Capital Financing
FIN-TRE-VI-140

About This Policy

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Responsible University Office:
Office of the Treasurer

Responsible University Administrator:
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Related Information

* FIN-TRE-VI-130, Internal Loan Policy for Capital Construction and Renovation Projects - Capital Lending Program
* Investor Disclosure Website

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Scope

All University departments and operating units.

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Policy Statement

I. Authority for Financing Programs and Instruments

All debt issued by the Indiana University (“University” or “IU”) will be issued pursuant to duly authorized resolutions of the Board of Trustees of Indiana University (“Trustees”) 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), as a 501(c)3 issuer, or it Obligations based on an exemption under Section 3(a)(4) of the Securities Act. The University, at its discretion, may also choose to issue public debt that is taxable. The authority to issue debt is provided in the following Indiana statutes:

A. Student Fee Bonds Indiana Code (IC) - 21-34-6 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. IU may issue debt for energy savings projects under this code, and if so the debt is on parity with other student fee bonds.

B. Revenue Bonds - IC 21-35-3 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 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. Lease-Purchase Obligations - IC 21-33-3-5 IU is authorized to issue debt in the form of lease purchase obligations (previously 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 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. IU may issue debt for energy savings projects under Student Fee Bonds rather than separate Qualified Energy Savings loans. All the terms and conditions under this code apply regardless of loan or bonds.

F. Derivative and Swap Transactions - IC 21-29-3-1 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 manage its debt capacity. Core financial ratios that are strongly correlated with highly-rated institutions of higher education will be monitored by the Office of the Treasurer 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:

- Operating Cash Flow Margin
- Spendable Cash & Investments to Operating Expenses
- Spendable Cash & Investments to Total Debt
- Total Debt to Cash Flow

B. Use of Internal Financing
Use of IU’s internal cash liquidity for purposes of financing capital projects may be authorized by the Treasurer for strategic purposes, including projects for which statutory authorization for external borrowing is not available, subject to all appropriate and necessary internal and external approvals. The financing of projects is subject to the Capital Lending Program policies.

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 so no more than 20% of the total university debt portfolio is in variable rate debt instruments at any time. Variable

rate 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 OSVPCFO 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 principal payments, exclusive of periods where construction period interest is capitalized or paid). For new money issues that finance capital projects, the final maturity of the debt should not exceed the estimated useful life of the assets being financed. 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 or provide increased risk mitigation to liquidity and cash flows. 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. The OSVPCFO 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) comply with 21-34-6-6(b), (2) achieve debt service savings on outstanding fixed rate bonds, (3) restructure the debt portfolio, and/or (4) modify bond covenants contained in bond documents. The Treasurer 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 Treasurer 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 typically results in lower interest costs than taxable debt, depending on market conditions. 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. Additionally, taxable debt may provide enhanced financing flexibility and risk mitigation. 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, 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. 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 Treasurer and approved by the Trustees. Selection of the most appropriate law firms to serve as bond counsel and/or co-bond counsel, and which firms will be recommended to the senior underwriter to select its underwriter's counsel will be made by the Office of Vice President and General Counsel.

IU will generally sell bonds through a "negotiated sale" with the senior underwriter for a specific series of bonds. IU staff will assess the market 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

The Treasurer 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 toward construction of the project. A project may proceed to construction (i.e. contracts can be signed) only after confirmation by the Treasurer that 100% of the cash flow required to pay for the construction costs and any construction period interest has been identified. 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 derivates 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 Treasurer 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, lease purchase obligations 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). 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.

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Reason For Policy

I. Purpose

This policy governs the issuance and use of debt for the purpose of financing capital projects of the University. 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 the University. This policy is intended to be no less restrictive than the Debt Management Plan & Related Policies (“Plan”) by the Indiana Finance Authority (“IFA”) on October 16, 2014 as modified from time to time. To the extent that this policy differs from subsequent changes to those policies, the IFA Plan may apply based on IFA review of IU’s Plan of Finance prior to each issuance.

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
- Promote sound financial practices, proactive resource management, and thoughtful institutional financial planning.

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Procedure

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 here: .

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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 here: Institutional Capital Financing Credit Guidelines.

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Additional Contacts

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History

This policy was established on January 1, 2006 and updated in June 2017.