J. BEN WATKINS III
DIRECTOR

# STATE OF FLORIDA
# DIVISION OF BOND FINANCE



## MEMORANDUM

To: Board of Governors

From: J. Ben Watkins III

Date: June 2, 2023

Re: University of Florida Research Lab Renovations Project

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As required by Section 1010.62, Florida Statutes, the Division of Bond Finance ("DBF") has reviewed and analyzed the information provided to support the University of Florida's (the "University") proposed financing of research lab renovations located on its main campus (the "Project"). DBF has also reviewed the Board of Governors ("BOG") staff analysis of the Project and evaluated the proposed financing for compliance with the BOG Debt Management Guidelines (the "Guidelines"). The BOG staff analysis of the Project discusses the relevant aspects of the proposed financing and the deviation from the Guidelines. DBF has analyzed the proposed financing and highlighted the following specific issues for the BOG's consideration in connection with its evaluation of the Project.

### *Issuance of Taxable Debt*

Approximately $10 million of the debt is proposed to be issued on a taxable basis. While the Guidelines encourage universities to issue tax-exempt debt to take advantage of lower interest rates and interest cost savings, one of the research facilities being renovated will have significant private use. The University previously had to track private-use on the tax-exempt financing of the Translational Research Building and found the restrictions on use and necessary tracking for tax compliance to be onerous. Because of this, the tax-exempt bonds were subsequently refinanced for savings with taxable debt. Based on the University's prior experience with tax-exempt debt to finance research facilities and the restrictions on private-use under federal tax law, it is our opinion that using taxable debt for a portion of the financing is justified.

### *Capitalized Interest*

The University has proposed to finance approximately $2.6 million of interest cost during construction of the Project, i.e., capitalized interest. Under the Guidelines, capitalized interest is intended to pay debt service until a revenue-producing project is completed or to manage cash flows for debt service in certain circumstances. While this provision did not contemplate applying to a research project, the Project, when completed, will house federal research that generates revenue for the University. Capitalized interest can be included in the University's indirect cost reimbursement rate from the federal government, primarily the U.S. Department of Health and Human Services. The University will incur interest costs while it is unable to use the Project for sponsored research during the construction period and unless capitalized and included in the University's cost recovery rate, such interest costs would not be reimbursable under federal guidelines.

Additionally, while the University has sufficient revenues to pay interest during the construction period, borrowing a portion of the interest will free-up funds that would otherwise be needed to pay interest which can then be used to enhance the University's strategic goals, like recruiting additional researchers and primary investigators, to augment the University's sponsored research. The University anticipates generating approximately $20-30 million a year in additional sponsored research because of the research facility improvements being financed with the Project. The University has also adopted policies giving preference to the use of bond financed research space to research activities that generate research grants (revenues) for the University.

Borrowing a portion of the interest cost during construction will effectively, albeit indirectly, finance University research operating costs and increase the overall cost of the Project. Capitalizing interest is not necessary to the financial feasibility of the Project, however, using available funds to attract and retain researchers during the construction period rather than using them for interest cost may contribute to the overall financial feasibility of the Project and the strategic goal of the University to improve research rankings. Although the Board may choose to approve an exception to its Guidelines because of the small amounts involved and justification provided, it should not signal a precedent for future exceptions.

cc: Ray Rodrigues, Chancellor, Board of Governors
Kevin Pichard, Director, Board of Governors
Chris Cowen, Senior Vice President and Chief Financial Officer, University of Florida