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Determination of Financial Feasibility of Projects Requiring Loan Financing

<http://www.ucop.edu/ucophome/policies/bfb/bus55.html>

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Business and Finance Bulletin Home Page: <http://www.ucop.edu/ucophome/policies/bfb/>

I. REFERENCES

[Regents' Standing Order 100.4](#) - Duties of the President of the University

100.4 (gg) real property approvals

100.4 (nn) external financing approvals

[Business and Finance Bulletin A-59](#), Costing and Working Capital for Auxiliary and Service Enterprises

[Business and Finance Bulletin BUS-43](#), Materiel Management

[Schedule 1](#): Sample Summary Financial Feasibility Analysis for Real Estate Transaction Financing

[Schedule 2](#): Sample Summary Financial Feasibility Analysis for Capital Project Financing

II. SCOPE

The Senior Vice President--Business and Finance is the University's chief financial and business officer, and is responsible for determining the financial feasibility of all proposed projects that require loan financing and/or a significant commitment of University financial resources; the financial management of such projects; and the development and implementation of policies, procedures, and guidelines to ensure the University's ability to meet all scheduled annual debt service and reserve requirements. The Senior Vice President--Business and Finance is responsible for the negotiation of external financing arrangements and for acquisition, sale, and ground lease of real property for University-related purposes.

This Bulletin applies to proposed on-campus, off-campus and Office of the President projects that will result in liabilities on the University's balance sheet. Included within is an explanation of information which must be provided in support of a financial feasibility determination for any capital project requiring loan financing. Such projects encompass construction projects, projects involving capital leases and ground leases (Regents as

lessee), and purchases of real property for University-related use (collectively, *real property transactions*). Finally, the Bulletin establishes procedures for submitting proposals for review to the Office of the Senior Vice President--Business and Finance.

Information on requests for loans from working capital funds is addressed in Business and Finance Bulletin A-59.

III. DEFINITIONS

- Capital Project¹ -- A project involving the purchase, capital lease, or ground lease (Regents as lessee) of real property; a construction project; or a capital equipment purchase
- Capitalized Interest -- Interest on construction capital used by the campus prior to building occupancy. This interest is usually financed (*capitalized*) along with all other construction costs.
- Construction Project -- A proposal for new construction (including site work and utilities), substantial alterations, extension or improvement of existing structures (including related fixed and movable equipment).
- Debt Service -- The amount of principal and interest annually paid on borrowed funds.
- Equipment Project -- A proposal for the purchase, lease, and/or installation of major items of equipment that are not included in the Group 1 or Group 2 equipment categories in an approved Capital Construction Project (see [Equipment Budgeting for New or Remodeled Buildings](#), August 17, 1964). This category includes replacement of major energy systems as well as installation of new systems. Equipment which is normally obtained pursuant to Business & Finance Bulletin BUS-43 is not included in this category.
- Equity -- Cash contributions from specific campus fund sources (by name)
- Gift-Based Financing -- There are two types of gift-based financing:
 - Interim Financing is short-term financing of the gift pledge shortfall (total gift target for a project, less gifts pledged and/or collected for the project)
 - Standby Financing is short-term financing for a project for which a financial gift (or gifts) has been pledged but not yet collected.
- Loans -- Borrowed funds scheduled to be repaid over one or more future fiscal periods. External loans are funds obtained from the sale of revenue bonds, from lending agencies, or from any other sources outside the University. Internal loans are based on advances of Regents' funds.
- Real Property -- Land, including any buildings and improvements affixed to it.
- Real Property Transaction -- As used in this Bulletin, the term *real property transaction* refers to a purchase, capital lease or ground lease (Regents as Lessee) of

¹ For purposes of identification and budget control, both major and minor capital improvements are designated as projects.

real property (with or without improvements). In addition to providing the purchase price or rental payments associated with a real property transaction, the campus should itemize costs for (i) construction projects to prepare the property for the University's use; (ii) due diligence (e.g., appraisal, title reports, property investigations, surveys and testing); (iii) closing costs (e.g., escrow fees and title policies); and (iv) eminent domain proceedings and relocation costs, if applicable

- University-Related Use -- Use in connection with or in support of academic, research, public service, or business-related programs, both for campuses and units under the direction of the Office of the President. This category excludes the acquisition of real property purely for investment (endowment) purposes.
- Working Capital -- The excess amount of current assets over current liabilities. *Current assets* may include inventory and receivables.

IV. CAPITAL PROJECTS REQUIRING LOAN FINANCING (EXCLUDING REAL PROPERTY TRANSACTIONS)

Each capital project for which debt financing is proposed must be supported by a financial feasibility analysis. The financial feasibility analysis does not in any way replace the review and approval procedures established for capital projects by the [Vice President for Budget](#).

A. Project Information Requirements and Financial Feasibility Analysis

As applicable, the financial feasibility analysis must include a description of the proposed project identifying the user group and the benefits accruing to that group, risk factors and alternatives and detailed information in support of the programmatic need for the project.

Project Information includes:

1. Current operation / user group (and specific identification of the department that will have management responsibility for the Project).
2. A description of the program-related issues, auxiliary requirements and/or physical constraints driving the need for the project.
3. A description of how the proposed project responds to the broader needs and goals of the campus.
4. A description of user functions and activities to be accommodated, mapping the functional needs of the program onto facility requirements.
5. Identification of project risks and risk minimization measures, and alternative approaches considered to meet the project objectives.
6. If applicable, a statement on the physical, financial and/or programmatic relationship to existing projects. Examples might include adding a wing to an existing facility, replacement costs for parking, providing infrastructure (e.g., roads) for future development, and so on.

7. Secondary effects including “surge” and/or relocation requirements, if applicable.
8. Factors relating to existing buildings (if applicable) to be replaced or renovated, for example: the presence of hazardous materials, code requirements, adequacy of existing utility services and other infrastructure elements, as-built condition information, building services condition, seismic hazards, and so on.

The Financial Analysis includes:

A statement providing financial justification of the project. Such information might include but is not limited to: (i) project cost estimated as of the midpoint of construction; (ii) proposed source(s) of financing, including the proposed amounts and the proposed terms of the associated loans, the estimated annual debt service, and required or planned financial reserves; (iii) the source(s) of revenue proposed to cover debt service and reserves; and (iv) a “drawdown” schedule (i.e., timing of construction funds utilization).

Current interest rates, amortization schedules, and other loan planning criteria will be supplied by External Finance upon request. Schedules 1 and 2 (attached) present the suggested formats. Additional financial and related information to be provided includes:

- a. Project timing (start and occupancy dates) and identification of any expected phased delivery (i.e., occupancy of the facility in one or more stages);
- b. Start-up and/or operating costs associated with the new facility, and fund sources that will cover such costs;
- c. Prices, rates, or fees currently required to meet operating expenses (including maintenance); net revenue requirements of similar campus operations; and estimated increases in prices, rates, or fees necessary to meet the proposed additional requirements of the new project. If annual increases are projected, then the estimated annual rate of increase (\$ and %) should also be provided.
- d. Prices, rates, or fees currently charged in the off-campus community for comparable goods or services such as those planned for the new project. When comparing proposed on-campus fees and rates with off-campus fees and rates, explain whether estimated costs may include services not available in both facilities (free data line, utilities, etc.).
- e. A summary of any existing debt presently being repaid from the same or similar revenue sources noted in item (iii), above, including the name of the financial institution(s) providing the loan(s), the annual debt service and reserve requirements, debt service coverage, the number of years left to repay on existing loans, and any other known or anticipated factors that could affect the ability of the campus to assume the proposed additional debt.

- f. Any atypical assumptions used in the financial feasibility analysis and explanations for their application (e.g., lower than normal operating expenses due to consolidation, consolidation of existing leases, etc.).
- g. A report of any past failure to meet net revenue assessments or other debt repayment schedules on time.
- h. Any non-University use of space that will occupy a portion of the project (e.g., retail, restaurant, or any other third-party use that may not qualify for tax-exempt interest treatment).
- i. When applicable, data on current and projected (future) supply and demand for the goods or services which the proposed project would provide. Such a statement should list any existing campus and community facilities that would compete with the proposed project, and provide an assessment of the potential for future competition. When appropriate, the following supporting data should also be supplied: current and projected vacancy rates (or waiting lists); market area studied (defined); source of market data; number and volume (sales) of competing venues; relative competitive positions or features (qualitative and quantitative); and so on.
- j. Gross and net income actually generated in the past two years by campus activities similar to those addressed in the proposed project, and estimated gross and net income through the first three years of the proposed project's operation (include assumptions such as growth rates and inflation factors). When the proposed project adds to existing facilities or systems (e.g., parking, housing, student centers), the campus should provide financial data on the new facility along with the totals for existing and proposed similar facilities (shared fund source) on that campus. Note: The campus should provide cash flow data beyond the first three years when necessary to adequately demonstrate the financial feasibility of the proposed project.
- k. Additional factors bearing on the project, such as its relationship to campus academic plans or student programs, its impact on the community, and any other information that will assist in determining financial feasibility or economic viability. Examples might include reducing local vehicular traffic, providing space for community events, generating revenue for incremental services, and so on.
- l. Additional information as may be requested by the Office of the President.

B. Financial Feasibility Submittal Process

Financial feasibility analyses must be signed by the Chancellor or the Chancellor's designee,² and must be submitted to the Senior Vice President--Business and Finance for review at least two months in advance of the campus deadline for submission of the first Regents' Item on the proposed project. The siting of all capital projects must be in general conformance with the land use designations in the Long Range Development Plan. If a project site is not in general conformance,

² or by the Senior Vice President, Business & Finance for projects on behalf of the Office of the President

the LRDP must be amended by the appropriate authority (Regents' Grounds and Buildings Committee or the Senior Vice President) at the time of design approval. Information on project scope, cost, and funding sources should be submitted to the Vice President for Budget in accordance with the instructions for preparation of campus capital budgets.

Following a review of the financial feasibility analysis, the Senior Vice President--Business and Finance will make a preliminary determination of programmatic justification and financial feasibility. If the determination is in favor of the proposal, the campus will submit a Regents Item to the appropriate [UCOP Coordinator](#). The Office of the President will coordinate approval of financing, as supported by a favorable determination of financial feasibility. If approved, the Senior Vice President--Business and Finance will forward the request to The Regents.

Securing Regents' approval does not guarantee that a loan interest rate will be locked in upon approval. The University's ability to obtain external loans is dependent on prevailing market conditions, existing debt load, and other circumstances beyond University control. The amount of funds available for internal loans is also limited. Campuses with several projects pending may be asked to rank the projects in priority order.

Any project revision which increases the amount of financing will necessitate an additional financial feasibility review and will also require approval in accordance with Regental requirements. Scope changes may require Budget Office approval and updating of financial feasibility studies. All proposed revisions should be submitted in a timely manner to the Senior Vice President--Business and Finance and/or the Vice President for Budget, as appropriate.

V. REAL PROPERTY TRANSACTIONS REQUIRING LOAN FINANCING

From time to time, The Regents may deem it necessary or expedient to acquire long term control of off-campus real property for a University-related purpose. In some cases, campuses may plan to fund the transaction with external financing. Such acquisitions may involve unimproved land or land with existing improvements, such as an apartment complex. For real property transactions, responsibility for the following matters rests with the Senior Vice President--Business and Finance: (i) preparing purchase or ground lease proposals and negotiating transaction terms; (ii) determining the value of real property, review of title and general due diligence requirements, and (iii) determining financial feasibility.

At the earliest possible date, the campus should prepare and transmit a [Transaction Authorization Letter](#). This letter is required for all real property purchases and sales, ground leases, and capital leases (collectively referred to herein as real estate transactions). Each real property transaction must be supported by a preliminary financial feasibility analysis, submitted along with the Transaction Authorization Letter. To the extent applicable, the following information should be included in support of the analysis. Applicable information that is not reasonably available for inclusion with the Transaction

Authorization Letter must be provided before a final decision will be made to proceed with the real property transaction.

- A. For acquisitions (particularly if financed), ground leases (Regents as lessee) and capital leases, the appropriate information required in Section IV.A. above, *Capital Projects Requiring Loan Financing (Excluding Real Property Transactions)*
- B. Copies of appraisals, reports or other documentation prepared for the project (whether by the University or by an outside consultant)
- C. As appropriate, three years of operating statements, a current rent roll and abstracts of all leases on the property, and the campus relocation plan and relocation budget for any tenants that will be displaced. If the transaction involves holdover tenants and is to be financed, the campus must provide estimates of rentable square footage, the percentage of non-University occupancy, expected contributions to project income, and a relocation plan and budget.
- D. For any transaction involving existing improvements to be utilized on an interim or permanent basis, a summary of plans and the budget to bring the improvements in line with applicable University policies and to fully outfit the improvements for the University's intended use.
- E. For all acquisition and ground lease (Regents as lessee) transactions, the campus must provide a copy of the comprehensive due diligence plan to evaluate the physical (land and improvements), environmental, CEQA, and legal parameters of the real property. The due diligence plan must indicate whether evaluations will be performed by campus or Office of the President personnel. If any evaluation is to be performed by outside consultants, the plan must state the business name(s) of any consultant or significant sub-consultant.
- F. For capital leases, evaluate all leases against the criteria in the Real Estate Services Group Web Site at: <http://www.ucop.edu/facil/resg/>. For leases that may be questionable as to whether they pass the 90% test against fair market value, run the template provided and include it with your Transaction Letter package as appropriate.

If a proposal receives a favorable determination from the Senior Vice President--Business and Finance based on an analysis which encompasses information in support of the Transaction Authorization Letter, the Assistant Vice President for Facilities Administration may authorize UCOP staff and the campus to proceed with the transaction. As the transaction progresses, the campus must submit a final financial feasibility analysis, to be reviewed to confirm financial feasibility and the appropriateness of presenting the project to The Regents or the designee for approval. (See also [Authority to Approve and Execute Real Property Transactions for University-Related Purposes](#) under *University-Related Real Estate Approval Authority*.)

VI. ASSISTANCE IN PREPARING FINANCIAL FEASIBILITY ANALYSES

The offices of Financial Planning & Analysis, External Finance, State and Non-State Funded Capital Programs, and the Real Estate Services Group (RESG) will assist campuses and the Office of the President by providing information and advice on matters relating to loan proposals, financial feasibility analyses, Transaction Authorization Letters

and other questions of a financial, budgetary, or procedural nature. The RESG has primary negotiating authority for all acquisitions, sales and ground leases.

VII. RESPONSIBILITIES

For project financing and real property transactions, the Senior Vice President--Business and Finance is responsible for: (i) assuring the financial feasibility of all proposed projects which require external loan financing; (ii) developing and maintaining policies, procedures, and guidelines related to payment of debt service on loans and accrual of reserves; and (iii) review and approval of the range of University-related real property transactions.

The Vice President for Budget is responsible for review of proposed projects for inclusion in the Capital Improvement Program, and for authorizing the transfer of funds and loan proceeds pursuant to appropriate actions by The Regents and the President.

The Chancellor (or, on behalf of the Office of the President, the Senior Vice President--Business and Finance) is responsible for preparing and submitting financial feasibility proposals in accordance with this bulletin; for preparing and submitting related Regents' items; for preparing and submitting information on capital projects to be included in the University Capital Improvement Program Budget; and for exercising delegated authority.

The Office of External Finance is responsible for all negotiations with lending institutions regarding project financing, including terms and conditions pertaining thereto; the preparation for and sale of all revenue bonds and other public debt issues offered in the name of The Regents; establishment of feasibility rates for determination of project debt service and financing feasibility of specified revenues; and for negotiation, placement and issuance of any external financing approved for the project or real property transaction.