STATE UNIVERSITY SYSTEM OF FLORIDA
BOARD OF GOVERNORS
Facilities Committee
August 31, 2017

SUBJECT: A Resolution of the Board of Governors approving the issuance of debt by the University of Central Florida Finance Corporation on behalf of the University of Central Florida to refinance the outstanding Capital Improvement Revenue Bonds, Series 2007

(Note: The bold and italicized language represents analysis by the Division of Bond Finance that it wishes to emphasize.)

PROPOSED COMMITTEE ACTION

Adoption of a resolution approving a bank loan, for the University of Central Florida Finance Corporation (the "Finance Corporation) on behalf of the University of Central Florida (the "University"), in an amount not to exceed $64,000,000 (the "Debt") to refinance outstanding capital improvement revenue bonds and terminate the existing swap rate agreement associated with these bonds.

Staff of the Board of Governors, State University System of Florida, and the Division of Bond Finance has reviewed this resolution and all supporting documentation. Based upon this review, it appears that the proposed Financing Plan is in compliance with Florida Statutes governing the issuance of university debt and complies with the Debt Management Guidelines adopted by the Board of Governors. However, ***the proposed transaction requires additional borrowing of $13 million to pay a swap termination fee and the Division of Bond Finance is exploring other alternatives to avoid or reduce the swap termination fee. No definitive solution has been formulated to avoid the $13 million swap termination fee but discussions are on-going. Nevertheless, staff of the Board of Governors recommends adoption of the resolution and authorization of the proposed refinancing.***

AUTHORITY FOR BOARD OF GOVERNORS ACTION

Florida Board of Governors Debt Management Guidelines; Section 1010.62(3), Florida Statutes; and Article IX, Section 7, Florida Constitution.

BACKGROUND INFORMATION

In 2007, The Board of Governors approved the issuance of 30-year, variable-rate, tax-exempt revenue bonds (the "2007 Bonds") in an amount not exceeding $60 million for the purpose of partially financing the construction of the Burnett Biomedical Sciences

Building. The 2007 Bonds are secured by and payable from a lien on the indirect overhead cost portion of the University contract and grant revenues and are also secured by a letter of credit ("LOC") from Fifth Third Bank (the "Bank"). The 2007 Bonds were issued as variable rate debt with an interest rate swap agreement with the Bank to create a synthetic fixed rate; however, the LOC was tied directly to the swap and was only for 10 years which left the University exposed to increases in interest rates and financing costs. The 10-year term of the LOC has expired and the Bank increased the cost of the LOC from 24 bps to 175 bps, increasing the effective cost of the financing. Additionally, the new LOC is only for a 3 year term, subjecting the University to renewal risk on the LOC exposing itself to future increases in financing costs.

Due to increased LOC fees, annual debt service has increased and the University wants to refund the bonds to reduce annual debt service payments. Under the proposed new loan structure, annual debt service payments would be reduced over the initial fixed-rate period; ***however, the University would still be exposed to interest rate risk after the initial term of the proposed bank loan (either seven or ten years) and the refinancing will also require $13 million of additional debt to fund the cost of a swap termination fee. Since the LOC was tied directly to the swap agreement and cannot be terminated without also terminating the swap, the University does not have the option to find a lower cost LOC alternative without refinancing the debt or renegotiating the LOC and/or swap termination fee with the Bank.***

Universities have been authorized by the Board to engage in refundings for debt service savings without specific Board of Governors approval. However, in this instance, the University is seeking to increase debt and refinance the existing bonds and the Board is required to review this transaction compared to the current financing.

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

The University's Board of Trustees and the Finance Corporation's Board approved the refinancing of the 2007 Bonds at their July 20, 2017, meetings.

Supporting Documentation Included:	1. Requesting Resolution 2. Project Summary 3. Estimated Sources and Uses of Funds 4. Historical and Projected Pledged Revenues and Debt Service Coverage
Facilitators/Presenters:	Mr. Chris Kinsley

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

(*Note: The bold and italicized language represents analysis by the Division of Bond Finance that it wishes to emphasize.)*

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 Building (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 30-year bonds secured by and payable from a lien on the indirect overhead cost portion of the University contract and grant revenues and are also secured by a Letter of Credit ("LOC") with Fifth Third Bank (the "Bank"). Although the University would have preferred a traditional fixed rate financing option, the credit was not viewed strong enough to execute a long term fixed rate transaction and the University was unable to obtain bond insurance at a reasonable price. Consequently, the 2007 Bonds were issued as variable rate debt with an interest rate swap agreement, also with Fifth Third Bank, to create a synthetic fixed rate. The term of the LOC was less than the life of the bonds so the University was accepting renewal risk on the LOC and exposing itself to future increases in interest rates and financing costs.

Even though the swap agreement was for the 30 year term of the debt, the ***LOC was initially entered into with a 10 year***

term subject to renegotiation and extension thereafter. When the initial term of the LOC expired in 2017, the University and the Bank negotiated a three year extension with the Bank requiring substantially higher annual fees of 175 bps (compared to the initial rate of 24 bps). These increased LOC fees have resulted in an increase in the effective interest rate on the bonds of 151 bps, or approximately $9 million over the term of the loan, and increases in annual debt costs of approximately $800,000 in 2017-18 from $3.9 million to $4.7 million, and declining annually thereafter.

Since the LOC is tied directly to the swap agreement and cannot be terminated without also terminating the swap, the University does not have the option to find a lower cost LOC alternative without refinancing the 2007 Bonds or renegotiating the LOC and/or swap termination fee with the Bank. The swap termination requires the payment of a swap termination fee that is currently estimated to be almost $13 million.

Description of the Refinancing:

Given current market conditions and increased LOC fees, the University is seeking to refinance the 2007 Bonds to reduce annual debt costs and to reduce risks associated with variable rate debt, such as LOC renewal risk. As a result, the University is requesting authorization from the Board of Governors to refund the outstanding $49.825 million variable rate 2007 Bonds through a 20-year bank loan with an interest rate reset after either seven or ten years. 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 of approximately $13 million, and pay associated costs of the bank loan. ***The proposed refinancing does not eliminate interest rate risk and the potential for future increases in interest rates and financing cost for the BBS Building.***

The University is proposing to refinance the debt to provide budgetary relief by reducing annual debt service costs in the near term. Under the proposed new bank loan structure, annual debt service payments would be approximately $4 - $4.2 million over the initial fixed-rate period of seven or ten years compared to the annual cost of $4.4 - $4.7 million over that period without the refinancing and assuming no

renegotiation with the Bank; however, ***the University would still be exposed to interest rate risk after the initial interest rate period (either seven or ten years) and the refinancing will also require $13 million of additional debt to fund the cost of the swap termination fee.***

Total financing costs based upon the original structure of the debt and original LOC fees were estimated to be $112.4 million over the life of the financing. As a result of the increased LOC fees, the estimated total costs are $121.9 million, or $9.5 million more than anticipated. Total financing costs for the proposed refinancing are estimated to be $115.3 million for the 7-year option or $118.9 million for the 10-year option. However, this assumes interest rates are not higher at the end of the initial interest rate period.

Approvals: The University Board of Trustees (the "BOT") and the Corporation's Board approved the proposed refinancing 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 debt that was incurred to finance an existing building; therefore, private sector alternatives were not included as a part of this review.

Refinancing Cost and Financing Structure:

The 2007 Bonds will be refinanced with a not to exceed $64 million bank loan between the Corporation and a bank, which will be selected competitively. Selection was 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 refinancing will be structured as a 20 year amortizing loan, with a fixed initial interest rate period of seven or ten years, and an interest rate reset or put option thereafter. The refinancing 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 $13***

million. After the initial seven or ten year interest rate period, the interest rate will be reset or the outstanding loan amount will have to be refinanced. Therefore, the ultimate cost of the BBC Building financing cannot be determined because the refinancing proposal does not eliminate interest rate risk or refinancing risk.

(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 decreased 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 refinancing has been calculated using an interest rate of 2.55% for the first seven years of the loan, with annual debt service of 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 of 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 (interest rate risk), 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 existing relationships, 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 refinancing was approved by the University BOT and the Corporation's 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 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 the swap in connection with the proposed refinancing***, the Board is

required to review this transaction compared to the current financing. It is anticipated that the proposed refinancing will provide budgetary relief by reducing debt service costs during the initial fixed-rate term.

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 remaining life of the financing based on the assumption that the current 7-year estimated fixed rate of 2.55% applies 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, ***the proposed refinancing is estimated to cost the University $2.9 million more than the original financing prior to the LOC fee increase. The proposed refinancing will mitigate the impact to the University's budget caused by the LOC fee increase, but will still be more expensive than the original financing and still leave the University exposed to higher interest rates, i.e. interest rate risk. Notwithstanding the University's goal to eliminate interest rate risk related to possible future LOC increases, choosing a bank loan with either a seven or ten year interest rate reset or put option does not safeguard against interest rate risk and still leaves the University vulnerable to rising interest rates, which can potentially further increase the ultimate cost of financing the BBS Building.***

The proposed refinancing was precipitated by an increase in LOC fees and associated debt service cost. Normally an issuer would solicit a substitute LOC provider to address the price increase. However, the current LOC Agreement with the Bank does not allow another bank LOC to be substituted without also terminating the swap and paying a $13 million termination fee. All measures to eliminate, reduce, or renegotiate this requirement should be exhausted as a condition precedent to moving forward with the proposed refinancing.

It appears that the proposed refinancing 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 refinancing.