

Financing of Purchases

- Authority** This Guide Memo was approved by the Vice President for Business Affairs & Chief Financial Officer.
- Summary** This Guide Memo describes arrangements by which the University extends a loan to a department for purchase of equipment or facilities, which the department repays over a period of time. Section headings are:
1. DEFINITIONS
 2. PURCHASES ELIGIBLE FOR FINANCING
 3. APPROVAL
 4. LOAN TERMS
 5. AMORTIZATION SCHEDULE
 6. ASSET CATEGORIES AND LIVES
 7. CAPITAL EQUIPMENT FINANCING PROCEDURES

1. DEFINITIONS

- a. **“University financing”** is an internal mechanism whereby the University makes a loan to a department for capital equipment or facilities construction and recoups the loan, plus interest, over a period not exceeding the useful life of the asset by automatic transfer from a PTA (Project/Task/Award) or PTAs identified by the department. The loan is unsecured, and there might not be a formal loan agreement. The department retains all ownership responsibilities, including logging the equipment purchase into the Sunflower Assets asset management system as soon as it is received and in service.
- b. **“Amortization”** is the repayment of principal over the term of a loan. For service centers, the debt amortization serves as their depreciation charges for assets.

2. PURCHASES ELIGIBLE FOR FINANCING

Departments may obtain University financing for capital projects and programs. These capital projects and programs include academic capital projects and capital equipment purchases, service center capital projects and capital equipment purchases, auxiliary capital projects and capital equipment purchases, and backstopping of pledges and receivables.

If the Funding Agreement specifies that a capital project is for academic purposes and it is financed with debt, it is assumed that it will be used for academic purposes throughout its life. Penalties may occur if it is used for religious and/or Private Use purposes. Private Use includes activities that generate Unrelated Business Income. Contact the Tax Director in the Controller's Office if any non-academic use is contemplated to determine if the potential new use is allowable. If the Tax Director determines the new use is unallowable, you may contact the Director of Finance and Bond Holder Relations, in the office of the Vice President for Business Affairs and Chief Financial Officer, to request an exception.

3. APPROVAL

- a. **University Approval** – The Chief Financial Officer (CFO), or designee, is advised on all financing by a group consisting of representatives from the Provost's Office, Capital Planning, and the Controller's Office. Financing of all capital projects requires an appropriately authorized Form 1 or Board of Trustees approval. (For Form 1 approval procedures, see the Capital Planning Web Site at http://lbre.stanford.edu/cap_plan/.)

Capital project costs greater than the original approved amount require additional approval by the appropriate persons.

Backstopping gift pledges on a major construction project requires prior approval from the Provost in the form of a Funding Agreement. The Funding Agreement addresses financial responsibility during and after construction. See Section 4 d. for information about repayment of backstopping.

The Capital Accounting department of the Controller's Office is responsible for processing approval for all facilities projects and capital equipment loans.

- b. **School Approval** – Schools may require departments to obtain approval from the School Dean's Office before committing to finance a capital equipment purchase.

4. LOAN TERMS

The Chief Financial Officer is responsible for all University financing. The University borrows funds from external lenders and loans the proceeds to capital projects and programs. These capital projects and programs repay the funds plus interest over the remaining life of the project. Stanford is responsible for accumulating these funds and repaying funds to the external lender. All financing and debt issues must comply with the University's Debt Policy.

- a. **The Budgeted Interest Rate** – The University will accumulate in a single fund all interest expense and bond issuance costs ("Interest") from debt instruments used to finance capital projects and programs that support the academic mission of the University. Debt instruments that exist for the purpose of financing capital projects and programs that are unrelated to the academic, non-profit mission of the University will be excluded from the single Interest fund.
- b. **Exceptions to Single Interest Rate** – An exception to the policy is that capitalized interest for projects in construction will be charged at the monthly actual interest rate (the Blended Interest Rate) of the debt pool. The purpose is to make the capitalized interest expense calculation precise for depreciation purposes.
- c. **Calculation of Budgeted Rate** – Each year in March, or when needed for the Consolidated Budget, the Controller's Office will develop an estimated Pooled Interest rate, the Budgeted Rate, from the single Interest expense fund for the following fiscal year's budget. A pro-rata share of this Interest will be charged to each user of debt based on the proportion of principal borrowed from the debt funds.

During the course of the fiscal year, the Controller's Office will compare the actual Blended Pooled Interest Rate with the Budgeted Rate monthly. If the actual Blended Pooled Interest Rate during a fiscal year changes by less than 20 basis points (+/-0.20%) from the current Budgeted Rate, the Budgeted Rate will remain in effect for the fiscal year. If during the fiscal year new information changes the Estimated Pooled Rate by more than 20 basis points from the current Budgeted Rate, the Budgeted Rate for that fiscal year will be changed for the remainder of that fiscal year. The prior months' interest expense will not be restated.

- d. **Amortization of Loans** – In the month following the completion of a capital project, installation of capital equipment, or the withdrawal of funds for a program, the Controller's Office will begin to collect interest at the Budgeted Rate and principal, if appropriate, in the Revolving Debt Pool.
 - Academic fixed assets and auxiliary fixed assets and programs will amortize on an equal monthly payment schedule over the remaining life of the asset or program. If the Budgeted Rate changes, the payments will be changed to reflect the new rate and the same useful life.
 - Service Center fixed assets and capital equipment purchases will amortize on an equal principal payment schedule over the remaining life of the asset. If the Budgeted Rate changes, the payments will be changed to reflect the new rate and the same useful life.
 - Backstopping of pledges and receivables balances will decrease as the replacement funds are received. The loans will be charged interest for the period outstanding. If the Budgeted Rate changes, the interest payments will be changed to reflect the new rate. If it is determined that the funds will not be received, the school or department must do one of the following:

- (1) Immediately repay the funds.
- (2) Pay interest only for the first twelve months after completion of the project. Beginning in month thirteen, the balance will be amortized on an equal payment schedule over twenty-four months. If it is not determined until after thirty-six months after completion of the capital project that the pledges will not be received, the funds are due immediately.

5. AMORTIZATION SCHEDULE

- a. **PAYMENT** – The debt service payment starts one month following the month the asset is placed in service. For example, if a project is completed during May, the debt service payment will start in June. The project will be charged capitalized interest in May based on April’s ending balance. In June, the project will begin amortizing based on May’s ending balance. For purchased equipment, the debt service payment starts in the month following the payment for that equipment.
- b. **INTEREST** – The Budgeted Pooled Interest Rate will be used to calculate the interest portion of the debt service payment. The interest rate may change during a fiscal year. Prior months’ interest expense will not normally be restated. The University reserves the right to make retroactive adjustments when required.
- c. **SCHEDULES** – There are two amortization schedules: fixed payment and fixed principal.
 - **Fixed payment** – Academic and auxiliary capital projects will be amortized on an equal monthly payment schedule over the life of the asset. If the interest rate changes, the payments will be changed to reflect the new rate. The principal component will increase over time as the interest component decreases.
 - **Fixed principal** – Service Center capital projects and all capital equipment purchases will be amortized on an equal principal payment schedule over the life of the asset. If the interest rate changes, the payments will be changed to reflect the new rate. While the interest component will fluctuate based on the pooled rate, the principal component will not change and be spread straight line, over the life of the asset.

6. ASSET CATEGORIES AND LIVES

The amortization of debt is based on the useful life of the asset. The following are the depreciable lives (amortization periods) by asset category:

<u>Asset Category (1)</u>	<u>Life</u>
Computer Equipment	3 years
Vehicles	4 years
Data Handling Equipment	5 years
Scientific/Technical Equipment	5 years
Standard Telecommunications Equipment	5 years
IT (Information Technology) Systems	7 years
General Purpose Equipment	10 years
Complex Telecommunications Equipment	10 years
Furniture	10 years
Modular Furniture	10 years
Shop Machinery and Tools	10 years

Dedicated Special Purpose Building Space	15 years
Electrical and Utility Control System	15 years
Storm Drains	15 years
Building Renovations, including component Replacements	20 years
Steam and Chilled Water Utility Distribution Systems	22 years
Domestic Water and Sanitary Sewer Pipelines	30 years
New Building Construction	30 years
Parking Structures and Lots	30 years
Steam and Chilled Water Utility Production Equipment	30 years
Electric and Signal Ducts	40 years
Major Structures (dams and reservoirs)	40 years

These amortization periods reflect an asset's expected useful life and are consistent with the University's depreciable lives (for financial reporting). For indirect cost recovery and financial reporting, academic buildings and land improvements are depreciated by components, but for debt amortization, composite lives are used.

For assets not shown, please call Capital Accounting.

7. CAPITAL EQUIPMENT FINANCING PROCEDURES

- a. **PTA (Project/Task/Award)** – The department contacts Capital Accounting to obtain the financing PTA to which the purchase is initially charged.
- b. **Purchasing Standard Requisition (STD)** – The department completes a Purchase Requisition.
- c. **Repayment** – The principal is amortized in equal installments, plus interest on the remaining balance. Interest on the loan starts when the invoice for the purchase is paid. Amortization of principal starts the first month after the equipment is purchased. The debt service payment, including both principal and interest, is automatically charged monthly to the PTA(s) designated by the department.
- d. **Reports** – The interest and principal charges are shown on the expenditure statement(s) for the applicable PTA(s).
- e. **Loan Closeout** – Charges to the departmental PTA(s) stop when the loan is paid off.