

## Capital Projects and the Internal Bank Process

### Internal Bank Primary Functions

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). The Internal Bank manages about \$1.2B in assets as of June 30, 2022<sup>1</sup> from a combination of activities involving operating cash, bond proceeds, and loan payments.

The internal bank is governed primarily by Board policies<sup>2</sup>. The internal bank is the responsibility of the Vice President for Finance and Administration/CFO (VPFA) with oversight by the Provost and Executive Vice President (Provost).

### 10-Year Capital Forecast

OSU borrows money principally to support capital projects. A strategic general revenue bond issuance occurred in October 2020 for \$300 million to provide strategic flexibility during the pandemic and provide funding for expected needs within the 10-year capital forecast. The Board has adopted the Approval of Capital Projects<sup>3</sup> stage gate process, which is used for approval of identified funding sources, including bond proceeds. A portion of total cash and investments as of December 31, 2022, included \$285 million of unspent bond proceeds from taxable issuances. \$113 million of these unspent proceeds have not been approved by the Finance and Administration Committee for a specific project use. These funds are expected to be fully used in the 10-year forecast, which will be presented April 13-14, 2023, by the end of FY2027.

### Internal Bank Central Loan Program

The internal bank distributes funds for capital projects and strategic initiatives through a Central Loan Program.

The Central Loan Program can provide lending to departments or units for:

- Interim/bridge financing in anticipation of philanthropy or other external sources of funds.
- Financing options for projects with an identified internal/operations repayment source accompanied by an amortization schedule consistent with the useful life of the project.

There are two types of loans funded through the Internal Bank - temporary and permanent.

1. Temporary loans are used to provide funding on an as-needed basis during project construction or until secured pledges (gifts) are received from donors. Temporary loans pay monthly interest on the total balance outstanding based on cash payments made. Internal Bank funds are advanced, up to the maximum loan amount, as the project requires. Principal payments are typically not made on temporary loans with the exception where principal amounts are paid as gift funds are received from donors.
2. Permanent loans are used for asset purchases or when a construction project is substantially complete. Debt service payments on permanent loans to amortize the project's cost over the stated loan term are made on a semi-annual basis.

Loan rates vary by term of loan. Factors affecting length of term include projected payback timing and useful life of the asset being financed.

Current Rates as of July 2019 (reviewed annually per policy<sup>2</sup>)

Term	Annual Rate
Temporary: Construction/Gifts *	3.50%
Permanent: Term < 10 Years	3.50%
Permanent: Term > 10 Years	4.99%

\* Monthly interest charge on loan balance

<sup>1</sup> Internal Bank Annual Report

[https://leadership.oregonstate.edu/sites/leadership.oregonstate.edu/files/2023-01/fac-4c-fy2022\\_internal\\_bank\\_annual\\_report.pdf](https://leadership.oregonstate.edu/sites/leadership.oregonstate.edu/files/2023-01/fac-4c-fy2022_internal_bank_annual_report.pdf)

<sup>2</sup> Policies <https://fa.oregonstate.edu/controllers-unit/treasury/governance>

<sup>3</sup> Approval of Capital Projects

[https://leadership.oregonstate.edu/sites/leadership.oregonstate.edu/files/220527\\_amended\\_capital\\_projects\\_policy\\_corrected.pdf](https://leadership.oregonstate.edu/sites/leadership.oregonstate.edu/files/220527_amended_capital_projects_policy_corrected.pdf)

While the intention of the internal bank is to de-link loans from the University's external debt obligations and other financing sources, the borrower does need to be aware if there are compliance requirements determined by the type of funds being used to support the loan.

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 (The internal bank may build and maintain an Interest Rate Reserve to hedge future volatility in debt and investment markets.)

#### *Key Documents –*

- Project Agreement - Capital Planning and Development creates a Project Agreement (PA). The PA documents the scope of work, the project costs and source of funding commitments. The PA that includes reference to utilization of a central loan from the Internal Bank must document the repayment source to the Internal Bank. Treasury staff are required to sign-off on the PA confirming analysis and approval for use of Internal Bank funds.
- Internal Financing Agreement - All loans begin with an internal financing agreement (agreement). The agreement specifies the project, borrower, maximum loan amount, interest rate, loan term, and repayment amortization schedule (estimated for construction projects). Loan agreements are signed by the responsible budget authority of the debt paying entity and those who have delegated oversight over the internal bank.
- Amortization Schedule - The amortization schedule documents the periodic interest and principal payments over the life of repayment once the loan is considered "permanent".

#### **Other Financing**

Other forms of direct and indirect debt impact total debt capacity and affordability. Alternative forms of financing are considered part of the debt management oversight responsibility of the internal bank.

This includes but is not limited to:

- Leases
- Any debt instrument provided by a third-party credit providers
- Off-balance sheet financing structures
- Public Private Partnerships

#### *Internal Bank Initiatives –*

The Internal Bank's capacity for lending is limited. The Bank has to maintain sufficient liquidity and reserves for university operations which is a challenge in the current and forecasted environment.

- Annual Rate Review: PFM Financial Advisors is working with Treasury staff to evaluate the Internal Bank Central Loan Program lending rates. If a recommendation to change the rates is approved, stakeholders will be provided notice to allow for time to evaluate and discuss impacts to near-term projects.
- Oregon State University's Internal Bank began operating independently in FY2015. The opportunity to utilize funds received from internal loan repayments before the external debt payment is due is a primary key to the long-term success of using an internal bank. The development of a strategy counsel will be forthcoming, and more information will be provided as this new structure is developed.

<sup>1</sup> Internal Bank Annual Report

[https://leadership.oregonstate.edu/sites/leadership.oregonstate.edu/files/2023-01/fac-4c-fy2022\\_internal\\_bank\\_annual\\_report.pdf](https://leadership.oregonstate.edu/sites/leadership.oregonstate.edu/files/2023-01/fac-4c-fy2022_internal_bank_annual_report.pdf)

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