Treasury Management Policies

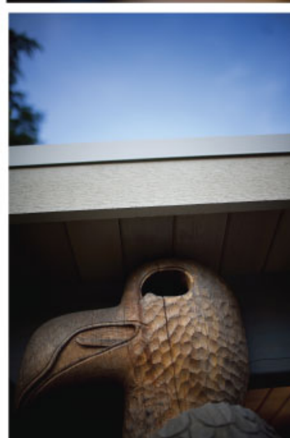
OSU Board of Trustees

Finance & Administration Committee

October 16, 2014








Internal Bank

- An Internal Bank is a separate accounting and operating entity designated to hold and invest all University operating cash balances and to manage the university-paid long-term debt portfolio for the University.
- The purpose is to facilitate long-term financial stability of the University through asset/liability management strategies and optimizing the University's capacity to access the capital markets.
- The Oregon University System (System) established an Internal Bank in 2010 to improve its treasury management practices.
- Pursuant to the SB 270, the System's Internal Bank policy automatically became Oregon State University (University) policy on July 1, 2014 and OSU began implementation of the University's own Internal Bank.

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Key Benefits of the Internal Bank

- Pool operating assets to decrease volatility of cash flows and improve investment earnings
- Manage University-paid long-term debt as a portfolio to lower the overall cost of capital
  - Long-term debt terms and timing can be negotiated strategically
  - Variable-rate debt can be introduced into the debt portfolio
  - Repayment schedules to borrowing departments can be more flexible
- Allows for tighter asset/liability matching and greater efficiencies in accessing the capital markets

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Management of Operating Assets

- The benefits of a pooled cash and investment structure:
  - Decrease cash flow volatility and better manage liquidity
  - Maximize return within a prudent risk/return profile
  - Increase revenues and net assets of the University

- Operating assets invested with the following objectives:
  - Safety
  - Liquidity
  - Return on Investment

Management of University-Paid Debt

The portfolio approach to debt management has the following advantages:

- *Minimizing the Cost of Capital* – by providing lower cost interim project financing and introducing variable rate debt.
- *Managing Interest Rate Volatility* – by establishing a fixed internal borrowing rate and maintaining a reserve to hedge future interest rate increases.
- *Flexibility with Capital project scheduling* - using University liquidity, lines of credit or other short term borrowing to reduce construction period interest.
- *Providing greater flexibility and clearer planning horizons* – by utilizing an internal borrowing program to de-link internal repayment terms from the actual debt service payments to bondholders.
- *Flexibility in the type of debt issued* - including fixed- and floating-rate debt, to lower the overall cost of capital.

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Treasury Management Policies

In order to establish appropriate controls and risk management processes for the operation of the Internal Bank, the following policies are needed:

- *Internal Bank Policy* – establishes the Internal Bank and sets forth its purpose and major operating parameters
- *Investment Policy* – establishes the guidelines pertaining to the investment of operating assets
- *Debt Policy* – establishes the guidelines pertaining to the issuance of debt and management of the debt portfolio

Discussion of these policies, as developed for OSU, will follow

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Internal Bank Policy – Management

Management of the Internal Bank-

The Associate Vice President for Finance and Administration will be responsible for:

- Establishing and maintaining the Central Loan Program, including setting the internal lending rates
- Managing the University's operating asset investments and debt portfolio
- Developing and maintaining related internal control processes and procedures
- Accounting for the operation of the Internal Bank
- Developing financial and other performance monitoring reports
- Developing and implementing operating policies and procedures
- Developing and managing the Internal Bank annual operating budget
- Maintaining access to liquidity sources to meet the needs of the University

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Internal Bank Policy – Operations

The Vice President for Finance and Administration will seek approval of the Board of Trustees for the following transactions undertaken by the Internal Bank:

- Investment of operating assets that fall outside of the Investment Policy
- Issuance of new debt for capital or operating purposes in accordance with the Debt Policy
- Transactions to acquire external liquidity
- Transactions to manage the debt portfolio in accordance with the Debt Policy

Internal Bank Policy – Operations
(Continued)

In accordance with the Debt Policy, the University will operate a Central Loan Program. Funds available for lending include:

- Proceeds from new debt issuances
- Proceeds from repayment of internal loans via the Central Loan Program
- Internal Bank Liquidity

The Associate Vice President for Finance and Administration, in consultation with the Vice President for Finance and Administration, will:

- Periodically establish the interest rate to be credited in accordance with University policies and procedures
- Annually establish the Central Loan Program interest rates

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Internal Bank Policy – Operations
(Continued)

- The Internal Bank may build and maintain an interest rate reserve to hedge future volatility in debt and investment markets by:
  - Charging a spread between the investment income generated and the amount distributed
  - Charging a spread between the internal lending rates charged and the blended opportunity cost of capital
- The Associate Vice President for Finance and Administration, in consultation with the Vice President for Finance and Administration, may establish additional reserves to be held by the Internal Bank

Investment Policy

- *Purpose of the Investment Policy* – To set prudent investment policies, providing guidelines for suitable investments while maximizing cash management efficiency
- *Scope* – The investment policy covers the investment activity of all funds except quasi- and true endowments and retirement funds
- *Prudence* – The Associate Vice President for Finance and Administration and the Board are held to the prudent investor standard

Investment Policy - Objectives

The primary objectives of the investment activities of the University, in priority order, are:

- *Safety* – Safety of principal (preservation of capital) is the foremost objective of the investment program.

- *Liquidity* – The investment portfolio will retain sufficient liquidity to meet cash flow requirements

- *Return on Investment* – The investment portfolio will be designed to attain market returns throughout budgetary and economic cycles

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Investment Policy – Delegations

- The responsibility for managing the investment portfolio is delegated to the Associate Vice President for Finance and Administration
- The Associate Vice President for Finance and Administration will monitor and review investments for consistency with this policy
- The Associate Vice President for Finance and Administration may delegate investment decision-making and execution authority to an investment advisor

Investment Policy – Ethics/Conflicts of Interest

- Officers and employees involved in the investment process shall:
  - Refrain from personal activity that could conflict with the proper execution and management of the investment program
  - Disclose to the Board any material interests in financial institutions with which they conduct business and any personal financial/investment positions that could be related to the performance of the investment portfolio
  - Refrain from undertaking personal investment transactions with the same individual with whom University business is conducted

Investment Policy – Permitted Investments

Investment pools

- Public University Fund
- Oregon Short-Term Investment Fund
- Oregon Intermediate Term Pool
- Any other investment pools managed by the Oregon State Treasury

Investment Policy – Permitted Investments (Continued)

Securities and Registered Funds:

- U.S. Treasuries
- U.S. Agency Obligations
- Municipal Obligations
- Bankers' Acceptances
- Time Deposits
- Negotiable CDs
- Commercial Paper
- Corporate Notes
- Asset-backed Securities
- Money Market Municipal Funds

The University will limit investments in any one non-government issuer, except investment pools, to no more than 5%, regardless of security type.

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Investment Policy – Maximum Maturity

- Maturities shall be based on a review of cash flow forecasts and scheduled to permit the University to meet all projected obligations.

- The University may not invest in a security with a final maturity that exceeds 10 years from the date of purchase.

- The maximum duration of the University's portfolio may not exceed 5 years.

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Investment Policy – Safekeeping and Custody

- University investment assets shall be secured through third-party custody and safekeeping procedures.

- Bearer instruments shall be held only through third-party institutions.

Investment Policy – Reporting

The Associate Vice President for Finance and Administration will present quarterly investment reports to the Board's Finance and Administration Committee which include:

For investment pools

- Cost, market value, dividend income and yield, and quarterly performance for investment pools and registered funds

For securities

- Description, interest rate or YTM, purchase date, maturity date, purchase price, par value, current market value, and overall portfolio yield based on cost

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Investment Policy – Biennial Review

- The Associate Vice President for Finance and Administration will biennially present the Investment Policy to the Board for review.

Debt Policy

- *Purpose of the Debt Policy:* To formalize the link between the University's strategic plan and the issuance of debt
- *Objectives of Debt Policy* (among others):
  - Outline the University's philosophy on debt
  - Provide guidance for the use of available bond programs
- *Goals of debt management at the University:*
  - Maintain access to financial markets
  - Manage the University's credit rating
  - Optimize the University's debt mix
  - Ensure funds are available to support future capital projects
  - Coordinate debt management and asset management decisions

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Debt Policy – Overview

- Sets forth Available Bond Programs
- Covers all types of debt and borrowing obligations
- Clarifies only Board approved projects will be financed
- Establishes annual reporting of debt issuance and status
- Sets forth guidelines for selection of financing team
- Establishes policies around debt capacity and affordability
- Establishes framework for consideration of financing sources
- Requires established of post-issuance compliance policies and procedures

Debt Policy – Debt Capacity and Affordability

- *Debt Capacity* – is a subjective measure, typically associated with balance sheet strength and ability to repay debt on demand.

- *Debt Affordability* – also a subjective measure, typically associated with income statement strength.

- *University Strategy and Mission* – are the primary drivers of its capital investment and use of debt. The University will not manage its debt portfolio to achieve a specific credit rating.

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Debt Policy – Related Ratios

- *The University will monitor five financial ratios to assist the Board in evaluating debt capacity and affordability:*
  - Viability Ratio (balance sheet leverage)
  - Primary Reserve Ratio (income statement leverage)
  - Debt Burden Ratio (affordability)
  - Debt Service Coverage (affordability)
  - Debt to Revenues Ratio (income statement leverage and affordability)
- *Prior to New Debt Issuances, the Vice President for Finance and Administration will evaluate its impact on these ratios for discussion with the Board*

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Debt Policy – Portfolio Management

- The University will actively manage the risks and opportunities in its debt portfolio.
- Before entering into any derivative transaction, the University will seek approval of the Board to amend this policy to adopt guidelines for the use of derivative products.
- Exposure to variable interest rates may be desirable in certain circumstances.
- The University will monitor the debt portfolio to identify opportunities to lower overall cost of capital by refinancing or restructuring outstanding debt.
- Overall debt is to be managed through a Central Loan Program.

Debt Policy – Central Loan Program Management

- The University's Central Loan Program provides funding for projects through loans de-linked from external debt obligations.
- The University will manage and optimize its debt obligations on a portfolio basis.
- The interest rate charged on internal loans will be rate based on the University's expected long-term cost of capital plus the funding of reserves.
- The blended rate will be reviewed annually, but is not expected to change.

Debt Policy – Monitoring and Reporting

- The Vice President for Finance and Administration will review the Debt Policy periodically to ensure it remains consistent with University objectives and industry standards.
- At least annually the Vice President for Finance and Administration will review the University's debt capacity and affordability ratios and will report any concerns to the Board's Finance and Administration Committee.
- When debt transaction approval is sought from the Board, the Vice President for Finance and Administration will inform the Board of the impact of the debt transaction on the University's debt capacity and affordability.

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Questions?

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