UNIVERSITY OF KENTUCKY
AND AFFILIATED CORPORATIONS

INTERNAL LOAN PROGRAM POLICY

Amended April 9, 2019

University of Kentucky
University of Kentucky Research Foundation
University of Kentucky Gluck Equine Research Foundation, Inc.
University of Kentucky Humanities Foundation, Inc.
University of Kentucky Mining Engineering Foundation, Inc.

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I. Overview and Allowable Loan Structures

This policy establishes guidelines and procedures for University units to borrow money from the University's operating funds investment pool to finance certain projects or operations through an internal loan, cash advance, or a working capital line of credit, based on the intended use of funds.

This policy is administered by the Debt Management Committee, as defined in the Debt Policy. The Debt Management Committee generally meets at least twice a year to review the University's internal and external debt capacity, liquidity measures and projects requested to be funded in whole or in part with debt.

Internal Loans

An internal loan can provide an alternate source of funding for a project when external debt is not available or when there is a gap between the receipt of funds, such as a gift or grant, and the date of acquisition or construction of a project. The life of an internal loan generally ranges from one year to ten years; however see the ***Maximum Loan Term*** section for more information. University Financial Services will be responsible for tracking the approved internal loans.

Working Capital Lines of Credit

A working capital line of credit can be established for self-supporting units to cash flow operations. Lines of credit shall be secured by investments that can be liquidated within 90 days, such as a quasi-endowment. The total amount of the working capital line of credit cannot exceed 80 percent of the market value of the secured investment at the time of the advance. University Financial Services will be responsible for tracking the approved working capital lines of credit.

Cash Advances

The University may advance cash to self-supporting units for capital projects or operations for any length of time provided the self-supporting unit maintains an overall positive fund balance. If the self-supporting unit has an overall negative fund balance, then the cash advance may not exceed 90 days. All cash advances must be approved by the Executive Vice President for Finance and Administration and the Provost or Executive Vice President for Health Affairs, if applicable. The University Budget Office will be responsible for tracking the approved cash advances.

Self-supporting units with an overall negative fund balance must re-classify any approved cash advance as an internal loan or as a working capital line of credit, based on the use of funds, if the advance exceeds 90 days. Cash advances reclassified as internal loans or working capital lines of credit are subject to this policy.

II. Interest Rate

The University will charge an interest rate for loans based on the projected rate of forgone earnings on the funds loaned. The interest rate will be based on the University's projected total returns for the cash provided based on the duration of the loan as follows:

Term of Loan	Rate
0 to < 5 years	Based on the overall Tier III, Short/Intermediate Investments, as defined in the Operating Fund Investment Policy
5 to < 10 years	Based on the overall Tier III, Intermediate/Long-Term Investments, as defined in the Operating Fund Investment Policy
10 or more years	Based on the University's external cost of capital

The University may collect amounts to pay for costs of managing the debt portfolio in addition to charging the borrower interest. These costs will be clearly articulated at loan origination and will be passed on to the borrower in the form of a rate surcharge and/or an upfront fee for loan origination. The surcharge may also include a reserve for interest rate stabilization purposes. The Debt Management Committee may review and adjust these periodically as needed.

On or about April 1st of each year, the Debt Management Committee will meet to review and approve the interest rates to be used for the upcoming fiscal year. The Committee may adjust the interest rates at any time during the fiscal year if the projected Operating Fund Investment Tier earnings projections change due to market conditions or if there are changes in the University's overall external cost of capital. The interest rate on all outstanding internal loans will be reset annually based on the most current projected earnings.

Loans originating prior to March 1, 2017 will be charged interest under the prior policy. The interest rate will be based on the two-year treasury note plus 100 basis points (1 percent), determined each March 1st and effective for the following fiscal year.

III. Memorandum of Agreement, Loan Application Process and Approvals

Memorandum of Agreement

An executed Memorandum of Agreement ("MOA") is required for all borrowing requests. Prior to the transfer of funds, an MOA shall be executed by the Executive Vice President for Finance and Administration and the Provost or Executive Vice President for Health Affairs, if applicable. The agreement shall identify the debt service fund source, formal repayment schedule, interest rate, specified term and in the case of working capital lines of credit the MOA shall identify the secured investments.

Maximum Amount Eligible for Internal Loans

Any borrowings from the University's operating funds investment pool may not compromise the operating liquidity of the University. When evaluating an internal loan, University Financial Services will determine the impact of the proposed loan on the overall credit rating and liquidity of the University.

On or about April 1st of each year, the Debt Management Committee will set preliminary guidelines as to the maximum internal loan capacity of the University for the upcoming fiscal year.

When setting the guidelines, the Debt Management Committee will consider the monthly days cash on hand as well as the overall leverage of the University. On or about November 1st of each year, the Debt Management Committee will set the final maximum internal loan capacity guidelines for the current fiscal year.

The aggregate of outstanding internal loans will be continuously monitored by University Financial Services and should not exceed 15 percent of the University's operating funds investment pool based on the average of the trailing twelve months balances.

Maximum Loan Term

The Debt Management Committee will consider the nature and life of the asset and attempt to match the life and cash flow structure with the term of the loan. The term for an internal loan cannot exceed 75 percent of the estimated useful life of the asset or 20 years, whichever is less.

Loan Application and Approval

All internal loan and working capital line of credit requests shall be submitted to the Debt Management Committee for review and approval. Each internal loan and working capital line of credit must receive majority approval from the Committee. Internal loans greater than $1,000,000 shall be submitted for approval by the Board of Trustees through the Office of the President.

The University's overall liquidity and financial leverage will be considered when a request is reviewed in addition to the attributes of the individual project to be financed such as the present value of the projected cash flows.

To apply for a loan, University units must submit the following to University Financial Services: (1) a completed loan application, (2) a projected plan and (3) a schedule of cash flows for the project. All applications must be approved by the unit's executive vice president or the Provost.

The project plan should include project costs, including incremental operating expenses and revenues. Incremental revenues include revenue increases directly associated with the project (e.g. usage fees) that can only be realized if the project is undertaken. Similarly, incremental expenses include any increase in estimated operating costs associated with the project. Revenues and costs savings should be estimated conservatively, especially for high risk projects. The net present value of each project will be calculated by summing the discounted value of the annual net project cash flows over the life of the project.

IV. Policy Review and Approval of Exceptions

The Internal Loan Program Policy should be reviewed at least annually by the Debt Management Committee in conjunction with review of the Debt Policy.

Exceptions to this policy must be approved by the President based on a recommendation from the Debt Management Committee.