure that the University can continue to issue debt and finance capital investments at favorable interest rates.

GUIDELINES RELATED TO CAPITAL DEBT

4.0 Whenever possible, loans shall be made on an unsecured basis. Mortgages may be given for residence related debt.

5.0 Project loans shall be amortized with annual principal repayments and in the case of non-amortizing loans - a sinking fund[1] shall be established to retire the principal owing at the end of the term.

6.0 The University has selected the following key ratios as benchmarks for the maximum level of debt. Compliance with these ratios should ensure that Lakehead maintains a strong credit rating and continuing access to new debt that may be required.

a) *Interest Coverage:*

This ratio measures a key determinant of debt affordability as it quantifies the capacity of surplus operating revenues to pay the University's current and potential interest burden. The University has established a threshold of excess of revenues over expenses at 2.5 times interest expense.

b) Debt per Student FTE:
This ratio measures the amount of total capital debt on a per FTE basis. The amount of total debt shall remain less than $13,000 per student FTE. Total capital debt for purposes of this ratio equals total capital debt less investments representing internally restricted amounts created from available funds in borrowings of the Series A unsecured debenture and the debt repayment sinking fund for projects being amortized over their initial terms.

c) Ratio of Debt to Revenues that are Available for Debt Repayment:
This ratio measures the amount of total capital debt as a percentage of revenues that are available to service debt. Such revenues include ancillary revenue, operating grants, federal indirect costs of research grant, tuition fees and investment income. Total debt shall remain less than 70% of revenues that are available to repay such debt.

d) Debt Service Coverage as a Percentage of Revenues:
This ratio measures the percentage of total revenue that is allocated to debt principal and interest payments. For this calculation, the amount of debt principal payments shall include only those repayments that are obligatory repayments under the terms of each loan. Special principal repayments, made at the discretion of the University, shall be excluded from the calculation. At a minimum, this ratio shall remain 1:1 (to be measured at the end of each fiscal year).

e) Net Cash and Investments to Net Direct Debt & (f) Net Cash and Investments to Operations
These ratios illustrate the University's liquidity position and provide an additional measure of security to bondholders. For this calculation, net cash and investments exclude unspent debenture proceeds and externally restricted endowments. At a minimum, this ratio shall remain greater than 0.5 (to be measured at the end of each fiscal year). Both ratios are used by Moody's as part of their rating analysis rationale.

REPORTING

7.0 The administration shall report annually or as needed through the Board Audit and Risk Committee to the Board of Governors on:

- current and projected debt levels
- compliance with the debt ratios listed above
- sinking fund[1] value with respect to risk tolerance and re-evaluation of investment strategy

[1] **Sinking Fund** – Designed to provide sufficient funds to repay principal on outstanding debt, when due, and should be invested with the objectives of: 1) Maximizing investment earnings over the time horizon and to achieve a minimum annual average rate of return at least equal to the blended rate on the University's debt over the life of the fund 2) Provide appropriate diversification of asset mix to ensure prudent and effective management of the funds.

Review Period: Annually;
Date for Next Review: 2022;
Related Policies and Procedures: None;
Policy Superseded by this Policy: None.

The University Secretariat manages the development of policies through an impartial, fair governance process, and in accordance with the Policy Governance Framework. Please contact the University Secretariat for additional information on University policies and procedures and/or if you require this information in another format:

Open: Monday through Friday from 8:30am to 4:30pm;
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