

Policy and Procedures Manual

SUBJECT: BUDGET AND FINANCE

Policy 202: CSUS Board Debt Management Policy

Board Policy

The Colorado State University System's Debt Management Policy (Debt Policy) establishes guidelines for the prudent use and management of debt for the CSUS, including the recognition of the CSUS's consolidated revenue pledge.

Debt financing is a source of funding that allows the CSUS to finance the cost of capital improvements for one of its component institutions over a period of time typically related to the useful life of the asset.

The CSUS may use debt financing for academic, administrative, and auxiliary facilities and equipment, as well as any other infrastructure needs or property acquisitions, that are consistent with the CSUS's strategic priorities and part of the CSUS's capital plans. Decisions regarding the appropriate use of debt should be balanced to ensure the CSUS's financial health – as well as the financial health of its component institutions - while also considering the effects of current decisions on future costs of capital and operating budgets. Adherence to the following policies will ensure that risks associated with debt issuance are effectively managed.

Procedures

A. Affordability

1. When issuing debt, the CSUS will seek the lowest-cost source of funding available commensurate with the most favorable financial terms, conditions, and risks that are consistent with the CSUS's capital structure and financing requirements.
2. External borrowings will be coordinated to the extent practicable so that multiple project needs can be accomplished in a single borrowing, thereby reducing issuance costs.
3. The CSUS will consider credit enhancement, such as bond insurance, letters of credit or the Colorado Higher Education Intercept Program, when it is cost beneficial to do so and/or results in more favorable loan covenants.
4. All debt-financed projects must have an identified revenue stream (or cost reduction) and must be supported by an achievable plan of finance that includes servicing the debt and meeting any new or increased operating costs.

5. The cost of debt-financed capital acquisitions should be charged to the future users of the capital asset over the period the debt is outstanding and the asset's useful life (as legally permitted). The CSUS may, however, issue debt for a term shorter than the asset's useful life.
6. All debt payments will be provided for in the annual operating budget.

B. Debt Structure

1. In general, fixed-rate debt will be utilized. However, the CSUS may utilize variable-rate debt when appropriate for a particular financing plan, taking into consideration bond market conditions, the CSUS's liquidity position, and risks associated with variable rate debt (including interest rate risk, remarketing risk and liquidity renewal risk)
2. The financing mode, term, and financing instrument must be appropriate for the project(s) financed. Given the CSUS's credit consolidation efforts, the master revenue bond resolution is intended to be the primary debt issuance vehicle, however, certificates of participation, commercial paper, and separately secured bonds may be issued if the Board deems such issuance to be in the CSUS's best interest.
3. The use of capitalized interest will only be considered for projects whose identified funding stream will not be able to immediately generate sufficient revenues to repay debt. In those instances, interest will not be capitalized for a period in excess of the construction period plus three months.
4. The CSUS's debt capacity will be determined from time to time, recognizing it is a subjective measure. Consideration should be given to bond rating agencies and related industry guidelines; however, the CSUS does not manage its debt portfolio to achieve a specific rating. The CSUS recognizes that strategy and mission must be the primary drivers of its use of debt.
5. The CSUS shall evaluate, on a case by case basis, whether to utilize the Colorado Higher Education Intercept Program (or any successor programs) to provide credit enhancement to the CSUS's transaction.

C. Risk Management

1. The CSUS will consider refinancing outstanding debt only when savings for the refinancing, measured on a net present value basis, are positive, or when the refinancing accomplishes other strategic objectives including budgetary relief or reducing or eliminating future risks.
2. The CSUS will not default on its bond covenants and obligations. Meeting debt service obligations will be prioritized over competing budgetary needs of the CSUS and institutions, including the use of reallocations and reductions when required.

3. Financial covenants and restrictions will be minimized to the extent possible, taking into consideration the long-term capital requirements of the CSUS.
4. The CSUS's cash flow procedures will be managed to ensure the timely payment of debt service.
5. Compliance with debt reporting and financial covenants will be closely monitored and adhered to by the Chief Financial Officer with validation by external auditors. The CSUS utilizes a post-issuance securities compliance firm to file and disseminate information provided by the CSUS in connection with its continuing disclosure agreements to investors. The CSUS may engage or appoint alternative agents to assist in satisfying its continuing disclosure requirements.
6. The following risks should be assessed before issuing debt:
 - a. Change in Public/Private Use
The change in the public/private use of a project that is funded by tax-exempt funds could potentially cause a debt issue to become taxable.
 - b. Default Risk
The risk that revenues for debt service payments are not all received by the due date.
 - c. Liquidity Risk
The risk that the CSUS will not be able to meet its current and future cash flow and collateral needs, both expected and unexpected, without materially affecting its daily operations or overall financial condition.
 - d. Interest Rate Risk
For variable rate debt, the risk that interest rates will rise, on a sustained basis, above levels that would have been set if the issue had been fixed.

D. Financing Procedures

1. The Chief Financial Officer (CFO) of the CSUS will have responsibility for any debt financing and issuances of debt and will coordinate all related activities with the campuses.
2. The Office of General Counsel has responsibility for all legal actions relating to any debt financing, including reviewing all documents and legal opinions, and determining the role of external legal counsel.
3. The campus responsible for a proposed project will provide the Chief Financial Officer of the CSUS the following information:
 - a. Total project cost.

- b. For auxiliary supported projects:
 - i. At a minimum, a 10-year pro-forma showing all available revenues, expenses, and net revenues available to pay debt service.
 - ii. A coverage ratio calculation within the Pro-forma applied to each project whereby revenues for the project exceed expenses and debt payments by a minimum of twenty-five (1.25) percent. Campuses may propose a lower debt coverage ratio but at a minimum must meet a ten percent threshold (1.10) on average.
 - c. Project time schedule.
 - d. A statement or certification to the CFO that a program plan was developed and approved by the board as required by Colorado Commission on Higher Education or the Capital Development Committee.
 - e. Evidence of necessary approvals from the board, Colorado Commission on Higher Education, Capital Development Committee and when necessary the Joint Budget Committee before bonds may be issued for a project.
 - f. Other information, as requested.
- 4. The CSUS CFO in conjunction with the campuses will work with selected underwriters, financial advisors, bond counsel, and General Counsel to develop all necessary financial resolutions, policies, procedures, projections, and documents needed to successfully finance a project before the sale of bonds.
 - 5. The CFO of the CSUS in consultation with the campuses, General Counsel, and the Chancellor will determine the best timeline and process for the Board to approve all necessary financing documents.
 - 6. The Office of General Counsel will assure that all legal opinions, bond documents, disclosure documents and any other required legal materials are satisfactory.

E. Procedures and Approvals for Refinancing

- 1. The CFO will review any refinancing plan presented by the CSUS's underwriting team and/or its financial advisor and the assumptions upon which the plan is based, and determine whether it is in the best interests of the CSUS;
- 2. The CFO will work with departments affected by the refinancing to determine the best method for allocating savings.

F. Procedures and Approvals for All Financings

1. The CFO will assure that any issuance of debt is structured cost effectively and in the best interest of the CSUS, taking into consideration the Debt Management Policy.
2. The Office of General Counsel will assure that all legal opinions, bond documents, disclosure documents and any other required legal materials are satisfactory.
3. The CFO, in consultation with the Office of General Counsel, will assure that all materials necessary for the Board to complete its review of the financing are provided to the Board in a timely manner.
4. The Board, upon a positive recommendation of the Finance Committee, will approve the bond purchase agreement and other financing documents.

G. Updates and Revisions

The CFO shall review this Debt Management Policy at least every three years and recommend any changes necessary to ensure that it continues to meet CSUS objectives. The policy should also be reviewed as soon as practicable in the event of the significant changes in/of financial personnel or following any material changes to the CSUS's credit rating.

H. Post Issuance Compliance

The Board of Governors of the Colorado State University System borrows through the issuance of tax-exempt bonds to finance acquisition and construction of, and improvements to, many of its facilities and other capital projects. Investors in tax-exempt bonds (which include bonds, Variable Rate Demand Notes and tax-exempt commercial paper notes) are willing to accept a lower coupon rate because interest earned on tax-exempt bonds is exempt from taxation. This exemption translates into a lower cost of capital for the University. Various requirements must be satisfied, however, for tax-exempt bonds to maintain their tax-exempt status.

This section explains the guidelines and practices that the CSUS follows to remain in compliance with rules and regulations relating to tax-exempt bonds. Compliance is required both upon the issuance of the bonds and during the post-issuance phase which extends through and beyond the life of the bonds. An exception to these Guidelines may only be authorized by the CSUS Post Issuance Compliance Coordinator, in consultation with the relevant University Post Issuance Compliance Coordinator and/or bond counsel based on a determination that such exception will not jeopardize the tax-exempt status of the applicable bond issue.

1. Roles, Responsibilities and Procedures

- a. CSUS Post Issuance Compliance Coordinator: The CSUS Post Issuance

Compliance Coordinator has primary responsibility on behalf of the CSUS for post-issuance compliance efforts. The CSUS Post Issuance Compliance Coordinator oversees the compliance program and monitors and ensures that compliance tasks are performed in an appropriate and timely manner. The CSUS Treasurer is designated as the CSUS Post Issuance Compliance Coordinator.

- b. University Post Issuance Compliance Coordinator: The University Post Issuance Compliance Coordinators have primary responsibility on behalf of Colorado State University or Colorado State University-Pueblo, as the case may be, for post-issuance compliance efforts for their campus. The University Post Issuance Compliance Coordinators oversee various aspects of the compliance program for their campus as they monitor and ensure that campus based compliance tasks are performed in an appropriate and timely manner. The University Post Issuance Compliance Coordinators will perform such tasks and provide such information as the CSUS Post Issuance Compliance Coordinator may request in support of the over-arching CSUS post-issuance compliance efforts. The University Post Issuance Compliance

Coordinator is to be designated by the President of each institution.

- c. School and Department Responsibilities: University or department senior finance officers have certain responsibilities with respect to capital projects and facilities financed with tax-exempt bonds. These individuals play a critical role in ensuring that their departments are in compliance with the Guidelines, and they are responsible for the accuracy and completeness of the information provided to their University Post Issuance Compliance Coordinator regarding the utilization of space. In addition, they are responsible for ensuring that their departments retain records for the appropriate timeframe. The Senior Finance Officers are designated by the respective University Post Issuance Compliance Coordinator.

2. Recordkeeping

The CSUS seeks to comply with regulatory record retention requirements. Good record retention and documentation provide evidence of compliance and is the foundation of a successful bond compliance program. The CSUS Office will also retain all records relating to debt transactions for as long as the debt is outstanding, plus three years after the final redemption date of the transaction.

3. Generally Accepted Accounting Principles (GAAP)

The CSUS and institutions will comply with the standard accounting practices adopted by the Financial Accounting Standards Board and the Governmental Accounting Standards Board when applicable. The CSUS

Post Issuance Compliance Coordinator shall establish operating procedures with respect to the maintenance of relevant records and shall oversee compliance with such operating procedures.

4. Arbitrage Compliance

Arbitrage arises when proceeds from a bond issue are invested and the yield on the investments is greater than the yield on the bonds. Negative arbitrage arises when the investment yield is less than the yield on the bonds. The Internal Revenue Code contains two separate sets of requirements relating to arbitrage, yield restriction and rebate, which must be satisfied to ensure that the bonds do not lose tax-exempt status.

a. Yield Restriction

The arbitrage rules generally prohibit proceeds of a bond issue from being invested in a yield in excess of the bond yield.

b. Rebate

Rebate—even if an exception to yield restriction applies, if arbitrage is earned on an issue, the excess earnings must be remitted to the U.S. Treasury Department unless an exception to rebate applies.

The CSUS's objective is to invest bond proceeds to the bond yield or higher, while minimizing arbitrage rebates to the extent permissible by rebate exceptions. Negative arbitrage is to be avoided. The CSUS Post Issuance Compliance Coordinator works in conjunction with the University Post-Issuance Compliance Coordinators to establish operating procedures with respect to arbitrage investment limitations and rebate requirements on behalf of the CSUS. The CSUS Post Issuance Compliance Coordinator shall oversee compliance with such operating procedures to avoid any investment or rebate compliance errors.

5. Expenditures and Assets

The CSUS Post Issuance Compliance Coordinator will coordinate compliance for this area and in consultation with the University Post Issuance Compliance Officers, may designate individuals on each/any campus to assist in achieving and maintaining compliance.

6. Allocation of Proceeds

Allocation of bond proceeds to capital projects is an important element in the ongoing compliance effort. The default methodology used for making an allocation of bond proceeds is "specific tracing," meaning the proceeds are deemed to be spent on the expenditures to which they are traceable. The CSUS Post Issuance Compliance Coordinator will prepare or have prepared

an allocation certificate to memorialize the expenditure of bond proceeds (and other funding sources, if any) on relevant projects. The Compliance Coordinator reviews and updates fields as necessary on a regular basis, until the bond proceeds are fully allocated and all projects have been fully funded.

Typically, CSUS allocates equity or taxable debt to the portion of a project used for private use (if any exists), to minimize the private use of the bond, as documented in the allocation certificate.

7. Expenditure Policy

Applicable uses of CSUS debt are documented in the CSUS Finance Policy. Debt issuances must be approved by the Board of Governors.

8. Private Use

- a. Definition: Private Use (PU) means the use of bond-financed property in a trade or business by any person or entity other than the borrower, a tax exempt affiliate of the borrower or a state or local government entity or by the borrower for an unrelated trade or business. PU is measured separately for each outstanding bond issue and is limited to 10% for qualified bonds.
- b. Because bond issuance costs are considered to be PU, the allowable PU of bond-financed projects is reduced by the proceeds spent on issuance costs capped at 2%.
- c. Examples of Private Use:
 - Leases of university property to non-university entities
 - Noncompliant management or service contracts
 - Noncompliant sponsored research agreements
 - Unrelated trade or business use by borrower
 - Naming rights arrangements with a private user

Note: According to IRS regulations, activities are only PU if they are carried out in tax-exempt bond financed space.

d. Monitoring Private Use

- i. It is the CSUS's general policy that private use in tax-exempt financed facilities should be avoided. It is also the CSUS's current practice to finance capital projects with a layer of non-tax-exempt debt including CSUS funds or taxable debt where private use is expected to occur.
- ii. At the time of tax-exempt bond issuance, the CSUS Post Issuance Compliance Coordinator with the assistance of University Compliance Coordinators will assess and quantify any potential PU in capital projects and confirm that the equity contributions to the respective

projects will be sufficient to cover such PU. The CSUS Post Issuance Compliance Coordinator, in consultation with the University Post Issuance Compliance Coordinators, will establish a process for identifying and tracking existing PU for purposes of calculating, at least annually, the percentage of PU being conducted in bond financed projects per project and per bond issue.

- iii. The University Post Issuance Compliance Coordinators, in consultation with the CSUS Post Issuance Compliance Coordinator will each establish a process for their campus to review and approve/reject proposals that would result in PU being carried on in a tax-exempt bond financed space. Full information must be gathered prior to such decision-making, including the details and location of the (proposed) activity, the financing structures of the facilities in question, and information about other potential PU in those facilities. PU activity may be approved by the CSUS Post Issuance Compliance Coordinator only if:
- The capital project has enough equity (i.e., non-tax- exempt debt) to allow the potential PU to be fully allocable to equity.
 - Any allocation of potential PU to equity must not use up a majority of the equity funding available for that project.

e. Remedial Action

Each University department using tax-exempt debt is responsible for notifying the University Post Issuance Compliance Coordinator, or designee, before there is a change in use of the project or facility financed with tax-exempt debt. In the event such a change in use may result in excessive PU for a bond issue, the CSUS may avail itself of rules under Treasury Regulation section 1.141-12 which provide for “remedial action” by redemption or defeasance of nonqualified bonds. Remedial action, when properly taken, preserves the tax exemption of interest on the bonds. Failure to meet remedial action may result in significant penalties which will be borne by the University or department.

In limited circumstances, remedial action may be taken by applying disposition proceeds to other qualifying capital expenditures.

The CSUS will seek the advice of borrower and/or bond counsel in the event remedial action may be required. To the extent a potential violation of PU rules arises that cannot be corrected through remedial action, or in the event of a potential arbitrage violation, the System will seek the advice

of borrower and/or bond counsel concerning its alternatives, which may include approaching the Internal Revenue Service under the voluntary closing agreement program (VCAP).

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