STATE UNIVERSITY SYSTEM OF FLORIDA
BOARD OF GOVERNORS
Project Summary
University of Florida
$50M Research Lab Renovations

Project Description: The University of Florida (UF or University) is requesting approval from the Board of Governors (Board) to issue revenue bonds in an amount not to exceed $50M (Bonds) to finance extensive renovations to numerous existing aged research laboratories on its main campus (together, the "Project"). The Project consists of biomedical and life sciences laboratories, as well as other research-related spaces, within various colleges. In total, the renovations will upgrade and repurpose over 50,000 sq. ft. of research space with new equipment, such as chemical hoods and air handlers, and create updated workspaces for graduate students and faculty researchers, ultimately supporting current research activities with adequate facilities.

Over the past 10 years, UF's research enterprise has grown from $697 million to $1.076 billion. The largest research sector for UF is in the area of biomedical and life sciences, encompassing major activities within each of the six colleges within UF Health and included in the Project.

According to UF, state-of-the-art research facilities are one of the primary considerations for researchers (primary investigators or "PI's") in their selection of what institution to join. Therefore, providing funds for lab renovations and new facilities is critical to attracting and retaining leading faculty who are best able to attract external sponsored research funding.

The Project was approved by the UF Board of Trustees on December 9th, 2022 and is included in UF's approved Campus Master Plan.

Project Location: The research labs to be renovated are located on UF's main campus within the College of Medicine, College of Pharmacy, College of Public Health and Health Professions, Herbert Wertheim College of Engineering, Institute of Food and Agricultural Sciences (IFAS), and College of Liberal Arts and Sciences.

Project Cost & Construction Period: The Project will cost approximately $49.2M, including design, construction, lab equipment and a construction contingency of $3.5M (7.1% of total Project cost). The renovations comprise 50,725 sq. ft. of space, resulting in a cost of $970/sq ft. The Project will be administered by UF's Planning, Design, and Construction department, and vendors will be selected based on the size of each renovation component. The Project is expected to commence in late 2023 and be completed by the end of (calendar) 2025.

Financing Structure: Bond proceeds and, to a small degree, interest earned on invested balances, will fund Project cost ($49.2M), capitalized interest ($2.6M),

and cost of issuance ($500K). [see attached *Estimated Sources and Uses of Funds].*

It is expected that $10M of the Bonds will be issued as taxable debt due to 'private use' activities (i.e., sponsored research for the purpose of commercial goals) in one of the research facilities; the remainder will be issued as tax-exempt. The Bonds will have a 30-year term and fixed rates of interest. For the purpose of estimating debt service, a rate of 5.25% is assumed, representing the current long-term rate adopted in the EDR Consensus Estimating Conference. This results in level debt service of approximately $3.5M annually. [see attached *Projected Debt Service Schedule*].

Lien Structure & Pledged Revenues:

The Bonds will be secured by a first lien on all indirect cost reimbursement revenue received by the University from federal, state, and private research grants, and they will be issued on parity with the existing debt, i.e., 2020A Series bonds, $15.4M principal outstanding, maturity in 2030.

The research funding that UF receives has two components—direct costs and indirect costs. Direct costs represent actual costs to conduct the proposed research that is being sponsored. Indirect costs are sometimes referred to as facilities and administrative (F&A) costs and include costs necessary to run a research enterprise but not directly associated with a specific grant. Included in this amount are costs for laboratories, research space, libraries, and a portion of central administrative functions. For universities (unlike research institutes), allowable administrative costs are capped. As such, UF focuses on the facilities component to increase the amount of indirect cost recovery it receives.

The University's average indirect cost recovery rates (ICR) are 52.5% and 22% for federal contracts and state/private contracts, respectively, with the former representing the majority of UF's research enterprise. The federal ICR is negotiated every four (4) years with U.S. Department of Health and Human Services, namely the National Institute of Health.

Since 2018, UF's ICR revenue grew 7.8% per year, on average, from $110.6M to $149.3M, and projected to grow to $180M by FY2028.

Debt Service Coverage:

Once renovations are completed, pledged ICR revenues are projected to exceed $130M annually, which, given the first lien pledge, provides more than sufficient revenues to cover estimated total annual debt service of $5.6M (i.e., existing 2020A Series and proposed Bonds) with a debt service coverage ratio of at least 29x. [see attached *Historical and Projected Debt Service Coverage*]. According to UF, roughly 45% of ICR revenue is used to fund central administrative support. The remaining revenue is distributed to the researcher, department, and college. Nevertheless, UF believes that proposed renovations will help ensure adequate, if not increased, pledged revenues to service the debt.

Regardless, the first-lien pledge securing the Bonds prioritizes the payment of debt service above all other expenses typically paid via IRC revenues.

Capitalized Interest:

The financing structure includes capitalized interest (or "cap-I"), the use of which is governed by the SUS Debt Management Guidelines, as follows:

> "Capitalized interest from bond proceeds is used to pay debt service until a revenue producing project is completed or to manage cash flows for debt service in special circumstances. Because the use of capitalized interest increases the cost of the financing, **it should only be used when necessary for the financial feasibility of the project**."

The above provision mirrors the State of Florida Debt Management Guidelines.

The labs to be renovated, and consequently 'offline', represent a fractional share of UF's overall research enterprise, thus the Project can be completed without a material impact to pledged ICR revenues or jeopardizing the timely payment of debt service. As such, **the use of capitalized interest in the financing structure is not necessary for the *financial feasibility of the Project*,** representing a deviation from the Guidelines.

According to the University, it prioritizes all debt-financed research space to sponsored research activities. This is critical based on how UF's ICR (%) rate is negotiated, as it is a ratio of allowable overhead costs divided by the research space. The University submits eligible costs as identified in government regulations related to sponsored research. A significant allowable cost that can be included in negotiations is interest paid while a facility/lab is in operation as well as interest capitalized while a facility/lab is being constructed or renovated. UF stated that the goal is to justify the maximum amount of allowable costs to help the University keep or increase its ICR rate. The negotiated ICR rate is then applied to research grants – i.e., the higher the ICR rate, the higher the reimbursement to fund indirect costs of the research enterprise. However, it is never guaranteed that all allowable costs will be accepted.

Furthermore, according to the University, the subject research space will be 'offline' during renovations, not supporting research activity and related revenues. Consequently, the indirect overhead cost of that space (during renovations) must be funded from university resources that otherwise could be used to recruit and support research faculty. The use of capitalized interest effectively subsidizes operations, helping to avoid the reallocation of university resources away from recruitment and supporting research faculty.

Benefit to Stakeholders:

The University has continued to expand its research enterprise over the last 10 years; Contract and Grants (C&G) revenue has grown 54% from

$697M to $1.076B. Biomedical and Life Sciences represents the largest area of research and, likewise, the majority of federal funding. The Project will help to grow the research enterprise by updating existing research laboratories, bringing their capabilities up to the standard needed by the University. However, projecting incremental quantitative value is not feasible at this juncture, according to the University, nor is it a material contributing factor supporting the decision to pursue the needed renovations.

Return on Investment: Not applicable. See *Project Description*, as well as *Benefit to Stakeholders*, for justification of the proposed investment.

Method of Bond Sale: The University consulted with the State Division of Bond Finance (DBF). Based on an analysis of current market conditions and the proposed Bond issuance, it was determined that a competitive sale will yield the best results in terms of debt cost and structure.

Selection of Professionals: The Bonds will be issued through DBF, which has contracts with multiple outside professionals (including bond counsel, financial advisors, and verification agents) who will be engaged as needed, all of whom were selected through a competitive process.

Recommendation: Staff of the Board of Governors and the Division of Bond Finance have reviewed the resolution and supporting documentation provided by the University. Based upon this review, it appears that the proposed financing is compliant with Florida Statutes governing the issuance of University debt.

The use of capitalized interest in the proposed financing structure does not align with the SUS Debt Management Guidelines. However, satisfactory justification for its inclusion, as described in the 'Capitalized Interest' section above, describes how the proposed financing structure indirectly benefits the University's support of its research enterprise and offers mitigating factors to support the deviation from the Guidelines.