

Office of the President

TO THE MEMBERS OF THE COMMITTEES ON GROUNDS AND BUILDINGS AND FINANCE:

DISCUSSION ITEM

For the Meeting of September 16, 2015

UPDATE ON THE 2020 PROJECT, MERCED CAMPUS

EXECUTIVE SUMMARY

This item provides an overview of the financial structure and commercial terms of the Project Agreement for the Merced 2020 Project (Project). As previously discussed with the Regents, most recently at the March and July 2015 meetings, the Project involves the proposed expansion of the existing Merced campus and consists of the comprehensive development of 900,000 assignable square feet of academic, administrative, research, recreational, student residence, and student services buildings, as well as infrastructure, outdoor recreation facilities and open space, landscaping, roadways, and parking. The Project is intended to accommodate enrollment growth from the current 6,200 students to 10,000 students by the year 2020.

The campus is currently soliciting proposals from three short-listed teams to enter into a public-private partnership to design, build, finance, operate, and maintain the Project under a project agreement (Project Agreement or Agreement). The term of the Project Agreement is 39 years, commencing on the date of contract execution. The plan of finance has been structured as a “hybrid” financing that includes a combination of public and private financing components. This hybrid financing approach balances the University’s cost of capital with the goal of sharing performance risk.

Construction is expected to be completed in two phases, with the first set of facilities to be available in the 2018-19 academic year, and with substantial completion of the Project in 2020. Construction is expected to take four years.

The Project is being procured under the competitive bidding procedures applicable to the Regents contained in Section 10503(e) of the California Public Contract Code. The campus has issued a draft Request for Proposals (RFP) to solicit feedback from the short-listed teams, and anticipates seeking Regents’ approval of the form of the RFP in November 2015. The final RFP would be released in late November, and the campus would receive proposals from the short-listed teams in March 2016. The campus anticipates selecting a successful bidder in May 2016, with the President of the University to execute the Project Agreement in the summer of 2016.

BACKGROUND

2020 Project Financial Structure

The 2020 Project represents a major financial commitment to fulfill the mission established for UC Merced. The transaction structure is designed to help manage the campus' lifecycle performance and financial risk at the lowest possible cost. The finance plan for the Project has been modeled as a "hybrid" version of an availability payment Design, Build, Finance, Operate, and Maintain (DBFOM) contract. This hybrid approach preserves the transfer of design, construction, and operations and maintenance risks and the lifecycle costing benefits of the availability payment procurement while bringing the overall cost of capital closer to the cost that would have been available if the University had financed the Project.

The total design and construction cost estimate under the DBFOM approach has been assumed to be \$900 million in 2014 dollars. With construction escalation, the year-of-expenditure assumptions approach \$1 billion.

As envisioned, the University would invest approximately 50 to 75 percent of the total project construction cost using a combination of General Revenue Bonds (GRBs) and Limited Project Revenue Bonds (LPRBs), with Regents-issued debt currently modeled at approximately \$600 million. The Developer would provide funding for the remainder, through a combination of equity and private debt. The Developer's financing would be repaid over time through availability payments. The University's requirement to make availability payments would be an unsecured contractual obligation under the Project Agreement.

The GRBs and LPRBs will be used to fund three milestone payments (two during construction and one upon Final Acceptance). A portion of previously issued GRBs (Century Bonds) allocated to the Merced campus will be used for the first milestone payment. GRBs and/or LPRBs for the last two milestone payments will be issued in the same manner and have the same priority as all other Regents' debt issuances.

Depending on the terms of the final Project Agreement, rating agencies will more than likely view availability payment obligations – like the 2020 Project – as debt and include them in their analysis of the system's debt burden. The Office of the President anticipates continuing to brief credit rating agencies on the 2020 Project over upcoming quarters.

The draft plan of finance anticipates financing payment obligations under the Project Agreement from legally available Merced campus funds, such as auxiliary revenues, other Merced campus revenue and fee sources, and certain State sources available for capital expenditures.

In November 2015, the 2020 Project will be incorporated into a request for the Regents to approve the *2016-17 Budget for State Capital Improvements*. Approval of the use of State General Funds for the 2020 Project would enable the University to use State General Funds for the repayment of GRBs issued to fund milestone payments and/or to make availability payments under the contract, subject to the provisions of Section 92493, *et seq.* of the Education Code. The campus has developed a pro forma lifecycle financial analysis that incorporates assumptions

about the financial resources and expenditures of the campus over time, including both operating and capital components. Based on these assumptions, legally available campus gross revenue (including capital-eligible sources as well as State General Funds) would be 3.37x the total amount of annual debt service and availability payments in fiscal year 2020-21 increasing to 3.90x by fiscal year 2024-25.

2020 Project, the Request for Proposals and the Project Agreement

The 2020 Project Request for Proposal (RFP) consists of two basic documents: the Instruction to Proposers (ITP) and the form of the Project Agreement. The ITP sets forth in detail the terms and procedures to be followed in the procurement process, and delineates the University's requirements and rights with respect to the procurement (*e.g.*, the right to terminate the procurement process at any time) and the proposer's obligations as a participant in the procurement process. The ITP specifies the required submittals for a responsive proposal and describes the selection process and the criteria that will be used to evaluate the proposals. The ITP contains published standards for the procurement and ensures that proposals will be compared on a uniform basis as required under Section 10503(e) of Public Contract Code.

The Project Agreement is an integral part of the RFP and will be included, in its final form, in the RFP presented to the Regents for consideration and approval. The Project Agreement is based on an established form of contract used for similar projects that have been successfully delivered in the U.S. and Canada. It has been customized to reflect the facility types and performance needs of the Merced campus, and to incorporate relevant University policies and practices. Each provision has been carefully considered from legal, financial, technical, and risk standpoints to ensure that the terms reflect the needs and financial constraints of the campus and the system, and allocate risk responsibly and appropriately.

The Project Agreement consists of three volumes containing the commercial terms, technical specifications, and performance standards for both the design/construction and operating periods.

After the successful bidder is selected, the University will finalize the form of Project Agreement for execution, incorporating commitments made in the selected bidder's proposal. The Project Agreement will not be subject to extensive negotiation after an award is made.

The Parties to the Project Agreement

If approved by the Regents, the Project Agreement will be entered into between the selected developer or concessionaire (Developer) and the University. A special purpose entity comprised of the equity partners will be created and will be responsible for all of the performance obligations under the Project Agreement. The Developer, in turn, will contract with a design-build team and a lead operations and maintenance (O&M) contractor. The Developer remains the responsible party for the duration of the Project Agreement term and is responsible for fulfilling all of the contractual commitments to the University. The University will not have a contractual relationship with the design, construction, or operation and maintenance contractors, and any

disputes or litigation among those parties would be resolved by the Developer and would not involve the University.

The Structure of the Project Agreement

The Project Agreement consists of three separate volumes.

Volume I – Project Agreement and Appendices: The commercial terms are contained in Volume I and its Appendices, as described in more detail in Attachment 2.

Volume II – Technical Requirements and Appendices: The technical design, construction, and O&M requirements are contained in Volume II and its Appendices, and include:

- Section 1 – Project Description
- Section 2 – Project Requirements and Provisions for Work
- Section 3 – Design and Construction Requirements
- Section 4 – Operations and Maintenance Requirements
- Section 5 – Handback Requirements

Volume III – Additional Mandatory Standards: Volume III is a compendium of authorizations, policies and other binding documents with which the Developer is required to comply.

The Project Agreement: Key Terms

The following is a summary of the key commercial terms in the proposed Project Agreement. (Italicized text refers to specific sections within the Project Agreement.) A summary of the key terms is provided in Attachment 2. Following the Regents' consideration and approval of the RFP at their November 2015 meeting, the terms of the Project Agreement will be finalized and the final RFP released to the bidders in late November 2015.

Compensation to Developer

The Developer will receive two "milestone" payments and a final acceptance payment during construction. In addition, the Developer will receive availability payments during the operation and maintenance period. The first milestone payment of \$50 million will be paid upon delivery of evidence that a minimum of \$100 million in design and construction work has been completed, provided that there exists no uncured Developer Default. The second milestone payment of \$250 million will be paid upon issuance of Certificates of Occupancy Readiness for all "First Delivery Facilities" (defined in the Project Agreement) and delivery of notice demonstrating that Developer has completed all First Delivery Facilities (approximately 50 percent of overall 2020 Project program). A final acceptance payment of \$300 million will be paid upon issuance of a Certificate of Project Final Acceptance and upon delivery of notice demonstrating that

Developer has incurred costs in excess of \$400 million associated with State-eligible space. The availability payments commence upon substantial completion. (*Section 12.1-12.3*)

Developer's Responsibilities

The Developer is required to design, construct, finance, operate, and maintain the Project subject to terms and conditions of the Project Agreement and applicable law.

Design and Construction Phase

The Developer is responsible for preparing designs, plans, and specifications in accordance with contract documents using appropriately qualified and licensed design professionals, and is responsible for errors and omissions discovered in the plans or final design documents. (*Section 4.2.1-2*)

The Developer must submit all preliminary design submittals prior to January 1, 2017. If the Developer fails to do so for any reason other than as a direct result of a relief event (refer to the section below for a detailed discussion concerning "Relief Events"), the Developer is responsible for complying with all changes in the building code that go into effect January 1, 2017 with no additional compensation, time extension, or other relief. (*Section 4.2.3*)

Of the First Delivery Facilities, certain "Core" facilities must be delivered by May 1, 2018 and certain "Non-Core" facilities must be delivered by June 1, 2018. The Developer will be assessed liquidated damages for late delivery of the First Delivery Facilities, and failure to achieve occupancy readiness of all such First Delivery Facilities by November 1, 2018 is a Developer Default. Final acceptance of each facility must occur within 120 days of its occupancy readiness/substantial completion. These deadlines are subject to adjustment for Relief Events, but liquidated damage amounts are scheduled to fixed calendar dates. (*Section 5.1, Appendix 20*)

When the Developer has satisfied all of the design, construction, work, submittals, and approvals contemplated in the agreement, a determination of substantial completion will be conducted. If satisfactory, the University will issue a "Certificate of Substantial Completion." The certificate will indicate the state in which the Developer achieved substantial completion. The Developer must exercise its best efforts to achieve substantial completion on or before the scheduled substantial completion date. Failure to achieve substantial completion by the substantial completion "long stop" date (180 days after the scheduled substantial completion date) is a Developer Default. (*Section 4.9.1*)

Various conditions precedent must be satisfied for substantial completion, including completion of the design and construction work, Campus Fire Marshall and Building Official approval, confirmation that all facilities are ready for use for performing specified facilities activities, and all governmental approvals and third-party approvals required for use and operation of the Project have been obtained. (*Section 4.9.2*)

The Developer must obtain from all of its contractors warranties appropriate for work of similar scope and scale, that extend to any third parties for whom work is being performed. The warranties provided by key contractors must be for the periods specified in the Technical Requirements. (*Section 4.13.3*)

Operations and Maintenance

The Developer is required to commence the O&M Services: (a) on the applicable occupancy date for any facility for which a Certificate of Occupancy Readiness has been issued; and (b) on the substantial completion date for all other facilities. (*Section 6.1*)

The Developer is required to perform the O&M Services in accordance with best management practices (as defined) as they evolve from time to time, the contract documents, all applicable laws and governmental approvals, specified plans, and any safety compliance orders. Failure to meet the performance standards specified in Section 4 of the Technical Requirements entitles the University to various rights and remedies, including assessment of noncompliance points, payment deductions, and termination for Developer Default. (*Section 6.2.1.1-2*)

The Developer is responsible for performing renewal work in accordance with a renewal work schedule, which will be updated by the Developer and agreed to by the University (“Owner”) on an annual basis. (*Section 6.5-6*) In addition, a reserve for renewal work is set up approximately five years before the end of the contract, which the Developer must fund with the value of the replacements.

On the expiration of the term of the Project Agreement, the Developer is required to transfer the Project to the Owner in the condition meeting the handback requirements, as specified in the Technical Requirements. (*Section 6.8.1*)

Noncompliance Points

Noncompliance points are key elements of the contract that incentivize performance during the Operations and Maintenance period. A noncompliance point has monetary value. Appendix 5 of the Project Agreement sets forth a Noncompliance Points Table, identifying specific breaches or failures in performance that will result in the assessment of “noncompliance points” and accrual of “noncompliance instances.” In addition to noncompliance points, certain instances of noncompliance will result in monetary deductions from the University’s Availability Payment in accordance with Appendices 3-B and 6 of the Project Agreement. (*Section 7.1-3*) These monetary deductions are permanent and cannot be recovered by the Developer.

The Developer acknowledges that any monetary deductions assessed under the contract documents are reasonable liquidated damages to compensate the Owner for increased costs of administration, loss of tuition and auxiliary revenues, and loss of reputation, and are the Owner’s sole remedy unless otherwise expressly provided in the Agreement. (*Section 7.4*)

Relief Events

Relief Events are defined in Appendix 1 of the Project Agreement. These are specified events for which Owner agrees to bear the risk as between the parties should they occur, subject to certain limitations and conditions. The Developer may make claims for additional compensation, time extension, and other relief for Relief Events. The Developer must follow the claims procedure and is not entitled to any other compensation or relief for a Relief Event beyond what is provided for in the Project Agreement. Deductible relief events are subject to a \$50,000 per claim costs deductible, and a 90-day deductible for delayed payment relief. All entitlement to compensation is net of insurance proceeds. (*Section 10*)

Monetary compensation is limited to direct costs, as defined in Appendix 18 of the Project Agreement, and, if applicable, compensation for delayed receipt of milestone payments and/or availability payments due to a Relief Event delay that delays achievement of the corresponding milestone, substantial completion or final acceptance. Time extensions are limited to extensions of completion deadlines for critical path delay. (*Appendix 18*)

Owner Changes

The Owner has the right to direct an Owner change at any time during the term of the Agreement. An Owner change may include alterations or changes in the work, additions and deletions to scope (up to a cap of ten percent of the cost for the design and construction work), and changes to requirements applicable to the work. Owner changes may include renovations during the operating period, for which the Developer must solicit competitive bids in accordance with policies and procedures of the Owner and applicable laws. The Owner change procedure is set forth in Appendix 21 of the Project Agreement (including determination of cost of an Owner change). An Owner change is a Relief Event, and therefore provisions with respect to any delayed payments, time extension, and other relief required as a result of an Owner change also apply. (*Section 11.1*)

Developer Default

The Project Agreement identifies 22 types of Developer Defaults, including failure to satisfy conditions precedent to Notice to Proceed #1 (NTP 1) within 30 days of the Agreement effective date, failure to commence design work within ten days following NTP 1, failure to commence construction work by the construction commencement deadline, failure to achieve occupancy readiness of all such First Delivery Facilities by November 1, 2018, failure to achieve substantial completion by the Substantial Completion Long Stop Date, persistent Developer noncompliance, persistent Developer breach, and insolvency or bankruptcy.

The applicable cure periods for Developer Defaults vary from zero to 30 days. In limited circumstances, an additional cure period is allowed, provided the Developer is taking meaningful steps to cure a default that cannot be completed within the specified period. (*Section 19.1.2*)

The Owner has a right to terminate the Project Agreement if a Developer Default has not been cured within the applicable cure period. Upon occurrence of a Developer Default and expiration of any applicable cure period without full cure, subject to the Lenders' rights under the Direct Agreement (the agreement by and among the Owner, Developer, and the Lender), the Owner has step-in rights under Section 19.2.4. (*Section 19.2*)

Subject to the Lenders' rights under the Direct Agreement, the Owner has the right, without incurring liability to the Developer, to suspend the work in whole or in part if due to a failure of the Developer to comply with its obligations under the contract documents. (*Section 19.2.7*)

Owner Default

Owner defaults under the Project Agreement include: (1) failure to make payment of undisputed amounts due under the Agreement when due; (2) any material breach of a specific set of representations or warranties made by the Owner; and (3) the Owner or other governmental entity confiscates, condemns, or appropriates the Project or material portion thereof, excluding any exercise of a right of termination under the Agreement. The Owner cure periods range from 30 to 180 days. (*Section 19.3*)

Termination Rights

The Owner may, in its sole discretion, terminate the Agreement in whole if it determines that such termination is in its best interest (*i.e.*, Termination for Convenience). (*Section 20.1*)

Either party may terminate the Agreement if a Relief Event has occurred and results in: (i) a delay in achieving substantial completion beyond 180 days of a Relief Event delay, or if the written notice is given after the substantial completion date, or (ii) if all or substantially all of the Facilities are inoperable for 270 days or more (*i.e.*, Termination for Extended Relief Event). (*Section 20.2*)

If the Owner issues a suspension order for more than 270 days that is not due to the Developer's fault, the Developer has a right to terminate the Agreement upon written notice with immediate effect (*i.e.*, Termination for Suspension of Work). (*Section 20.4*)

Termination compensation due to the Developer depends on the type of termination. The applicable formulas for termination compensation are set forth in Section 20.1 through 20.4. In the event of Termination for Convenience, Owner default, or suspension of work, the Lenders and equity will be made whole. For Termination for Developer Default, the Agreement requires Lenders and equity to accept a reduced payment. In instances of Termination for Extended Relief Events or by court ruling, Lenders are made whole but equity is reduced. Detailed termination procedures and Developer obligations are set forth in Section 20.5. (*Section 20.1-20.5*)

Dispute Resolution Procedure

All disputes arising under the Project Agreement are subject to the dispute resolution procedures contained in the Agreement except any decision that is expressly provided to be subject to the Owner's sole or absolute discretion. The Owner's initial determination is binding pending any final determination of the dispute unless otherwise expressly provided. A decision that is expressly provided to be subject to the Owner's good faith discretion is binding unless finally determined by clear and convincing evidence that it was arbitrary or capricious. Disputes that are not resolved between the Parties are referred to a standing three-person Disputes Review Board (DRB) for a non-binding decision. Disputes that remain unresolved after issuance of the DRB's recommendations regarding such disputes may be resolved by litigation. An accelerated dispute resolution process applies to certain key decisions, including achievement of Occupancy Readiness, Milestones, Substantial Completion, Final Acceptance, and satisfaction of Handback Requirements, and a DRB recommendation is provisionally binding pending resolution by litigation. (*Section 25*)

Performance and Payment Bonds

The Project Agreement currently requires that the Developer obtain \$275 million in Performance and Payment Bonds as a condition precedent to NTP 1. (*Section 17.2*)

Indemnity

The Developer is required to indemnify the Owner for liabilities, claims, and losses, asserted or incurred by or awarded to any third-party to the extent caused by various specified events, including: breach or alleged breach by Developer of the Project Agreement, or key contract with a first-tier contractor or a financing or security document; failure or alleged failure to comply with governmental approvals and applicable laws; intellectual property infringement; negligence, willful misconduct, or breach of law by any developer-related entity (as defined); stop notices/liens filed in connection with the work; or actual or threatened releases of contaminated materials by any developer-related entity. (*Section 17.4*)

Owner's Limitation on Liability

The Owner is not liable to Developer for punitive damages or indirect, incidental or consequential damages arising under any theory of liability, subject to certain exceptions such as losses covered by insurance proceeds for which the Owner self-insures, losses arising out of fraud, criminal conduct, intentional misconduct, reckless or bad faith of any developer-related entity, and any amounts the Owner owes under the express provisions of the Project Agreement. (*Section 19.4.3*)

Appendices to the Project Agreement

The Appendices include certain critical contract obligations that supplement the main volume of commercial terms. The key appendices include:

- Developer's proposal commitments, reflecting the elements of the Developer's proposal that become project commitments, including the Master Plan for the Project site and conceptual building plans for representative buildings;
- Construction period payment deductions for (a) liquidated damages for failure to meet the first delivery dates, and (b) failure to meet specified availability and performance standards for O&M services provided during the construction period;
- Non-compliance points table setting forth the points that may be assessed for specific types of noncompliance;
- Availability Payment and deduction mechanism documentation;
- Project insurance requirements;
- Form of the dispute resolution agreement and dispute resolution procedures;
- The form of the Direct Agreement with the Developer's lenders and Developer;
- Forms of Project performance and payment bond requirements;
- Extensive energy utilities management requirements for the Project;
- Owner change procedures; and
- Provisions controlling the direct costs that can be charged in the event of increased costs resulting from any sort of Relief Event, including Owner changes.

Next Steps: Finalization of the Project Agreement

The Project Agreement, including both the commercial terms and technical requirements, is being discussed with the short-listed teams in a controlled "industry review" process designed to ensure the integrity of the procurement process. During this process, the University team, consisting of campus representatives, the Office of the General Counsel, Office of the President staff, and the campus' technical and financial experts, receive extensive written and oral feedback on the draft ITP and Project Agreement. Based on the information received in the three rounds of industry review, the campus will make revisions to both the commercial terms and the technical requirements of the Project documents to reflect industry comments it receives, in order to ensure that the final Project Agreement is commercially and technically viable.

The Campus has completed the second round of industry review and is in the process of revising the ITP and Project Agreement. The commercial terms summarized in this Item reflect this most recent round of revisions. The campus anticipates that the third and final round of industry review meetings will focus on technical issues.

The RFP, including the ITP and the commercial terms of the Project Agreement, will be presented to the Regents in November for approval. The campus will also seek delegation of the execution of the Project Agreement to the President. The RFP will be released after Regents

approval. The Project Agreement would be executed by the President, in consultation with the General Counsel, after the selection of the successful bidder, finalization of the contract documents, and approval of external financing by the Regents.

KEY TO ACRONYMS

DBFOM	Design-Build-Finance-Operate-Maintain
DRB	Disputes Review Board
GRB	General Revenue Bonds
ITP	Instruction to Proposers
LPRBs	Limited Project Revenue Bonds
NTP 1	Notice to Proceed 1
O&M	Operation and Maintenance
RFP	Request for Proposals

[Attachment: Summary of 2020 Project Agreement and Appendices](#)