

UNIVERSITY OF SOUTH ALABAMA
BOARD OF TRUSTEES

Budget and Finance and Executive Committees

The Budget and Finance Committee and the Executive Committee of the University of South Alabama Board of Trustees were duly convened by Mr. Mayer Mitchell on September 4, 1997, at 10:00 a.m. in the Board Room of the Administration Building.

Members Present: Messrs. Jack R. Brunson, Ken Kvalheim, Mayer Mitchell; Mayor James Nix; Mesdames Jerry Goodwin, Bettye Maye; Dr. Max McLaughlin; Judge Herman Thomas

Members Absent: Drs. Steve Stokes and Ulysses McBride

Others Present: Judge Charles Woods; Mr. Pleza Watson; Drs. Frederick Whiddon, Dale Adams, William Gardner, John Filer, J. David Stearns; Ms. Maxey Roberts; Messrs. Wayne Davis, Nolan Leake, Ron Rosenberger, George Smith, Steve Simmons

Mr. Mitchell stated that a combined meeting of both committees was for the purpose of fully exploring the lease/leaseback financing issue. Dr. Whiddon commented on the value to be received from such transaction, including funding for scholarships for students and professorships for faculty. Ms. Roberts introduced Mr. Nolan Leake, Senior Partner of King & Spalding in Atlanta, and Ms. Patricia Ferrari, Tax Attorney with King & Spalding in New York, present by telephone.

Mr. Leake briefly explained the Section 467 tax theory of such transactions which has been used by tax-exempt organizations such as the Birmingham Jefferson Civic Center Authority. Ms. Ferrari gave a general overview of the structure of lease/leaseback financing. As a head lease lessor, the University would identify buildings to lease to a specially designed entity, the equity investor. The equity investor would enter into a loan agreement with a financial entity that would have a security interest in the lease. A sub-lease, which would mirror the original lease, would provide for leasing the property back to the University. Under current tax laws, the lease would pay the debt. The sub-lease rental would match the original lease payment to net zero for the University. The equity investor receives a tax benefit from the property and deductions for the nonrecourse debt. The University receives benefit by the initial payment from the equity investor. Costs incurred in connection with placing the debt, legal fees, and appraisals would be the responsibility of the University. Ms. Ferrari reviewed each element at length, noting that most such transaction size usually range from \$200-\$400 Million.

Mr. Mitchell requested an analysis of potential risks, liabilities, for the University with a transaction of this type. Ms. Ferrari responded that all potential risk areas are covered in the term sheet. Liability technically rests with the borrower--the equity investor. Risks to the University include credit problems of the financial institution holding the monies to pay the debt.

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If the financial rating of the financial institution should fall below a certain level, the University would have to negotiate with the equity agents to move the debt to another financial institution. Dr. Whiddon stated that the defeasance accounts held by the financial institution would need to be "buttoned down" and Ms. Ferrari stated that the transition will clearly provide that the cash is held in reserve to pay the debt.

Another risk would be indemnity which is an unknown contingent liability and the University would be expected to indemnify several different areas, e.g., the lender for regulatory risks and withholding tax risks, general indemnity for losses relating to leased facilities, and tax indemnity. These are undefined risks; Ms. Ferrari reviewed several ways in which the University could mitigate these risks. She also noted that one representation that must be made is that the University is not compelled to exercise the option at the end of the lease term to buy back the buildings under the lease. That representation is a part of the tax indemnity. In addition, the University would assume risk on any action that the University may undertake during the lease to adversely impact the equity investor's tax position or benefit. Ms. Ferrari and the tax department of King & Spalding have evaluated the potential risk and have minimized that risk by negotiating a cap on the ultimate liability under that provision not to exceed the benefit ordinarily received by the institution. Dr. Whiddon, referring to general indemnity claims, stated that the worst case scenario would be that the up-front money would be returned, but the interest that had accrued over the period of the transaction would be retained by the University. Ms. Ferrari concurred with that interpretation.

Mr. Kvalheim questioned the desirability of issuing a bond issue rather than assuming the lease/leaseback. Ms. Ferrari responded that when issuing bonds there is an agreement to repay where with a lease/leaseback the money is received with no payback as the money from the equity is ultimately paying the debt. The Birmingham Jefferson Civic Center received a total cash payment of \$15 million, with expenses of approximately 6 million, from a \$205 million deal. Mr. Mitchell stated that bond issues are done against cash flow not real property collateral.

Mr. Wayne Davis stated that the entire process would take at least three-four months and there would be an initial exposure of approximately \$100,000 which would include the required appraisal of facilities to determine value and remaining useful life.

Ms. Ferrari was thanked for her presentation and excused. Mr. Mitchell stated that the no action was required on the lease/leaseback subject, but will be the first item of agenda for the full Board.

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Upon the motion of Mr. Nix, seconded by Mr. Brunson, the combined Budget and Finance Committee and Executive Committee was adjourned.

Submitted by:

Attested to:

Mayer Mitchell, Chair

Bettye Maye, Secretary