UNIVERSITY BUDGET OFFICE
5801 SOUTH ELLIS AVENUE
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MEMORANDUM

From: Katrina Spencer, Associate Vice President of Finance and Budget Director
To: University of Chicago Unit Finance Leaders
Date: June 01, 2018

Subject: Funding for Capital Projects in the New University Budget Model

I. Purpose

The purpose of this memorandum is to provide budget and financial management leadership teams with additional information on using unit funds for capital projects in the new budget model. This does not impact the Space Cost Allocation Model, which is the allocation of depreciation and interest for previous capital projects. The new budget model envisioned that all capital projects would be paid for centrally and units would be charged depreciation and interest going forward. However, as we have worked to operationalize the overall model we have come to realize that this is not flexible enough to meet the needs of units across campus. To provide more flexibility, allow use of banked funds for capital, and to better align capital needs and capital funding, we have modified the process and funding sources for capital projects going forward. Funding for capital projects will be a hybrid of what was done previously (use of unit funds – including Banked Funds) and the new budget model structure (central funding with units paying ongoing depreciation and interest) for capital funding. As always, if you have questions please contact your budget analyst or email the Budget Office at budgetoffice@uchicago.edu.

II. Overview

As part of moving to the new budget model, it was intended that all capital projects would be paid for centrally and units would pay interest and depreciation for the useful life of the asset. While there are some strong reasons for this, and it will continue to be a valuable part of capital funding, this methodology is not flexible enough to meet all the needs of the University. In general, sources of funds available to units to fund capital projects include **(1) University (center) funds; (2) gifts made to a unit and restricted for the purpose of funding a specific capital project, (3) units' current year revenues, (4) banked funds or accumulated fund balances, and (5) any combination of funding types (1) through (4)**. Consistent with the new budget model, any capitalized assets funded with central sources will be capitalized and depreciated, with the units responsible for depreciation and other allocated space charges according to the University Space Cost Allocation Model. However, when units utilize their own current year revenues, unit banked funds, or accumulated balances for capital projects, the portion of the project funded by the unit will be transferred from the unit's account(s) to fund the project, resulting in an expense on the unit's operating statement in the period in which the transfer occurs. In subsequent periods, once the capitalized asset is in service, the unit will receive a space credit equal to the original amount expensed to the unit divided by the useful life of the asset. In essence, the unit will not pay depreciation or interest if they paid the initial capital expense. The maximum amount of space credit that the unit may receive in any given period is 100% of the depreciation and interest charges for the capitalized asset in that period.

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III. Background

Prior to FY18, under the Operating Budget Summary (OBS) model, capital projects were funded centrally in ledger 8 capital accounts. If a unit wanted to move funds to the capital ledger, they would charge the subaccount "Transfers to Ledger 8." This transfer was the only impact to the unit's operating budget and was incurred as an expense in the period in which the transfer was completed. The expense was reversed in the central budget, or Centrally Budget Items (CBI), so that on a University level, there was no immediate net impact to the operating budget. Once the capital project was completed and the asset went into service (which may be in future fiscal years), if the project was capitalized, annual depreciation costs were charged to CBI. If the project fell below the capital threshold, then it was fully expensed in CBI at the time of completion.

In the new Standard Budget Report (SBR) model all capital projects were to be funded centrally and any capitalized assets funded with central sources would be capitalized and depreciated. Specifically, centrally-funded capital projects would be funded in ledger 8 capital accounts. Any future depreciation charges would be distributed to the units using the Space Cost Allocation Model (see Budget Office Memorandum re: Space Cost Allocation Budget Model, dated March 16, 2018) and based on unit occupancy.

We will now allow each of these options, with a preference for units to use their own funds when possible for capital projects. Unit funded capital projects will not incur future depreciation or interest charges for units. Instead, units will incur an expense on their operating statements in the period in which unit funds are transferred to fund capital projects, and will receive credits in future periods against future depreciation and interest charges associated with those capital investments. Centrally funded projects will be capitalized, and units will be charged depreciation and interest in future periods. The manner in which units are charged depreciation or receive a credit depends on the sources of funds (central vs. unit funded).

IV. Example Capital Transactions Using Unit Funds

Below are examples of each of the funding scenarios described above for capital projects to provide additional clarity for units that are considering using their own sources of funds for capital investments.

(1) For **University (center) funded capital projects**, the initial project expenses are funded by the University and are capitalized as an asset. The unit is charged annual depreciation over the useful life of the asset. The Budget Office allocates depreciation to units based on the % occupancy (%NASF) of units occupying spaces in buildings that benefit from the capital project. The unit must budget for these annual depreciation and interest expenses within their annual operating budgets.

(2) **Gifts directed to a unit and restricted for the funding of a capital project** are treated as "gifts matched to depreciation" for accounting purposes. For these types of funded projects, the University recognizes the initial gift as deferred revenue, and once the capital asset goes into service, the appropriate amount of depreciation and interest will be allocated to a unit's

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space charges on an annual basis. Simultaneous to the depreciation and interest recognition, a pro-rata amount of the gift funds will be allocated to the unit as other operating income, and effectively offsets the depreciation and interest charges from a unit operating budget perspective. This has no net impact on the unit's operating statement.

(3) If a unit wishes to use **current year revenues** that it has raised to fund a capital project, and it has sufficient current year revenues to fund the entire cost of that capital project, then the unit may fund the project outright. In this situation, the unit transfers the amount for the project from the unit's operating account to a Ledger 8 central account, and the transfer is recognized on the unit's annual operating statement as an expense in the period in which the transfer occurs. After the completion of the project and the asset is in service, when the University begins recognizing depreciation and interest expenses on that asset, the unit will receive a space credit for the portion of the project funded by unit revenues that was previously expensed. The amount of space credit the unit will receive will be equal to the original amount expensed to the unit divided by the useful life of the asset. The maximum amount of space credit that the unit may receive in any given period is 100% of the depreciation and interest charges for the capitalized asset in that period.

(4) To use **banked funds or accumulated fund balances** for a capital project, a unit must submit a request to the Budget Office that identifies the amounts and types of banked fund (restricted, unrestricted, endowment) intended to be used as funding sources. Funds identified must not be restricted from use for capital projects. In general, banked funds available for capital projects will be the unit's unrestricted bank balance. When banked or accumulated fund balances are used for capital projects, those funds effectively function the same as current year revenues in that the unit is charged an expense for the initial costs of the project by way of a transfer to a ledger 8 central account. When the funding for the capital project is transferred, the unit recognizes the expense in the period in which the transfer occurs. (This will result in an end-of-year net loss and counted against banked balances.) After the completion of the project and the asset is in service, when the University begins recognizing depreciation expense on that asset, the unit will receive a space credit for the portion of the project funded by unit banked or accumulated fund balances and previously expensed. The amount of space credit the unit will receive will be equal to the original amount expensed to the unit divided by the useful life of the asset. The maximum amount of space credit that the unit may receive in any given period is 100% of the depreciation and interest charges for the capitalized asset in that period.

(5) If a unit desires to use multiple funding sources for a capital project it may do so. Each component of funding determines the impact to the unit's future depreciation and interest expenses and any space credits as described above. Two scenarios are provided below to illustrate how this may occur:

   a. A unit wants to use $2M of banked funds and $3M of unit current year revenues for a $5M capital project. In this instance, assuming the project is approved, and the unit has been authorized to utilize banked funds as a source, the unit transfers $3M of current year revenues for the project from the unit operating account to a ledger 8 central account, and an additional $2M of banked funds would also be transferred to a ledger 8 central account to fund the $5M project expense. The transfers to ledger 8 are recognized as expenses on the unit's operating statement in the period in which they occur. This would result in a year-end net loss to the unit and go against banked balances. After the completion of the project and the asset is in service, when the University begins recognizing depreciation and interest expenses on that asset, the unit will receive a space credit for the entire cost of the project previously expensed. The amount of space credit the unit will receive will be equal to the original amount expensed to the unit divided by the useful life of the asset. The maximum amount of space credit that the unit may receive in any given period is 100% of the depreciation and interest charges for the capitalized asset in that period.

b. A unit received a $2M gift designated for a capital project. The unit plans to use the $2M gift, $1M of unit current year revenues, and $3M of central University funds for a $6M capital project. In this case, assuming the project is approved, the unit transfers $1M of current year revenues for the project from the unit operating account to a Ledger 8 central account, and the University funds $3M. In addition, the $2M gift funds directed for the purpose of this capital project are utilized for initial capital project expenses. The total expense of $6M is capitalized as a University asset, and the unit is charged 100% of the depreciation – the annual depreciation and interest charges will be offset by both the portion of the asset funded with the $2M gift designated for this capital project and a space credit for the portion of the asset funded with $1M of the unit's revenues, effectively meaning the unit would be charged 1/2 of the annual depreciation and interest charges in their annual operating budget.

V. Frequently Asked Questions (FAQs)

1) Does this memo change the capital request process?

No. This memo is provided to the units for informational purposes only and is intended to explain capital funding sources and uses and their associated impacts to units' operating budgets under the new University budget model.

2) What if a unit wishes to use other types of funds not described above such as grant funding for capital projects?

This memo describes the most common scenarios and the sources of funds typically available to units for capital investments. For funding sources not described above, the specific accounting treatment will be determined on a case-by-case basis in accordance with the University's capital asset accounting policies.

3) Does this impact the Space Cost Allocation Model and what we will pay for depreciation and interest in FY19?

No.

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4) **How does this impact the use of banked funds?**
Units may use banked funds for capital as described in the memo above, but units are not limited to using banked funds for capital projects. Banked funds may be used for other purposes as described in the Budget Office Memorandum re: Internal Bank Operations and FY18 Balances, dated April 25, 2018.

5) **What about other facilities or infrastructure-related projects (maintenance, construction, renovation, interior redesign, etc.) that do not meet the accounting definition of a capital project – can we still used banked funds or unit funds for these purposes?**
Yes. However, requests for all such facilities or infrastructure-related projects must be made through the University capital project request process and be reviewed and approved by Facilities Services, regardless of whether the project meets the capitalization threshold described in University Policy *1004.1 Capitalization Policy: Land, Buildings, Equipment, and Books*. If banked funds are to be used for any of these types of projects, the use of banked funds must be requested through the Budget Office by submitting a Use of Banked Funds Request Form (see Budget Office Memorandum re: Internal Bank Operations and FY18 Balances, dated April 25, 2018.) As always, if you have questions related to a specific project request or anything else related to the use of banked funds, please contact your Budget Analyst or email the budget office at budgetoffice@uchicago.edu.