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MEMORANDUM

To: Board of Governors

From: J. Ben Watkins III

Date: January 19, 2021

Re: University of Florida University Athletic Association – Series 2021 Bonds

As required by Section 1010.62(3)(b)4, Florida Statutes, the Division of Bond Finance (“DBF”) has reviewed and analyzed the information provided to support the University of Florida University Athletic Association’s (the “UF UAA”) proposed financing of (a) the construction and equipping of the James W. “Bill” Heavener Football Training Center, a new stand-alone football team complex and dining hall and lounge for all student athletes, and (b) the construction of improvements to the existing Lacrosse facility and the construction of a Soccer facility to house all Soccer program functions in one complex (the “Project”). DBF has also reviewed the Board of Governors (“BOG”) staff analysis of the Project.

COVID-19 and measures taken to combat its spread have had unprecedented operational and financial impacts on higher education in general and athletics in particular. Many of the policies embedded in the BOG Debt Management Guidelines (the “Guidelines”) are not designed to accommodate such extraordinary circumstances. DBF has analyzed the UF UAA’s proposed financing and highlighted several deviations from the Guidelines noted below for the BOG’s consideration. This memo is limited to specific attributes of the financing that do not comply with the Guidelines and is not intended to address other business/financial issues and uncertainties associated with university athletics and COVID-19. Additionally, deviations from the Guidelines may be warranted because of the exigencies caused by COVID-19 or, alternatively, the BOG may approve the financing conditioned on specific modifications to the UF UAA’s proposal.

Financing Structure

The University of Florida Board of Trustees (the “UF BOT”) authorized the UF UAA to issue tax-exempt debt not to exceed \$50 million (the “Series 2021 debt”) to finance the Project pursuant to a negotiated sale as either publicly-offered bonds or a privately-placed bank note as a variable rate, short-term fixed rate, or longer-term fixed rate financing with a final maturity of 30 years. However, the proceeds from the Series 2021 debt will be insufficient to finance the Project. The UF UAA plans to cover the additional Project costs, approximately \$42.7 million, from capital gifts and unrestricted cash and investments.

The UF UAA has represented that it intends to issue the Series 2021 debt on a variable rate basis for an initial term shorter than the 30-year final maturity via a direct placement note. However, the UF BOT resolution does not limit the UF UAA to this representation as the resolution leaves the decision on the final structure with the UF UAA. The BOG resolution also provides the UF UAA the flexibility to make a final determination on the structure of the Series 2021 debt based on market conditions at the time of issuance. The lack of definitive financing structure is unusual and the BOG may wish to impose specific conditions

on the final structure of the Series 2021 debt as a means to address concerns and/or deviations from the Guidelines.

Non-Level Debt Service Structure

Generally, the Guidelines require debt to be structured on a level debt basis, i.e. structured so that the annual debt service repayments will be substantially equal in each year. The purpose of this policy is to discourage deferring the cost of repaying debt to some future time (i.e. repaying interest only or having bullet maturities). The Guidelines allow a financing to deviate from this requirement if such structure is demonstrated to be in the university's best interest.

The UF UAA has represented that its debt service payments are structured on a "generally level basis as specified in the Guidelines." However, the requirement that debt be structured on a generally level basis applies to each individual issuance of debt. The UF UAA's proposed structure of non-level debt service on the Series 2021 debt allows for substantial deferral of principal payments and is a deviation from the Guidelines. The principal amounts being deferred are not material to the UF UAA's overall debt structure, but an exception to the BOG policy may set a precedent for future UF UAA financings and for other institutions in the state university system. Also, except for the next two years, the UF UAA projections indicate sufficient resources will be available to amortize the debt with level payments without a material impact on its finances.

Variable Rate Debt

The Guidelines permit the UF UAA to issue variable rate debt where, considering the totality of the circumstances, the issuance of variable rate debt can reasonably be expected to reduce the total borrowing cost over the term of the financing. The BOG submission does not include a cost comparison showing the potential savings versus fixed rate debt. The amount of the UF UAA's variable rate debt is relatively high according to rating agency standards; however, the UF UAA does not have any rated debt outstanding. Although the proportion of the variable rate debt on the UF UAA's balance sheet is considered high, it has historically amortized its variable rate debt over time, which has precluded imprudently deferring the principal payments and mimics amortizations as if it were fixed rate debt. The UF UAA has successfully used variable rate financings advantageously and has historically managed the interest rate and rollover risk effectively.

Endowment Funds as a Hedge

The interest rate and rollover risk associated with the relatively high levels of variable rate debt in the UF UAA's current debt portfolio is hedged by the UF UAA's cash and cash equivalents, and short-term investments; which, as of June 30, 2020, were approximately \$10.6 million and \$68.5 million, respectively. Additionally, as of June 30, 2020, the UF UAA had approximately \$49.2 million in long-term investments in its endowment, which strengthens its balance sheet and provides some protection against unexpected liquidity needs. The UF UAA has approximately \$70 million in outstanding debt with variable rates or subject to interest rate resets. It is prudent to maintain substantial cash, short-term investments and unrestricted endowment investments to mitigate the risks inherent in variable rate debt.

Approximately \$47.2 million of the Project cost will be funded through a combination of contributions from private donors and the UF UAA's unrestricted cash and investments. Additionally, projections provided by the UF UAA indicate an operating loss in Fiscal Year 2021 of approximately \$24.3 million and break-even for next fiscal year. It appears that a portion of the UF UAA's resources will be needed to cover operating losses in the current fiscal year, which diminishes the resources available to offset or hedge the inherent risks associated with its variable rate debt.

Debt Service Coverage Ratio

The Guidelines require the BOG to consider the projected debt service coverage ratio when approving the issuance of debt; the five-year projection of pledged revenues should provide debt service coverage of at least 1.20x for both outstanding parity debt and for the proposed new debt for all years within projection period. Neither of these coverages are projected to be satisfied in the current and next fiscal years. However, the UF UAA's operating revenues and net revenues available for debt service are projected to recover in Fiscal Year 2023 to 1.9x and thereafter are in compliance with policy.

Quantitative Metrics

The Project will not produce a return on investment because it is not revenue generating. Because the Project is not revenue generating, the Guidelines require the UF UAA to prepare an analysis of appropriate quantitative metrics. The UF UAA has represented that the Project is expected to enhance the experience of student athletes and coaches but no quantitative metrics have been provided.

cc: Marshall M. Criser, Chancellor, Board of Governors
Kevin Pichard, Assistant Vice Chancellor, Board of Governors
Melissa Stuckey, Associate Athletic Director, University of Florida Athletic Association