

**BOARD OF GOVERNORS
STATE UNIVERSITY SYSTEM OF FLORIDA
Project Summary
University of Central Florida
Burnett Biomedical Sciences Building**

Project Description: The Burnett College of Biomedical Sciences Building project (the "Project") will be a 198,000 square foot multi-story building containing research laboratories, specialty laboratories, laboratory support and administration offices for the Burnett College of Biomedical Sciences. It is currently planned to build out four floors and shell in the fifth.

The Project is not required to be in the University Campus Master Plan because it will be constructed on land owned by the UCF Real Estate Foundation and subject to the City of Orlando permitting process. The cost of any required permits are included in the project cost.

Facility Site Location: The Burnett Biomedical Sciences Building will be located on the University Health Sciences campus at Lake Nona in southeast Orlando.

Projected Start and Opening Date: It is anticipated that construction of the Project will commence in June 2007 and will be available for occupancy in May 2009 with the building opening for the fall term of 2009.

Demand/Need Analysis: The Biomedical Sciences Building is intended to become an integral part of the University of Central Florida Health Science Campus at Lake Nona. It will be the first building constructed on the Lake Nona Campus, will provide educational and research facilities for the UCF College of Medicine, and will support other biomedical and clinical activities attracted by the medical college. Over time, it is anticipated that other health-related programs will be relocated to the Lake Nona Campus including nursing, physical therapy, health information systems, communicative disorders and radiological technology. The instructional and research initiatives of these health-related programs will benefit from interactions with one another and with the rapidly growing medical cluster also located nearby which includes the Burnham Institute and a possible hospital. The proposed building supports the university's mission, which places a heavy emphasis on research programs.

Beginning in fall 2009, only the students associated with the M.D. programs and the graduate biomedical programs will be located at the Lake Nona Campus. It is anticipated that the upper division students associated with nursing and various allied health programs will move from the UCF main campus to the Lake Nona site in Fiscal Year 2011 and Fiscal Year 2013, respectively. The campus FTE is projected to grow from 72 in 2009 to 3,756 in 2018.

**Project Cost and
Financing Structure:**

The Project construction cost is expected to be \$99 million. The Project will be funded with \$22 million of PECO moneys made available in fiscal years 2006 and 2007, \$10 million of donations and a corresponding \$10 million in Courtelis State matching funds, and \$57 million from tax-exempt bonds issued by the Corporation in an amount not to exceed \$60,000,000. Additionally, the financing includes \$2.7 million to fund capitalized interest during the first 12 months of construction through July 1, 2008. During the second year of construction, rather than financing capitalized interest, the interest payments for fiscal year 2009 will be paid from Pledged Revenues until the Project is occupied by biomedical research generating contract and grant revenue. The financing will be structured as level debt with principal payments starting in July 2010 and the 30-year final maturity in 2037. There will not be a debt service reserve fund.

The bonds will be issued as variable rate debt. The Corporation plans to use an interest rate swap agreement to create a synthetic fixed rate on the debt (see "Variable Rate Debt" below).

A \$7 million line of credit has been obtained and will be used to provide temporary financing in the event that donations and matching funds are not immediately available when needed to pay construction costs. To date, approximately \$13.8 million of the expected \$20 million of donations and matching funds have been received or appropriated by the legislature. The line of credit will be structured with a five year term, semiannual interest payments with principal due at maturity and will be secured by and repaid from donations and pledges. The Corporation and University Board of Trustees have authorized the interim financing.

Security/Lien Structure: The bonds will be secured by a lien of the indirect overhead cost portion of University contract and grant revenues ("Pledged Revenues") and the payment of debt service will be prior to any

other payments pursuant to a lease agreement between the University and the UCF Health Facilities Corporation (the "Corporation"). The Pledged Revenues are derived from contracts and grants related to University research activities. The fixed rate swap obligation will be on a parity with the variable rate bonds.

Pledged Revenues and Debt Service Coverage:

The indirect overhead cost component of a contract and grant award is based on the terms of the grant or contract and is a percentage of the total grant or contract (currently 10% for State grants and 43% for Federal grants). The indirect overhead cost payments are received over the life of the grant or contract as payments are received.

During the five year period from fiscal year 2001-02 to 2005-06, total contracts and grants awarded to the University ranged between a low of approximately \$75.2 million in fiscal year 2001-02 to a high of \$104.6 million in fiscal year 2005-06. Awards declined only once in that period in fiscal year 2003-04 to \$82.6 million from \$88.8 million in the prior year before two consecutive years of awards exceeding \$100 million. The contract and grant payments allocated to indirect overhead costs nearly doubled during the five-year period from approximately \$8.9 million in Fiscal year 2001-02 to approximately \$17.2 million in fiscal year 2005-06. Pro forma historical debt service coverage on total indirect overhead cost revenue would have ranged between 2.21x and 4.30x on \$4 million of annual debt service during the five-year period.

During the five year period from fiscal year 2006-07 to 2010-11, contract and grant awards are expected to increase to \$110 million for fiscal year 2006-07 or 5.1% over fiscal year 2005-06, by 9% to \$120 million for fiscal year 2007-08, and by approximately 5-6% annually thereafter. This increase is based on the expectation that the expansion biomedical research will result in additional grant applications and subsequent awards. Pledged indirect overhead cost revenue will be at least \$16 million for 2006-07 based upon collections through April 2007, up from a projected \$14.6 million. Pledge Revenue is projected to be \$15.5 million for 2007-08 and grow at an approximate annual rate of 6% thereafter through fiscal year 2010-11. The University anticipates debt service to not exceed \$4 million annually assuming an interest rate of 4.25% based upon an interest rate swap agreement. Projected debt service coverage on pledged revenues for the next five years ranges from 3.65x for fiscal year 2006-07 to 4.62x for Fiscal year 2010-11.

While the bonds are payable from the Pledged Revenues prior to making any other payment, the actual indirect overhead costs must also be paid. Such indirect costs for fiscal years 2002 through 2006, varied from \$4 million to \$8.6 million and would have produced pro forma debt service coverage from a low of 1.17x to a high of 2.44x. Expenditures associated with the indirect costs of the contract and grant programs are estimated to range from \$8 million for Fiscal Year 2007 to \$9 million for Fiscal Year 2011. After payment of the indirect costs, Pledged Revenues remaining to pay debt service range from \$6.6 million in 2006-07 to \$9.4 million in 2010-2011 and provide debt service coverage of 1.65x to 2.38x.

It is significant that payments on the bonds will continue after all payments are received from current contracts and grants. Accordingly, the University's ability to service the debt is totally dependent on its continued success at procuring contract and grant awards in the future and the level of the indirect overhead cost portion of those awards. The University's ability to obtain future awards is dependent on conditions outside of the University's control, such as levels of funding available at any point in time from Federal, State and private sources and competition from other institutions for available funds.

(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 plans to issue variable rate bonds because the limited history and type of revenue pledged, according to the University's financial advisor, would preclude the bonds receiving municipal bond insurance. Without bond insurance, it is highly unlikely the bonds could be sold at reasonable fixed rates. The University, however, is able to secure a liquidity facility in order to issue the bonds as variable rate debt. Since this will be the only issue secured by the pledged revenues, variable rate debt will account for 100% of the debt secured by such revenues; however, the Corporation is planning to convert the financing to a synthetic fixed rate through an interest rate swap agreement.

A debt management plan has been prepared relating to the issuance of the proposed bonds as variable rate debt. The purpose of the plan is to mitigate, to the extent possible, the liquidity and interest rate risks over the life of the debt.

To mitigate liquidity risk, the Corporation has obtained a commitment for a letter of credit. The letter of credit is for 10 years, thereby mitigating the risk of non-renewal of the letter of credit and price increases. The letter of credit will also include an evergreen provision that will provide for annual renewals for an additional year. This will effectively give the Corporation up to nine years notice to secure another letter of credit or other form of guarantee in the event of a non-renewal.

SWAP Agreement:

The Corporation will utilize an interest rate swap agreement to mitigate interest rate risk. Because the Corporation is utilizing an interest rate swap, it has prepared a swap management plan addressing the risks involved. The term of the agreement will be for the life of the underlying debt, thereby mitigating the “rollover risk” which would subject the Corporation to possibly higher interest rates if the swap were to expire prior to final maturity of the bonds. In the event that the swap agreement terminates prior to final maturity of the bonds, as discussed below, the Corporation’s debt will revert to a variable interest rate and could again be fixed, albeit at a potentially higher interest rate, with a subsequent swap agreement or through a refinancing of the bonds.

The Corporation has addressed the risk that, in the event of a termination of the swap agreement, it could be required to make a termination payment if swap rates are lower at the time of termination than the fixed rate it is paying to the counterparty under the agreement. This would only occur if swap rates declined from the current level of 4.25% which the Corporation estimates it would have to pay on a swap. If the Corporation had to make a termination payment immediately after execution of the swap agreement,, it has estimated that fixed swap interest rates would have to, decline 100 basis points to approximately 3.25% to generate a payment of approximately \$6.7 million for the entire \$60 million amount of the swap agreement. The amount of the estimated termination payment declines gradually over time as the amount of the swap declines. The Corporation currently has a fund balance of approximately \$36 million and informally plans to maintain a minimum of two times the debt service requirement or \$8 million in fund balance which could be available. Alternatively, the Corporation could choose to refinance the outstanding bonds incorporating the termination payment at the lower interest rate or make the termination payment from contract and grant funds. Only the Corporation has the option to terminate at any time. The

swap provider can only terminate in the event of a default by the Corporation. Therefore, the Corporation generally controls when it would have to make a termination payment.

The Corporation feels that any risk due to differences between the variable rate payment it receives from the swap counterparty and the actual rate it pays the bondholders (known as basis risk) is small (no more than 1 to 2 basis points or \$6,000 to \$12,000 annually). 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 bonds or a change in marginal tax rates, by entering into a swap transaction based upon the BMA index. With a BMA 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.

To mitigate its exposure to the swap counterparty, the counterparty is rated Aa2/AA/AA- by Moody's, Fitch and Standard and Poor's, respectively, consistent with the University's derivative management guidelines. Those guidelines also call for diversifying counterparties. However, since this is the first swap transaction by the University, there will be only one counterparty. The counterparty will also be required to post collateral of differing amounts depending upon the counterparty's long term credit rating. Those amounts and rating levels have not yet been negotiated, but the collateral will only consist of U.S. Treasury obligations held by a third party. The Corporation will not be required to post any collateral.

The Corporation has stated that it does not possess the expertise necessary to properly manage the swap agreement. Therefore an independent swap advisor will be engaged to manage the Corporation's swap.

Type of Sale:

The University provided an analysis of the most appropriate method of selling the bonds (competitive versus negotiated) as required by the Debt Management Guidelines. The University is requesting approval for a negotiated sale of the bonds. Because of the volatility of the Pledged Revenues, the lack of market awareness of the credit and the likely inability of the bonds to obtain bond insurance, 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 University selected Fifth Third Bank through an RFP process to provide underwriting, re-marketing, letter of credit and swap provider services from a total of nine proposals.

**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. Based upon the information provided, the University feels that the addition of a research facility will support the attraction and growth of biomedical contracts and grants. Indirect cost revenues are projected to grow based on an expected increase in grant awards as well as an expected increase in the percentage of indirect cost allocation associated with State grants. While the University has a record of obtaining awards at levels sufficient to pay debt service, continued success is also dependent on conditions outside of the University's control. In the event that contract and grant awards do not continue, continue at lower levels in the future or the indirect cost allocation percentage decreases, stress could be placed on the Corporation's ability to pay debt service. 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.