Approved by the Regents
December 17, 2010

# THE UNIVERSITY OF MICHIGAN
REGENTS COMMUNICATION

## REQUEST FOR ACTION

**Subject:** Issuance of Debt by Merit Network, Inc.

**Action Requested:** Authorization to Issue Guarantee of Merit's Debt through Assessment Agreement by the University

**Background and Summary:**

Merit Network, Inc. is a nonprofit, member-owned organization formed in 1966 to design and implement a computer network between public universities in Michigan. Merit provides high-performance networking and services to the research and education communities in Michigan and beyond. Merit's mission focuses on serving educational, libraries, health care, government and public safety institutions. Present members include: The University of Michigan (the "University"), Central Michigan University, Eastern Michigan University, Ferris State University, Grand Valley State University, Lake Superior State University, Michigan State University, Michigan Technological University, Northern Michigan University, Oakland University, Wayne State University, and Western Michigan University.

Merit has been awarded $102.9 million under the American Recovery and Reinvestment Act to build approximately 2,300 miles of an advanced fiber-optic network throughout Michigan focusing on underserved and remote areas (the "REACH Michigan Middle Mile Collaborative or REACH 3MC'). Merit's portion of the project will allow constituents to connect to Merit's high performance network, which will enable them to lower costs, consolidate services and provide more to Michigan's citizens. As part of the award, Merit is responsible for $8.2 million in cost sharing toward total project expenditures.

The Michigan Strategic Fund, a Michigan State agency for economic development in the State, would issue up to $8 million limited obligation tax exempt bonds at an estimated interest rate of 3.2% to lend the funds to Merit pursuant to a loan agreement between the Michigan Strategic Fund and Merit. Merit would be responsible for the debt service of the loan to be used to repay the bonds. JP Morgan Chase Bank would purchase and hold the bonds and has requested that the members of Merit guarantee the loan through an assessment agreement. Each Merit member would pay, as part of its annual fee, an additional assessment called the Member Debt Service Amount to cover the debt service of the bonds. If any of the members withdraws from Merit, the Member would still remain obligated for its share of the assessment. In case of default, the remaining members would be responsible for a higher share of the assessment.

Because Merit would need to complete the issuance of the debt prior to the end of the year due to expiration of some tax benefits, the liability of each of The University of Michigan or Michigan State University would initially be $4 million of Merit's debt plus interest and fees. As the other ten universities join the assessment agreement the obligation of the University is expected to decrease to a minimum level of $2.2 million of debt plus interest and fees corresponding to the present allocation of the University of Merit's fees (27%). The support of the University would correspond to an annual debt service of principal and interest of $470,000 for five years after two years of interest only payments of $70,000. The maximum annual liability of the University could reach $870,000 of debt service for $4 million of secured debt plus interest and fees. The obligation of the University to pay the Member Debt Service Amount will be payable solely from General Revenues. Due to the fact that the ultimate liability to the bondholders will reside with each institution, approval of the transaction is being requested as if the institution was actually issuing the bonds.

Merit indicates that the debt service for the project is expected to be covered from increased demand for the fiber-optic network, savings in current circuit expenses, and pay down of an existing loan.

**We recommend** at this time that the Regents adopt the attached resolution authorizing the Executive Vice President and Chief Financial Officer or the Associate Vice President for Finance, or the Treasurer to:

- Develop the final terms, and negotiate and execute the legal documentation for the support by the University of the proposed Merit's debt through the assessment agreement.
- Obtain and approve any agreements required for the support of the Merit's debt.

Respectfully submitted,

Timothy P. Slottow
Executive Vice President
and Chief Financial Officer

December 2010
Attachment

**RESOLUTION OF THE REGENTS OF THE UNIVERSITY OF MICHIGAN APPROVING AN ASSESSMENT AGREEMENT WITH MERIT NETWORK, INC,**

WHEREAS, the Regents of the University of Michigan (the "Regents") is a body corporate created by and existing under the Constitution of the State of Michigan with full constitutional authority over and general supervision of The University of Michigan (the "University") and control and direction of all expenditures from the University's funds; and

WHEREAS, Merit Network, Inc. ("Merit"), a Michigan nonprofit corporation, has been formed to promote computer resource sharing through the provisions of resources, including a high-speed research and education network within the State of Michigan for use by public universities in Michigan and other education and research groups and institutions; and

WHEREAS, the governing members of Merit are the Regents, the Board of Trustees of Michigan State University (the "Trustees"), and ten other public universities in Michigan (collectively, the "Members"); and

WHEREAS, Merit has been awarded grants from the federal government in the approximate amount of $103,000,000 to be used for the construction of additional network facilities within Michigan; and

WHEREAS, in order to receive and utilize the federal grant for the purposes described above, it is necessary for Merit to borrow the sum of not to exceed $8,000,000 through the issuance of a tax-exempt bond (the "Bond") by the Michigan Strategic Fund, the proceeds of which will be loaned to, and repaid, with interest, by, Merit; and

WHEREAS, J.P. Morgan Chase Bank (the "Bank"), has agreed to purchase the Bond, but only upon the execution of an Assessment Agreement (the "Assessment Agreement") by the Members, under which the Members agree to pay to Merit sufficient funds to pay the debt service requirements on the Bond; and

WHEREAS, the benefits to the University from its membership in Merit and from the indebtedness to be incurred by Merit and guaranteed under the Assessment Agreement include:

- Service by Merit to its Members of advanced networking services on a high-quality network infrastructure. As controlling Members of Merit the universities ensure themselves that they have a trusted source for network connectivity.

- As Members of Merit, the public universities in the State of Michigan have access to and control a private network. They are their own regulators of costs and the policies on that network. Access, both in scope and capacity, is not dictated by an outside service provider. The Members have available to their facilities almost unlimited use of bandwidth. Merit is the only allowed provider in the State of multiple connections to Internet2 and to other Midwest regional networks required for research purposes. Merit partners with over 20 national and international networks to provide peering relationships; providing a direct path to and from other networks for exchanging sensitive data. This connectivity permits Michigan based universities to work with other institutions across the nation on research and educational projects over their private networks.

- The borrowed funds with the federal grant would build approximately 2,300 miles of an advanced fiber-optic network throughout Michigan focusing on underserved and remote areas (the "REACH Michigan Middle Mile Collaborative or REACH 3MC').

- Membership in Merit provides residual interests in the assets of Merit upon its dissolution.

; and

WHEREAS, the Bond is being delivered and sold under certain provisions of the Internal Revenue Code of 1986, as amended, which provisions expire on December 31, 2010; and

WHEREAS, the execution and delivery of the Assessment Agreement by the Members of Merit requires that the governing boards of each public university Member authorize such execution and delivery, and it may not be possible for all of the Members to achieve such authorization in time to permit the Bond to be delivered on or before December 31, 2010; and

WHEREAS, in order to assure that the Bond can be delivered prior to December 31, 2010, it is necessary for the Regents and the Trustees to each agree that they will assume up to one-half of the liabilities under the Assessment Agreement until such time as the remaining Members have authorized and executed the Assessment Agreement, upon which the liabilities of the Regents and the Trustees will be proportionately reduced; and

WHEREAS, the Regents, in the exercise of its constitutional duties, has determined that the guarantee of a portion of Merit's obligation with respect to the Bond through the execution and delivery by and on behalf of the Regents of the Assessment Agreement as described above is in the interest of the University;

NOW THEREFORE, BE IT RESOLVED AS FOLLOWS:

1. The guarantee by the Regents of a portion of the obligations of Merit in connection with the Bond through the execution and delivery of the Assessment Agreement is hereby authorized and approved; provided, however, that the obligations of the Regents under the Assessment Agreement shall be limited obligations of the Regents, payable solely from General Revenues, as defined in the trust agreements under which the General Revenue Bonds of the Regents have been issued. As provided in the Assessment Agreement, the Regents' liabilities may be increased in the case of default by any other Member, but in no event shall the Regents' obligations under the Assessment Agreement exceed the

principal amount of four million dollars ($4,000,000), plus interest on that principal amount and any penalties, premiums or other charges related to that principal amount. Upon execution of the Assessment Agreement by all of the Members, the primary liability of the Regents will be reduced to a minimum principal amount of $2,200,000 plus interest on that principal amount and any penalties, premiums or other charges related to that principal amount.

2. The initial form of the Assessment Agreement on file with the Secretary of the University is hereby approved, and the Executive Vice President and Chief Financial Officer, the Associate Vice President for Finance and the Treasurer (each an "Authorized Officer") or any one of them individually are hereby authorized to execute and deliver the Assessment Agreement substantially in such form, with such changes not inconsistent with the terms of this Resolution as the executing officer may determine appropriate, as evidenced by his signature thereon. Each of the Authorized Officers and each other appropriate officer or representative of the Regents is hereby authorized to negotiate, execute and deliver, for and on behalf of the Regents, any other certificates, opinions, documents or instruments necessary to effect the purposes of this Resolution.

3. The Regents find that the value of the benefits derived and to be derived by the University from the proceeds of the indebtedness related to the Bond exceeds the liabilities to be incurred by the Regents from the execution and delivery of the Assessment Agreement.