

**STATE UNIVERSITY SYSTEM OF FLORIDA
BOARD OF GOVERNORS
Project Summary
University of South Florida
Reimbursement of USF Arena and Convocation Center Renovation**

Project Description: The USF Arena and Convocation Center (the “Arena”) Renovation Project (the “Project”) included modifications to the existing 250,000 gross square foot arena aimed at improving the building’s overall functionality. The modifications extended the useful life of the Arena for an additional 30 years which included the replacement of the 10,000-seat bowl structure, added new seating with retractable sections at the lower level, enhanced life safety and energy efficient HVAC, added a new concourse level with concession stands and restrooms, added ten new loge boxes with premium seating, added new student, upscale hardwood and arena clubs, added a new retail area, added a new center hung scoreboard with ribbon and display boards and a 4-cluster sound system, added new NCAA broadcast capabilities including level C lighting and a large media conference room, enhanced the southeast, northeast and southwest entries, modified the temporary hurricane shelter, and restored the plaza, loading dock, broadcast and performer staging areas, sidewalks, parking, landscaping and exterior concrete. The upgrades allowed the Arena to be on par and competitive with other NCAA Division I and Big East collegiate basketball arenas. The Project is consistent with the mission of the University.

The Project is complete and the University of South Florida (the “University”) is seeking to be reimbursed \$20 million of the \$35.64 million Project costs. Amounts reimbursed with the proposed financing will be re-deposited in the accounts from which they were transferred and used for their permitted lawful purposes.

Financing History:

On March 24, 2011, the Board of Governors (the “Board”) authorized the University to borrow up to \$26.5 million to fund a portion of the Project. However, because the projected net revenues were not sufficient to cover expenses and debt service for the first years of operation or to maintain the required coverage ratio without annual support payments from the USF Foundation Inc. (the “Foundation”), the Board conditioned the approval upon the Foundation setting aside \$20 million in a restricted account to guarantee payment of the debt. The Board provided that the University could later request a reduction or removal of the \$20 million Foundation reserve if it

could present documentation, including an opinion of a financial advisor, to support the financial feasibility of the Project.

Rather than issue the debt with the conditions imposed by the Board, the University decided to fund the Project from the University's Auxiliary Fund Internal Loan Program and a \$10 million equity contribution from the Foundation. On June 3, 2011, the University's president sent a letter advising the Board of the University's decision, stating that it had developed "a more efficient financing arrangement that [would] not require external debt." The letter provided that the financial support of the USF Foundation and USF Athletics "combined with a judicious use of existing University auxiliary resources, enables the University to accomplish [its] goal in a fiscally prudent manner." The letter further explained that the Project was expected to generate sufficient revenues to replenish the internal funds used.

Subsequently, on November 1, 2011 the Financing Corporation adopted a Resolution, stating its intent to do an interim financing of the Project from internal University resources and reimburse the internal funds with a tax-exempt or taxable financing in the future if it was determined to be the most fiscally prudent and efficient course of action. The University did not advise the Board of its modified financing plans.

Now that the Project is complete, the University is seeking to reimburse itself \$20 million in Project costs to repay a portion of the internal auxiliary loan. The balance of the loan from the University's Auxiliary Fund Internal Loan Program after the reimbursement will be \$7.354 million (after including financing costs and the funding of a debt service reserve account into the overall Project costs). The University plans for the balance of the loan to be repaid in the future from Project net revenues, after the payment of debt service.

The use of University funds eliminated construction cost risk and enables the University to show actual revenues for a partial year. However, revenue growth, as well as some of the pledged revenues (e.g. naming rights revenues), remain speculative. Additionally, the projected net revenues for Fiscal Year 2012-13 (the first year of operation of the renovated Arena) are not yet final and, as projected, would be insufficient to cover future maximum annual debt service. Accordingly, the ability to meet future debt service obligations is dependent on additional revenue growth.

The University has provided the opinion of a financial advisor stating that the proposed credit structure is “conservative, prudent and well crafted, with adequate bondholder protections in the event that Pledged Revenues are not generated as outlined in the proforma.” However, the University’s financial advisor did not prepare a financial feasibility report on the operations of the Arena and relied solely on the University’s proforma in reaching its opinions with respect to the proposed credit structure.

Facility Site Location: The Project is located on the Tampa Campus of the University in the USF athletic district. The Arena is reflected on the approved master plan of the University.

Projected Start and Opening Date: Design of the Project commenced December 2010 and the Project was completed for occupancy in May 2012.

Quantitative Demand And Construction Analysis:

In 2009, the University engaged a consultant to perform an assessment of the Arena. The existing Arena had reached the end of its effective service life partly due to its age. The existing mechanical infrastructure was inefficient and obsolete. Additional building systems that needed replacement included the electrical and retractable seating systems. The electrical system was unable to accommodate the increasing electrical needs for NCAA Division I sound, broadcasting, and lighting standards. The state of the retractable seating system warranted replacement. Moisture infiltration had become a problem for the Arena. Water penetrated the lower roof membranes resulting in damage to ceiling and walls. The exterior of the Arena was in fair to poor condition. Though the existing Arena was structurally sound, moderate to large size sections of concrete continued to spall, exposing the steel reinforcements to the elements.

The renovation enhanced the southeast, northeast and southwest entries and restored the plaza, loading dock, broadcast and performer staging areas, sidewalks, parking, landscaping and exterior concrete, as well as other exterior improvements, which greatly improved the exterior appearance of the Arena. Through permanent and interactive signage, the upgraded entries allow for Arena and event identification. Enhancing the patron experience and providing increased participation in events has been achieved by providing a fixed seating bowl from the main concourse. The uninterrupted bowl design allows for improved sightlines with an intimate atmosphere and has resolved accessibility and seating

issues. The fixed bowl provides an interior concourse, concessions, restrooms, club rooms, and loge boxes which all provide increased revenue.

Based on total gross sales, total attendance and number of shows in 2012, the renovated Arena was ranked 5th in the nation in “2012 University Top Stops” by Venues Today Magazine. This honor was achieved after only 6 months of post-renovation operations.

**Study of Private Sector
Alternatives:**

The University looked at various options before deciding to renovate the Arena. The feasibility study conducted in 2009 considered various levels of renovation, including complete demolition and reconstruction at an estimated cost of \$100 million, which was not financially feasible. The University did not consider demolishing the Arena and using other venues because the University believes that the Arena is strategically important for a university the size and stature of USF.

The University has outsourced the management of the Arena to a professional arena management firm. In addition, they have outsourced key contracts to outside partners, including concessions, ticket sales, marketing and advertising. The University is also using a national marketing firm to market the naming rights for the Arena.

**Project Cost and
Financing Structure:**

The construction costs and associated soft costs for the Project totaled \$35.64 million and were initially funded by a \$10 million equity contribution from the Foundation and \$25.64 million borrowed from internal central auxiliary funds. The central auxiliary funds were provided pursuant to the University’s Auxiliary Fund Internal Loan Program.

The University is seeking to reimburse a portion of the central auxiliary funds borrowed for the Project with the proceeds of a fixed rate, taxable bank loan (the “Debt”) issued by the USF Financing Corporation (the “Financing Corporation”), a direct support organization of the University, in an amount not to exceed \$20 million. The balance of the borrowed auxiliary funds equaling \$7.354 million (after including financing costs and the funding of a debt service reserve), will be considered an equity contribution of excess auxiliary funds of the University. The University anticipates that the \$7.354 million will be repaid over time from net revenues of the operation of the Arena after payment of debt service on the Debt.

The Debt will be structured with a 20 year final maturity and level annual debt service payments with the first principal payment occurring in July 1, 2014 and a final maturity date of July 1, 2033. The interest rate on the Debt has been estimated at 5.25%. The actual terms from SunTrust specify a rate based on the Federal Reserve's 10-year swap rate plus a 1.94% bank rate spread, which as of 5/14/13 was calculated at a total of 3.99%. The Project has an estimated useful life of 30 years, which is beyond the anticipated final maturity of the Debt.

A taxable bank loan was chosen by the University after assessment of the Arena's revenue generating activities determined that less than 10% of the total debt could be attributed to tax-exempt use. The University concluded that any potential savings from issuing a portion of the Debt as tax-exempt would be consumed by tax compliance costs.

(See Attachment I for an estimated sources and uses of funds).

Security/Lien Structure: In consideration of the Financing Corporation borrowing the funds necessary to refinance the Project costs, the University will enter into an operating agreement with the Financing Corporation pursuant to which the University will manage and operate the Arena and agree to make payments to the Financing Corporation required to make the debt service payments on the Debt. The University's payments will be secured by a senior lien on Arena event rental revenue, facility fees, concession revenue, pouring rights revenue, event parking revenue, premium seating revenue, sponsorships, naming rights, premium charges on events and novelties. The University is currently marketing the naming rights but does not yet have a contract for those revenues. The current pouring rights contract with Coca Cola expires in 2017 and will have to be renewed.

The University is legally authorized to secure the Debt with the revenues to be pledged pursuant to section 1010.62, Florida Statutes. The University and the Financing Corporation are committed to ensuring that sufficient revenues will be generated to fulfill the obligations with respect to the proposed Debt. The Debt will not be repaid by student fees and thus will not be a cost borne by students.

**Pledged Revenues,
Debt Service Coverage
And Return on
Investment:**

For fiscal years 2007-08 through 2011-12 gross revenues of the Arena declined from \$1,204,500 to \$195,200 and, after payment of operating

expenses, a net loss was realized in each of those years varying from (\$59,500) to (\$473,483) per year. This was due first to a decline in events held in the Arena, and then due to the closure of the Arena during fiscal year 2010-11 as a result of poorly functioning mechanical and structural elements. The Arena was closed for most of fiscal year 2011-12 for renovation. For fiscal year 2012-13, the first year of operation after renovation, pledged revenues are estimated to be \$2,956,000 and net revenues are estimated to be \$1,432,000.

Although gross Arena Revenues before operating expenses are pledged, the ability of the Arena to pay its expenses, as well as meet its debt obligations, should be considered in analyzing whether the proposed financing is feasible. When looking at debt service coverage based on net revenues of the Arena, the estimated net revenues for fiscal year 2012-13 would be insufficient to cover future maximum annual debt service of \$1,639,046, with coverage of only 0.87x. For fiscal years 2013-14 to 2017-18, net revenues of the Arena are projected to grow from \$2,085,187 to \$2,788,499, with projected maximum annual debt service coverage from net Arena revenues of 1.27x in 2013-14 and 1.70x in 2017-18. The projected debt service coverage has been calculated using an assumed interest rate of 5.25% on the Debt through the assumed maturity date of July 1, 2033.

The University anticipates growth in revenues sufficient to cover debt service payments. If projected revenue growth is not realized, the University will adjust rates and expenses accordingly to cover the debt payments. To help ensure repayment of the debt, the University is setting aside a debt service reserve fund equal to maximum annual debt service on the Debt.

The internal rate of return of the Project has been estimated by the University to be is 8.71%

(See Attachment II for a table of historical and projected pledged revenues and debt service coverage prepared based upon revenue information supplied by the University of South Florida. See Attachment III for the Project internal rate of return calculation prepared by the University).

Type of Sale:

The Debt will be structured as a privately placed bank loan with SunTrust, which was selected through a competitive RFP process.

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 provided by the University indicate that sufficient revenues will be generated to pay debt service on the Debt as well as cover operating expenses of the Arena; however, the ability of the Arena to meet all of its obligations is dependent upon the realization of revenue growth and certain additional revenues which are somewhat speculative, such as naming rights. It is uncertain as to whether or not the Project will meet the revenue projections provided and failure to meet projections could create financial challenges. The University believes it has sufficient financial flexibility to absorb any operating deficits without creating a materially adverse effect on its athletic programs or student athletic activities.

The Board's prior issues associated with construction risk have been addressed in as much as the Project is complete. However, financial feasibility continues as a concern, with projected revenue growth, remaining speculative. The Debt is to be issued subject to the restriction that proceeds from the Debt cannot be used for operating expenses. The Debt shall only be used to reimburse the University for the portion of the Arena Capital Project capital costs specified. Any further use the proceeds for other capital projects is subject to future approval by the Board of Governors.

The Division of Bond Finance has analyzed the proposed transaction. One issue that must be appropriately considered is the Division's assertion that the proposed Debt, which is a reimbursement of internal funds expended for a completed project, is not contemplated by S. 1010.62 or the SUS Debt Management Guidelines. Both the statute and the Guidelines provide for financing of new projects and refunding of outstanding debt. Neither provides criteria by which to analyze whether a financing for reimbursement purposes is appropriate or address permissible uses of reimbursement proceeds. Approval of the University's proposal, as presented, would essentially permit the University to draw upon its equity in the Arena, creating liquidity that could be used for whatever purposes the University deems appropriate, without any oversight from the Board.

S. 1010.62, F.S. gives the Board the final authority to make the determination as to whether to authorize the issuance of the proposed Debt. Board staff opinion is that the proposed financing appears to be in compliance with the Florida Statutes governing the issuance of university debt and is in compliance with the Board of

Governors' Debt Management Guidelines. However, for the reasons state above, staff of the Board of Governors makes no recommendation for or against adoption of the resolution authorizing the proposed financing.