Ideas in Action
Florida TaxWatch Inc.

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Non-Tax Capital Funding Alternatives

By Pat N. Groner, President Emeritus, Baptist Health Care

In the latter part of 1987, the University of South Florida presented to the Board of Regents a plan to construct a $6.5 million research facility on its campus. The 51,000-square-foot structure was to serve the Medical School and Colleges of Engineering and Natural Sciences. It was to have been financed and constructed by the Tampa Research and Development Park Authority through the issuance of tax-exempt bonds. The University of South Florida was to have leased the facility over a period of 20 years after which ownership would have been vested in the university.

Prior to the December 7, 1987 meeting of the Board of Regents at which this decision was made, T. Terrell Sessums, the outgoing chairman of the board, had this to say: "In my opinion, this is a subject of great importance, both to the University of South Florida and to the State University System. The guidelines involved could be adapted to apply to many other public/private partnership opportunities that our state universities could use to develop revenue-producing facilities."

This method of "off-balance-sheet"[1] financing is quite common. Lease payments were to have been made from sponsored research overhead representing less than 25 percent of the annual purposes of these funds. However, the new facility was not approved because of state and/or Board of Regents regulations and policy.

The sad sequel to this costly regulation was reported in a news item in the USF Oracle of November 13, 1990 announcing that the University of South Florida was among the top 100 research institutions in the nation . . . but these statements and quotes pointed to jeopardized future research funding:

> " . . . limited space on campus will inhibit future growth in this field (research)."
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> "The one limiting factor in the University is space . . . There just isn't enough of it."
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> " . . . space is the dominant factor holding this department back from greater achievements."

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[1] A financing obligation that does not directly pledge the credit of the institution, relying on lease or rental income, user fees and similar sources.

"We are really in bad shape for space . . . we can't even ask for more money, because we don't have the space to do the work."

" . . . space problems in this college (College of Engineering) will inhibit what can be done."

"space is probably the single most thing that is strangling us for future growth . . . without space you can't hire more people."

" . . . we are at the maximum that we can handle right now . . . "

Had the facility proposed in 1987 been constructed, this article three years later would have reflected a happier and more productive condition.

In a follow-up with Merrill-Lynch Capital Markets regarding off-balance-sheet financing in general and research/educational facilities in particular, they listed seven types of non-tax capital financing, only one of which the State University System is utilizing. The following are reports on two facilities in which Merrill-Lynch was involved at the time and which were financed in this manner.

Indirect Cost Recovery Bonds

$4,060,000
State Board of Regents of the State of Utah
Utah State University of Agriculture and Applied Science
Revenue Bonds
1989 Series A
USU Biotechnology Research Facility)

Debt issued to finance Utah State's new biotechnology center is backed by reimbursed overhead revenue received by the university. These funds are derived from current and future research and training contracts, and interest earnings on various trusteed bond funds. In 1988, Utah State conducted over $55 million worth of research, producing pledged revenues of $5.3 million and debt service coverage of over 11.0 times.

$9,515,000
The Regents of the University of Colorado
Research Building Revolving Fund
Refunding Revenue Bonds
Series 1986

The University of Colorado's research building revenue bonds are secured by lease rentals derived from certain research buildings and interest earning on pooled research funds, in addition to indirect cost recoveries. In 1989, research totaled $170.9 million at Colorado, resulting in pledged revenues of $17.1 million and over 7.0 times coverage of debt service.

The January 1993 J.P. Morgan Securities, Inc. report lists nine state universities with 11 active bond issues of this nature in which it is the mortgage banker.

The story continues. Under construction at the University of South Florida is a new $10 million Bio-Science Facility. The student newspaper at the University of South Florida (April 7, 1992 issue of The Oracle) reports that cuts in state funding may preclude the availability of operating funds upon its opening. Had those privileges available to the state universities in Colorado and Idaho been available to the State University System of Florida, it appears that both capital and operational funding could have been provided.

Research Overhead

For the past year or two there has been much in the press concerning leading research universities charging federal government excessively for overhead expense related to research grants. This was such an issue at Stanford University that it was paramount among the factors that forced the resignation of its president. The situation in Florida is entirely different--state universities charge only a fraction of the going rate for research overhead. This loss of millions of dollars annually has been termed as "subsidizing the federal government."

This was first brought to the attention of the Board of Regents at its January 1989 meeting. At that meeting representatives of J.P. Morgan Securities presented a master financing plan which recommended that the State University System utilize research overhead payments in funding laboratories, classrooms and research facilities construction and operations. In their presentation, documentation demonstrated that $265,327,000 of research overhead funding, under certain circumstances, was available for capital needs at that time. The report went on to point out that this funding could be increased by another $470 million if the universities were to successfully negotiate a higher rate of indirect cost recovered from research contracts and grants. Exhibit 1 is a calculation as to the average of indirect cost to the state universities at that time, 12.39 percent.

The J.P. Morgan proposal called for an increase to 30 percent in indirect cost which would place the State University System at about the national average for comparable institutions. An increase to only 25 percent, well below the mode, median and mean of the top 100 research universities, would increase the funding capacity by $391,892,000 to a total of $657,119,000 available for capital financing.

HB 1279 was introduced in the 1990 Florida Legislative Session by Representative Peter Rudy Wallace which, along with other regulatory latitude, would have enabled the Board of Regents to engage in this type of financing. The legislation failed to pass.

While the University of West Florida is unable to utilize this non-tax revenue source, its neighbor, Pensacola Junior College, is not so bound. Through its foundation and other avenues, a number of needed services and facilities have been acquired or constructed. Its vice president for Business Affairs, Rand S. Spiwak, states, "As you can see, the use of tax exempt or third party provided facilities is only limited to one's imagination and adherence to state rules and regulations. Legislative encouragement for these efforts through statutory language will significantly reduce the burden on the taxpayer and provide facilities and services that are needed at the institutions." These investments, beneficial to all concerned, will relieve the state and students alike of increased tax and fee burdens.

One specific example of "subsidizing the federal government" was reported in the March 9, 1990 issue of The Gainesville Sun. Results of a visit by a research consultant reflected that some department heads expressed ambivalence about the University's Division of Sponsored Research. Specifically, the consultant said, "There is no question . . . that (a college) has compromised the University's ability to negotiate a better indirect cost rate." It is interesting to note in Exhibit 1 that the University of Florida reported 13.0 percent research overhead factor and even less in the 1990-91 Fact Book of the State University System.

In its release of the "Top 100 institutions in total research and development spending, Fiscal 1991" the National Science Foundation lists the University of Florida as 37th in total funds in research and development. Ranked behind Florida were 39 of the top 100 in research funding, which averaged 27 percent or higher in research overhead received from the federal government. In Fact Book 1990-91 the State University System as a whole reports receiving 10.4 percent in research overhead on $414,343,476 total contracts and grants expended during that period. Translated to dollars and assuming a 25 percent overhead factor is reasonable, it appears the loss in overhead reimbursement exceeds $60 million annually.

Groner

About the Author

Pat Neff Groner served on the Florida Board of Regents from 1987 to 1993 and has spent a great portion of his career as the chief executive officer for Baptist Hospital in Pensacola, Florida. Mr. Groner's contributions to health care have benefitted hospitals all over the U.S. and his vision and energy has led to innovations that are now standard at most American hospitals. In addition, Mr. Groner is also an active member and valuable mbassador of Florida TaxWatch.

Ideas in Action is a public forum to present discussions on vital issues affecting the economy, public policy and concerns that touch the lives of many Floridians. Views expressed in this letter do not necessarily represent those held by the members, staff, or the distinguished Board of Trustees of Florida TaxWatch.

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