

# Auxiliary Corporation Facilitates Campus Expansion

## Cal State Fullerton Foundation Purchases \$29 Million Dollar Office Complex to Enable Campus Growth

by

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Simply put, the problem is that enrollment has been increasing by more than 1,500 students each year. When compounded by faculty retirements, the University finds that it must hire at least 50 new tenure-track faculty positions each year for the next several years. But the 225 acre campus is already bursting at the seams, so much so that the University is already spending more than \$650,000 each year to rent nearby office space.

**Possible Solution:** Purchase the 200,000 square foot office building (known as College Park) in which the university already rents nearly 50,000 square feet of space.

**Complication:** You're a public institution – and new capital projects often require as much as five to ten years (or more) from inception to approval – so how do you address your current demand for 50+ offices for next year?

**Creative Solution:** The University's 501(c)3 Corporation that oversees Auxiliary Services purchases the building – and leases the necessary space back to the university – essentially creating a win-win situation for the campus, the auxiliary corporation and most importantly, those new faculty who could now be assigned an office instead of merely sharing a desk with several other colleagues.

How is this possible, you ask? You just may be very surprised at how relatively easy it was for Cal State Fullerton, a four-year public institution, to acquire an additional 200,000 square feet of office space (on 8 acres of land) in a matter of months.



It began in the Fall of 1999, when the University's enrollment surpassed 28,000 students for the first time – an increase of nearly 5 percent from the previous year. More importantly, it was a sign that the enrollment growth of recent years was not only continuing but, in fact, expanding, and in the process, creating an overwhelming demand on already saturated campus facilities.

The campus was already renting approximately 50,000 square feet of space immediately adjacent to the campus and was in the process of negotiating to rent an additional 20,000 square feet for the following year. As one might imagine, it didn't take an Einstein Scholar to quickly come to the realization that, over time, it made a lot more sense to try to purchase the building, as opposed to continuing to rent more and more space.

But as obvious as that might seem, how does a public institution acquire the necessary funds to purchase a \$20,000,000 office building – especially when history has shown that it takes several years to convince “the powers that be” of the need for the additional space?

The Answer – have your auxiliary 501(c)3 corporation (assuming you are fortunate enough to have one) purchase the building – and rent the vacant space back to the campus – thereby allowing the campus to accumulate some equity, as opposed to continuing to pay out in rent. Once the debt is retired, the auxiliary can

merely donate the building back to the campus.

As logical and simple as that might sound, there actually were a couple of hurdles that first had to be overcome.

First and foremost, the University had to come up with the money – and though the auxiliary was a successful enterprise with annual revenues in excess of \$30,000,000 a year, it didn't exactly have an extra \$20,000,000 to purchase the building outright. So outside financing was going to be critical to a successful acquisition.

And since it was apparent that, beyond the actual purchase price, a considerable amount of additional money would be required to renovate the space for university use, the preferred method of financing quickly boiled down to a series of 30 year bonds – which because non-university tenants occu-

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pied 40 percent of the building's space, had to be a combination of both taxable and tax exempt bonds.

To facilitate such an "unusual" acquisition, George K. Baum & Company (which had brokered the majority of Auxiliary Bond Financings throughout the CSU) was engaged to broker the deal. And though the majority of these CSU bond financings have been done as general obligations of the 501(c)3 auxiliary corporation, in this case, the CSUF Foundation was reluctant to incur any long-term debt against its balance sheet because it was in the midst of several other possible "opportunities" – some of which could be jeopardized if the Foundation were to assume any significant debt.

Though the office building, itself, showed the potential of more than \$3,000,000/year in rental income, at the time of purchase, some 40 percent of the space was vacant. Therefore, developing a financing plan in which the bond purchasers would be satisfied with "stand alone" financing from the building itself (with no recourse to the auxiliary corporation) would become paramount to structuring a successful deal.

Once again, the answer to what could have been a major hurdle, turned out to be much simpler than might first be imagined. Since the university was already renting a considerable amount of space in the building through a series of several separate leases, what if the university was to essentially consolidate those leases AND, most importantly, agree to rent ALL of the additional vacant space at the same time?

Such a lease, especially if extended over the 30-year lifespan of the bonds, essentially guarantees a steady flow of income in sufficient amounts to more than satisfy the purchasers of the bonds – a most significant factor in assuring the lowest possible rate for the bonds.

Of course, it would mean that the university would be making a significant commitment in annual funds to rent the space (initially about \$1.8 million/year) but over time, the university would be acquiring much-needed space – essentially on a rent-to-own basis. It is important to point out that, as a public institution, this 30-year lease was, "contingent upon continued annual funding" from the State. However, unless the University was to essentially go out of business (a highly-unlikely possibility), this should not prove to be a problem. This was, most importantly, not a concern of those who actually purchased the bonds.

As stated earlier, terms of the lease call for the auxiliary to "gift" the office building to the university upon retirement of the bonds. For this reason, the acquisition is treated as an "investment" essentially being "held" by the foundation, as opposed to a standard building acquisition that would become subject to depreciation. As such, the building will be "valued" at the end of each fiscal year as part of the auxiliary corporation's investment portfolio, as opposed to being depreciated over 30 years. The result, of course, is a much more favorable (and accurate) treatment of the transaction on the foundation's balance sheet.

So as a result of this rather unique acquisition, the Cal State Fullerton campus has grown by approximately 8 acres, the University has immediately gained some 60,000 square feet of vacant space – and it will eventually gain 80,000 more square feet of space.

The CSUF Foundation has played a pivotal role in helping the university acquire this property. Most importantly, it did so without incurring needless limitations on its own future debt capacity – a factor that was clearly critical to a successful transaction. But in the end, this building acquisition was merely another example of a University and its 501(c)3 Auxiliary Corporation working together for the betterment of the university. ♦



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