

Agreement to Loan Funds to Virginia Tech Applied Research Corporation**FINANCE AND RESOURCE MANAGEMENT COMMITTEE****October 20, 2023**

Virginia Tech's strategic plan reaffirms the institution's commitment to the expansion of the research enterprise through development of innovative and cutting-edge technology in the areas of translational research and practical applications that serve to benefit the university, local communities, the commonwealth, and the nation. To promote the university's role in providing a pipeline for science and technology innovation that spawn new enterprises, §23-38.87:10 5 of Higher Education Opportunity Act of 2011 encourages the university to promote university-based research that produces outside investment in Virginia, fuels economic advances, triggers commercialization of new products and processes, fosters the formation of new businesses, leads businesses to bring their facilities and jobs to Virginia, and in other ways helps place the commonwealth on the leading edge in the knowledge-driven economy. In pursuit of this vision, the Virginia Tech Applied Research Corporation (VT-ARC), formerly named Virginia Tech Research Corporation, was established in December 2009, as a private, non-stock, Virginia corporation. VT-ARC was approved as a university affiliated corporation by the Board of Visitors at the March 22, 2010 meeting.

VT-ARC is one of the key strategies for growth in research through a corporate structure which enables the pursuit of research opportunities that cannot easily be accomplished within the university environment due to regulatory constraints that often accompany federal government contracts such as "time and materials" requirements. VT-ARC performs translational and applied research and development as an extension of the basic and scholarly research performed within Virginia Tech. The corporation pursues such research activities both independently and in collaboration with university faculty. Currently, VT-ARC's research initiatives and priorities are aligned with Virginia Tech's four research frontiers in Health, Security, Artificial Intelligence, and Quantum.

VT-ARC began operations in 2011. The funding for the initial phase of the operations and the investment in equipment and specialized information technology infrastructure needed for the research programs was provided by the Virginia Tech Foundation (VTF). Since its formation, the corporation has established the infrastructure required to pursue government and private contracts. It was anticipated that initial funding from VTF would be sufficient and that the corporation would quickly generate revenues to become self-sufficient. However, VT-ARC's success in obtaining externally funded contracts was slower than originally anticipated. In addition, its progress towards becoming self-sufficient was adversely impacted by the slowdown of the economy and federal budget reductions. As a result, VT-ARC needed an investment of additional funds for working capital during this extended start-up period.

Accordingly, the university provided a \$2 million loan of start-up financing to provide working capital to the Virginia Tech Applied Research Corporation (VT-ARC) in 2013.

In the spring of 2015, the university assessed the operations of VT-ARC and asked the corporation to explore its business options, including a suspension of operations, the sale of all or certain assets, and continuation of current operations. VT-ARC's Board established a subcommittee to explore these options.

During fiscal year 2016, as this subcommittee continued its work, VT-ARC continued full operations and relied on the remaining line of credit funding from the Virginia Tech Foundation (VTF) to cover its operating cash flow requirements. The work of the VT-ARC subcommittee was completed in June of 2016. The subcommittee supported a proposal to restructure the relationship of VT-ARC with the university's research programs and to continue operations in an effort to strengthen and grow the impact of VT-ARC on the university's research operations. The work of that subcommittee, and its recommendations, were reviewed with the Finance and Audit Committee of the Board of Visitors during its August 2016 meeting.

As a result, VT-ARC continued to operate as a related corporation during fiscal year 2017 and to comply with the requirements of their Affiliation Agreement with the university. The activities to restructure and reinvent VT-ARC were led by the Vice President for Research and Innovation, working closely with the new CEO of VT-ARC. As part of the reinvention of VT-ARC, the Board of Visitors approved the discharge of the \$2 million loan and the board of the Virginia Tech Foundation, Inc. discharged all but \$3 million of the amounts loaned to VT-ARC in fiscal year 2017. The discharge of the debt was essential to VT-ARC's ability to continue operations. In addition, in the last two years the university took over operations of the secure space and created a separate LLC to manage grants and contracts with terms and conditions the university could not accept. The assumption of these activities which generated ongoing losses for VT-ARC, also contributed significantly to the financial viability of VT-ARC.

The new management team at VT-ARC has been very successful in growing the corporation and has had a positive impact on the university's research ecosystem and is a significant contributor to the university's strategic initiative of becoming a top-100 global research university. Revenues for each of fiscal years 2022 and 2023 averaged about \$20 million and projected activity for this fiscal year is approximately \$24 million. However, the excess of revenues over expenses for their portfolio of grants and contracts is relatively small. Consequently, VT-ARC is requesting a line of credit from the university for up to \$3 million to provide temporary liquidity to fund the gaps between cash expenditures on sponsored projects and subsequent payments from the government.

The Restructuring Act of 2005 provides Level 3 institutions with the needed authority to execute such loan transactions. Specifically, under section 23-38.101 of the Restructuring Act titled "Creation of entities; participation in joint ventures", the Board of Visitors has authority to approve loans or obligate university funds to or on behalf of its affiliated organizations or joint

venture activities. The referenced language under section 23-38.101 providing this authority to the Board of Visitors is displayed in Attachment A. Further, the university believes this action is an appropriate step for supporting the university's research mission through VT-ARC.

Therefore, the university requests authorization to provide a line of credit loan of up to \$3 million to VT-ARC to finance the temporary liquidity needs of VT-ARC as it continues to develop and expand its research portfolio to buffer unanticipated cash flow delays. This initiative is an investment of university resources for the achievement of the university's strategic plan to become a top-100 global research university.

The basic conditions and requirements for this loan would include:

- the loan will be made in accordance with university procedures for authorizing internal loans to operating units; however, the terms and conditions will be more similar to a commercial line of credit with an interest rate approximating the foregone short-term interest that could have been earned by the university on such funds and the term of the agreement would be for ten years.
- the line of credit loan would be underwritten by the university's research overhead funds, a nongeneral fund revenue source, and
- the line of credit loan is being made pursuant to the understanding that this is a revolving loan, the principal amount of which may be borrowed, repaid, and re-borrowed, to provide temporary liquidity, not a permanent loan and that VT-ARC will include anticipated repayment of principal and interest in the annual budget approved by the Board of Directors of VT-ARC.

The Vice President for Finance, in coordination with the Executive Vice President and Chief Operating Officer, will be responsible for finalizing these terms, authorizing specific advances, and may alter the terms as needed in the future to achieve the objectives of this research initiative. Staff of the Vice President for Finance will be empowered to process authorized transactions and to implement procedures for this line of credit loan program.

RESOLUTION FOR AUTHORITY TO EXECUTE AGREEMENTS TO PROVIDE A LINE OF CREDIT LOAN TO VIRGINIA TECH APPLIED RESEARCH CORPORATION

WHEREAS, the university's strategic plan envisions the expansion of the research enterprise through development of innovative and cutting edge technology; and

WHEREAS, the university established the Virginia Tech Applied Research Corporation (VT-ARC) as a university related corporation to access research opportunities not easily accomplished within the university structure and to leverage the basic and scholarly research performed within the university; and

WHEREAS, VT-ARC has successfully obtained significant external research funding both independently and in collaboration with university faculty through operation of unique facilities to align with Virginia Tech's four research frontiers in Health, Security, Artificial Intelligence, and Quantum; and

WHEREAS, VT-ARC has developed needed contracting and facilities infrastructure and is now successfully competing for externally funded research grants and contracts at an increasing level, which are supportive to the top- 100 global research university strategic initiative; and

WHEREAS, VT-ARC is planning for the next level of operations beyond its start-up activities, and making investments to continue its growth trajectory, and is not yet generating sufficient working capital reserves to fully cover temporary liquidity needed to fund the gaps between cash expenditures on sponsored projects and subsequent payments from the government and desires to have access to a line of credit to provide additional temporary liquidity; and

WHEREAS, the university desires to support VT-ARC through the provision of funding from nongeneral fund sources of up to \$3 million in revolving line of credit loans, the principal amount of which may be borrowed, repaid, and re-borrowed, to provide temporary liquidity, if needed, to finance ongoing operations of VT-ARC and to provide them the opportunity to maintain and grow a sustainable level of external grants and contracts funding; and

WHEREAS, the university will act as a fiscal agent for processing all loan related transactions with VT-ARC; and

WHEREAS, the university loan repayment schedule will be consistent with the terms of a commercial line of credit from a financial institution at the interest rate approximating what the university could earn on short-term investments and the term of the line of credit agreement should be for ten years; and

WHEREAS, under section 23-38.101 of Restructured Higher Education Financial and Administrative Operations Act of the Code of Virginia the Board of Visitors has the authority to authorize such transactions.

NOW, THEREFORE, BE IT RESOLVED, that the Board of Visitors authorizes, at the President's discretion, the negotiation and execution of a revolving line of credit loan, the principal amount of which may be borrowed, repaid, and re-borrowed, and the related promissory notes and loan agreements for temporary liquidity financing from the university to VT-ARC for up to \$3 million to be repaid with interest by VT-ARC.

NOW, THEREFORE, BE IT FURTHER RESOLVED, that the Vice President for Finance, in coordination with the Executive Vice President and Chief Operating Officer, will be responsible for finalizing these terms, authorizing specific advances, and may alter the terms as needed in the future to achieve the objectives of this research initiative. Staff of the Vice President for Finance will be empowered to process authorized transactions and to implement procedures for this line of credit loan program. The loan is contingent upon VT-ARC including repayment of estimated principal and interest in their budget, as approved by their Board of Directors.

RECOMMENDATION:

That the resolution authorizing, at the President's discretion, the negotiation and execution of a line of credit and the related promissory notes and revolving line of credit loan agreements for temporary liquidity financing from the university to VT-ARC for up to \$3 million to be repaid with interest by VT-ARC, be approved.

November 6, 2023