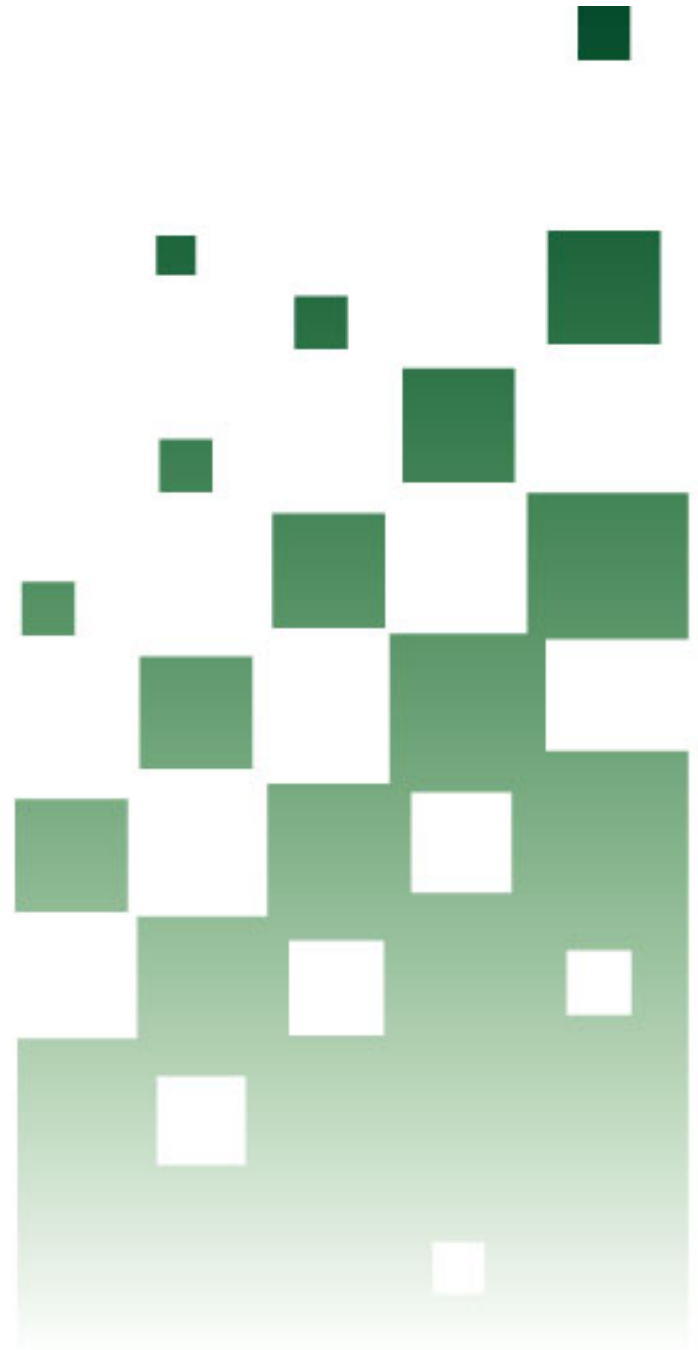


Strategic Treasury Management Bank

The Evolution of a
Central Bank at the
University of Washington



Evolution not Revolution

Many institutions, including UW, are using the central bank structure to strategically manage financial assets and liabilities.

- ◆ **The “Central Bank” structure has paved the way to strategic treasury management or STM.**
- ◆ **The focus of STM is integrated management of assets and liabilities.**
- ◆ **The goal of STM is maximizing financial resources to assets to fund strategic priorities.**
- ◆ **It requires strategic active management of debt and working capital .**
- ◆ **Historically the realm of centralized universities; there is growing adoption of STM at decentralized schools.**
- ◆ **Implementation brings significant structuring choices depending upon institutional objectives and priorities.**

The Devil is in the Details

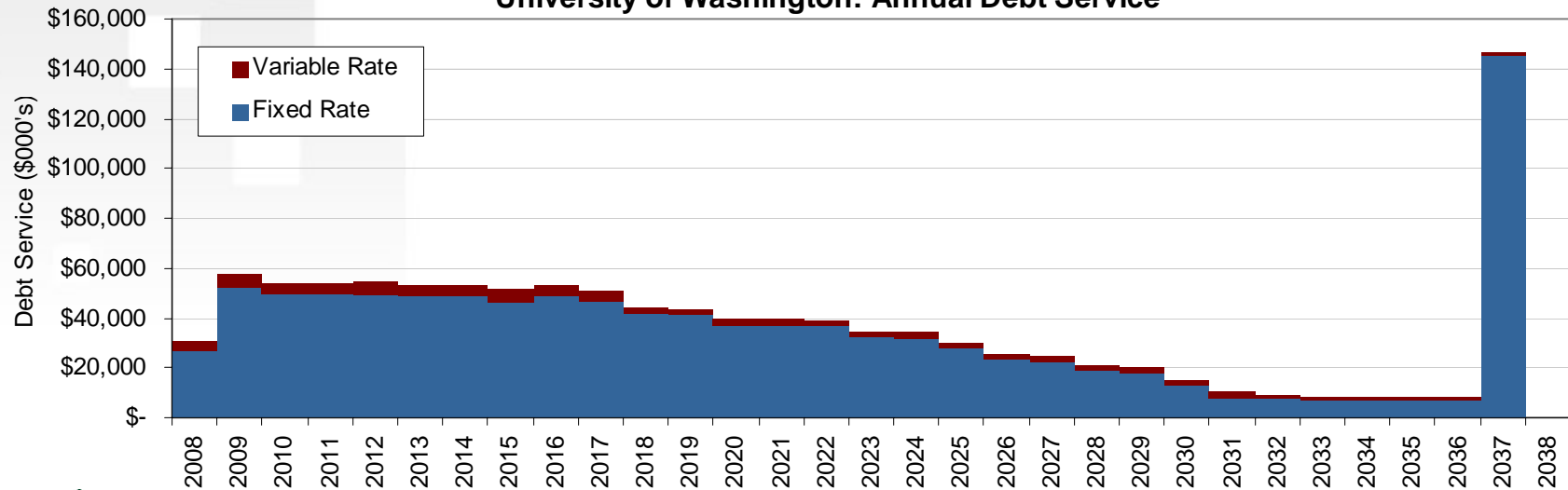
It is important to establish objectives and priorities upfront.

- ◆ **Who benefits from a central bank's accumulated assets? How are they or are they allocated between the institution and internal depositors and borrowers?**
- ◆ **What is the institution's risk tolerance when it comes to financial assets and liabilities?**
- ◆ **What assets and obligations are to be excluded from the bank?**
- ◆ **What is the right balance between long term assets and liabilities (i.e. equity exposure in operating funds and variable rate exposure in the debt portfolio)?**
- ◆ **How active will assets and liabilities be managed and what resources are required? Are the necessary skills and systems in place to implement?**
- ◆ **What is the process for future review and evaluation? How will success be measured and reported?**

University of Washington Profile

Campuses in Seattle, Tacoma, and Bothell	As of 6/30/2007
Founded:	1861
Student Enrollment / Faculty and Staff	43,494 / 28,188
Total Assets:	\$ 7.1 billion
Total Research Funding:	\$1.0 billion
Total Revenues:	\$ 3.7 billion
Total Expenses:	\$ 3.1 billion
Increase in Net Assets:	\$ 595 million
Tuition and Fee Revenues:	\$ 397 million

University of Washington: Annual Debt Service



Out of the Sea and on to the Land

Filling the hole in capital funding resulting from declining state support forced the UW to seek additional statutory authority necessary to implement a central bank.

◆ **Pre-2003**

- Business units issued revenue bonds.
- State funded research, hospital, and educational facilities with state General Obligation (GO) bonds.

◆ **2003-2007**

- UW obtained statutory authority to issue University bonds and use capital leases for research facilities.
- Created the General Revenue Bond (GRB) platform.

◆ **2007**

- UW obtained statutory authority to issue University bonds for any purpose.

One Thing Leads to Another

Development and implementation of new financing tools and structures were driven by specific financing needs.

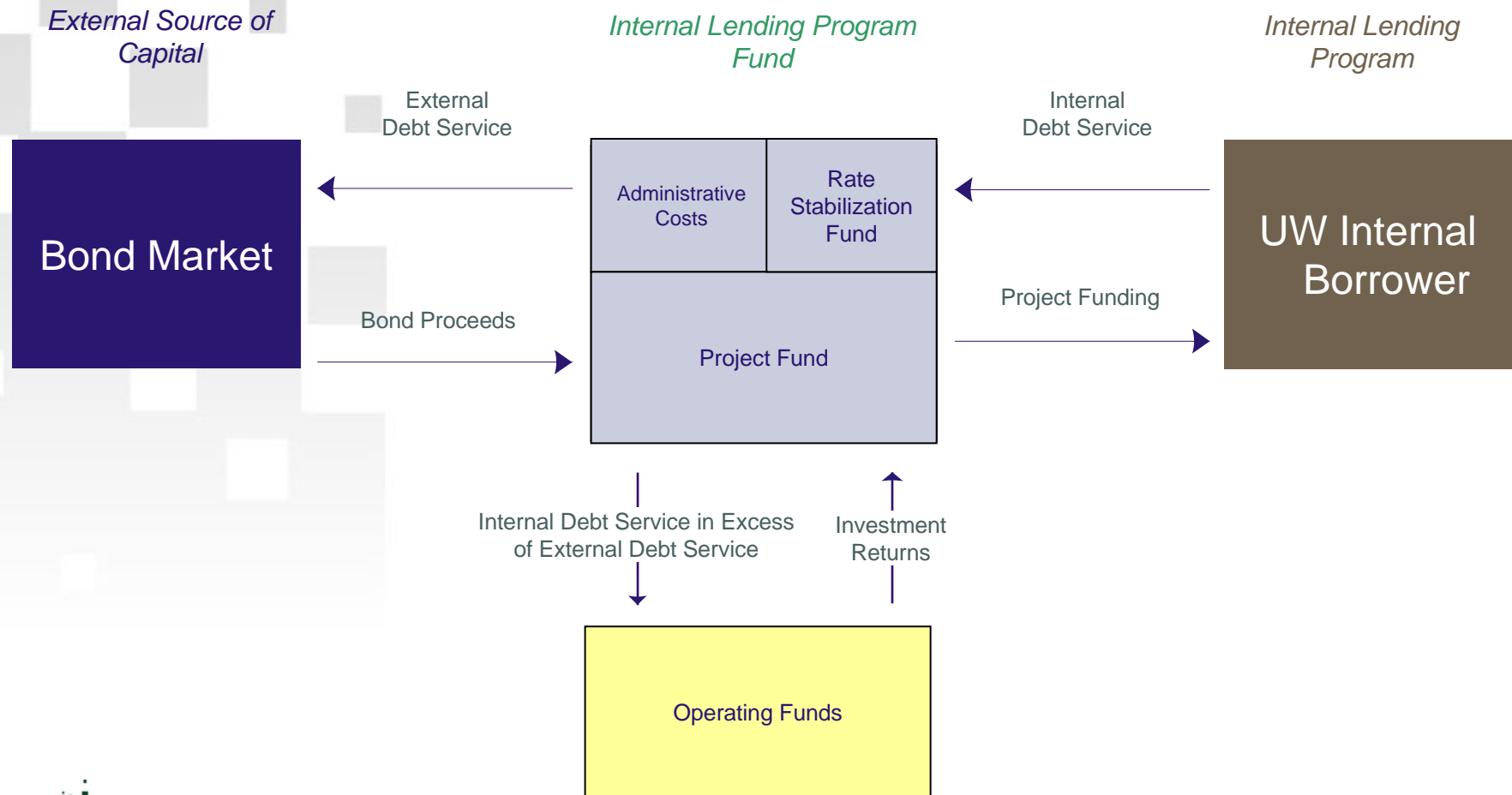
- ◆ Local financing authority for research purposes led to creation of the General Revenue Bond (GRB) platform.
 - UW Medical Center, South Lake Union, Genome Sciences research projects.
- ◆ Ability to leverage all local funds via GRB platform led to pressure for expanded University borrowing authority.
 - Safeco Insurance Tower acquisition.
- ◆ Expanded University borrowing authority approval process led to implementation of commercial paper program.

UW Central Bank -- Internal Lending Program (ILP)

- ◆ Uniform internal lending rate:
 - No discrimination among internal business unit credits.
 - Weighted average cost of funds, fully amortizing loans.
- ◆ Rate stabilization account:
 - Buffers internal lending rate against external rate volatility.
- ◆ All future debt issued at General Revenue level:
 - Business units no longer issue revenue bonds.
 - Just-in-time CP funding, GRB takeout at CP limit (\$250M).
- ◆ “Legacy” debt folded into “new” debt portfolio:
 - “Legacy” debt raised to prevailing internal lending rate.
 - No increase in debt service on “legacy” debt.
- ◆ Active management of external debt portfolio:
 - Strategic refundings, derivatives, non-amortizing debt.
 - ALM coordination with operating funds portfolio.

UW Central Bank -- ILP Structure

The ILP structure separates the external borrowing process from the internal funding process. The institution actively manages the debt portfolio to ensure a stable and predictable rate over time and is paid a premium to do so. Excess ILP fund balances are available for institutional priorities.



UW Central Bank ILP -- In Process

- ◆ Internal operations:
 - Accounting changes
 - Cash flow management
 - Debt portfolio management
- ◆ Internal loan underwriting and management:
 - Due diligence process
 - Loan compliance monitoring
 - Private use monitoring
- ◆ Governing board:
 - Final approval
 - Reporting structure and process
- ◆ IT systems:
 - Upgrade tracking and reporting technology infrastructure

UW Central Bank -- Investment Program

Management of UW's operating assets mirrors the management of the debt portfolio.

- ◆ Depositors receive annual distributions based on the fund's total return.
- ◆ Not all depositors are created equal. Short duration funds receive 0% to 3%. Long duration funds receive 4.25%. Time horizon – if assets are not needed for a long period of time, the investment horizon should be similarly long.
- ◆ Depositor principal and daily liquidity guaranteed.
- ◆ Total return distribution policy supports higher risk profile over the long run.
- ◆ Accumulated appreciation belongs to the institution and provides a rate stabilization buffer.
- ◆ Excess accumulated appreciation is available for institutional priorities.

Strategic Treasury Management

Other Considerations

- ◆ Focus on spending lowest cost sources of capital first (may differ by institution).
- ◆ Evaluate central bank risk analysis taking into consideration the combined re-pricing risk in asset and liability portfolio.
- ◆ Project potential uses for internal re-lending (especially for non-tax-exempt eligible purposes).
- ◆ Include greatest number of inflows and outflows for fungibility, flexibility, and improved management.
- ◆ Unitize operating balances to permit greater flexibility in investment options.
- ◆ Set rules regarding investments, withdrawals (minimum balances) and reporting.

Top 8 Lessons Learned – So Far!

1. Learn from others.
2. Understand the central bank structure first.
3. Establish objectives.
4. Anticipate questions.
5. Get campus engaged, be flexible.
6. Consider the accounting implications.
7. Set deadlines.
8. Recognize that real events can change your course.

The Road Ahead

- ◆ Hire internal operations manager.
- ◆ Consider hiring asset/liability manager and additional internal credit analyst.
- ◆ Refine strategy to integrate financial management of operating funds and debt portfolio.
- ◆ July 1, 2008 implementation of Internal Lending Program.

Participants

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Discussion

1. **Capital Planning:** How are capital projects evaluated and prioritized? Can standard criteria and rules be established? How do you allocate an institution's limited debt capacity among departments/units?
2. **Central Bank issues:** *What are the real goals of the "Central Bank" – to create transparency/fairness, pass on lowest rate to units/departments, generate funds for central purposes or other? What types of other mechanisms are used to generate central funds and/or support less "profitable" units/departments (taxes, subsidies)? How do you get buy-in from Deans and other constituents? How is the Bank governed?*
3. **Cash flow management and projection:** What systems are available (Treasury Workstations)? What are some of the implementation issues/challenges? Can they be used to help manage Capital Banks?
4. **Off-Balance sheet obligations, such as post retirement health care and other:** What, if any, is the real impact of new reporting requirements regarding post employment benefits? How will debt ratios/policies be affected? What are other off-balance sheet obligations which might become on-balance sheet?
5. **Compliance and regulatory issues:** What type of procedures can be imposed to assure compliance with private use restrictions? What type of experience have schools had with audits? Follow-up on IRS questionnaire issues?