

**BOARD OF GOVERNORS
STATE UNIVERSITY SYSTEM OF FLORIDA
Project Summary
University of South Florida
Medical Faculty Office Building**

Project Description: The University is planning to construct a 100,000 square foot medical faculty office building (the "Project") for the USF Physicians Group (the "Physicians Group") on the Tampa campus of the University to provide faculty and administrative office space for the College of Medicine.

The Project is included in the University Campus Master Plan.

Facility Site Location: The Project will be located at the northeast corner of USF Holly and USF Laurel Drives in the northwest quadrant of the campus adjacent to the Center for Advanced Health Care (the "CAHC") which is presently under construction.

Projected Start and Opening Date: It is anticipated that construction of the Project will commence in September 2007 and will be available for occupancy in May 2009.

Demand/Need Analysis: The Physicians Group currently leases 41,000 square feet of space in a private, off-campus facility which will not support anticipated growth. The new 100,000 sq. ft. facility will provide offices and support functions for planned growth of the College of Medicine and physicians, faculty and staff working in the CAHC. Additionally, the University has performed an analysis indicating that it is cost beneficial to construct and own the building for the Physicians Group rather than lease.

Project Cost and Financing Structure: Project construction cost is expected to be \$21.4 million. Additionally, the financing includes \$1.4 million to fund capitalized interest during the 21 month construction period through May 2009.

The Project will be financed by the USF Financing Corporation (the "Corporation") through the issuance of tax-exempt Certificates of Participation in an amount not to exceed \$26,000,000 (the "Certificates"). The financing will be structured as level debt with a 30-year final maturity, with the first principal payment occurring

in July 2009 and the final maturity in July 2037. There will not be a debt service reserve fund.

The Certificates will be issued with a variable rate of interest with mandatory amortizations. The Corporation plans to use an interest rate swap agreement to create a synthetic fixed rate on the debt (see "Variable Rate Debt" below). The Corporation's outstanding Certificates of Participation Series 2006A were also issued as variable rate debt and converted to a synthetic fixed rate with an interest rate swap.

Security/Lien Structure: The Certificates will be issued on parity with the Corporation's Certificates of Participation Series 2006A outstanding in the amount of \$47,315,000. Debt service on the Certificates will be secured by a senior lien on lease payments received from a lease of the Project to the University of South Florida Medical Services Support Corporation ("MSSC"). The lease payments will also be secured by a guarantee of the University Medical Service Association ("UMSA"). Together, MSSC and UMSA comprise the Physicians Group. In essence, therefore, it is the revenues of the Physicians Group which are securing debt service on the Certificates.

Pledged Revenues and Debt Service Coverage: The revenues of the Physicians Group consist primarily of revenues received from the treatment of patients and from grants, contracts and awards. Grants, contracts and awards cannot be pledged or used indirectly to pay debt service. Accordingly, the revenues and the expenses associated with grants, contracts and awards are excluded from an analysis of the Physicians Group's ability to pay debt service on the Certificates. Because the bonds are secured by a guarantee of the Physicians Group, all revenues (excluding contracts, grants and awards), and all expenses (excluding those associated with contracts, grants and awards) must be examined to assess the ability of the Physicians Group to pay debt service.

Net patient service revenues grew 37% over the historical five-year period from 2003 through 2007 with wide differences in the annual growth rates from a high of 21.6% in 2005 to an estimated approximate 1% growth in 2007. The variance in net patient service revenues reflects periodic changes in the composition of the Physicians Group and negotiations of payment contracts with Federal and private medical benefit providers. Over the same period operating expenses excluding those related to contract and grant activities increased 38% primarily due to a significant

increase in staff salaries in 2006. Tiber Group/Navigant Consulting and NBBJ prepared a comprehensive study for the University which analyzes the existing and potential demand for health care services which would be provided by the Physicians Group. Financial projections included in the study provided the University with the basis for using a 5% growth for projecting net patient service revenues. The study also considered the impact of incorporating diagnostic capabilities within clinics constructed with 2006 Certificate proceeds and developed revenue forecasts which the University included in the revenue projections provided. The projections show a total revenue growth of 10% in 2008 and 12% in 2009 before settling to an annual growth rate of approximately 5% for 2010 through 2012. Operating expenses are expected to grow 8% in 2008 and 10% in 2009 as the new facilities become operational and then grow approximately 5% annually from 2010 through 2012.

For Fiscal Year 2008, projected revenues available to pay debt service after payment of other expenses will produce an estimated coverage of 3.87x because debt service payments include only interest on the 2006 Certificates of Participation. In 2009 through 2012, debt service coverage ranges from 1.66x to 2.02x, based on debt service for both the 2006A and 2007A Certificates of Participation. University staff has indicated that the Physicians Group will provide for debt service prior to other expenses; and the Physicians Group intends to maintain an investment balance of \$40 to \$50 million which can be used for debt service if necessary.

Debt service coverage has been based on current fixed swap rates for the 2006A Certificates and an assumed true interest fixed rates cost of 4.70% for the proposed Certificates. (Current estimates are that the fixed swap rates that can be expected are approximately 3.75% based on the 10-year swap rate; the fixed rate for the proposed certificates of 4.70% is for a 30-year term.)

(See Attachment 2 for a table of historical and projected pledged revenues and debt service coverage, which are based on information supplied by the University and the Corporation).

Variable Rate Debt:

The Corporation is planning to issue all of the Certificates as variable rate debt obligations and to convert the financing to a synthetic fixed rate through an interest rate swap agreement. The Corporation believes issuing variable rate debt obligations with a synthetic swap for the entire amount versus issuing fixed rate debt

will save approximately \$1.4 million on a present value basis. The outstanding \$47 million 2006A Certificates variable rate certificates have also been converted to fixed rate through the use of an interest rate swap agreement which will expire in 2015. Accordingly, 100% of the outstanding certificates of participation of the Corporation will be variable rate obligations converted to a fixed rate with the use of a swap agreement.

The University has prepared a debt management plan related to the issuance of the proposed Certificates as variable rate obligations. The purpose of the plan is to mitigate the liquidity and interest rate risks associated with the debt. The existing variable rate 2006A Certificates are, and the proposed Certificates will be, variable debt obligations which will provide the holders with the right to put the securities to the Corporation, thus creating potential liquidity risk. The Corporation plans to mitigate this risk with an irrevocable direct-pay letter of credit with a maturity of not less than five years and an automatic annual renewal provision for an additional year. This will effectively give the Corporation up to four years notice to secure another letter of credit or other form of guarantee in the event of a non-renewal. The Corporation will have the option to convert the Certificates to auction rate securities which would eliminate liquidity risk because bondholders would no longer have the ability to put the certificates back to the Corporation.

The Corporation will utilize an interest rate swap agreement to mitigate interest rate risk. Because the Corporation is using an interest rate swap, it has prepared a swap management plan addressing the risks involved, as discussed below.

The term of the interest rate swap agreement will be determined based on market conditions, but in no event for a period less than 10 years. If the term of the interest rate swap agreement does not extend through the maturity date of the underlying debt, then the interest rate applicable to the financing will change before the debt matures. This "rollover risk" subjects the Corporation to interest rate risk and possibly higher interest rates in the future on the Certificates and the outstanding variable rate obligations which have been synthetically fixed with a swap agreement. The Corporation's debt will revert to variable interest rate upon termination of the applicable swap agreement but could again be fixed, albeit at a potentially higher interest rate, with a subsequent swap agreement if desirable. Prior to the maturity of the existing \$47 million swap or the new swap associated with this financing,

the Corporation will make an assessment of its liquidity needs, system finances and market conditions and will most likely extend the maturing swap with a new swap contract. The Corporation or could alternatively permit all or a portion of the variable rate debt to remain unhedged. This would increase its exposure to interest rate risk to the extent that its investment balance is less than the amount of the variable rate debt. At issuance of the Certificates, the outstanding variable rate balance will be approximately \$73 million; the Physicians Group will maintain an investment balance of \$40 to \$50 million.

The Corporation has also addressed the risk that a termination of the swap agreement could require it to make a termination payment if fixed swap rates are lower at the time of termination than the fixed rate it is paying to the counterparty under the agreement. For this to occur fixed swap rates would have to decline from the current level of 3.75% which the Corporation estimates it will have to pay on a swap. In the event that the Corporation would be required to make a termination payment, it has estimated that fixed swap interest rates would have to decline 100 basis points to approximately 2.75% to require a payment of approximately \$1.2 million for the entire \$26 million amount of the new swap agreement. In this event, the Corporation would use cash balances (estimated to remain between \$40 and \$50 million) to accommodate the payment. The amount of the estimated termination payment declines gradually over time, depending upon general market interest rates, as the amount of the swap declines. It is important to recognize that only the University has the sole right to terminate the swap agreement, except in cases of counterparty default. One example of an event of default would be if the counterparty's credit rating declined from AA- to less than A. In that event, the counterparty would be required to post collateral as its rating declines, thereby protecting the Corporation in the event a termination payment would be owed by the counterparty. Therefore, for the most part, the University controls when it would have to make a termination payment.

The difference between the variable rate payment the Corporation would receive from the swap counterparty and the actual rates it will have to pay the certificate holders as set under the terms of the certificates is known as basis risk. The Corporation expects that this difference will be no more 9 basis points or approximately \$65,000 annually on both swaps and can be paid from cash flows. The Corporation is also addressing the tax risk associated with the

swap, that is, the impact to the Corporation from a change in the tax status of the certificates or a change in marginal tax rates, by entering into a swap transaction based upon the SIFMA (formerly BMA) index. With a SIFMA swap, any change in the tax status of the bonds will equally affect both the variable rate received from the swap and the variable rate paid on the bonds.

In its swap management plan, the University states that it will use different counterparties to diversify its counterparty exposure and will require that counterparties be rated at least AA-. The risk that a counterparty will default and leave the issuer exposed to an unhedged variable rate position is mitigated by requirements for the posting of collateral with a custodian in certain conditions such as a decline in the counterparty's credit rating. In such a case, the collateral would be used to make the termination payment due the Corporation and a SWAP agreement executed with a new counterparty.

Finally, the University has used, and will continue, to use an independent swap advisor in the structuring and execution of a swap.

The University also actively manages its variable rate debt by monitoring interest rates on a continuous basis, budgeting conservatively high interest rates on variable rate debt, and maintaining fund balances in reserve to pay debt service, if needed.

Type of Sale:

The University provided an analysis of the most appropriate method of selling the certificates of participation (competitive versus negotiated) as required by the Debt Management Guidelines. The University is requesting approval for a negotiated sale of the certificates of participation. Because the Corporation is a relatively infrequent issuer and there is a lack of capital market awareness of the credit, the University believes the most cost effective financing is on a variable rate basis supported by a letter of credit. A negotiated sale is the best method for implementing a variable rate financing.

The Certificates will be sold pursuant to a negotiated sale with an underwriting firm that is a member of a team of underwriters selected in a competitive process in 2005.

**Analysis and
Recommendation:**

Staff of the Board of Governors and the Division of Bond Finance has reviewed the information provided by the University with respect to the request for Board of Governors approval for the subject financing. The projections of revenues provided by the University indicate that revenues of the Physicians Group will be sufficient to pay debt service and expenses of the Physicians Group. The projections were based upon information provided by Tiber Group/Navigant Consulting and NBBJ, feasibility consultants employed by the University. The Physicians Group has included an investment balance of \$40 to \$50 million as part of its finance plan to cover unexpected revenue shortfalls. Also, it appears that the proposed financing is in compliance with the Florida Statutes governing the issuance of university debt and the Board of Governors Debt Management Guidelines. Accordingly, staff of the Board of Governor's recommends adoption of the resolution authorizing the proposed financing.