UNIVERSITY OF KENTUCKY AND AFFILIATED CORPORATIONS

INTERNAL LOAN PROGRAM POLICY

Amended April 19, 2022

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 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 capital 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. University units can request an internal loan to help support internal operations through the Innovation Pilot Program ("IPP")[1]. Advances from the IPP will be limited to supporting innovative initiatives furthering the mission of the unit and the University. 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. If the self-supporting unit has an overall negative fund balance, then the cash advance may not exceed 90 days. For self-supporting units maintaining an overall positive fund balance, see the ***Maximum Loan Term*** section for more information on term lengths. 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.

[1] On September 28, 2021, upon recommendation from the Debt Management Committee, the President approved an exception to the then published Internal Loan Program Policy to establish a $25,000,000 Innovation Pilot Program within the internal loan pool.

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:

Capital Project Internal Loans, Cash Advances and Working Capital Lines of Credit

Term of Loan	Rate
0 to < 5 years	Based on the overall Tier III, Short/Intermediate Term 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

Innovation Pilot Program

Term of Loan	Rate
0 to < 5 years	The 0 to < 5 years rate for capital project internal loans, cash advances and working capital lines of credit
5 to < 6 years	The 0 to < 5 years rate for capital project internal loans, cash advances and working capital lines of credit plus 50 basis points (0.5 percent)
6 to < 7 years	The 0 to < 5 years rate for capital project internal loans, cash advances and working capital lines of credit plus 100 basis points (1 percent)
7 years	The 0 to < 5 years rate for capital project internal loans, cash advances and working capital lines of credit plus 150 basis points (1.5 percent)

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 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 Innovation Pilot Program pool, within the internal loan pool, is limited to a maximum outstanding balance of $25,000,000 with no internal loan exceeding $5,000,000.

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 and cash advance for capital purposes cannot exceed 75 percent of the estimated useful life of the asset or 20 years, whichever is less. The term for a cash advance for operations and a working capital line of credit will be determined at the time of initiation based on funding need, duration, budgetary constraints and other financial considerations. The term of IPP internal loans cannot exceed seven years.

Loan Approval

All internal loan and working capital line of credit requests must be approved by the Executive Vice President for Finance and Administration and the Provost or Executive Vice President for

Health Affairs, if applicable before being submitted to the Debt Management Committee for review and approval through University Financial Services. Each internal loan and working capital line of credit must receive majority approval from the Committee. Borrowings for capital projects 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 and project plan.

The project plan should include project costs, including incremental operating expenses and revenues as well as demonstrate the ability to repay the loan within the prescribed timeframe. 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 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.

V. Policy History

Revised: April 2022
Revised: April 2019
Original: May 2017[2]

[2] Prior to May 2017 the policies and procedures for the internal loan program were included in the Debt Policy.