BOARD OF REGENTS **AGENDA ITEM 3c**
STATE OF IOWA **AUGUST 2-3, 2012**

Contact: Joan Racki

HOSPITAL REVENUE BONDS, SERIES 2012

Actions Requested: Consider authorizing:

1. The sale of $190 million in Hospital Revenue Bonds at the September 2012 Board meeting to complete the financing for the UIHC - Children's Hospital project.

2. The investment of the proceeds from the sale in the most advantageous manner, within the requirements of *Iowa Code* and Board policies, including the use of competitively bid Guaranteed Investment Contracts.

Executive Summary: At its February 2011 meeting, the Board approved a resolution authorizing the Executive Director to fix the date or dates for the sale of up to $190 million in Hospital Revenue Bonds (providing approximately $176 million in proceeds for the project). Since that time, various financing scenarios have been discussed and considered:

- Single sale in September 2012 for $190 million;
- Two bond sales of $95 million each occurring in September 2012 and September 2013; or
- Four bond sales of approximately $47.5 million each to be sold approximately 6 months apart beginning in September 2012.

Historically, the issue size of Board of Regents bonds has been limited to a sale amount of approximately $30 million or less to take advantage of the double tax-exemption (interest exempt from both federal and state taxes) available for Iowa individual investors. Springsted, Inc., the Board's financial advisor, indicates that bond sales of up to $50 million could likely take advantage of the double tax exemption, but bond sales exceeding that amount would not be absorbed primarily in the Iowa market and would need to be sold in the national market. Since buyers on the national market can only take advantage of the federal tax exemption, it is anticipated that the interest rate on a sale exceeding $50 million would be approximately 10 basis points higher on average than the rate on smaller sales.

While the projected interest rate for a sale greater than $50 million is anticipated to be slightly higher, the University of Iowa Hospitals & Clinics, in consultation with Springsted, Ahlers & Cooney (Board's bond counsel), and Board Office staff, recommend selling a single bond issue to complete the external financing planned for this project, for which the Board approved a $292 million project budget in June 2012. (Other sources of project funds include the University Hospitals Building Usage Fund, and designated Children's Hospital gift funds.) Factors leading to this conclusion include:

- Elimination of interest rate risk. Interest rates are at historic lows and Springsted believes they are not likely to go much lower. However, given the uncertainty regarding the global economy, it is much more likely that interest rates will rise in the future;
- Uncertainty over future political events, including future national debate regarding the long-term viability of allowing exempt organizations to issue tax-exempt debt;
- Uncertainty over possible future financial market dislocations are eliminated by issuing a single bond issue; and

- Elimination of financing uncertainties prior to award of major construction contracts.

The primary rationale for the sale of multiple smaller bond issues is to minimize the negative arbitrage (investing the bond proceeds at a rate lower than the interest rate being paid on the bonds) associated with borrowing money to complete construction of the Children's Hospital. In a stable interest rate environment, it is usually better to issue debt to generate proceeds that match project cash flows as this approach lowers the cost of borrowing. Given the current interest rate environment, it is projected that total debt service payments over the life of the bond issue would total $3.7 million more, on a present value basis, from the sale of one large bond issue compared to four smaller bond issues. If interest rates were to rise in the near term, this calculated net present value cost would decrease and move toward a break-even point. If interest rates were to increase materially after the September 2012 bond sale, it is probable that issuing one bond issue in September would be more advantageous on a net present value basis than issuing a series of smaller bond sales.

Investment of Bond Proceeds: Bond proceeds are typically invested by the University's Treasury Department in accordance with provisions of *Iowa Code* and the Tax Exemption Certification. Construction proceeds needed for near term expenses are held in money market funds organized in trust form registered with the federal Securities and Exchange Commission. Debt service reserve funds are invested in direct obligations of the United States Government or its agencies; the maximum maturity date is five years from the date of investment.

Guaranteed Investment Contracts: For this bond sale, the University recommends hiring Springsted to coordinate a Request for Proposals (RFP) designed to maximize investment returns on the construction proceeds. Springsted has informed the University that Guaranteed Investment Contracts (GICs) can be laddered to meet the University's cash flow needs for construction draws, while improving investment returns by 20-30 basis points. Ahlers & Cooney, the Board's bond counsel, has confirmed that GICs are permitted by *Iowa Code* and can be structured in a manner that return of principal is guaranteed. The use of an RFP process that complies with government rules will result in competitive bids by providing investment vehicles that are safe, provide a better yield, and match bond proceed cash disbursement schedules during the construction period. Springsted's RFP would be structured to assure that only high quality and secure institutions will be eligible.