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

Background:

In 2007, the Board of Governors approved the issuance of variable-rate, tax-exempt revenue bonds in an amount not exceeding $60 million for the purpose of partially financing the construction of the Burnett Biomedical Sciences (the "BBS") Building. The BBS Building is a 198,000 square foot building on the University of Central Florida (the "University") Health Sciences Campus at Lake Nona in southeast Orlando. This multi-story building contains research laboratories, specialty laboratories, administration offices and laboratory support. The BBS Building was funded through PECO funds ($22 million), private donations ($10 million), the Courtelis Matching Fund ($10 million) and tax-exempt bonds ($60 million) (the "2007 Bonds") issued by the UCF Health Facilities Corporation (now the University of Central Florida Finance Corporation, the "Corporation").

The 2007 Bonds were issued as variable rate debt with an interest rate swap agreement to create a synthetic fixed rate on the debt. The bonds are secured by a lien on the indirect overhead cost portion of the University contract and grant revenues. Although the University would have preferred a traditional fixed rate financing option, the variable rate finance structure was chosen because the Pledged Revenues represented a new credit and the University was unable to obtain bond insurance at a reasonable price.

During the time of initial financing, the University projected that debt service would not exceed $4 million annually assuming an interest rate of 4.25%, based on an interest rate swap agreement, used to mitigate risk. The swap agreement was executed prior to the downturn of the economy when rates were increasing and was entered into with Fifth Third bank at a rate of 4.376%.

In an effort to further assess risk, the University initially stress tested the probability of rates declining 100 basis points to 3.25%, which would have generated a swap termination fee of approximately $6.7 million. The current market swap rate is 1.92% (233 basis points lower than projected) which has now resulted in a swap termination fee of approximately $13 million (as of June 2017).

The swap agreement was secured by a Letter of Credit ("LOC"), also issued by Fifth Third Bank. The LOC fee for the first ten years was set at 24 basis points; however, the LOC recently renewed for another three years at a fee equal to 175 basis points, with no indication from the bank or guarantee that the LOC fee will not increase further. Due to the increase in LOC fees, the overall interest rate on the bonds has effectively increased to 6.30%, with annual debt service expenses increasing from approximately $4 million to approximately $4.5-$4.7 million for the next 10 years, with a slight decline annually until maturity in 2037 (assuming no further increase in fees).

Given the current market conditions and increasing LOC fees, the University is seeking to reduce costs, lower market risk and interest risk exposure, and lower debt service. As a result, the University is requesting authorization to refund the existing revenue bonds and refinance the debt through a 20-year bank loan with an interest rate reset after either seven or ten years.

The Debt Management Guidelines of the Board of Governors generally do not require the approval of the Board of Governors for refundings for debt service savings. However, given that the University is seeking to increase debt by approximately $13 million to terminate a swap agreement in connection with the refinancing of the variable rate 2007 Bonds (which are complex in nature), the Board is required to review this transaction compared to the current financing. It is anticipated that the proposed refinancing will provide debt service savings and eliminate associated bond costs (bond remarketing, bank trustee, surveillance rating, swap fees and LOC costs) during the initial fixed rate term; however, because of the interest rate reset in either seven or ten years, there is no guarantee that the refinancing will result in an overall interest rate savings over the remaining term of the debt.

Description of the Refinancing:

The University is requesting authorization from the Board of Governors to refund the outstanding $49.825 million variable rate 2007 Bonds through a bank loan which will be at a fixed rate for the first seven or ten years. As part of the refinancing, the issuance of additional debt will be necessary to finance the payment of the approximately $13 million swap termination fee relating to the 2007 Bonds.

The proposed bank loan will be issued in an amount not exceeding $64 million to refund the outstanding 2007 Bonds, fund the swap termination fee, and associated costs of issuance of the debt (the "Project").

Approvals: The University Board of Trustees (the "BOT") approved the Project on July 20, 2017; the Corporation Board approved the proposed financing terms of the Project on July 20, 2017.

Quantitative Demand Analysis:

The purpose of the BBS building is to provide educational and research facilities for the UCF College of Medicine (the "COM") and College of Biomedical Sciences. As a part of the COM, the BBS Building serves as an anchor to the Lake Nona Medical Center, University of Florida School of Pharmacy (Orlando campus) and the Sanford Burnham Prebys Medical Discovery Institute.

The BBS building houses a total of 225 employees (as of June 2017) divided between research-intensive faculty with labs and office space, PhD and MS graduate students in the UCF Biomedical Sciences Graduate Program, Burnett School undergraduate students doing independent research studies and the staff who support the research and training activities. Approximately 50% of all of the thesis graduate students in the UCF-wide Biomedical Sciences Graduate Program are being trained in labs in the BBS building.

The BBS building supports a research intensive culture. In FY17, there were 98 applications submitted by 33 BBS researchers requesting $77 million in extramural support. Currently, there are 39 extramural research awards that provide $7.4 million in support for researchers in the BBS building – 96% of the FY17 research dollars in the BBS building are awarded to Burnett School faculty.

The main research efforts in the BBS building are focused on: Cancer, Infectious Disease, Neurosciences, Cardiovascular Diseases, Biomedical Engineering, and Public Health. Some of the high profile research programs include: Crohn's Disease, Zika Virus Immunity, Neuroscience Movement Disorders, Mosquito Research Colony, Clinical and Translational Research Core, Animal Imaging Core, Merit Awardee and Biosafety Level 3 Labs.

Study of Private Sector Alternatives:

The proposed debt issuance is for the purpose of refinancing an existing building; therefore, private sector alternatives were not included as a part of this review.

Project Cost and Financing Structure:

The Project will be financed with a not to exceed $64 million bank loan between the Corporation and a bank, which will be selected competitively. Selection is tentatively scheduled during the week of August 11th. The maturity date of the proposed loan will not be extended beyond the term of the outstanding debt.

The proposed financing will be structured as a 20 year amortizing loan, with an interest rate reset or put option after seven or ten years. The Project assumes an overall level net debt service structure with semi-annual payments starting in January 2018 through July 2037. If the initial interest rate period is seven years, the estimated interest rate is 2.55%. If the initial interest rate period is ten years, the estimated interest rate is 3.00%. However, it should be noted that the proposed refinancing will increase the existing debt due to the required swap termination payment of approximately $12.7 million. After the initial seven or ten year interest rate period, it is currently unknown what interest rate the Corporation will need to pay for the remaining thirteen or ten year period of the loan.

(See Estimated Sources and Uses of Funds)

Security/Lien Structure:

The debt will be secured by a lien on the indirect overhead cost portion of the University contract and grants revenues ("Pledged Revenues"). The pledge of the Pledged Revenues is a gross pledge, meaning that payment of debt service will be paid prior to any other payments from the Pledged Revenues. The Pledged Revenues are derived from contracts and grants related to University research activities.

Pledged Revenues and Net Debt Coverage:

During the historical five-year period (2012-2016), Pledged Revenues dropped from $20.1 million to $18.2 million, resulting in corresponding gross debt service coverages decreasing from 5.34x in 2012 to 4.91x in 2016. Future gross debt service coverage is projected to be in the 5-6x range.

During the same period, net debt service coverages, after including operations and maintenance expenses, decreased from 1.03x in 2012 to 0.80x in 2016. In 2013, debt service coverage fell to 0.42x due to increased expenditures in Services, Supplies and Utilities. This line item grew from $8.03 million (in 2012) to $11.2 million (in 2013).

Based on projections, the University expects that Pledged Revenues will grow from $20.2 million (in 2017) to $24.6 million (in 2021). Net coverage ratios are expected to improve to 1.36x in 2020; rising from an all-time low of 0.24x in 2017.

The projected debt service for the Project has been calculated using an interest rate of 2.55% for the first seven years of the loan, with annual debt service at approximately $4 million. The University has also presented estimates for a bank loan with a ten year fixed rate period at 3.00%, with annual debt service at approximately $4.2 million; however, the loan rate and resulting debt service payments will have to be renegotiated after the initial fixed-rate term based on market rates at that time, or the University can secure other fixed rate financing solutions at any time upon the exercise of their call option which they intend to include with the terms of the bank loan.

(See detailed summary of historical and projected debt service coverage)

Type of Sale:

The University provided an analysis which details the desired method of selling the debt as required by the Debt Management Guidelines. The University is requesting approval for a structured bank loan through private placement under a competitive bid process. The bank loan structure was chosen because of certain limitations with a bond issues: higher debt service, lower debt service savings, volatility in possible bond ratings, requirement of a funded debt service reserve, and other restrictive covenants.

Selection of Professionals:

The professionals involves in this transaction were selected due to previous long-standing affiliations, with the exception of the bank.

The bond counsel is Bryant, Miller and Olive and the financial advisor is Hilltop Securities Inc.

Analysis and Recommendation:

The project was approved by the University BOT and the Corporation BOT on July 20, 2017, and submitted by the University to the Board of Governors Office and the Division of Bond Finance for review.

The results of the review by the Division of Bond Finance have been incorporated into the project summary, unless otherwise noted.

The University originally borrowed $60 million (10 years ago), of which $49.825 million remain outstanding. If the Project is approved, the new outstanding debt will total $64 million, albeit at a potentially lower interest rate.

Including all financing costs and the cost of the $13 million swap termination fee, the University is estimating debt service savings of approximately $6 million over the life of the financing based on the assumption that the current 7-year estimated fixed rate of 2.55% is held constant for the full 20 year maturity of the loan. Similarly, the University also provided cost savings based on a 10-year, 3% fixed rate option, estimated at $3.1 million. However, choosing a bank loan with either a seven or ten year interest rate reset or put option does not fully safeguard against interest rate risk and leaves the University vulnerable to rising interest rates, which can potentially decrease the anticipated savings of $6 million after the initial seven or ten year initial interest rate period.

It appears that the proposed financing is in compliance with the Florida Statutes governing the issuance of university debt and is in compliance with the Board of Governors' Debt Management Guidelines. Accordingly, staff of the Board of Governors recommends adoption of the resolution authorizing the proposed financing.