Budget and Finance Committee

January 26, 2023

Minutes

The meeting was called to order at 9:49 a.m. by Governor Kelly, serving as chair for today's meeting, in the Student Center Ballroom. Secretary Miller called the roll. A quorum was present.

Committee Members Present: Governors Atkinson, Gaffney, Kelly, and Stancato; Linda Beale, Faculty Representative (via video conference) and Jane Fitzgibbon, Faculty Alternate Representative; and Cordelia Krawjewski, Student Alternate Representative

Committee Members Absent: Governor Barnhill and Ibrahim Ahmad, Student Representative

Also Present: Governors Busuito, Kumar, and Land (via video conference); President Wilson; Provost Kornbluh, Vice Presidents Burns, Ezzeddine, Massaron, Lindsey, Schweitzer, Staebler (via video conference), Stemmler, and Wright; and Secretary Miller

APPROVAL OF MINUTES, DECEMER 2, 2022

ACTION: Upon motion made by Governor Stancato and supported by Governor Gaffney, the minutes of the September 30, 2022, Budget and Finance Committee were approved as presented. The motion carried.

CONTINGENCY RESERVE

The Contingency Reserve had no activity to report.

STATE OF MICHIGAN SCHOOL OF MEDICINE FUNDING AGREEMENT/ BOND AUTHORIZATION RESOLUTION

Governor Kelly called on VP Massaron for an overview of the State of Michigan agreement. Vice President Massaron advised that the adopted budget for the state of Michigan included an appropriation from the State Department of Labor and Economic Opportunity. In the terms of the agreement the University would agree to accept that $100 million appropriation, receiving $50 million up front and $50 million after spending down the initial $50 million, for the construction of a School of Medicine building. The project includes a partnership with the Karmanos Cancer Institute for usage of space. The planned facility will have an anticipated 250,000 square feet of total space. The University will report to the state how the money was used, and the progress made on this project. By signing the agreement with the State to accept the $100 million, the University is committing to spend at least that amount of Wayne State funds for this facility.

Governor Kelly noted that the funding agreement and the bond authorization are interrelated and that questions for either of these two agenda items can be raised during this discussion.

Governor Kelly asked, given that the $100 million appropriation is contingent on the University's including Karmanos in this new medical facility, how the University's relationship with Karmanos will change. President Wilson advised that the lobbying effort for the building was conducted in partnership with Karmanos, and he does not see that the relationship will change. There is a long-standing operating agreement between the two entities, Wayne State and Karmanos, that details who's responsible for what, in terms of financial support, clinical care and research. The CORE grant, another name for the comprehensive cancer center designation, details how that is handled. He noted that if anything, the comprehensive agreement will deepen their commitment. In response to a question from Governor Kelly, President Wilson confirmed that Karmanos will not have an ownership interest in the building. Wayne State will own the building and receive indirect cost for the research performed by Karmanos faculty who are Wayne State faculty.

Governor Kelly noted that a location for the building has not yet been identified and asked what assurances could be made against additional expenses incurred in this operation by having to purchase property in order to construct the building or for additional expenses to be funded. President Wilson noted that 3 potential sites have been extensively studied. All 3 sites are owned by Wayne State, and there are no anticipated additional expenses outside of cleaning the chosen site. A committee of faculty from both KCI and Wayne State have been meeting on this for several months. There is a meeting scheduled in two 2 weeks, and it is anticipated that a decision on where to site the building will soon be reached.

President Wilson advised that their intention is to design a building that will fit what the University can afford. There are no plans to come back to the board for additional funding. VP Massaron added that under the leadership of Rob Davenport's group, and in preparation for site selection, there has been soil testing, environmental testing, and location of underground utilities, before receipt of the funds, to mitigate risks.

In response to a question from Governor Busuito on whether the University will be able to retain R-1 rating research status without Karmanos, President Wilson advised that they would not.

Governor Kelly asked if Karmanos is responsible for raising any of the money needed to build the facility. President Wilson advised that they are, and confirmed that both entities are committed to raising funds. Karmanos has identified a potential donor considering a gift between $25 to 40 million and the University will also be trying to raise as much money as possible towards constructing a building that both entities want. He reiterated they are going to design a building that they can afford.

Governor Kelly asked about the estimated costs. President Wilson advised that estimates based on the work of the committee, with the help of Rob Davenport's team and a professional team from Plante Moran, identified costs ranging from a low of $250 million to a high of $400 million, and that they will be able to flex between these ranges based on how the fundraising progresses. He explained that under the $400 million estimated, they would completely move out of Scott Hall, and likely demolish the building. Under the $250 million plan, they will continue to use Scott Hall for a period of time. The President indicated that he is asking the board for some flexibility in spending and recapped that there will be the $100 million from the State, anywhere from $100 to $150 million in bonding and anywhere from $50 to $100 million in philanthropy.

He advised that the board will be asked to approve the top limit of $150 million for the bonds, which could be offset by the fundraising. Governor Kelly asked whether this represents the biggest capital outlay project for the University. VP Massaron advised that notwithstanding past projects adjusted for inflation, in terms of dollars the University plans to spend, this is the largest new money borrowing and the largest capital project he can identify. While the State Hall project is significant, the amount of funding provided by the State of Michigan was less.

Governor Kelly asked VP Massaron to address the impact of this project on the long term financial condition of the University. VP Massaron advised that he prepared a short 2-part presentation on the bonds themselves, which is responsive to this question.

Before moving to the presentation, Professor Beale asked if the objective of having a state-of-the-art research facility could be met at the low end estimate and renovation of Scott Hall. She commented on the previous loss of many good research faculty in Medicine in part because of the state of research facilities. President Wilson responded, and advised that the most desirable situation is to move completely out of Scott Hall, and build ideally two separate buildings, housed together, so that KCI, the cancer center, has its own identity, but the estimated costs for that, at $450 million, is cost prohibitive.

The current plan is for a quality single building with some identity and branding that separates the cancer center apart from the School of Medicine. He also mentioned recent investments and improvements at Scott Hall, including the upgrades to the Vivarium, among others. There is anticipation that any new fund-raising campaign will potentially raise enough funds to be able to demolish Scott Hall at a future date. The goal is to have a state-of-the-art building, and the reality is that the project will have to be done in stages. Mr. Davenport added that the concept is that the new facility will be research-centric and the remaining units at Scott Hall will be the Vivarium, Anatomy, Administration and Academic space, with additional academic space in the new building.

Professor Beale asked about the planning for fundraising and philanthropy. President Wilson advised that the next campaign has begun, and they have identified potential $1 million dollar donors, $10 million donors, and $25 million dollar donors, and discussions are underway.

VP Burns advised that Karmanos does not have a chief development officer in place and that has slowed progress on their side. She advised that getting to $100 million in donations will be very difficult but there are prospects and verbal commitments. She believes that $50 million is more doable, based on her analysis. Professor Beale asked if there is any progress at Karmanos in fixing the lack of coordination. President Wilson advised that he has a meeting soon with representatives from both McLaren and Karmanos to discuss this issue and how to move forward.

In response to a question from Governor Gaffney asked about the timeline for the project, VP Massaron advised that it will be approximately a 4-5 year project. Governor Kelly asked that the board be kept current on progress and activities of the project at every meeting, and VP Massaron agreed.

Governor Kelly asked for the following clarification. If the board authorizes a $150 million bond issue, and the University raises sufficient money through philanthropy so that the entirety of the bond was not used, could it be paid back to reduce University debt or utilized toward other sources with the Board's prior approval? President Wilson responded yes, it could. She then asked if there was any worry about the project's repercussions with other medical institutions. President Wilson advised that the medical landscape is complicated but there are no real concerns related to this project at this time.

Professor Beale asked whether more money will be spent on Scott Hall before the project begins and if yes, how much will be spent. President Wilson advised that it is likely funds will be spent. VP Massaron advised that he is working to validate the number, as there are immediate and long term needs to keep the building functional before and during the project. An example, he indicated the HVAC systems needed care.

Professor Fitzgibbon asked if the City of Detroit is going to be involved and asked whether they would have to approve it. VP Massaron advised that the City of Detroit is not involved, and noted that the project is not subject to city zoning or other administrative approvals other than inspections of elevators and a few small regulatory items. VP Lindsey advised that the Director of City Planning and Development has been apprised of the project and will continue to be updated. He further advised that he is exploring opportunities to synergize with the city.

VP Massaron then introduced Erik Kelly, president of Blue Rose Capital Advisors, and the financial advisor for the University, to provide a brief market update. Mr. Kelly began with an update on the market in the context of the project and the interest rates forecast for the current market environment. He advised that future financing is not likely to be executed in the very short term but over some medium-term period later in 2023 or early in 2024.

He noted three takeaways including that long term rates are at their long term historical average, tax exempt rates are not as elevated as their taxable counterparts and short term rates, particularly the rate the Federal Reserve controls, are elevated and are expected to remain so. He then spoke on how these impact the University's finance plan for the project and how these rates can be favorable for the university. Mr. Kelly shared several slides with the committee showing longtime historical averages. Current tax-exempt rates are near their historical average and he highlighted where rates stood before the financial crisis in 2007 and where they are at currently.

The University captured long term favorable rates on prior financing and as the model for a potential 30-year tax exempt financing is formed, borrowing costs are estimated to be in the 4 to 4.5% range. He added that the forecast for interest rates is not expected to have meaningful upward pressure in the near term during 2023, and therefore the University will expect to be able to obtain an attractive cost of capital.

The University last entered the market in the summer of 2020, predominantly for the State Hall renovations, and borrowed on a taxable basis rather tax exempt. For a substantial project and to secure a lower cost of capital, this current project will qualify for tax exempt financing and that will be pursued. Mr. Kelly then provided a market update and a forward-looking perspective with three different rates, showing recent history and a projection based on economists' forecasts. He advised that rates were near 0% since the pandemic in March of 2020 but rose in early 2022 to combat inflation. Long term 10 and 30-year taxable treasury rates rose during 2022 while short term rates fell because the market was expecting a mild recession.

Interest rate markets are forecasting this and therefore are beginning to come down from highs of 2022. From a forecast perspective, economist's expectations are that regarding long term rates, both 10 and 30-year taxable rates are not expected to move upward. He added that this is a favorable environment and locking in those long-term rates will avoid longer term interest rate risks. The market will continue to be monitored and advice will be given along the way in terms of timing if the market shifts during the course of 2023, as the financing element of the overall project is an important component of the overall affordability.

Next, VP Massaron called on Tom LeMarbe from the WSU Treasury for an overview of what the authorizing resolution provides, and some additional background and highlights of the University's annual debt service and a comparison to in-state peers.

Mr. LeMarbe advised that the resolution calls for up to $150 million of project funding with a minimum of $100 million dedicated to the School of Medicine and KCI building, with the residuals for various other campus infrastructure projects and building enhancements.

The resolution identifies up to $11.25 million to cover 1 year's capital interest on the project and the cost of issuance. The other component part of the resolution will authorize David Massaron to enter into a contract to go to the market for the bonds. The resolution also provides V P Massaron the authority to execute any refunding of the current debt of the University. Next, Mr. LeMarbe presented a summary of the University's outstanding bonds. There are 8 bond series outstanding with a balance of $524 million, with an estimated value of around $650 million. He advised that the University has some opportunity in the next few years to refund a few of its issues, and the resolution provides Vice President Massaron that authority.

Governor Gaffney asked what the criteria is used for refunding. Mr. LeMarbe advised it depends on a reduction in interest rates. VP Massaron advised that this also impacts the timing in which the University would issue new bonds. The University will want the bonds to be refundable, meaning the University could borrow the money and compress the time where the debt is held outstanding to minimize interest costs.

Mr. LeMarbe then reviewed a slide illustrating pro-forma total debt service by fiscal year. The chart shows the incremental impact of the new money. In this structure, over the first 7 years of the new money, the university will pay interest only, and then in 2031, when the principal component of this issue kicks in, the University will have received some savings from existing issues, and the net overall debt service for the University will drop by $3 or 4 million. Looking forward another 6 years in 2037, there will be further reductions in principle of payments in existing issues. The overall total debt for the University will drop to just below $39 million, $600,000 lower than the University is currently paying.

There was some interest in how the University's debt related to other peer universities. To answer this question, Mr. LeMarbe presented a Moody's scorecard with weighted average scores of Wayne State against its peer institutions. Peer institutions are defined by the University's Institutional Research Office as urban universities heavily involved in research. He explained that Wayne State has an AA3 rating, a decent position. The lower the score, the stronger credit rating. Wayne State, as compared against its sister institutions in Michigan, looks very healthy, and the metrics and relationships are not expected to change with this proposed borrowing.

While there is no guarantee, Moody's was apprised of the university's plans to enter the market with an issue around $150 million. Based on the University's operating revenue strength and its reputation, their initial response was that they did not feel that it would be an issue or negatively affect the university's credit rating. VP Massaron advised that this issue alone will not result in a rating change. The University will have to continue to perform on enrollment, as the rating agencies in the past raised issues around the diversification of the Medical School's relationships.

Mr. LeMarbe advised that the project timeline is preliminary. As the university moves closer to site selection, the commitment to those three sites discussed earlier allowed the university to move forward to hold a TEFRA hearing. TEFRA is an IRS regulation, the Tax, Equity and Fiscal Responsibility Act, which requires that a 501c3 organization, issuing tax exempt bonds, where a private partner would benefit from that borrowing by using those facilities, is required to conduct a public hearing. He advised that the TEFRA hearing was conducted on January 6 and went well, and that the hearing needed to be held before a vote on the bonds was taken.

The State's $100 million equity investment in this project provides the University with some flexibility in timing, as the University will be able to rely on spending those monies first, which is not normally the case.

A large bond issue is of concern but it is an exciting time for the University. Through this issuance, the University will be communicating to the faculty, researchers and students its commitment to continue to invest in its infrastructure to conduct important teaching, research, and service in alignment with the University's 2022 through 2027 Strategic Plan.

Governor Gaffney asked for further clarification of the additional materials sent to the Board regarding the Moody's Scorecard comparison with peer institutions. Mr. LeMarbe advised that Moody's examined various ratios like cash on hand, debt to operating and debt to expense ratios. Mr. Kelly added that Moody's established a new methodology for rating higher education institutions two years ago and they used 10 factors to create a quantitative score to benchmark all institutions. Those factors ranged from financial leverage and financial statistics to operating statistics with 70% of the factors quantitative and 30% qualitative.

An example of a qualitative analysis factor is the demographic and operating environment under which an institution operates, including governance and leadership of the institution. That factor was used as a benchmark to compare institutions to one another. A lower score is considered better, and Wayne State's lower score means it has a higher rating and secures lower borrowing costs in the marketplace when bonds are issued. Governor Gaffney asked about the overall indebtedness of the peer institutions. VP Massaron noted that the marketplace and our comparison, particularly with in-state peers indicates that the University is one of the top 4 rated institutions. From the rating agency's perspective, that is means the University is more able to handle its debt obligations than others. Mr. Kelly advised that Moody's looks at the total financial resources of an institution against the total amount of debt, but also at the context within the overall balance sheet health of an institution, and Moody's specifically looks at total financial resources for that statistic.

Governor Busuito asked if the University is prepared to handle increased debt service over the next seven years under its current finances. VP Massaron advised that the University has a strained financial picture but will be prepared for the short and medium term until the demographics of the state turn around.

Governor Busuito followed up his question by asking if the University should also be prepared to have a moratorium on bonds and borrowing over those next 7 years. VP Massaron advised that decisions on investments should be made on a case-by-case basis in combination with the Board and he hesitated to say a moratorium be imposed. If opportunities are presented for significant increases in revenue, the University will want to be able to borrow. He advised that caution in any new money debt issuance is important.

Governor Atkinson advised that it is important to understand what makes an investment like this so critical, and she believes that the University should be able to tell this story. She asked who could be responsible for putting that together? President Wilson advised that much of the story was noted during the launching phase, and provided an excerpt: "Scott Hall is a very, very old building. It's over 50 years old and it's decrepit in many ways. We have a great medical school, one of the largest in the country with a great history of 153 years and is the medical school where most of the physicians in Michigan have trained."

He added that Hayley Thompson, a researcher at KCI who does a lot of community-involved projects, is going to be a centerpiece of this building, on the first floor. He noted that is part of this story, and sends a message to the community. VP Wright addressed Governor Atkinson's question about who would write the story, and advised that he would happily craft the background story to accompany the project. VP Lindsey added his office will also assist. Professor Beale added that it is important that the University expresses the academic role in society and its research role as an urban R1 university. Governor Kelly noted that this will be part of the follow-up addressed at the next meeting.

INFORMATIONAL REPORT: MAJOR CAPITAL PROJECTS SUMMARY

Mr. Davenport highlighted two items on this informational report. The Hilberry Gateway project certificate of occupancy is trending toward the end of the month. The concrete continues to be poured in the front, and the interior is progressing nicely. He added that construction activity on the Valade Jazz Center has begun.

Regarding State Hall, there has been a delay in receiving the AV equipment, but installation has now been scheduled for July. Immediately after installation, a 12-week commissioning and training process will begin and will conclude in October. This will impact the first floor, the lecture halls and the active learning environments in the building.

VP Massaron praised Rob Thompson, CIO, for his efforts in getting the technology in place. He advised that the pandemic and overseas supply chain issues affected the lead time. Governor Gaffney asked the building will open for students in the fall. Mr. Davenport advised that students will be in the building. Governor Gaffney also asked about completion of the Hilberry Gateway Performance Complex, and whether it is on schedule. Mr. Davenport advised that all is on schedule.

PURCHASING EXCEPTIONS

There were no questions on the purchasing exceptions report. Mr. Doherty advised that the next report would cover a two-month period.

ADJOURNMENT

There being no further business, the meeting adjourned at 11:06 am.

Respectfully submitted,

Julie H. Miller

Julie H. Miller
Secretary to the Board of Governors