Proposed University Treasury Management Policies

INTRODUCTION

Over the past several years, the Oregon University System (System) worked with the Oregon Legislature, the State Treasurer, the Department of Justice, financial advisors, bond counsel, and key financial managers to improve the treasury management practices of the System via the establishment of an Internal Bank. Pursuant to SB 270, System policies automatically became Oregon State University (University) policies on July 1, 2014, and the University began implementation of its own 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 of the Internal Bank is to facilitate the long-term financial stability of the University through effective asset/liability management strategies and optimize the organization's capacity to access the capital markets in the amounts needed at a reasonable price.

The benefits of implementing an Internal Bank, as well as the key policies necessary for its operation, are delineated below.

KEY BENEFITS OF IMPLEMENTING AN INTERNAL BANK

Universities across the country are finding creative ways to improve their treasury function. With declining state revenues appropriated to public colleges and universities, the level of operating assets needed to hedge the volatility in a more tuition-dependent environment has been increasing. Universities are beginning to pool operating assets for investment purposes to decrease the volatility of operating cash flows. With these increasing levels of operating assets and the decreased volatility that accrues through pooling, the opportunities for expanding the investment practices applied to these assets (with an appropriate risk-return profile) have become more attractive.

Additionally, universities have begun looking at long-term debt management from a portfolio perspective. The traditional approach to long-term debt management, where fixed-rate securities are issued and the debt service related to proceeds allocated to specific projects is tied to the underlying debt, is giving way to a portfolio approach to debt management. With a portfolio approach, the terms of long-term debt and the timing of issuance can be negotiated more strategically, taking into consideration the current capital markets. True variable-rate debt can be introduced and maintained at an appropriate level to lower the overall cost of capital and its debt service volatility can be mitigated through both a blended rate and through the volatility of returns on operating assets. The repayment schedule relating to allocations of proceeds can be more flexible (unbound by the underlying debt issuance), based on blended rates and different repayment time frames.

Bringing the pooled approach to managing cash balances and investing operating assets together with the portfolio approach to managing long-term debt in the Internal Bank allows tighter asset/liability matching and greater efficiencies in accessing the capital markets, both from the investment and long-term debt perspectives.

MANAGEMENT AND INVESTMENT OF OPERATING ASSETS

The objectives of a pooled cash and investment management structure are to:

- Pool operating assets to decrease cash flow volatility and better manage liquidity.
- Manage the investment of operating assets from an overall risk basis, rather than a security-type approach.
- Maximize return on operating assets within a prudent risk/return profile.
- Increase revenues and net assets of the University.

All University cash will be pooled and invested with the following objectives:

Safety – Safety of principal will be the foremost objective of the investment program. Investments of the University will be undertaken in a manner that seeks to ensure preservation of capital in the portfolio. The University will seek to mitigate credit and interest rate risk.

Liquidity – The investment portfolio of the University will remain sufficiently liquid to enable it to meet its cash flow requirements including payroll, accounts payable and debt service.

Return on Investment – The investment portfolio will be designed with the objective of attaining a market rate of return throughout budgetary and economic cycles, taking into consideration the safety and liquidity needs of the portfolio.

MANAGEMENT OF UNIVERSITY-PAID DEBT (XI-F(1) and OSU Revenue Bonds)

With the passage of several key legislative changes over the past eight years, including SB 270, the University has the needed flexibility to manage its university-paid debt as a portfolio. The University is authorized to issue fixed-rate and variable-rate debt, enter into interest rate swap agreements, and enter into lines of credit or issue commercial paper (CP) or use its own liquidity to provide interim financing for construction projects. With this flexibility, the University has begun pooling and managing its University-paid debt as a portfolio.

Under the pooled approach, utilizing its own liquidity, lines of credit or CP, the University is able to begin its capital investments on a schedule that is uninhibited by the timing of long-term debt issuances. The University times and structures the underlying long-term debt issuance to fund the repayment of interim funding and provide the remainder of the funds needed for capital investments to provide for the lowest cost of capital, utilizing a mix of fixed and floating-rate debt. The University provides the construction funds to each borrowing department via a loan from the Internal Bank at a cost of capital that is established based on the interest costs of the entire portfolio of debt—a blended cost of capital. This effectively de-links the debt payments made by the borrowing department to the Internal Bank from the debt service payments made by the Internal Bank to the bond-holders. The Internal Bank strategically manages the University-paid debt via continuous management of the entire debt portfolio and setting an equitable blended rate to all borrowing departments.

This approach to the management of University-paid debt has the following advantages:

Minimizing the Cost of Capital
The University will minimize its cost of capital by providing interim financing to lower interest costs during construction, by limiting the portion of taxable debt issued, and by maintaining a portion of the University's outstanding debt on a floating-rate basis. Due to the financing flexibility and typically low interest cost associated with variable-rate debt, it is desirable to have the flexibility to maintain a portion of the University's aggregate debt on a floating-rate basis. However, variable-rate debt also introduces volatility to the University's debt service obligations. Therefore, the University will balance the mix of variable and fixed-rate debt according to a target guideline that will be established based on the University's ability to hedge such exposure either through interest earned on its operating cash balances, through reserves maintained for that purpose, or some combination thereof. The actual percentage of variable-rate debt outstanding will fluctuate from time-to-time due in part to financing needs, utilization of lines of credit or CP, and prevailing market interest rates.

Managing Volatility
The University will manage interest rate volatility by establishing a standard "blended cost of capital" charged to the departments by the Internal Bank that is sufficient to cover debt interest costs, fund the administrative costs of the Internal Bank, and build a reserve to hedge variable-rate movement.

Providing Greater Flexibility and Clearer Planning Horizons
The University provides greater flexibility and clearer planning horizons to its departments by de-linking the actual debt service payments on outstanding debt from the campus projects that the debt funded. Utilizing internal loans from the Internal Bank to fund their capital investments, campus departments can:

- Better predict their debt service costs at the beginning of a project.
- Take out debt on terms more tailored to their specific project.
- Repay debt early.
- Focus their concern on managing the project and less on the financing.

By establishing a blended cost of capital, departments can worry less about the interest rate markets and the timing of bond issuances, focusing instead on the project itself.

Maximizing Allowable Arbitrage Earnings
The University will maximize allowable arbitrage earnings by strategically entering the capital markets and through strategic management of any debt sinking funds to help avoid arbitrage rebate.

OPERATION

In order to continue operating the Internal Bank with appropriate controls and risk mitigation processes, there are several policies that need to be reviewed and approved by the Board. These policies are:

- Internal Bank Policy
- Investment Policy
- Debt Policy

INTERNAL BANK POLICY (See Attachment A)

The Internal Bank Policy establishes the Internal Bank and sets forth its purpose and major operating parameters. The following provisions are included:

- *Purpose of the Internal Bank Policy* – Describes the purpose of the Internal Bank and its guiding policy.
- *Management of the Internal Bank* – The University Vice President for Finance and Administration delegates to the University Associate Vice President of Finance and Administration the responsibility to manage the Internal Bank and sets forth his/her roles and responsibilities, including both management responsibilities and reporting requirements.
- *Operations of the Internal* Bank:
    - Establishes the approvals required for certain transactions of the Internal Bank.
    - Lists the funds available for internal lending via the Central Loan Program.
    - Describes the process for establishing and maintaining the Deposit Interest Rate.
    - Describes the process for establishing the Internal Lending Rate.
    - Provides for the establishment of Internal Bank Reserves.

INVESTMENT POLICY (See Attachment B)

This policy establishes the investment guidelines pertaining to the operating assets of the University. The following provisions are included:

- *Purpose of the Investment Policy* – Discusses the basic purpose of the Investment Policy.
- *Scope* – Sets forth the specific types of investments that are covered by the Investment Policy.
- *Prudence* – Describes the standards that guide the investing activities of the University with respect to this investment category.
- *Objectives* – Sets forth the primary objectives of the investing activities of the University with respect to this investment category.
- *Delegation of Authority* – Delineates the delegation of investment management authority from the Oregon State University Board of Trustees (Board) to the University Vice President of Finance and Administration.
- *Ethics and Conflicts of Interest* – Discusses the responsibilities of and disclosures to be made by the University officers and employees with respect to personal activities and interests that could conflict with their investment management activities.

- *Permitted Investment Instruments* – Sets forth investment limits and lists the various investment instruments available to the University with respect to this investment category.
- *Maximum Maturity* – Provides the maximum investment maturity and portfolio duration limits.
- *Safekeeping and Custody* – Sets forth the custody and safekeeping procedures and requirements.
- *Reporting Requirements* – Describes the frequency and contents of periodic reports to the Board on investment activity and performance.
- *Review of Investment Policy* – Requires biennial review of the Investment Policy by the Board.

DEBT POLICY (See Attachment C)

The Debt Policy establishes the guidelines pertaining to the issuance of debt and the management of the debt portfolio. The following provisions are included:

- *Purpose of the Debt Policy* – Discusses the objectives and goals of the Debt Policy.
- *Bond Programs*– Details the range of bond financing options available to the University for its capital investment financing needs.
- *Scope of the Debt Policy* – Sets forth the specific types of University debt that is covered by the Debt Policy.
- *Capital Investment Funding Prioritization* – References the University's capital planning and financing prioritization process.
- *Debt Management Approval Process* – Describes how debt financing for capital investments is approved.
- *Selection of Finance Consultants and Service Providers* – Delineates the guidelines for the selection and hiring of bond counsel, financial advisors, underwriters, banks, other credit providers, and other service providers.
- *Debt Capacity and Affordability* – Sets forth the procedures and financial indicators to be used to assess debt capacity and affordability.
- *Financing Sources* – Details the various financing structures and funding sources available to the University.
- *Compliance with IRS Regulations* – Summarizes the various IRS regulations regarding the usage of tax-exempt bond proceeds in order to maintain the bonds' tax-exempt status.
- *Debt Portfolio Risk and Opportunity Management* – Discusses debt portfolio risks, the use of derivative products, limitations on variable rate debt exposure, and the monitoring of refinancing opportunities.
- *Central Loan Program Management* – Summarizes provisions and benefits of the internal loan program.
- *Debt Policy Monitoring and Reporting* – Details the debt policy monitoring and debt capacity and affordability reporting process.

Staff Recommendation to the Committee

Staff propose that the OSU Board of Trustees' Finance and Administration Committee recommend to the Board that it approve the Internal Bank Policy (Attachment A), the Investment Policy (Attachment B), and the Debt Policy (Attachment C).

Attachment A
DRAFT Oregon State University Internal Bank Policy

I. Purpose of the Internal Bank Policy

The Oregon State University Board of Trustees (Board) has established within the Office of the Vice President for Finance and Administration an Internal Bank that will operate in perpetuity with the following objectives:

a) To more efficiently and effectively carry out the treasury management function within Oregon State University (University);
b) To facilitate the long-term financial stability of the University through effective asset/liability management strategies and optimizing the University's capacity to access the capital markets at a reasonable cost; and
c) To accumulate unrestricted net assets for the University.

The Internal Bank integrates the three primary functions of treasury management: (1) cash management, (2) limited term investment management (i.e., management of non-endowment assets), and (3) debt management (both short- and long-term). In order to integrate these functions, the Internal Bank will operate as follows:

- Cash and limited term assets of all University departments and units are pooled for investment purposes, and the Internal Bank is charged with the responsibility to manage those funds to maximize investment returns with a prudent level of risk while assuring necessary liquidity.
- Financing necessary for capital investments approved pursuant to University policy is provided by the Internal Bank to departments or units through a Central Loan Program:
  - Interim financing may be provided for capital investments in anticipation of philanthropy, planned issuance of long-term debt or from other sources of funds.
  - Permanent financing may be provided for projects with an identified repayment source and will include an amortization schedule for a term consistent with the useful life of the project.
- The University's debt is managed in a portfolio approach and the Internal Bank is charged with the responsibility to minimize the University's cost of capital within a prudent level of risk.

II. Management of the Internal Bank

The Internal Bank will be the responsibility of the University Vice President for Finance and Administration. The University Vice President for Finance and Administration delegates to the University Associate Vice President for Finance and Administration the responsibility for management of the Internal Bank, who may employ staff to provide the services that align with the goals of the Internal Bank. The Internal Bank's operating expenses will be paid out of the Internal Bank's income, generated by interest rate spreads and service fees.

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

- Establishing the internal lending rate.
- Establishing and maintaining the Central Loan Program.

- 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 annual operating budget of the Internal Bank.
- Maintaining access to adequate liquidity sources to meet the needs of the University.

The Internal Bank may contract with professional advisory firms to assist with the management of the investment and debt portfolio, as described in the University's Investment Policy and Debt Policy.

The operation of the Internal Bank will comply with all applicable federal and state statutes, rules and policies. Where applicable, the Internal Bank will coordinate and cooperate with the Oregon State Treasurer and Department of Administrative Services in making investment and debt financing decisions.

The University Associate Vice President for Finance and Administration will monitor the operating performance of the Internal Bank and its ability to achieve stated long-term goals. The Vice President for Finance and Administration will annually report to the Board on the Internal Bank's performance. Any material adverse change in performance will be reported to the Board.

III. Operations of the Internal Bank

Required Approvals

The University Vice President for Finance and Administration will make recommendations to the Board's Finance and Administration Committee and request approval for the following transactions:

a) Investment of operating assets that fall outside of the Oregon State University Investment Policy or related policies.
b) Issuance of new debt for capital or operating purposes in accordance with the Oregon State University Debt Policy.
c) Transactions to acquire external forms of interim financing, such as bank lines of credit or commercial paper for liquidity purposes.
d) Transactions to manage the debt portfolio in accordance with the Oregon State University Debt Policy.

Funds Available for Internal Lending via the Central Loan Program

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

1. Proceeds from new debt issuance
2. Proceeds from repayment of internal loans via the Central Loan Program
3. Internal Bank liquidity, to be provided through University cash or external borrowing, after considering:

i. Anticipated external debt service requirements
ii. Operating cash flow needs
iii. Operating costs of the Internal Bank
iv. Adequacy of Internal Bank reserves, such as an interest rate reserve

Deposit Interest Rate

The University Associate Vice President for Finance and Administration, in consultation with the University Vice President for Finance and Administration, will develop procedures to establish the interest rate to be credited to departments or units that have funds on deposit in the Internal Bank. The rate will be periodically evaluated and adjusted as necessary.

Internal Lending Rate

Annually, the University Associate Vice President for Finance and Administration, in consultation with the University Vice President for Finance and Administration, will establish the Central Loan Program interest rates, which may vary based on internal loan duration. It is the goal and objective to establish those rates to remain in perpetuity. However, it is understood, should the capital markets behave in an unanticipated manner and the reserves available to the Internal Bank are projected to become depleted or excessively large, the Central Loan Program interest rates may be modified on all loans outstanding, including loans that relate to financings undertaken before the establishment of the Internal Bank. This is critical to ensure the interest rate adjustment is equitable across borrowers and is not unfairly applied to only the projects financed subsequent to the establishment of the Internal Bank.

Internal Bank Reserves

The Internal Bank may build and maintain an Interest Rate Reserve to hedge future volatility in debt and investment markets by:

1. Charging a spread between the investment income generated on operating cash and limited term assets and the amount credited to departments or units that have deposits with the Internal Bank.
2. Charging a spread between the Internal Lending Rates charged to internal borrowers and the blended opportunity cost of capital.

The University Associate Vice President for Finance and Administration, in consultation with the University Vice President for Finance and Administration, may establish additional reserves to be held by the Internal Bank that align with its goals and objectives.

Attachment B
DRAFT Oregon State University Investment Policy

I. Purpose of the Investment Policy

The purpose of this document is to identify the policies for prudent investment of Oregon State University ("University") funds by providing guidelines for suitable investments while maximizing the efficiency of the University's cash management program.

The investment policies and practices of the University are based on state law and prudent money management. All funds will be deposited and invested in accordance with this Policy and all statutes, ordinances and policies governing the University.

II. Scope

It is intended that this policy cover all funds (except quasi-endowment, endowment, and retirement funds) and investment activities under the direction of the Oregon State University Board of Trustees (Board).

III. Prudence

The Vice President for Finance and Administration, Associate Vice President for Finance and Administration and the Board are fiduciaries subject to the prudent investor standard. When investing, reinvesting, purchasing, acquiring, exchanging, selling, or managing public funds, a trustee shall act with care, skill, prudence, and diligence under the circumstances then prevailing, including, but not limited to, the general economic conditions and the anticipated needs of the University, that a prudent person acting in a like capacity and familiarity with those matters would use in the conduct of funds of a like character and with like aims, to safeguard the principal and maintain the liquidity needs of the University.

IV. Objectives

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

1. *Safety* — Safety of principal is the foremost objective of the investment program. Investments of the University shall be undertaken in a manner that seeks to ensure preservation of capital in the portfolio. The University shall seek to mitigate credit and interest rate risk.

    a. Credit Risk. The University will minimize credit risk, the risk of loss due to the financial failure of the security issuer or backer, by:
        - Pre-qualifying the financial institutions, broker/dealers, and advisers with which the University conducts business.
        - Diversifying the investment portfolio so that potential losses on individual securities will be minimized.
        - Actively monitoring the investment portfolio holdings.

b. Interest Rate Risk. The University will minimize the risk that the market value of securities in the portfolio will fall due to changes in general interest rates by:
   - Structuring the investment portfolio to provide enough liquidity to meet cash flow needs.
   - Maintaining a conservative duration target.
   - Structuring the portfolio to consist largely of securities with active secondary or resale market.

2. *Liquidity* — The investment portfolio of the University will remain sufficiently liquid to enable the University to meet its cash flow requirements including but not limited to payroll, payroll related liabilities, accounts payable, and debt service.

3. *Return on Investment* — The investment portfolio shall be designed with the objective of attaining a market rate of return throughout budgetary and economic cycles, taking into consideration the safety and liquidity needs of the portfolio.

V. Delegation of Authority

The management responsibility for the investment program is hereby delegated by the University Vice President for Finance and Administration to the University Associate Vice President for Finance and Administration. The Associate Vice President will monitor and review all investments for consistency with this investment policy. The Associate Vice President may delegate investment decision-making and execution authority to an investment advisor. The advisor shall follow the policy and such other written instructions as are provided.

VI. Ethics and Conflict 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, or that could impair their ability to make impartial decisions. Officers and employees shall disclose any material interests in financial institutions with which they conduct business. Disclosure shall be made to the governing body. They shall further disclose any personal financial/investment positions that could be related to the performance of the investment portfolio. Employees and officers shall refrain from undertaking personal investment transactions with the same individual with whom business is conducted on behalf of the University.

VII. Permitted Investment Instruments

Where this section specifies a percentage limitation for a particular security type, that percentage is applicable only on the date of purchase. Credit criteria listed in this section refers to the credit rating at the time the security is purchased. If an investment's credit rating falls below the minimum rating required at the time of purchase, the Associate Vice President for Finance and Administration will perform a timely review and decide whether to sell or hold the investment.

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

Investment Pools

1. The **Public University Fund** established by Section 7 of House Bill 4018.

2. The **Oregon Short-Term Investment Fund** (OSTF)/Pool as managed by the Oregon State Treasury in accordance with the terms approved by the Oregon Investment Council.

3. The **Oregon Intermediate Term Pool** (OITP) as managed by the Oregon State Treasury in accordance with the terms approved by the Oregon Investment Council.

4. Any other investment pools managed by the Oregon State Treasury in accordance with terms approved by the Oregon Investment Council.

Prior to investing in any investment pool, the University will review the pool's governing document, prospectus (if available), permitted investments, fees, and management.

Securities and Registered Funds

1. **U.S. Treasuries.** United States Treasury notes, bonds, bills, or certificates of indebtedness, or those for which the full faith and credit of the United States are pledged for the payment of principal and interest.

2. **U.S. Agency Obligations.** Federal agency, instrumentalities of the United States, or United States government-sponsored enterprise obligations, participations, or other instruments, including those issued by or fully guaranteed as to principal and interest by federal agencies, instrumentalities, or United States government-sponsored enterprises.

3. **Municipal Obligations.** Lawfully issued debt obligations of the agencies and instrumentalities of any State or their political subdivisions in the United States with a long-term rating of at least 'A' or the equivalent from two Nationally Recognized Statistical Rating Organizations (NRSRO) or with the highest rating for short-term municipal debt. The maximum percent of the portfolio that may be allocated to this sector is 25%.

4. **Bankers' Acceptances**. Issued by domestic banks or domestic offices of foreign banks, which are eligible for purchase by the Federal Reserve System with a maturity of 180 days or less. The issuing corporation, or its guarantor, must have a short-term debt rating of at least "A-1" or the equivalent from two NRSROs. The maximum percent of the portfolio that may be allocated to this sector is 25%.

5. **Time Deposits.** Certificates of deposit or time deposits of domestic banks and domestic branches of foreign banks with a short-term debt rating of at least "A-1" or the equivalent from two NRSROs.

6. **Negotiable Certificates of Deposit.** Negotiable certificates of deposit issued by a nationally or state-chartered bank, a savings association or a federal association, a state or federal credit union, or by a state or federally-licensed branch of a foreign bank. The maximum percent of the portfolio that may be allocated to this sector is 25%.

7. **Commercial Paper**. "Prime quality" commercial paper, with a maturity of 270 days or less, issued by domestic corporations (corporations organized and operating under the laws of the United States or any state thereof) provided that the issuing corporation, or its guarantor, has a short-term debt rating of at least "A-1" or the equivalent from two NRSROs. The maximum percent of the portfolio that may be allocated to this sector is 25%.

8. **Corporate Notes.** Corporate and depository institution debt securities issued by corporations organized and operating within the United States or by depository institutions licensed by the U.S. or any state, and operating within the U.S. Corporate notes must have a long-term rating of at least 'A' or the equivalent from two NRSROs. The maximum percent of the portfolio that may be allocated to this sector is 30%.

9. **Asset-backed Securities.** Mortgage pass-through security, collateralized mortgage obligation, mortgage-backed or other pay-through bond, equipment lease-backed certificate, consumer receivable pass-through certificate, or consumer receivable-backed bond which is rated at least "AA" or the equivalent from two NRSROs. The maximum percent of the portfolio that may be allocated to this sector is 20%.

10. **Money Market Mutual Funds.** Shares in an open-end, no-load investment funds provided such fund:

    a) Is registered under the Federal Investment Company Act of 1940,
    b) Is rated "AAAm" or "AAAm-G" or the equivalent by a NRSRO, and
    c) Complies with the requirements of Rule 2(a)-7, or any successor rule, of the United States Securities and Exchange Commission.

    Before investing in any mutual fund, the University will obtain a copy of the fund's prospectus and review permitted investments, fees, and management.

VIII. Maximum Maturity

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

Unless otherwise noted within this investment policy, the University may not invest in a security with a final maturity that exceeds ten years from the date of purchase. The maximum duration of the University's portfolio (which incorporates a bond's yield, coupon, final maturity and call features into one number, expressed in years, that indicates how price-sensitive a bond or portfolio is to changes in interest rates) may not exceed 5 years.

IX. Safekeeping and Custody

The assets of the University shall be secured through third-party custody and safekeeping procedures. Bearer instruments shall be held only through third-party institutions.

X. Reporting Requirements

The University Vice President for Finance and Administration, or his/her delegate, will present to the Board quarterly investment reports, which will include:

Investment Pools and Registered Funds

- Cost basis
- Market value
- Dividend income
- Dividend yield
- Quarterly performance

Securities

- Description of investment instrument
- Interest rate or yield to maturity
- Purchase date
- Maturity date
- Purchase price
- Par value
- Current market value as of the date of the report and the source of this valuation
- Overall portfolio yield based on cost

XI. Biennial Review of Investment Policy

The University Vice President for Finance and Administration, or his/her delegate, will present the Investment Policy to the Board for review on a biennial basis.

Attachment C
DRAFT Oregon State University Debt Policy

I. Purpose of the Debt Policy

In support of its mission, Oregon State University (University) maintains a long-term strategic plan. The strategic plan establishes University-wide priorities as well as divisional programmatic objectives. In support of its strategic plan, the University maintains a capital plan to support these priorities and objectives.

The Debt Policy formalizes the link between the University's strategic plan and the issuance of debt. Debt is a limited resource that must be managed strategically in order to best support the University's priorities. The University's use of debt plays a critical role in ensuring adequate and cost-effective funding for its capital plan and operating needs. By linking the objectives of the Debt Policy to the University's strategic objectives, the University increases the likelihood of achieving its mission.

The objectives of this policy are to:

a) Outline the University's philosophy on debt.
b) Provide guidance for the use of bonding programs available to the University.
c) Establish a control framework for approving and managing debt including reporting guidelines.
d) Identify metrics to monitor debt capacity and affordability.
e) Identify financing sources available to the University.
f) Establish a framework for analyzing and managing debt portfolio risk and opportunities.
g) Describe the goals of a Central Loan Program within the University's Internal Bank.
h) Provide an ongoing monitoring and reporting framework.

Under the policy, debt is being managed to achieve the following goals:

a) Maintain access to financial markets: capital, money and bank markets.
b) Manage the University's credit rating to maintain the highest possible creditworthiness based on the strategic needs of the University.
c) Optimize the University's debt mix (e.g. fixed/floating rate mix, average life, weighted average cost of capital, liquidity objectives, etc.).
d) Ensure funds are available to support future capital investments and strategic initiatives.
e) Coordinate debt management decisions with asset management decisions to optimize the overall funding and portfolio management strategies.

II. Bond Programs

The University has a range of State and University bond financing options available for its capital investment financing needs, as described below.

State General Obligation (GO) Bonds

State GO Bonds are backed by the full faith and credit of the State of Oregon and are authorized by Articles in the Oregon Constitution specific to each GO bonding program, as shown below. Bond issuance must be authorized by legislative action and repayment may come from the State or the University.

Article XI-F(1) Bonds	• Used for higher education projects. • Typically issued for auxiliary enterprise projects as the University must demonstrate sufficient operating revenues to pay debt service and operate the project. • General Fund appropriations may not be used to repay bonds.
Article XI-G Bonds	• Used for higher education projects which are authorized to receive aid from the State General Fund. • Limited to financing academic facilities. • The Legislature or the University must provide a dollar-for-dollar match to XI-G bonds, which cannot be from proceeds of another GO bond. • Future General Fund appropriations are ‘guaranteed’ to repay XI-G bonds.
Article XI-M Bonds	• Used to plan and implement seismic rehabilitation of public education buildings. • Future General Fund appropriations are ‘guaranteed’ to repay XI-M bonds.
Article XI-Q Bonds	• Used to finance both personal property acquisition and capital construction. • Repayment source is determined by legislative action.

Lottery Bonds

Lottery bonds are backed by lottery revenues and may be used for educational projects authorized by legislative action. Repayment is made from future lottery revenues.

State Energy Loan Program (“SELP”) Loans

SELP Loans are offered and approved by the Oregon Department of Energy for projects that save energy, produce energy from renewable resources or use recycled materials to create products, or use alternative fuels. SELP Loans are financed by State GO Bonds and repayment is generally made from university revenues, although they can be repaid using State General Fund appropriations as authorized by legislative action.

Availability of State Bonding Program

The availability of State bonding programs is subject to:

- The State’s debt capacity
- Compliance with lottery revenue bond covenants
- Legislative approval

Revenue Bonds

In addition to State bonding programs, the University may issue University Revenue Bonds based on its own credit rating. University Revenue Bonds may be backed by a general or specific revenue pledge of the University. No legislative action is required for the issuance of University Revenue Bonds.

Bond Program Selection

University Revenue Bonds potentially offer the most flexibility in funding capital investments. Important advantages include:

1. Provide a source of matching funds for State GO Bonds.
2. Project timing is not constrained by the legislative approval process.
3. Access to funds is not constrained by competing legislative priorities.
4. Funding is not constrained by State debt capacity limits or lottery revenue bond covenants.

While these represent important considerations, the University recognizes that other State bond programs may be preferable depending on the circumstances, especially if State or lottery funds are the source of repayment. As a general guideline, the University will pursue the bond program that results in the lowest cost of funds and/or the most favorable terms while considering timing and project constraints.

III. Scope of Debt Policy

The University recognizes it has limited control over debt issuance and management decisions for State GO and Lottery Bonds when University revenues are not the source of repayment. As such, these decisions are not included in the scope of the Debt Policy. However, the University will consider such debt in its overall assessment of debt capacity and affordability.
In addition to bonds payable from University revenues, other forms of direct and indirect debt covered by this policy may include but are not limited to:

- Capital leases
- Operating leases (considered indirect debt)
- Bank loans, lines of credit and any other debt instruments provided by third party credit providers
- Off-balance sheet financing structures
- Public-Private Partnerships

IV. Capital Investment Funding Prioritization

The University will implement a capital planning process in which capital investments are vetted for debt financing based on their economics, strategic importance and other relevant factors. The capital plan will be reviewed and approved by the Board periodically, and only Board-approved capital investments will be eligible for funding, with the exception of specific debt or lease transactions that have been delegated to the University Vice President for Finance and Administration.

V. Debt Management Approval Process

The University Vice President for Finance and Administration is responsible for implementing this policy and for all debt financing activities of the University. This policy provides the framework for debt management decisions.

All new debt issuances will be authorized through an Oregon State University Board of Trustees (Board) resolution that includes any specific parameters regarding the size, structure and pricing of the transaction. The University Vice President for Finance and Administration will report to the Board's Finance and Administration Committee, no less than annually, any issues that may impact the University's debt capacity resulting from unanticipated changes in operating or investment performance.

VI. Selection of Finance Consultants and Service Providers

The University Vice President for Finance and Administration or his/her designee shall be responsible for establishing a selection process for securing professional services related to the issuance or management of debt. The professional services shall be provided by qualified professionals and firms with experience in municipal finance, higher education and providing such services to Oregon-based entities.

Described below are guidelines for the selection and hiring of professional service providers:

a) *Bond Counsel* - The University's Office of General Counsel and the Vice President for Finance and Administration may jointly appoint a qualified bond counsel firm.
b) *Financial Advisor* - The University Vice President for Finance and Administration may select a financial advisor to assist the University with the issuance and management of debt, as well as with ongoing strategic and financial planning advice.
c) *Underwriters* - The University Vice President for Finance and Administration may select underwriters to execute the sale of bonds on the University's behalf.
d) *Banks and other Credit Providers* - The University Vice President for Finance and Administration may select banks or other credit providers to provide financing on an interim or permanent basis for operating or capital purposes.
e) *Other Service Providers* - The University Vice President for Finance and Administration may periodically solicit for providers of other services necessary to carry out the debt issuance and management activities of the University, including disclosure counsel, paying agent, escrow agent, verification agent, trustee, and services related to post-issuance compliance, among others.

VII. Debt Capacity and Affordability

Debt capacity is a subjective measure, typically associated with balance sheet strength and the ability to repay debt on demand. The University's risk tolerance will inform the amount of leverage that can comfortably be assumed.

Debt affordability is also a subjective measure and typically associated with income statement strength. Operating performance and the ability to meet debt service requirements will inform the affordability of existing and additional debt.

The University recognizes that its strategy and mission must be the primary drivers of its capital investment and use of debt. Although external credit ratings provide a view on debt capacity and affordability, the University will not manage its debt portfolio to achieve a specific rating. Success in achieving University objectives will result in a stronger financial profile and higher ratings over time.

The University will monitor five financial ratios to assist the Board in evaluating debt capacity and affordability, as described below.

1. Viability Ratio (balance sheet leverage ratio)
   Expendable Resources (inclusive of Foundations) / Debt
   Measures the ability to repay debt with financial resources and the ability to use debt to strategically advance the University's mission

2. Primary Reserve Ratio (income statement leverage ratio)
   Expendable Resources (inclusive of Foundations) / Total Expenditures
   Measures whether financial resources are sufficient and flexible enough to support OSU's mission

3. Debt Burden Ratio (affordability ratio)
   Debt Service / Total Expenditures Minus Depreciation Plus Principal Payments
   Measures OSU's dependence on debt to finance its mission and the relative cost of borrowing to overall expenditures
   Guideline maximum debt burden ratio = 7%

4. Debt Service Coverage (affordability ratio)
   3-Year Average Net Operating Income Plus Non-Operating Revenues Plus Interest and Depreciation / Debt Service
   Measures the sufficiency of operations on a cash flow basis to cover debt service

5. Debt / Revenues (income statement leverage and affordability ratio)
   Measures the amount of leverage relative to the size of operations

All ratio calculations will be based on industry standards and include all 'direct debt'. In addition to bonds and bank debt, direct debt includes capital leases and any off-balance sheet or similar financing structures that would be considered on-credit.

Indirect debt, such as operating leases, is excluded from the above calculations. However, indirect debt is considered part of the University's 'comprehensive debt', which is a broader measure of the University's debt obligations. The University recognizes that the use of indirect debt has an impact on debt capacity and affordability.

Prior to the issuance of any new debt, the University Vice President for Finance and Administration will evaluate the impact on these ratios for discussion with the Finance and Administration Committee of the Board.

VIII. Financing Sources

The University has access to a wide range of financing structures and funding sources, each with specific benefits, risks and costs. All potential funding sources are reviewed by management within the context of the Debt Policy and the overall portfolio to ensure that any financial product or structure is consistent with the University's objectives. Regardless of what financing structure is utilized, due-diligence review must be performed for each transaction, and may include (i) quantification of potential risks and benefits, (ii) analysis of the impact on the University's long-term creditworthiness, debt capacity and debt affordability, and (iii) impact on the budget.

The University may access funds from either the capital markets or directly from banks and other third parties. Described below are some of the main financing structures and funding sources available to the University:

- **Tax-Exempt Debt**. Tax-exempt debt is a significant component of the University's capitalization due in part to its substantial cost benefits. The University manages the debt portfolio to maximize utilization of tax-exempt debt relative to taxable debt whenever possible, recognizing that the University must adhere to Internal Revenue Service ("IRS") regulations regarding the use of facilities financed by tax-exempt debt, among other restrictions.

- **Taxable Debt**. In instances where capital investments do not qualify for tax-exempt debt or more flexibility is desired, the use of taxable debt may be considered. In addition, taxable debt may be used to finance working capital or other operating needs which are not eligible for tax-exempt financing.

- **Fixed Rate Debt**. Fixed rate debt, in which the interest rate is fixed until maturity, represents a significant component of the University's capitalization. Fixed rate debt provides budgetary certainty but is typically more restrictive in its prepayment flexibility compared to short-term or variable rate debt.

- **Internal or External Sources of Liquidity**. The University may use internal funds or external funds, which may include bank lines of credit, floating rate notes, or commercial paper, to provide funds to the Internal Bank for interim financing of projects in anticipation of philanthropy, planned issuance of long-term debt or reimbursement/repayment from other sources of funds. The use of external sources of liquidity may provide greater flexibility relative to the timing and structuring of individual transactions. The external sources of liquidity are a form of short-term financing and are generally variable rate debt.

- **Other Types of Variable Rate Debt**. The University may desire more variable rate exposure in its capital structure to potentially lower its overall cost of capital, provide greater redemption or refinancing flexibility compared to fixed rate debt, or to diversify its debt portfolio, among other reasons. Products, such as Variable Rate Demand Bonds, Floating Rate Notes and other structures in which the interest rate is periodically reset based on an index or remarketing, can potentially provide these benefits. The University recognizes that these structures also have risks that must be weighed against the potential benefits.

- **Bank Products**. Rather than accessing funds via the capital markets, the University may find it more advantageous to access funding from banks or other third parties. Some considerations in evaluating the attractiveness of private sources of capital include cost of funds, size of borrowing, timing constraints and other terms.

- **Capital and Operating Leases**. Lease structures provide another source of funding for capital investments and other needs. The University recognizes that capital leases and operating leases may constitute direct or indirect debt for credit purposes. Before entering into a lease agreement, the University will assess the economics, risks and benefits compared to other forms of financing.

- **Off-Balance Sheet Financing, including Public-Private Partnerships**. Third parties may provide other types of funding for capital investments and other needs. The University recognizes that these structures can be more expensive than traditional debt structures, and may carry risks beyond financing risk, including risks to the University's reputation and student experience. The University recognizes that these structures may have a direct or indirect impact on the University's debt position or overall credit profile. The University will evaluate the potential financial and qualitative risks and benefits of these structures before entering into any contracts or agreements.

IX. Compliance with IRS Regulations

In order to access tax-exempt financing, the University must comply with all applicable IRS regulations including, but not limited to, regulations relating to the use of bond proceeds, the use of bond financed facilities, and arbitrage in order to maintain the bond's tax-exempt status. The University will ensure that pre-issuance and post-issuance compliance procedures are in place to ensure full compliance.

X. Debt Portfolio Risk and Opportunity Management

The University will actively manage the risks and opportunities in its debt portfolio. This includes monitoring and seeking opportunities to mitigate risk. However, the University recognizes that in certain situations it may be prudent to assume risk if the potential benefits outweigh the potential risks. In all cases, the University will only assume risk if the University is adequately compensated.

Debt Portfolio Risk Framework

Debt portfolio risks can be categorized as either components of interest rate risk or liquidity risk. Interest rate risk components impact the University's cost of funds and can generally be budgeted for and managed as part of the University's operations. Liquidity risk components represent more immediate and unexpected events that may require the University to draw on its financial resources. The University will seek to quantify these risks whenever possible as part of its management of the debt portfolio. Described below are key components of these risks.

Interest Rate Risk Components

Market Rate Risk	Customarily thought of as interest rate risk, but limited to market risk only (e.g. risk that interest rates in general will rise due to inflation expectations or other reasons)
Credit Risk	Risk that any actual or perceived changes in creditworthiness result in a higher cost of capital
Tax Risk	Risk that any actual or potential changes in Federal and/or State law will adversely impact the pricing or availability of tax-exempt debt
Bank Liquidity or Credit Facility Re-pricing Risk	Risk that the cost of liquidity facilities to support uncommitted debt or working capital lines of credit will increase
Basis Risk*	Risk that interest rate hedges will be inefficient
Swap Counterparty Credit Risk*	Risk that expected payments from swap counterparties are not received

Liquidity Risk Components

Roll/Remarketing Risk	Risk that put bonds, commercial paper, variable rate demand bonds or similar products cannot be rolled or remarketed
Bank Liquidity or Credit Facility Renewal Risk	Risk that liquidity facilities to support uncommitted debt or working capital lines of credit may not be available at all or on acceptable terms
Failure of a Liquidity Facility Provider	Risk that a liquidity facility provider ceases to operate due to bankruptcy or other cause
Swap Collateralization Risk*	Risk that collateral may need to be posted under a swap agreement
Swap Termination Risk*	Risk of a an involuntary termination triggered by an automatic termination event

* Risks related to derivative products. As noted below, the University has no plans to utilize derivative products at this time.

Derivative Products

Derivative products, including interest rate swaps, may be employed primarily to manage or hedge the University's interest rate exposure. Before executing any derivative product, the University will consider the State's Interest Rate Swap Policy and any other requirements of the State Treasurer.

At this time, the University has no plans to utilize derivative products. Prior to the issuance of any derivative product agreement, the University will seek approval from the Board to amend the Debt Policy and adopt guidelines for the use of derivatives.

Variable Rate Exposure

Exposure to variable interest rates in the University's portfolio may be desirable in order to:

- Take advantage of repayment and restructuring flexibility
- Benefit from historically lower average interest costs
- Reduce interest rate risk by providing a match or natural hedge between anticipated interest payments and the projected cash flows from the University's cash and investments
- Diversify its pool of potential investors and gain additional access to capital markets

The University will monitor the risks from variable rate exposure based on the debt portfolio risk framework. In addition, as a general guideline, the amount of variable rate debt outstanding shall not exceed 20% of the University's overall debt portfolio.

Refinancing Opportunities

The University will monitor the debt portfolio on a periodic basis to identify opportunities to lower its cost of funding or to optimize its risk position by refinancing or restructuring outstanding debt. The University may also seek to refinance debt for legal reasons, such as to ensure compliance with IRS regulations or to address any bond document related issues. Before proceeding with any refinancing or restructuring transaction, the University will ensure that any transaction complies with applicable Oregon State Law and Administrative Rules.

XI. Central Loan Program Management

In accordance with the University's Internal Bank Policy, the University has adopted a Central Loan Program under which it provides funding for projects through internal loans. These loans are de-linked from the University's external debt obligations and other financing sources. The University will manage and optimize its debt obligations on a portfolio basis. As a general guideline, the loan repayment schedule for a particular project will not be tied to a specific bond issue. The interest rate charged on internal loans will be a blended rate that reflects the University's expected cost of capital plus the funding of any reserves, such as an interest rate stabilization fund, and expenses deemed necessary to the operation of the Internal Bank. The blended rate will be reset periodically in accordance with the Internal Bank Policy. The benefits of the Central Loan Program include:

a) Enabling the structuring of transactions in the best economic interests of the University which may not be possible on a project-specific basis.
b) Providing continual access to capital for internal borrowers rather than having to wait for a bond issue or other type of financing to be completed.
c) Funding specific projects with predictable financial terms.
d) Enabling the funding of projects based on strategic need independent of external financing market conditions.
e) Reducing volatility and providing a more stable cost of funds over time for internal borrowers.
f) Permitting prepayment of internal loans without penalty.
g) Achieving equity among internal borrowers through a blended rate.

XII. Debt Policy Monitoring and Reporting

The University Vice President for Finance and Administration will periodically review the Debt Policy to ensure it remains consistent with the University's objectives and industry standards. Any recommendations for changes to the policy will be brought to the Finance and Administration Committee.

On at least an annual basis, the University Vice President for Finance and Administration will review the University's debt capacity and affordability ratios and will report any concerns to the Finance and Administration Committee of the Board. In addition, as part of the Board approval process for external financings, the University Vice President for Finance and Administration will inform the Board of the impact on the University's debt capacity and affordability ratios, as well as the operating budget.