Navigating the Current Public Private Venture Program

…Dispelling Operational and Financial Myths…

- ❖ RELATIONSHIPS, ROLES & RESPONSIBILITIES
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- ❖ ENHANCED RAPPORT WITH RATING AGENCIES
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❖ RELATIONSHIPS, ROLES & RESPONSIBILITIES:

MYTH #1
As it relates to the operation of Public Private Venture (PPV) projects; the roles and responsibilities of the campus, foundation, Trustee and Board of Regents (BOR) are clearly delineated and consistent throughout the System.

FACT #1 - The responsibilities of each party or entity engaged in the operation of a PPV project are clearly delineated in each project's bond financing legal documents and the associated agreements. These documents include the ground lease and the rental, loan and trust indenture agreements. The typical PPV transaction involves the:

- **campus who is responsible for paying the lease payments pursuant to a Rental Agreement, managing revenues and expenses and handling the repair and maintenance of the facility;**
- **foundation who receives the rent and pays the debt service payment;**
- **trustee who holds all of the escrow accounts and receives the debt service payment; and**
- **Board of Regents who serves as adviser, facilitator and advocate for the campus and foundation in addition to being the legal party to and signer of the ground and rental agreements.**

Typically, each entity (campus, foundation, Trustee and BOR) are represented by different individuals. However, some of our campuses are structured in the manner whereby the Chief Business Officer serves and represents both the campus and the foundation.

For the majority of decisions, the campus and foundation is in one accord and focused on making decisions that are best for the welfare of the students, consistent with the campus mission and strategy, as well as supporting the overall goals of the Board of Regents. Nevertheless, occasions may arise whereby the role representing the campus may be in direct conflict with the responsibilities associated with running the foundation or visa-versa.

It is imperative in making operational, financial or legal decisions regarding any PPV project that you are always fully aware of what interest you are representing and the legal obligations and responsibilities associated with that interest or position. In event there is any doubt or conflict, seek advice from the Board of Regents (Office of Real Estate and Facilities) and/or legal counsel.

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MYTH #2
Once a PPV project has been financed, constructed and occupied, the role and responsibility of the Board of Regents is purely advisory. The ultimate responsibility for the success of any Public Private Venture Project lies exclusively with each campus and foundation.

FACT #2 - The success of any PPV project rests with all parties; the campus, foundation as well as the Board of Regents. The life of a PPV project spans from inception to retirement of the bond financing (date that bonds are paid-off) and the BOR staff should be involved throughout this entire period.

1. **The primary role of the BOR's staff is to serve in an advisory capacity to each campus as it relates to the financial structuring, bond financing, designing and building and maintaining of each PPV structure.**

2. **The BOR (Office of Real Estate and Facilities) signs the Ground Lease and Rental Agreements that facilitate each transaction.**

3. **The staff of the BOR also serves as facilitator and advocate focused on providing the necessary coordination, document and plan review, advice and support and document approval and execution.**

4. **Even more importantly, the staff exists to help each campus navigate potential internal and external pitfalls and as a resource for information and shared experiences amongst all of the institutions. While the campus and foundation are focused on the performance and success of their respective PPV projects, the System Office concentrates on the overall performance of the entire PPV program.**

It is critical to understand that the entire PPV portfolio is only as strong as its weakest link or project. Said in another way, unfavorable results or the failure of one project will likely negatively impact all future projects. Therefore, ongoing involvement by the BOR in each PPV project *is critical, required and necessary.*

❖ FINANCIAL, REVENUE AND EXPENSE ACCOUNTABILITY:

MYTH #3
Leases for PPV facilities are legally and financially considered both Operating and Capital Leases.

FACT #3 - Leases for PPV facilities are "Operating Leases" and should never be confused with Capital Leases. The relationship between the campus and the foundation is that of tenant and landlord. The terms and conditions guiding the campus occupancy are delineated in the Rental Agreement and is best described as a legal and financial leasehold interest.

For <u>accounting purposes</u>, the PPV projects are treated the same as a "Capital Lease". These projects are recorded in the foundation annual financial statement and each campus accounts for and records the lease payments. In calculating the amount that should be recorded, the institution and foundation working in conjunction with the BOR (Office of Fiscal Affairs,) utilizes a formula that takes in consideration rental obligations over the term of the bond. The financial and accounting reporting of the PPV projects by the foundation and campus are completed pursuant to general accepted accounting principles. Great care should be taken at all times not to confuse accounting principles and processes with real estate finance practices.

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MYTH #4
The primary and exclusive financial concern for each PPV project is that the full rental and debt service payments are paid on a timely basis. It is the campus' and foundation's sole responsibility to focus on each project's financial and physical performance.

FACT #4 - The campus and foundation responsibilities include financial performance of the asset as well as the operation and management of the facility. Yes, it is important that all payments including the rent and debt service payments are paid in full and on a timely basis. But also as important, is the ongoing maintenance and proper reporting of the asset. All PPV projects require additional and ongoing reporting, coordination and communication with the BOR, rating agencies and Trustees. Each vested party to the transaction must be actively engaged in every aspects of ownership\rental of the facility throughout the duration of bond financing and useful life of the asset.

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MYTH #5

The original bond financing pro-forma reflects the basic economics of the deal and was created by the bond underwriter exclusively to support financing. This pro-forma does not have any relationship to the ongoing operations of the asset. Once the PPV facility has been financed, constructed and occupied, changes to the financial pro-forma and operations of the facility is delegated exclusively to the campus.

FACT #5 - The bond financed pro-forma contains the financial guideline for the ongoing operation and maintenance of each project. The pro-forma is created to support and explain the economic terms of the project and serves to delineate the projected revenue and expenses throughout the life of the project.

Every PPV project should have an approved pro-forma that is initialed by the CBO. Even when the bond financing includes multiple projects, the pro-forma will have numbers that reflect all projects combined as well as each individual project. The pro-forma addresses the deal structure from the campus and foundation perspective as well as outlining the basic economics of the deal. It focuses on revenue, expenses and other costs associated with the project. Depending upon which perspective is being presented (campus and/or foundation) the rental payments and debt service payments are indicated.

It is imperative that the campus and the foundation have a copy of the original signed pro-forma as well as any approved

modifications and annual budget. The foundation (working closely with the campus) is responsible for submitting annual changes to the financial pro-forma and operations to the BOR. Pursuant to the Loan Agreement each foundation (supported by the campus) is to prepare an annual Budget. The Budget is to be submitted and reviewed with the BOR staff prior to filing it with the Trustee and the Issuer.

In addition, each campus and foundation is charged with the responsibility of generating a revised pro-forma that more closely reflect the current operational and financial performance of the project. This revised pro-forma is to be reviewed by the BOR and signed by the CBO and Foundation.

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MYTH #6

Because the original pro-forma typically includes an allowance for expenses, it is within the campuses' delegated authority to make determinations as to what expenses are included and recorded for each project. Moreover it is also the campus' responsibility to pay all of the expenses invoiced by the Foundation.

FACT #6 - As to expenses, the pro-forma typically provides only a lump sum estimate which is based on an amount per square foot, per bed or some other basic assumptions. While the campus has some latitude and discretion as to how the facility is operated, there should be some consistency in the reporting of the expenses for all PPV projects on the campus and within the portfolio. The same expense items should be carried in all of the projects that are of the same type. To the extent there is variations, these differences should be noted.

It is critical that all expenses paid by the PPV project is consistent with the pro-forma and annual budgets. These financial documents dictate what expenses should be attributed to the project and paid by campus and foundation. The campus should not pay any expenses indicted as a foundation expense. Those expenses should be paid by the foundation. Great care must be taken to fully understand the pro-forma and annual budgets for each project and particular attention to knowing which expenses should be paid by each party. The foundation is typically responsible for ongoing fees associated

with the bond financing such as the Trustee, Foundation, BOR and Rating Surveillance Fees.

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MYTH #7

As to the PPV projects, it is the accepted practice for operating expenses associated with the structure to be allocated across projects and buildings on the campus versus directly metered and tracked. Any shortfall in revenue on a PPV project can be offset from another PPV project or other available funds.

FACT #7 - Due to the bond financing of each PPV projects it is critical that the finances of each project are kept separate. Ideally, all expenses associated with a particular project should be a direct expense as compared to allocated or estimated expenses. While a campus may provide campus wide services, the expenses associated with a PPV project should be tracked separately.

Each PPV project is underwritten to be financially viable and stable. In event there are operational shortfalls, the project reserves (other than the Debt Service Reserve Fund) should always be used first to offset the deficit. Should the reserves not be enough, then a campus may have to look to other available resources. It is important to remember to seek help at the BOR because at this point, the project may be considered a non-performing asset. The shared experiences and resources of the entire System may be beneficial in addressing the finances and operation of the project.

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MYTH #8

Access to the Repair, Replacement and Maintenance Fund is granted exclusively to the campus and does not require any approvals from foundation, Trustee or BOR. Similarly, it is within the delegated authority of the campus working in conjunction with their foundation to offset any shortfall in revenue on a PPV project with income from another PPV project or other available funds.

FACT #8 - The Trust Indenture document between the Issuer and the Trustee bank provides the legal guidelines for disbursing Repair, Replacement and Maintenance Funds. This document typically provides an Exhibit that must be completed and certified and signed by the authorized representative of the foundation prior to receiving funds. The Exhibit serves to document the amount of funds requested, the payee and the amount to be paid.

Each campus should review the Trust Indenture document and verify with its foundation and Trustee the specific requirements and procedures for requesting funds from the Repair, Replacement and Maintenance Fund.

Tapping into or use of any of the funds found in the Debt Service Reserve should occur as the very last option. These funds should never be touched unless all other potential means of meeting the debt service payment have been eliminated. When considering using these funds, contact should be made with the BOR and consensus reached as to the need to access this reserve account. Remember the Trustee is obligated to report any use of the Debt Service Reserve Account. Use of these funds can possibly trigger a downgrading of the bonds for the project as well as impact the rating of the entire System.

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MYTH #9

The term of the Lease Agreements between the foundation and the campus is automatically renewed each year and does not require any action by the foundation or campus.

FACT #9 - Pursuant to the Rental Agreement, each campus must submit an annual renewal notice indicating their intent on continuing to rent and occupy the project. This notice must be sent with the signature of either the President or CBO of the campus. A copy of the Rental notice should be sent to the BOR (Office of Real Estate and Facilities). A standard format for this notice can be provided by the BOR office.

MYTH #10
The annual Cash Flow Analysis data requested by the BOR, Office of Real Estate and Finance is a short-term initiative whereby the campuses are required to submit financial and operational information that is used exclusively for reporting at the portfolio level. This data is required purely to address internal questions at the System Office.

FACT #10 - Going forward, all PPV project participants are required to submit annual Cash Flow information that has been certified by the CBO. This data is critical to understanding whether each project is performing as originally underwritten in the pro-forma. In addition, this data is evaluated to understand the overall performance of the portfolio. The financial trends are to be analyzed and shared with each campus. Ultimately, it is envisioned that the data will be beneficial in developing "best practices" standards to be shared with all campuses.

❖ ENHANCING RAPPORT WITH RATING AGENCIES:

MYTH #11
The ultimate success and continued positive rating of each campus by the rating agencies is heavily attributed to the campuses financial and operations and less to the overall strength and performance of the portfolio and the System Office. Each campus and foundation is empowered and encouraged to engage in ongoing direct contact and conversations with any of the rating agencies. When talking with any of the rating agencies, it is our opportunity to share the good news and the not so good news. The rating agencies need to understand the limited resources available to each campus.

FACT #11 - The financial performance of each and every Public Private Venture project matters and is critical to the entire stability and positive rating and standing of the entire portfolio. **While each school's finance and operations are evaluated by the rating agencies, the continued success in financing various projects utilizing bond financing rest with the strength and performance of the entire portfolio and that of the system. Rating agencies look at the underlying financial wherewithal of the system to be able to back the individual schools financial obligations. Moreover, as the program continues to grow, rating agencies will evaluate the performance of the portfolio's projects located on the campus seeking bond financing**.

Ongoing and direct dialogue between the campus and the rating agencies is encouraged and extremely important to the overall success of the PPV program. Great care should be taken to address all questions and inquiries in a timely manner and with accurate data. It is important to remember that the rating agencies are underwriting and/or reviewing the financial strength and ongoing stability of the campus and its' operations. Moreover, the language spoken by the agencies may be slightly different than that which is customarily heard within education. A campus may view its abilities to manage and meet objectives with limited and severely decreased resources as extremely positive. On the other hand, the financial market may incorrectly consider this as a sign of deteriorating financial stability for your school and/or the system.
Great care should be taken to provide a true and accurate account of the financial condition of the institution. The campus should refrain from editorializing individual efforts.

If there is any doubt or confusion regarding a request, contact the BOR. Likewise, it is just good business practice to keep the BOR informed of any extraordinary requests, visits or discussions with any of the rating agencies. Many times the rating agencies will verify information obtained at the campus level with the BOR and other sources in the marketplace. Everyone engaged in the financing of the transactions at the campus, foundation and BOR must be able to communicate the same financial and operational picture. Therefore, accuracy and consistency of information and communication is of highest priority.

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MYTH #12

There is no relationship between the requested financial data in the Annual Cash Flow Analysis and the Continuous Disclosure Statement that is submitted to the rating agencies. The campus and the foundation should not be mutually engaged in the completion and submittal of the Continuous Disclosure Statements requested by the rating agencies.

FACT #12 - The annual Cash Flow data requested by the BOR and the Continuous Disclosure Statement are very similar. The Continuous Disclosure Statement requires additional data beyond that requested in the annual Cash Flow submittal. Data submitted pursuant to these requests is used to evaluate the financial and operational stability of the PPV project. The data focuses on the cash position of the project by evaluating revenue and expenses. Also addressed are rental payments, repair and replacement and capital expenses and capital. As needed, the campus and the foundation should work together in compiling and verify requested information. For any given period, the information submitted for these two requests should be consistent.

❖ BENEFITS OF PARTICIPATING IN THE SYSTEM'S POOLED INSURANCE PROGRAM:

MYTH #13 *Participating in the System's Pooled Insurance Program only provides marginal to no benefit to a campus.*

MYTH #14 *The System's Pooled Insurance Program does not cover all the insurance as required in the ground lease and rental agreements.*

FACT #13 & 14 The System's Pooled Insurance program is in its third year of existence and thus far has derived substantial savings for all participating campuses. On average the program is achieving 25-27% savings in premiums for participants in addition to offering enhanced coverage (higher limits, coverage for flood and earthquake). Moreover, the program generates consistency in coverage across the portfolio and guarantees compliance with all of the legal requirements found in the Ground Lease and Rental Agreements