



INDIANA UNIVERSITY

Financial Institutional Policy VI-140 Capital Financing

FULL POLICY CONTENTS

Scope
Policy Statement
Reason for Policy
Procedures
Definitions

ADDITIONAL DETAILS

Additional Contacts
Web Address
Related Information

Effective: *January 2006*
Last Updated: *March 2010*

Responsible University Office:
Office of the Treasurer

Responsible University Administrator
Office of the Vice President and CFO

Policy Contact:
Office of the Treasurer, Capital Finance

Scope

All University departments and operating units

Policy Statement

I. Authority for Financing Programs and Instruments

All debt issued by the University will be issued pursuant to duly authorized resolutions of the Board of Trustees of Indiana University and will conform to levels of approval and authorization as provided for in enabling statutes in Indiana and Federal law. The University issues tax-exempt debt under Section 103 of the Internal Revenue Code (the Code). The University, at its discretion, may also choose to issue public debt that is taxable. Authority to issue debt is provided in the following Indiana statutes:

A. Student Fee Bonds Indiana Code (IC) - 21-34-6 (formerly 20-12-6; Acts of 1965)

The Board is authorized to issue student fee bonds, notes and other forms of debt for the financing of academic facilities which would include, but not be limited to, such facilities as classrooms, laboratories, libraries, and telecommunication and utility needs.

B. Revenue Bonds - IC 21-35-3 (formerly 20-12-8; Acts of 1927) IU is authorized to issue revenue bonds, notes and other forms of debt which is repaid by revenues from the facilities financed by these bonds including dormitories and housing units, food service facilities, parking facilities, health service facilities, including hospitals, and research facilities on the Bloomington and Indianapolis campuses.

C. Commercial Paper and Interim Borrowing - IC 21-32-2 (formerly 20-12-9.5) IU is authorized to issue debt in the form of temporary borrowing (such as commercial paper) in anticipation of future long-term borrowing for projects that are authorized under the code.

D. Certificates of Participation and Lease-Purchases - IC 21-33-3-5 (formerly 20-12-5.5) IU is authorized to issue debt in the form of certificates of participation in a capital-lease purchase agreement, in order to finance the acquisition of facilities.

E. Qualified Energy Savings Debt - IC 21-34-10-7 (formerly 20-12-6-17) IU is authorized to issue debt in the form of qualified energy savings debt that is issued specifically for the financing of qualified energy savings projects as defined in the statutes. The debt service is to be paid using energy savings that result from the reduction in energy costs after the project is completed. Current state law caps the amount of debt that can be outstanding under this statutory authorization at \$15 million per campus.

F. Derivative and Swap Transactions - IC 21-29-3-1 (formerly 20-12-1.3-1) IU is authorized to enter into "swap" agreements (defined to include an agreement that is a rate cap agreement or similar agreement) for the purpose of managing an interest rate or similar risk that arises in connection with, or incidental to, the issuance, carrying or securing of debt obligations.

II. Strategic Consideration

A. Institutional Debt Capacity Institutional borrowing capacity is a valuable resource that will be actively managed in support of the institutional mission. IU will maintain debt capacity consistent with the Aa2/AA rating categories as assigned by Moody's and S&P, respectively. Core financial ratios that are strongly correlated with Aa2/AA rated institutions of higher education will be monitored by the Office of the Vice President and Chief Financial Officer (OVPCFO) to ensure oversight of borrowing levels and total leverage.

Ratios that are strongly correlated to this rating category level, and which will be monitored and reported on to the Trustees on an annual basis include, but are not limited to, the following:

- Total Resources to Debt
- Expendable Resources to Debt
- Debt to Cash Flow
- Debt Service to Operations

B. Use of Internal Financing Use of IU's internal cash liquidity for purposes of financing long-term capital projects may be authorized by the OVPCFO for strategic purposes for which statutory authorization for external borrowing is not available, subject to all appropriate and necessary internal and external approvals. Internal financing for capital purposes is the subject of a separate policy.

C. Interest Rate Exposure and Variable Rate Allocation Variable rate debt can provide for relatively lower costs of capital than fixed rate debt, however, variable rate debt also introduces additional risk and potential volatility with the debt portfolio. IU will seek to manage the debt portfolio over time in a manner that will achieve a range of between 25% - 30% of the portfolio in variable rate debt instruments. This range may be achieved either directly through debt issuance or indirectly by entering into interest rate swap agreements. On not less than an annual basis, the OVPCFO will evaluate IU's debt portfolio mix between fixed and variable rate debt to determine an appropriate amount of interest rate exposure, as defined by the potential increase in capital costs resulting from rising short-term interest rates.

D. Maturity and Amortization Term Exposure The amortization and maturity of debt shall be established based on the (1) statutory or governmental restrictions, (2) types of assets to be financed, (3) projected availability of cash flows to meet debt service requirements, and/or (4) tax regulations. No debt repayment period shall exceed the expected useful life of the asset being financed, and in some instances may be limited to 120% of the IRS regulation-established useful life guidelines. Debt service that is subject to fee replacement shall not have a repayment period that exceeds 20 years, unless approved by the State Budget Committee and State Budget Director (i.e. 20 annual principle payments, exclusive of periods where construction period interest is capitalized or paid). Debt that is to be repaid from facility-related revenues may be amortized over periods of up to 25 years.

E. Credit Enhancement and Insurance Credit enhancement products, such as bank facilities and insurance, may be utilized to achieve interest cost savings. At times, market conditions may be such that it may be fiscally prudent to issue debt without credit enhancement, even if some net present value savings would result from credit enhancement. In consultation with the underwriting team members, the OVPCFO will assess the cost/benefit issues associated with utilizing either externally or internally provided credit enhancement as a matter of practice in conjunction with each financing transaction.

F. Refunding Bonds Refunding bonds may be issued to (1) achieve debt service savings on outstanding fixed rate bonds, (2) restructure the debt portfolio, and/or (3) modify bond covenants contained in bond documents. The OVPCFO will actively consider the refunding of outstanding debt issues when net present value savings from the refunding meet or exceed the minimum savings guidelines that are established by the Indiana Finance Authority. Refundings may also be considered to eliminate restrictive bond covenants or for portfolio restructuring purposes. However, given that tax regulations limit the number of allowable refundings for bonds, the OVPCFO will evaluate a number of factors with respect to proposed refunding transaction including the value of any call options to be exercised, the amount of time to the call date, and the amount of time from call date to maturity.

G. Tax-Exempt or Taxable Financing IU has traditionally issued tax exempt debt because it results in significantly lower interest costs than taxable debt. However, in certain circumstances, the intended use of the debt-financed facilities may preclude the use of tax exempt debt because of restrictions imposed by the tax regulations. In such instances, IU may issue taxable debt, but any use of taxable debt will require the same process of authorizations and approvals that tax exempt debt would require. Further, in such circumstances, IU will strive to allocate any available resources, including equity capital, among projects so as to minimize the need to issue taxable debt.

H. Method of Sale From time to time, IU will utilize a request for proposal (RFP) process to engage qualified investment banking firms, law firms, and financial consultants, as needed, to assist in evaluating, preparing and executing financing transactions. IU is committed to involving minority business enterprises (MBE) firms in financing transactions. Selection of the most appropriate investment banking firms to serve in the roles of senior manager, co-senior manager, and/or co-manager within the underwriting group will be made by the OVPCFO and approved by the Trustees on a transaction-by-transaction basis. Selection of the most appropriate law firms to serve as bond counsel and co-bond counsel, and which firms will be recommended to the senior underwriter to select from to serve as underwriter's counsel and co-underwriter's counsel will be made by the Office of University Counsel.

IU will generally sell bonds through a "negotiated sale" with the senior underwriter for a specific series of bonds. IU staff will consult with other member-firms in the underwriting team and, in some cases, with external financial advisors in order to provide assurance that the interest rates, bond purchase prices, and other terms proposed by the senior underwriter are fair and reasonable under current market conditions. Notwithstanding any of the above, IU may elect to sell any particular bond issue through a competitive bidding process rather than a negotiated sale, if circumstances are such that a competitive sale would produce a more optimal result for IU in the current market conditions.

I. Use of Gifts, Grants, Reserves and Other Forms of Equity Capital The OVPCFO will work with the campus and/or departmental sponsor of capital projects to be financed in order to determine the optimum ordering and timing of the application of bond proceeds, gifts, grants, reserves and other forms of equity capital toward construction of the project. A project may proceed to construction (i.e. contracts can be signed) only after confirmation by the OVPCFO that 100% of the cash flow required to pay for the construction costs and any construction period interest has been identified and is available for use during the construction period. Sources of such cash flow may include bond proceeds, cash reserves, legally enforceable gift or grant agreements maturing in five years or less, approved internal financing, and other acceptable guarantees. Bequests or other deferred gift instruments, for which the receipt of gift funds by the University are predicated on the occurrence of future events for which the dates of occurrence are uncertain or subject to change, cannot be counted toward the project financing cash flow requirements.

J. Use of Derivatives and Swap Agreements The use of derivatives and interest rate swaps may be employed as an interest rate risk management tool. A framework will be

used to evaluate potential derivative instruments by evaluating the variable rate allocation, the market and interest rate conditions, and the market incentive (compensation) for undertaking counterparty exposure. IU may engage financial advisors to assist in evaluating either specific derivative proposals or to provide on-going expertise with respect to the use of derivatives within the institutional debt portfolio. Under no circumstances will a derivative transaction be entered into that is not fully understood by the OVPCFO or that imposes inappropriate levels of risks.

K. Debt Compliance and Reporting IU will meet the ongoing disclosure requirements in accordance with SEC Rule 15c2-12. IU will submit all reporting required with respect to outstanding bonds, notes, or certificates of participation to which such rule applies. In so doing, IU will provide updated financial information, operating data, and timely notice of specific material events, through the Electronic Municipal Market Access system (EMMA) effective July 1, 2009. IU will also provide, on a timely basis, notice of compliance with bond covenants, and any additional information, as may be required by bond indentures and documents to the appropriate trustee or other parties.

Reason for Policy

I. Purpose

This policy governs the issuance and use of debt for the purpose of financing capital projects of Indiana University (IU). Prudent management of debt can help IU achieve its institutional mission and strategic objectives through efficient and low cost access to the capital markets. Debt management policy and best practices can also help the institution strike an appropriate balance between high credit quality, financial flexibility, and mitigation of risk, through the application of sound and professional financial analysis, collaborative and thorough planning, diligent compliance efforts, and the regular review and assessment of results. The purpose of this policy, the Institutional Capital Financing Credit Guidelines, and any associated practical and procedural guidance, is to provide a framework for prudent management of the debt portfolio as a valuable resource of Indiana University.

II. Policy Objectives

The objectives of the Capital Financing Policy include the following:

- Support the institutional mission by providing for capital financing needs of the university through efficient and low-cost access to the public debt markets
- Promote the integration of long-term financial planning with long-term capital planning

- Limit debt portfolio risk to appropriate levels as determined by executive management and the Trustees of Indiana University (the Trustees)
- Maintain credit rating of Aa2/AA as conferred by Moody's Investor Services (Moody's) and Standard & Poor's (S&P), subject to periodic review of the

- appropriateness of the rating category with respect to institutional strategic priorities.
- Promote sound financial practices, proactive resource management, and thoughtful institutional financial planning.

Procedures

Capital Financing Procedures included in the *Institutional Capital Financing Credit Guidelines* are incorporated into this policy by this reference. Please see the procedures related to this policy at: <http://www.iu.edu/~iutreas/pdfs/creditguidelines.pdf>

Definitions

Capital Financing Definitions included in the *Institutional Capital Financing Credit Guidelines* are incorporated into this policy by this reference. Please see the definitions of certain terms used above at: <http://www.iu.edu/~iutreas/pdfs/creditguidelines.pdf>

Additional Contacts

<i>Subject</i>	<i>Contact</i>	<i>Phone</i>	<i>Email</i>
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Web Address for this Policy

http://www.indiana.edu/~vpcfo/policies/treasurer/vi140_cap_financing.pdf

Related Information

Institutional Capital Financing Credit Guidelines:
<http://www.indiana.edu/~iutreas/pdfs/creditguidelines.pdf>

Financial Institutional Policy VI – 130, Internal Loan Policy for Capital Construction & Renovation Projects:
http://www.indiana.edu/~vpcfo/policies/treasurer/vi130_internal_loan.pdf

Investor Relations Website: <http://www.iu.edu/~iutreas/investorrelations/disclaimer.html>