TOPIC: University of Maryland, Baltimore: Amendments to Ground Lease and Refinancing of Fayette Square Apartments

COMMITTEE: Finance

DATE OF COMMITTEE MEETING: January 29, 2015

SUMMARY: The University of Maryland, Baltimore (UMB) seeks approval to modify the financing and certain terms of the Ground Lease with the Maryland Economic Development Corporation (MEDCO) approved by the Board of Regents on February 8, 2002 and amended most recently on April 12, 2010, for purposes of improving the financial performance of Fayette Square Apartments and to remove covenants in the ground lease which place limitations on UMB's ability to participate in additional housing projects.

The Fayette Square Apartments (Project) is a public-private partnership where MEDCO owns the project for the duration of the ground lease, contracts with an operator to manage the facility, and if the project cash flow allows, pays the University a ground rent equal to the net residual cash flow for the year. The facility reverts to the University upon termination of the ground lease, which is designed to end after the earlier of 40 years, or the final payoff of the debt issued to fund the project.

For the past four years, occupancy has been consistently high, operating at or near full capacity. Rental rates have increased, but the cash generated from rents is barely sufficient to cover debt service, forcing the University, MEDCO and the management company (Capstone On-Campus Management, LLC) to defer reimbursement of portions of their annual expenses. The surrounding housing market constrains the ability of the Project to raise rental rates to a point necessary to meet debt service coverage requirements, fund the necessary reserves and pay the University for utilities, security and telephone services provided to the Project. This trend is expected to continue unless there is a refinancing. The University's current deferred expenses for utilities, security and telephone services as of June 30, 2014 total $1.3 million. Building maintenance and facility upgrades to the 10-year old facility have also been deferred because of insufficient funding.

The proposed refinancing plan is designed to decrease the annual debt burden and fund necessary capital improvements to Fayette Square Apartments, enabling the Project to meet its operating goals. MEDCO proposes to issue bonds to:

- (i) refund its outstanding Series 2003A Bonds in the amount of $28.8 million;
- (ii) fund approximately $500,000 in building envelope repairs and provide $460,000 to fund interior maintenance and furnishings replacement over a four-year period;
- (iii) provide a debt service reserve fund; and
- (iv) pay costs of issuance.

UMB proposes to enter into a contingency agreement with MEDCO to lease the number of vacant beds in any given year for the duration of the ground lease, to the extent necessary to generate a 1.0 times debt service coverage ratio and to defer reimbursement for certain expenses in certain situations where there may be insufficient cash flow to make debt service payments.

Certain modifications to the ground lease, including eliminating limitations on UMB's ability to support other proposed housing projects (e.g., Drovers Project), are considered necessary to eliminate a possible challenge to the University's ability to successfully execute a ground lease for proposed project or support other housing projects.

ALTERNATIVE(S): If the refinancing does not occur the Project would continue to require subsidies from the University, MEDCO and possibly Capstone to meet obligations and properly maintain the facility. Without amendments to the existing ground lease provisions restricting UMB's ability to construct or support additional housing, it is possible the proposed Drovers property development project would be negatively impacted.

FISCAL IMPACT: With this refunding the University expects be reimbursed annually for its expenses going forward and anticipates recouping the $1.3 million in deferred expense payments in the future as cash flow from the project improves. Once all deferred and subordinated obligations are met, the University would receive the Project's surplus cash flow in the form of ground rent payments. However, if the debt service coverage ratio drops below 1.0 times debt service, the University will be responsible for leasing vacant beds and if operating costs are 10% or more over what is budgeted resulting in the debt service coverage ratio dropping below 1.0 times debt service, the University will be required to defer reimbursement from the Project for operating expenses.

CHANCELLOR'S RECOMMENDATION: That the Finance Committee recommend that the Board of Regents approve the revised financial terms between the University and MEDCO as described above, and delegate to the Chancellor the authority to (a) complete negotiations with MEDCO relating to revisions to the ground lease and related documentation, and (b) to execute after appropriate legal review, all revisions to the ground lease and required documentation consistent with the applicable University System of Maryland "Policy on Acquisition, Disposition and leasing of Real Property." The University shall continue to work with the University System of Maryland Office of the Vice Chancellor for Administration and Finance and the Office of the Attorney General throughout the document development processes.

COMMITTEE RECOMMENDATION: RECOMMEND APPROVAL DATE: 1/29/15

BOARD ACTION: DATE:

SUBMITTED BY: Joseph F. Vivona (301) 445-1923

UNIVERSITY OF MARYLAND, BALTIMORE