Financing of Purchases

Authority Approved by the Vice President for Business Affairs & Chief Financial Officer.

Summary This Guide Memo describes arrangements by which the University advances loans that are repaid over time to schools and departments to finance capital projects, programs or purchase equipment.

Section headings:

1. DEFINITIONS

a. "University financing" is an internal mechanism whereby the University makes an unsecured loan ("Internal Loan") to a school or department to finance capital projects, programs or purchase equipment and recovers the loan principal, plus interest, over the useful life of the asset by system generated journal entries from a PTA (Project/Task/Award) or PTAs identified by the department. The authorization to borrow is documented in a Funding Agreement for projects that are approved by the Board of Trustees (BOT) and in a Form 1 for other projects. While the asset is owned by the University, the school/department retains all ownership responsibilities, including recording the equipment purchase into the Sunflower Assets System as soon as it is received and in service.

b. "Amortization" also referred to as debt service, is the repayment of principal and/or interest over the term of an Internal Loan. For service centers, the principal component of debt amortization payments on a project is treated as a proxy for asset depreciation expense charges and is included in the service centers' rates as such. Interest is charged and principal balances are amortized based on the prior period's ending principal balance.

c. "Religious Use" means any use including services, meetings and any other activity conducted by or for a religious group or organization in a University facility.

d. "Private Use" generally means the use of tax-exempt-financed property in a trade or business by any person or entity other than the borrower, a 501(c)(3) affiliate of the borrower, or a state or local government entity, and use by the borrower [or any other 501 (c)(3) organization] in an "unrelated trade or business." The use does not have to result in unrelated business income to be considered private use. Private use examples may include but are not limited to: lease of university property to non-university entities; non-compliant management or service contracts (e.g., food service contracts); non-compliant corporate sponsored research agreements; naming rights arrangements with a private user.

e. "Substantial Completion" occurs when an asset is "placed-in-service." An asset is placed in service when one of the following conditions is met (in order of availability and importance):

(1) issuance of a Temporary Certificate of Occupancy (TCO),

(2) signed-off Permit, or

(3) certification by a Project Manager.

2. PURCHASES ELIGIBLE FOR DEBT FINANCING

Schools and departments may obtain Internal Loans for academic capital projects, capital equipment purchases, service center capital projects and capital equipment purchases, auxiliary projects and capital equipment purchases, bridge financing the receipt of gift pledges and receivables, and other University programs such as the Faculty Staff Housing Program.

Once an Internal Loan is approved, the Treasurer's Office and Capital Accounting determine whether the project is eligible for taxable, tax-exempt, or a mix of taxable and tax-exempt debt. If the Funding Agreement or Form 1 indicates that a capital project is designated for academic purposes and tax-exempt debt is allocated to the project, it is implied that there will not be a change in use throughout the life of the project. Penalties may be incurred if religious and/or private use take place in facilities financed with tax-exempt debt. The Treasurer's Office, the Tax Director or the Capital Accounting Bond/Tax Compliance Analyst in the Controllers' Office should be notified if religious and/or private use in a tax-exempt financed facility is contemplated at any time. Questions regarding Private Use or Religious Use can be directed to the Capital Accounting Bond/Tax Compliance Analyst.

3. APPROVALS

a. **University Approvals —** The Chief Financial Officer (CFO) or his/her designee is advised on debt allocations by a group consisting of representatives from the Provost's Office, Land Buildings and Real Estate (LBRE), and the Controller's Office. Certain allocations of debt may be subject to completion of a debt affordability analysis conducted by the Treasurer's Office and approval by the CFO. Financing of all capital projects requires an authorized Form 1 or, approval from the BOT and an executed Funding Agreement. Form 1 approval procedures are outlined on LBRE's Planning website at http://lbre.stanford.edu/cap_plan/. Guide Memo 83 (Capital Projects) provides guidance on capital projects.

   The BOT must review and approve increases in budgeted project costs for BOT level projects (a new building, expenditures exceed $10 million, material exterior renovation, or increased GUP square footage).

   Bridge financing of gift pledges for capital projects requires prior approval from the Provost and must be documented in a Funding Agreement. The Funding Agreement addresses financial responsibility during and after construction. See Section 4.f for information on the repayment of Internal Loans bridge financing the receipt of gifts.

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

b. **Capital Equipment Approvals -** Schools may require approval from the School Dean's Office before committing to finance a capital equipment purchase.

4. INTERNAL LOAN TERMS

The BOT approves University debt issuances and delegates responsibility to the CFO to issue debt in the capital markets and to advance Internal Loans to schools and departments. The organization responsible for servicing Internal Loans (Paying Organization) and funding sources must be identified at the time of approval and documented in a Form 1 or in a Funding Agreement. The Paying Organization will be responsible for monthly amortization payments (interest and principal) on an Internal Loan over the remaining useful life of the asset being financed. The CFO's Office is responsible for the repayment of external debt.

a. Budgeted Interest Rate (BIR) — The University accumulates, by project, in a single fund (Single Interest Fund) all interest expense and bond issuance costs ("Interest") from notes and bonds issued to finance capital projects and programs that support the academic mission of the University. The BIR is the weighted average rate of all Interest related expenditures, including administrative costs, over the projected outstanding debt of the University available for project/program loans during the same accounting period (generally the University's fiscal year). The BIR is charged to the outstanding unamortized Internal Loan principal balance. Notes and bonds or other debt issued to finance activities unrelated to the academic not for profit mission of the University, or issued to finance a specific asset are excluded from the BIR calculation.

b. Taxable Debt Premium - If, as a result of management decisions, the project funding structure requires taxable debt when tax-exempt debt would have otherwise been permitted, a 1.5% interest premium "Premium" will be assessed. The Premium will be calculated on the Internal Loan principal balance outstanding and charged directly to an operating account until the taxable debt is fully amortized. The 1.5% Premium is subject to change throughout the internal amortization period and cannot be capitalized.

c. Prepayment Penalty — The borrower may incur a prepayment penalty ("Penalty") equivalent to interest expense on the corresponding bond obligation, if debt requested for the project is reduced after the Form 1 or Funding Agreement has been executed.

d. Exceptions to the BIR — The BIR is not charged to projects for which construction is in progress (CIP). During CIP and until Substantial Completion, interest on Internal Loans is added to the loan principal balance outstanding and capitalized. During CIP, the interest rate charge is the effective monthly weighted average interest rate computed by Capital Accounting. The intent is to make the capitalized interest expense included in the cost of construction, an accurate component of the total cost of the building, which is then used to calculate depreciation expense for financial reporting.

e. BIR Calculation — Each year in December, or as needed for the general funds forecast, the Treasurer's Office in collaboration with the Capital Accounting group develop a BIR forecast for next fiscal year's budget.

During the course of the fiscal year, the Capital Accounting group compares the effective BIR with the approved BIR. The CFO determines if the variance between effective and approved BIR requires an interim adjustment. In the event of a mid-year reset, the prior months' interest expense will not be restated.

f. Amortization of Internal Loans — In the month following Substantial Completion of a capital project, installation of capital equipment, or the drawdown of an Internal Loan for a program, the Capital Accounting group assesses the BIR on Internal Loans principal balances outstanding and collects principal amortization. Amortization proceeds are deposited in the recycling pool and used for certain Internal Loans.

- Debt service on projects financed with tax-exempt debt must be funded with current operating revenue. The Paying Organization must provide an operating account PTA to be included in the Form 1 or Funding Agreement.
- Projects that are assets for academic facilities and auxiliary programs amortize on monthly level payments (principal payments increase and interest decrease) over the remaining life of the asset or program. Monthly payments are adjusted to reflect changes in the BIR.
- Service Center fixed assets and capital equipment purchases amortize on a fixed principal payment schedule (straight-line amortization) over the remaining useful life of the asset. Straight-line amortization is used because the principal amortization component matches the asset's financial depreciation expense, which is included in service center rates. Monthly payments are adjusted to reflect changes in the BIR.

- Internal Loans bridge financing the receipt of gift pledges are charged interest monthly on the outstanding balance, and the balance is reduced as gifts are received. Interest payments are adjusted to reflect changes in the BIR. If, after Substantial Completion of a project, gifts have not been identified, do not have signed pledge agreements, or will not be received, the CFO will determine whether the school or department financially responsible for the Internal Loan must:
  (1) Immediately repay the funds, or
  (2) Pay interest only for the first 12 months after the project's Substantial Completion, and amortize the Internal Loan principal balance outstanding on a level payment schedule over 24 months starting in month thirteen.

  If 36 months have elapsed since the project's Substantial Completion and it is determined that pledges will not be received, the Internal Loan principal balance is immediately due and payable.

5. AMORTIZATION SCHEDULE

a. Payment — Debt service payments start one month following Substantial Completion. 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 (not included in a capital project), the debt service payment starts in the month following the payment for that equipment.

b. Interest — The BIR is used to calculate the interest portion of the debt service payments. The BIR may change during a fiscal year. Prior months' interest expense will not be restated. The University reserves the right to make retroactive adjustments to the BIR if required.

c. Schedules — There are two amortization schedules – level payment and fixed principal.

- **Level payment** — Internal Loans for academic and auxiliary capital projects are amortized on a monthly level payment schedule over the useful life of the asset being financed. Payments are adjusted to reflect changes in the BIR. The principal component increases over time as the interest component decreases.

- **Fixed principal** — Service Center capital projects and all capital equipment purchases are amortized on a fixed principal payment schedule over the life of the asset. Payments are adjusted to reflect changes in the BIR. The interest component fluctuates with the BIR, but the principal component remains the same and is charged straight line, over the useful life of the asset.

6. ASSET CATEGORIES AND LIVES

Amortization of Internal Loans is based on the lesser of the estimated useful life of the asset category or the actual useful life of the asset (e.g., asset disposal or sale). The following are amortization lives (amortization periods) listed by asset category:

Asset Category	Life
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

Asset Category	Life
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

Capital Improvements to a Leased space – lesser of the initial lease term or the asset's estimated useful life.

These amortization periods reflect specific assets' expected useful life and are generally consistent with the University's depreciable lives used for financial statements reporting. For indirect cost recovery and financial statement reporting, academic buildings and land improvements are depreciated by components, but for the amortization of Internal Loans, composite lives are used.

For assets not shown, or if asset life does not fall within the guidelines, please contact 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 —** Internal Loan principal balances are amortized in equal installments, plus interest, on the remaining balance. Interest on the loan is charged in the month following the invoice for the purchase is paid. Amortization of principal starts the first month after the equipment is purchased. Debt service payments, including both principal and interest, are automatically charged monthly to the PTA(s) designated by the department (in the requisition).

d. **Reports —** Interest and principal charges can be viewed on expenditure statement(s) for the applicable PTA(s).

e. **Loan Closeout —** Charges to a departmental PTA(s) stop when an Internal Loan is paid off.