January 24, 2007

SALEM STATE COLLEGE DEBT POLICY

> **"…The College's mission is to provide its students with a foundation of knowledge and scholarship, to refine the teaching-learning process and to serve as a center for entrepreneurial solutions designed to strengthen the region's cultural, environmental and economic character."**
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> ***Source: Salem State College Mission Statement***

I. GOALS AND OBJECTIVE:

The College's Strategic Plan guides the spirit and substance of the pursuits in the evolution and the fulfillment of the College's mission. In support of the Strategic Plan, the college has developed a debt policy. The Salem State College Debt Policy provides a framework for making capital financing decisions and for financial condition self-analysis.

The College balances the need for both current and future facilities investment, teaching, student, and other needs and competing initiatives for capital from limited resources. This policy, in conjunction with the Strategic Plan, College's Comprehensive Facilities Plan, and, Budget Plans will help the administration in ensuring that an appropriate mix and types of funding sources are utilized. Debt is viewed as a long-term component of liabilities and must be managed on a long-term portfolio-basis. Debt should not be used to pay for operating expenses.

II. DEBT FUNDING SOURCES:

Salem State College, under the aegis of the Board of Higher Education (BHE), receives funding for capital projects from three sources: Commonwealth General Obligation Bonds, bonds issued by the Massachusetts Health and Educational Facilities Authority (HEFA) and bonds issued by the Massachusetts State College Building Authority (MSCBA).

General Obligation Bonds:

General obligation bonds provide capital funding for all of state government. Portions of the funds available through this source are assigned to various agencies through debt caps determined by the Executive Office of Administration and Finance. The cost of this debt and its availability depends on the creditworthiness of the Commonwealth as a whole. The Commonwealth, not the College specifically, is responsible for the payment of this debt.

HEFA and MSCBA:

HEFA and MSCBA debt is issued by quasi-public authorities for specific types of capital projects and are paid for via dedicated revenue streams. HEFA states its mandate as providing financing or refinancing for any capital project related to the "primary charitable purpose" of an institution. The MSCBA issues debt to finance student activity and residential buildings. The cost and availability of HEFA and MSCBA debt depends on the creditworthiness of the individual college for which a project is being financed.

Capital leases:

Whenever feasible, Salem State College will use the Commonwealth of Massachusetts Equipment Lease-Purchase (TELP), Massachusetts Higher Education Consortium (MHEC) leases and other viable leasing mechanisms within the Commonwealth's rules and regulations.

Alternative Financing:

The College will work closely with the Board of Higher Education, various state or federal agencies, and other State Colleges to explore and/or develop other potential debt financing vehicles.

III. GENERAL DEBT POLICY:

In the case of General Obligation Bonds, Salem State College contributes to the credit of the commonwealth as part of the greater whole. It is with HEFA and MSCBA funding that a debt policy most directly affects Salem State College's ability to acquire and manage debt. Because these sources of funding are backed ultimately by the institution using the funds, the success of a HEFA or MSCBA bond issue is closely related to the College's fiscal performance and overall management.

This policy, as approved by Salem State College Board of Trustees, plays a role in providing the College with possible sources of financing outside of the General Obligation, HEFA and MEFA bonding. The presence of a debt policy demonstrates a level of readiness and competency regarding the use of debt that makes a case for allowing Salem State College to take advantage of other opportunities. A copy of Salem State College Debt Policy, as approved by the College's Board of Trustees, will be filed for reference purposes with the Board of Higher Education.

IV. QUALIFIED PROJECTS:

Debt financing may only be used to finance those projects that have been approved by Salem State College Board of Trustees, and, as appropriate, have been reviewed and approved by the Board of Higher Education and other State or Federal agencies as required.

V. FINANCIAL FEASIBILITY AND REVIEW:

Before the College starts considering using debt to finance all or part of a project, it must complete a financial feasibility study. The study should include the various sources of funding and use of expendable assets to the extent necessary to minimize borrowing to an acceptable level as approved by the College's Board of Trustees. The study must take into account how the College will make debt service payments. In addition, it must have a contingency plan for how to make debt service payments if the assumptions used in determining feasibility do not prove true.

The financial feasibility study must demonstrate the College's ability to assume debt. Actual and pro forma financial ratios can signal whether an institution is operating within appropriate financial bounds. Although, other ratios may also be used, these primary financial ratios as recommended by the Board of Higher Education are:

Viability Ratio

This ratio measures the availability of expendable net assets to pay off long term debt. A ratio of 1.0 or higher indicates an institution has sufficient net assets to satisfy debt requirements.

Ratio = Expendable Net Assets/Long-Term Debt

Debt Burden Ratio

This ratio expresses annual debt service payments as a percent of total expenses. It measures an institution's ability to repay debt service on all outstanding debt and its impact on the institution's overall budget.

Ratio = Annual Debt Service/Total Expenses

As a general guideline, it is believed that if more than 5% of an institution's budget were devoted to debt service, that institution's flexibility to devote its resources to other needs would be compromised. It is understood that rising expenses could make this ratio seem more attractive, though misleading, and is evaluated in conjunction with an institution's income statement.

Primary Reserve ratio

This ratio provides a snapshot of an institution's financial strength and flexibility. The ratio indicates how long the college could operate using expendable reserves without relying on additional new assets generated by operations. Trend analysis indicates whether an institution has increased its net worth in proportion to its rate of growth. A negative or decreasing trend indicates a weakening financial condition.

Ratio = Unrestricted & Expendable Net Assets / Total Operating Expenses

Return on Net Assets Ratio
This ratio reports whether an institution's resources are growing and if it is financially better off than in previous years. It is important to assess this ratio as a linear trend – an increasing trend indicates an increase in net assets and an increased likelihood that the institution is able to set aside financial resources to strengthen future flexibility. Single year events, like a substantial gift or extreme investment performance, can cause significant year-to-year volatility.

Ratio = Increase (Decrease) in Net Assets / Beginning of Year Net Assets

Net Operating Revenues Ratio
This ratio indicates whether operating activities resulted in a surplus or deficit. It measures financial performance by answering the question "*did the college live within its means during a fiscal year*?" A positive ratio indicates the college experienced an operating surplus; a continuing decline or pattern of deficits indicates financial problems.

Ratio = Adjusted Net Operating Revenues / Adjusted Total Income

VI. REPORTING:

Annually, through the Management's Discussion and Analysis (MD&A) section of the financial statements audit, the Vice President for Administration and Finance will report on the status of College debt and adherence to this policy to the College's Board of Trustees.

VII. OVERSIGHT:

The Vice President for Administration and Finance is responsible for the administration, monitoring and reporting requirements associated with debt. S/he is responsible for ensuring adherence to this policy, updates, and periodic review of the College's debt in an effort to minimize payments.

VIII. REVISIONS TO POLICY:

Any revisions to this policy will require approval by the College's Board of Trustees and then forwarded for reference purposes to the Board of Higher Education.