

Testimony to the
Government Finance Committee

by
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Good morning, Chairman Delzer and members of the Government Finance Committee.

I appreciate the opportunity to provide to you this morning some information about REAC. My testimony will directly respond to the REAC-related issues on the agenda:

Number One: An overview of the original ground lease for the REAC building, including what would happen if the original lease terms were broken.

Sections 16, 18 and 20 of the ground lease addressed the questions of default or bankruptcy by the UND Research Foundation (UNDRF) (we provided a copy of the ground lease to the committee's staff). The lender's interest was secured by the building, so the lender would have acquired possession of the building in the event of bankruptcy. UND now owns the REAC building, so the lease has been terminated.

Number Two: The total cost to construct the REAC building and the sources of funds used by the UND Research Foundation for the construction of the building.

The total cost to construct the building was \$17,114,539. The cost of research equipment and office furniture/equipment was an additional \$1,780,656. Funding sources included:

- \$1,499,621 from EDA
- \$3,557,547 from Centers for Excellence (ND)
- \$1,493,664 from Department of Commerce (COE)
- \$500,000 from the City of Grand Forks
- \$1,079,451 from DOE and COE for furnishings and equipment
- \$10,000,000 in loans (listed below)

Number Three: The liabilities incurred by the UND Research Foundation to construct the facility, the liabilities of the Foundation as of December 31, 2012, and the current liabilities of the Foundation.

Liabilities to construct the facility included a construction/permanent loan of \$6,250,000 (Bremer), a working capital term loan of \$250,000 (Bremer), a construction loan with a

balloon payment of \$1,000,000 (ND Development Fund), and a tax-exempt bond of \$2,500,000 (GF County) for a total of \$10,000,000. In addition, capital leases of \$494,141 were executed for furniture, fixtures and equipment (FF&E).

Liabilities reported by UNDRF as of December 31, 2012, included a \$5,924,161 construction/permanent loan (Bremer), a \$223,000 term loan (Bremer), a \$936,521 construction loan (ND Development Fund), a \$2,338,769 tax-exempt bond and \$190,494 in capital leases for a total of \$9,612,945.

The UND Research Foundation has advised that it currently has no outstanding liabilities.

Number Four: The legal obligations of the University System and the state to repay any loan or financing obtained by the UND Research Foundation for the construction of the building:

Based on guidance from the President of the State Board of Higher Education and one other Board member in June of 2012, UND sought outside counsel regarding potential financial liability, its relationship with UNDRF (possible conflict of interest questions) and options to mitigate risk. An independent appraisal was also recommended and obtained. Advice provided by outside counsel to UND indicated that there was no express contractual acceptance of liability by UND. However, outside counsel also indicated that reasonable arguments could be made that UND did have some financial obligation. If UND chose to do nothing, resulting in bankruptcy of UNDRF and the reversion of the building to the lender, there was a strong likelihood that this situation would end up being resolved in court.

Additional factors considered included potential legal costs, reputational risk, loss of productivity/occupancy of facility during litigation period, uncertainty as to the length of time needed to resolve the issue, and uncertainty as to the ultimate outcome. Understanding that the State of North Dakota had an interest in the building as evidenced by the investment made towards the initial cost of construction, as well as towards research/development occurring in the facility, UND leadership decided to seek approval from the State Board of Higher Education and the Legislative Assembly to purchase the REAC building. Therefore, although there may not have been a "legal obligation" to repay the several loans, UND leadership decided to purchase the building, which thereby required repayment of the loans.

Number Five: An overview of the facility, including the total amount of rentable square feet, the total square feet currently leased to other entities, and the amount of revenue generated by the leases.

The building contains 31,982 rentable square feet. Currently, 14,263 square feet are occupied by non-UND entities and 3,436 square feet are occupied by Medical School Basic Sciences for research purposes, for a total of 17,699 square feet occupied (55% of capacity).

Number Six: Limitations on building uses.

Grant funding by definition must be used for the purpose for which it is received. In this case, the purpose was to construct a building to be used for economic development. More specifically, the grant proposal stated that the original intent of constructing the facility was to provide space for the growth and development of technology based companies targeted to life sciences and advanced engineering. This space was intended to be occupied primarily by private sector partners, spin off companies and business alliances, with related limited University usage also possible. The stated intent for use was the basis for grant funding from the EDA (proposal incorporated by reference), which funded the infrastructure on the site for the building. EDA has verbally approved transfer of the grant conditions to UND effective with the purchase and the documents are in process. They have also indicated a willingness to provide some flexibility to insure the overall success of the project. UND continues to work towards full occupancy consistent with the original stated intent and will coordinate with EDA as appropriate.

Number Seven: Funding provided by UND each year since 2009 to support the operations of the facility.

UND provided a \$335,000 one-time payment in FY2011 per the lease agreement between UND and UNDRF for the period February 2009 through March 31, 2011. A total of \$1,441,374 was paid by UND to UNDRF in FY2012 for the 15-month period April 1, 2011 through June 30, 2012, per the revised lease agreement dated May 6, 2011. Finally, a \$250,000 payment was made by UND to UNDRF in FY2013 per the Memorandum of Understanding dated September 6, 2012. These documents were provided to Legislative Management during the 63rd Legislative Assembly.

Number Eight: Membership of the UND Research Foundation Board of Directors at the time of the construction of the building and the current membership of the Board of Directors:

The composition of the board of directors changed over time in response to the needs of the organization (UNDRF), the push by University officials for increased communication and accountability, the need to mitigate potential conflict of interest related to the sale/purchase, and the personal circumstances of various board members (see enclosed lists). Changes in board composition and voting status were fully disclosed on the IRS Form 990 (the annual tax return for nonprofit organizations) as required by law.

Number 9: An update on the status of the purchase of the building:

UND completed all transactions to purchase the REAC building on September 16, 2013. The purchase agreement has been provided to committee staff.

We appreciate the opportunity to provide you with this additional information. At the conclusion of our presentations, we will answer any questions the Committee may have.