Navigating the Current Public Private Venture Program

…Dispelling Operational and Financial Myths…

- RELATIONSHIPS, ROLES & RESPONSIBILITIES
- FINANCIAL, REVENUE AND EXPENSES ACCOUNTABILITY
- ENHANCED RAPPORT WITH RATING AGENCIES
- BENEFITS OF PARTICIPATING IN THE SYSTEM'S POOLED INSURANCE PROGRAM

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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.

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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.

Navigating the Current Public Private Venture Program

...Dispelling Operational and Financial Myths...

Navigating the Current Public Private Venture Program

...Dispelling Operational

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

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 requir.21927AFF 79MsInden0001 Tcument btic

MYTH #10
The annual Cash Flow Analysis data requested by the BO

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 deteriorat

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