Board of Regents Special Meeting

March 2022

March 31, 2022

3:00 p.m.

Boardroom, McNamara Alumni Center

BOR - MAR 31, 2022 - Special Meeting

1. Amendment to the Resolution Related to Issuance of Century Bond
- Review/Action

BOARD OF REGENTS
DOCKET ITEM SUMMARY

Board of Regents **March 31, 2022**

AGENDA ITEM: Amendment to the Resolution Related to Issuance of Century Bond

☐ **Review** ☒ **Review + Action** ☐ **Action** ☐ **Discussion**

☐ *This is a report required by Board policy.*

PRESENTERS: Myron Frans, Senior Vice President
Michael Volna, Associate Vice President, Finance

PURPOSE & KEY POINTS

The purpose of this item is to review and act on the amendment to the resolution related to issuance of a century bond. The Board approved the issuance of a century bond at the February 2022 meeting. Due to recent market volatility and trends in interest rates, the President recommends modifying the original resolution to increase flexibility in the type of debt issued, provide an interest rate target, clarify the intended purposes for the debt, and authorize additional underwriting syndicate members.

Specifically, the resolution modifies the February 2022 resolution as follows:

1. Issue some or all of the $500,000,000 in the form of shorter-term bonds that would price at a lower interest rate than the target interest rate of 4.5 percent and mature earlier than 100 years.
2. Replace the not to exceed fixed interest rate of 4.5 percent per annum with a target fixed interest rate of 4.5 percent per annum for any century bond debt issued, with the understanding that the final rate could exceed this target.
3. Appoint Barclays as lead underwriter. The treasurer is also authorized to select one or more additional syndicate managers from the pool previously approved by the Board.
4. Add refinancing of existing debt outstanding as a permissible use of proceeds.

The amendments have no impact on the overall capital financing strategy previously presented to the Board. Additional information on the proposed changes is included in the docket materials.

The results of the issuance will be reported to the Finance & Operations Committee at the meeting following the completion of the transaction.

BACKGROUND INFORMATION

The purpose of the issuance of a century bond and/or other long-term low fixed rate bonds is to create an internal bank revolving loan program. The bonds provide a source of low-cost funds for loans that will be made from the internal bank. Proceeds will be added to the internal bank and loaned internally for capital projects. Each loan will be established with a repayment plan that fully collects principal and interest. The interest collected from internal borrowers will be used to pay the interest owed to external bondholders. The principal that is collected will be recycled into new loans for additional capital needs. This "recycling" feature ensures original bond proceeds are used many times over, rather than just once, and acts as a multiplier of the University's debt capacity.

Since the February Board meeting, a combination of Federal Reserve rate increases and geopolitical uncertainty has caused fluctuations in the financial markets. The proposed amendments to the century bond program provide greater flexibility to respond to market conditions at the time the bonds are priced, and enhance the University's ability for a successful bond offering.

As noted in February, the issuance of this debt supports Action Item 5.3 of MPact 2025 Systemwide Strategic Plan (MPact2025), which is designed to advance innovative financing to support long-term strategic objectives.

This topic was previously discussed by the Finance & Operations Committee at the December 2021 meeting and acted on at the February 2022 meeting.

Approval is sought in compliance with Board of Regents policies as follows:

- *Reservation and Delegation of Authority*, Article I, Section VII, Subd. 4
- *Debt Transactions*, Section III, Subd. 4

PRESIDENT'S RECOMMENDATION

The President recommends approval of the amendment to the resolution related to issuance of century bond.

REGENTS OF THE UNIVERSITY OF MINNESOTA

AMENDMENT TO THE

Resolution Related to Issuance of Century Bond

WHEREAS, on February 11, 2022, the Board of Regents (Board) approved the Resolution Related to Issuance of Century Bond (Original Resolution), which authorized the issuance of up to $500,000,000 of long-term taxable debt to mature not later than 101 years after the respective date of issuance for purposes of financing capital projects (Debt) for the University of Minnesota (University); and

WHEREAS, due to recent market volatility and trends in interest rates, the president recommends modifying the Original Resolution to increase flexibility in the type of Debt issued, provide an interest rate target, clarify the intended purposes for the Debt, and authorize additional underwriting syndicate members.

NOW, THEREFORE, BE IT RESOLVED that the Board amends the Original Resolution and authorizes the administration to do the following:

1. Issue some or all of the $500,000,000 in the form of shorter-term bonds that would price at a lower interest rate than the target interest rate of 4.5 percent and mature earlier than 100 years.
2. Replace the not to exceed fixed interest rate of 4.5 percent per annum with a target fixed interest rate of 4.5 percent per annum for any century bond debt issued, with the understanding that the final rate could exceed this target.
3. Appoint Barclays as lead underwriter. The treasurer is also authorized to select one or more additional syndicate managers from the pool previously approved by the Board.
4. Add refinancing of existing debt outstanding as a permissible use of proceeds.

Except as amended hereof, the Original Resolution shall remain in full force and effect.

Board of Regents
March 31, 2022

Overview: Amendment to the Resolution Related to Issuance of Century Bond

In preparing to issue a century bond as part of the capital financing strategy approved by the Board in February, the University is closely monitoring economic and market conditions. Based on last week's bond market rates and the likely trend in rates, it is possible the University would not be able to price a century bond within the 4.5% interest rate cap contained in the Board's February 2022 resolution. Three recommendations are being provided to modify the February 2022 resolution and provide the administration with the tools to complete a successful bond offering.

How the Amended Resolution Aligns with the Recommendations

The proposed resolution would amend the resolution adopted on February 11, 2022. It aligns with the recommendations (detailed below) as follows:

- Recommendation number 1 is reflected in the first Resolved statement by allowing for the issuance of shorter-duration bullet bonds in combination with, or in lieu of, a century bond.
- Recommendation 2 is reflected in the second Resolved statement by removing the "not to exceed 4.5%" language and replacing it with language reflecting the Board's expectations for issuance of bonds at a target rate of 4.5% or less.
- Recommendation number 3 is reflected in the third Resolved statement by authorizing the administration to add co-manager underwriters from the pre-approved pool of underwriters and clarifying that Barclay's will serve as lead underwriter for this offering.

The fourth Resolved statement in the amending resolution represents a technical amendment clarifying that proceeds from this bond issuance may be used for future refinancing activities, such as in situations where commercial paper has been used to finance construction and there is a desire to replace (refund) the commercial paper with longer-term financing. This language is typically included for other bond offerings authorized by the Board.

Economic and Market Conditions Continue to Fluctuate

Federal Reserve rate increases and geopolitical uncertainty continue to affect the financial markets. Municipal bond interest rates continue to fluctuate. This volatility is being factored into planning for the bond sale, particularly in considering how the bonds will be priced. Prudence advises planning for various scenarios, and that the administration return to the Board to advise on the implications of a more volatile and uncertain bond market and obtain the appropriate corresponding authority.

Recommended Changes to February Board Resolution

To provide greater flexibility to respond to market conditions at the time the bonds are priced and enhance the University's ability for a successful bond offering, the following recommendations are made. The recommendations were developed with external advisors and underwriters, and in consultation with the internal University team.

Recommendation 1 - Provide the administration with the authority to issue some or all of the $500 million in the form of shorter-term, interest-only bonds that would price at a lower interest rate and mature earlier than 100 years.

The two most common types of bonds used for internal banks are century bonds and interest-only bonds with a term shorter than 100 years before they mature. Shorter-term interest-only bonds, sometimes called "bullet" bonds, are issued for durations shorter than 100 years (for example,10-year, 30-year, or 40-year durations) but are similar to century bonds in that they require the payment of interest only during the time they are outstanding. Bullet bonds have both advantages and disadvantages when compared to century bonds. The biggest advantage to bullet bonds is that they typically are priced lower than a century bond, often between one-half and one full percent lower. Two of the disadvantages are: (1) the issuing organization is less insulated from interest rate changes because the length of the bond is shorter than a century bond; and (2) the institution incurs additional transactional costs every time the bonds are re-issued.

In the context of the current market conditions and rates, the rationale for recommendation 1 is that when century bonds are combined with lower-interest rate bullet bonds, the overall "blended" interest rate of the full $500 million will likely result in a rate that is less than the rate a century bond alone would price at. While we will continue to be governed by the 4.5% target for the century bond portion of the offering, the market uncertainty has led to planning for the bullet bond options and the potential benefits of a blended approach given the current market condition.

The following table illustrates how this blending of longer-term and shorter-term debt can achieve the desired low interest rate results. The illustration assumes the issuance of $300 million of century bonds and $200 million of shorter duration interest-only bullet bonds, using three different maturity scenarios: 10 years, 30 years, and 40 years. The illustration also assumes a century bond would be priced exactly at the 4.5% interest rate cap contained in the February 2022 resolution. All other rates shown are based on March 22, 2022 market rates, but keep in mind there is no guarantee these rates will be achieved when the bonds are priced in April.

	Century + 10-Yr Bullet Bond Example	**Century + 30-Yr Bullet Bond Example**	**Century + 40-Yr Bullet Bond Example**
$300 million Century Bond*	4.50%	4.50%	4.50%
$200 million Interest-only Bonds	3.12%	3.60%	3.80%
Blended Rate with current 4.5% cap	3.99%	4.14%	4.22%

**We have been advised that a century bond offering of less than $300 million would not be viewed as a readily marketable bond offering and thus, we assume that our century bond offering will range between $300 million and $500 million.*

If the Board approves this recommendation, the administration will be able to assess the market conditions throughout the week that bonds are priced. The administration will have the flexibility to issue a combination of a century bond and shorter-term interest-only bonds, up to $500 million, that will result in the lowest interest cost for the University. The ability to lock interest rates for 100 years at what are still historically attractive rates, combined with the ability to blend down rates with shorter-term bonds, combines the benefits of both types of bonds to provide an attractive alternative to achieve the capital financing strategy.

In the event the administration reasonably believes, the day before the bond pricing, a century bond cannot be priced within the 4.5% target range, the bonds will be issued entirely as shorter-term interest-only bonds, up to the authorized $500 million. This will provide the funds for the capital financing strategy at even lower rates, but for a shorter duration and with less predictability around long-term affordability.

Issuing some or all of the $500 million as bullet bonds still supports the strategy of providing low-cost funds for the six-year plan. Furthermore, issuing bullet bonds will be no different in terms of our credit rating than issuing a century bond. Finally, with the expectation that interest rates will continue to rise over the next few years, there is an opportunity cost to not proceeding with this issuance. It is very likely the University would pay more for debt issued over the next few years as compared to what it would pay now, even taking into account the rate increases that have occurred since the beginning of 2022.

Recommendation 2 - Provide the administration with a target rate of 4.5% for the century bonds rather than a "not-to-exceed" rate of 4.5% so we have the authority to close the sale in the event the market closes higher than 4.5%.

The goal before the bond offering will be to predict the likely treasury rate and market spread. As with any market prediction, there are no guarantees and markets can fluctuate more than anticipated on any given day. The strategy will be to base a prediction on a conservative estimate of the rates on the day of the offering so the final century bond price will be at or below 4.5%. However, in the event the actual price is at a rate higher than 4.5% for the century bond, the recommendation is for a target of 4.5% rather than a "not-to-exceed" rate in order to complete the bond offering.

Recommendation 3 - Authorize the administration to add up to three additional underwriters from the pool of pre-approved underwriters as co-managers for the offering.

Currently, the University has designated Barclays as the sole underwriter of this issuance. If the previous recommendation is approved, adding underwriters from the pre-approved pool is prudent to improve the marketing of those bonds and help drive down the rates. Adding underwriters does not increase costs; it merely results in a different split of the issuance costs across the various underwriters.

Bond Offering and Pricing Process

To better explain why the second recommendation calls for a "target" of 4.5% rather than a guaranteed cap, the description below lays out the decision-making steps leading up to the bond offering. The intent is to aim for a "target" rate of 4.5% or less subject to the market pricing process, which will necessarily introduce some uncertainty as to whether the actual price will match that intent. To the extent we blend in "bullet bonds," which carry a lower interest rate, that would temper the risk that the actual price of the century bond portion will exceed the 4.5% aim.

On the day of the bond offering, here is how the pricing will work:

1. The bond offering will go live in the morning.
2. Underwriters will spend the morning seeking commitments from many investors to buy the bonds.
3. The University will know the real-time U.S. Treasury bond interest rate. All bond pricing starts with this rate. This rate fluctuates all day.
4. Investors will agree to an interest rate "spread." This is the amount of additional interest paid over and above the U.S. Treasury interest rate that they are willing to pay.
5. After the "spread" is determined, the rate on the U.S. Treasury bond will be set at the conclusion of the process in mid to late afternoon.
6. Final pricing is based on the treasury bond rate at the time it is set plus the spread the investors agreed to pay during the offering.

Once the bond offering is live in the morning, the University will not know the final price until the end of day. Once the bond offering process begins, there is also no way for the University's reputation in the bond markets.

On the day before the bond offering, here is how the pricing strategy will work:

1. We will analyze treasury bond rates to anticipate the likely day of offering treasury bond rate.
2. We will analyze market spread to anticipate the likely day of offering market spread.
3. We will analyze advice from our financial advisors.
4. We will make a decision as to offer:
    a. one century bond for $500 million or a lesser amount, or
    b. a combination of one century bond for $300 million and one or more shorter duration bonds for a total of $500 million or a lesser amount, or
    c. no century bond and one or more shorter duration bonds for a total of $500 million or a lesser amount.
5. We will make a Go/No Go decision to proceed.

Timing

The pricing of bonds has been delayed by one week, to the week of April 11. This decision was made primarily to allow time for the administration to consult with the Board on plans for addressing the current market conditions. In addition, another highly rated university

will be pricing bonds, including the potential for century bonds, the week of March 28. Our ratings will be effective for up to 60 days after they are issued, which accommodates the change in the timeline, while also providing further flexibility to price the week of April 11 or delay the pricing by up to several weeks in response to geopolitical factors and market conditions.

Background: Why a Century Bond?

A "century bond" is a debt obligation that has a 100-year maturity. During the 100 years that the bond is outstanding, the University will pay interest only on the bond, with the full principal amount due and payable in 100 years. The Board resolution authorized a "not to exceed" interest rate of 4.5% for a century bond of up to $500 million.

The century bond is the mechanism used for providing capital to an internal bank, through which the funds can be loaned, collected, and reloaned over the life of the bonds. The 100-year commitment behind a century bond means that it is issued only once in those 100 years and it need not be renewed or reissued during that period, and the interest rate is locked in for 100 years for both the University and the investor. This results in a hedge against interest rate changes during the 100-year life of the bond.

A major consideration of the administration's recommendation to sell a century bond is to support the strategic 6-year capital plan for the University. The 6-year capital plan supports an important list of projects that necessitate action for the University to maintain its infrastructure and to provide for programming enhancements in the academic and research areas.

The University has maintained a stable and favorable credit rating, and the capital financing strategy which includes the issuance of a century bond supports that strategy while ensuring the availability of necessary and timely capital for completion of important capital projects. Put another way, going into the bond market at this time is a means to benefit from the University's credit standing by leveraging assets to provide funds that can be put to work for the University in return for an interest rate that is historically low. While there is risk in making this long-term commitment, declining to act carries opportunity costs as well.