

FINANCE AND CAPITAL STRATEGIES COMMITTEE

July 13, 2017

TO THE REGENTS OF THE UNIVERSITY OF CALIFORNIA

1. **FISCAL YEAR 2017-18 BUDGET FOR THE UNIVERSITY OF CALIFORNIA
OFFICE OF THE PRESIDENT**

The Committee recommends that the fiscal year 2017-18 budget for the University of California Office of the President, as shown in Table 1 below, be approved:

Table 1 – Total FY 2017-18 Proposed Budget

FY 2017-18 BUDGET SUMMARY OFFICE OF THE PRESIDENT (\$ millions)						
	TOTAL Proposed Budget FY 2017-18	Expenses (Projected) FY2016-2017	TOTAL Budget FY 2016-2017	Var-FY17-18 Budget to Projection	% More / (Less) Budget vs Projection	% More / (Less) to Prior Year Budget
OFFICE OF THE PRESIDENT						
Central and Administrative Services	277.77	249.82	267.70	27.96	11%	4%
Academic Affairs	30.04	28.11	29.93	1.93	7%	0%
Innovation & Entrepreneurship	61.93	53.60	52.73	8.33	16%	17%
Finance	40.85	33.09	39.77	7.76	23%	3%
Operations	118.58	111.32	119.30	7.26	7%	-1%
President's Exec. Office	2.61	3.41	3.18	(0.80)	-23%	-18%
Health Sciences	4.16	3.69	4.17	0.47	13%	0%
Governmental Relations	5.44	5.07	5.41	0.37	7%	1%
Public Affairs	14.18	11.53	13.21	2.65	23%	7%
Regents Officers	58.45	49.71	57.96	8.74	18%	1%
General Counsel	12.49	10.91	11.65	1.58	14%	7%
Secretary of the Regents	3.08	2.76	2.91	0.32	12%	6%
Ethics & Compliance	7.54	7.34	7.67	0.20	3%	-2%
Investments Office	35.34	28.70	35.74	6.64	23%	-1%
TOTAL w/o UCPath Operations	336.22	299.53	325.66	36.69	12%	3%
UCPath Operations	52.44	16.25	20.15	36.19	223%	160%
Grand Total (including UCPath Operations)	388.66	315.78	345.81	72.88	23%	12%

FY 2017-18 BUDGET SUMMARY OFFICE OF THE PRESIDENT (\$ millions)						
	TOTAL Proposed Budget FY 2017-18	Expenses (Projected) FY2016-2017	TOTAL Budget FY 2016-2017	Var-FY17-18 Budget to Projection	% More / (Less) Budget vs Projection	% More / (Less) to Prior Year Budget
SYSTEMWIDE ACADEMIC & PUBLIC SERVICE PROGRAMS						
Instruction	58.38	52.95	53.67	5.43	10%	9%
Research	172.28	106.68	108.58	65.60	61%	59%
Public Service	15.19	16.32	16.43	(1.13)	-7%	-8%
Academic Support	46.68	46.31	46.40	0.37	1%	1%
National Laboratories	4.27	3.59	3.94	0.68	19%	9%
Presidential Initiatives	9.77	5.57	9.77	4.20	75%	0%
TOTAL	306.58	231.43	238.79	75.15	32%	28%
Agriculture and Natural Resources	102.27	100.82	101.08	1.45	1%	1%
Grand Total (including ANR)	408.84	332.25	339.87	76.60	23%	20%
TOTAL OF BOTH TABLES (w/o UCPath)	745.06	631.77	665.53	113.29	18%	12%
TOTAL OF BOTH TABLES	797.50	648.02	685.68	149.48	23%	16%
Strategic Priorities Reserve Year End Projected						
Committed	38.7	57.1		(18.4)		
Uncommitted	16.2	29.9		(13.7)		

Committee vote: Regents Blum, Lemus, Makarechian, Sherman, and Zettel voting “aye.”

Board vote: Regents Anguiano, Blum, De La Peña, Elliott, Guber, Kieffer, Lansing, Lemus, Lozano, Makarechian, Mancina, Monge, Napolitano, Ortiz Oakley, Park, Pérez, Sherman, and Tauscher voting “aye.”

2. **AMENDMENT OF REGENTS POLICY 6102: GENERAL ENDOWMENT POOL INVESTMENT POLICY STATEMENT APPENDIX 1 (BENCHMARKS)**

The Committee recommends that Appendix 1 of Regents Policy 6102: Investment Policy Statement for General Endowment Pool be amended as shown in Attachment 1, effective July 1, 2017.

Subcommittee vote: Regents Elliott, Lemus, Makarechian, Sherman, and Zettel voting “aye.”

Committee vote: Regents Blum, Lemus, Makarechian, Sherman, and Zettel voting “aye.”

Board vote: Regents Anguiano, Blum, De La Peña, Elliott, Guber, Kieffer, Lansing, Lemus, Lozano, Makarechian, Mancina, Monge, Napolitano, Ortiz Oakley, Park, Pérez, Sherman, and Tauscher voting “aye.”

3. **APPROVAL OF BUDGET AND EXTERNAL FINANCING, NUEVO EAST STUDENT HOUSING PROJECT, SAN DIEGO CAMPUS**

The Committee recommends that:

- A. The 2017-18 Budget for Capital Improvements and the Capital Improvement Program be amended as follows:

From: San Diego: Nuevo East Student Housing – preliminary plans – \$8,515,000 to be funded from housing reserves.

To: San Diego: Nuevo East Student Housing – preliminary plans, working drawings, construction, and equipment – \$266,130,000 to be funded with external financing (\$247,115,000), housing reserves (\$17,015,000), and campus funds from investment income (\$2 million).

- B. The scope of the Nuevo East Student Housing project shall provide approximately 546,975 assignable square feet (ASF) of housing space, including approximately 1,414 beds to primarily support graduate and professional students, a student community center (approximately 14,450 ASF), and site improvements. The scope includes demolition of 22 existing buildings (consisting of 336 beds) and the removal of 224 surface parking spaces in the northern portion of Mesa Housing.

- C. The President of the University be authorized to obtain external financing in an amount not to exceed \$247,115,000 plus additional related financing costs. The President shall require that:
- (1) Interest only, based on the amount drawn down, shall be paid on the outstanding balance during the construction period.
 - (2) As long as the debt is outstanding, general revenues from the San Diego campus shall be maintained in amounts sufficient to pay the debt service and to meet the related requirements of the authorized financing.
 - (3) The general credit of the Regents shall not be pledged.
- D. The President be authorized, in consultation with the General Counsel, to execute all documents necessary in connection with the above.

Committee vote: Regents Blum, Lemus, Makarechian, Sherman, and Zettel voting “aye.”

Board vote: Regents Anguiano, Blum, De La Peña, Elliott, Guber, Kieffer, Lansing, Lemus, Lozano, Makarechian, Mancina, Monge, Napolitano, Ortiz Oakley, Park, Pérez, Sherman, and Tauscher voting “aye.”

4. **APPROVAL OF BUDGET AND EXTERNAL FINANCING, NORTH TORREY PINES LIVING AND LEARNING NEIGHBORHOOD, SAN DIEGO CAMPUS**

The Committee recommends that:

- A. The 2017-18 Budget for Capital Improvements and the Capital Improvement Program be amended as follows:

From: San Diego: North Torrey Pines Living and Learning Neighborhood – preliminary plans – \$22,250,000 to be funded from housing reserves (\$13,350,000) and campus funds (\$8.9 million).

To: (1) San Diego: North Torrey Pines Living and Learning Neighborhood – preliminary plans, working drawings, construction, and equipment – \$509,450,000 to be funded with external financing (\$494,950,000), gift funds (\$8 million), and housing reserves (\$6.5 million); and

(2) Upon Regents’ approval of the related concurrent item, *Approval of Preliminary Plans and Working Drawings Funds, Ridge Walk Academic Complex, San Diego Campus, San Diego: Ridge Walk Academic Complex* – preliminary plans and working drawings – \$12 million to be funded from campus funds.

- B. The scope of the North Torrey Pines Living and Learning Neighborhood project shall provide approximately 644,000 assignable square feet in a mixed-use environment, including approximately 2,000 undergraduate beds, resident support space, and residential dining; lecture halls and classroom; residential life and administrative space for students and staff in UC San Diego's Sixth College; market and retail space; and approximately 1,250 below-grade parking spaces. The project shall also realign Scholars Drive, make improvements to Ridge Walk along the eastern edge of the neighborhood, and other site improvements to create a pedestrian- and bicycle-friendly community.
- C. The President of the University be authorized to obtain external financing in an amount not to exceed \$494,950,000 plus additional related financing costs. The President shall require that:
- (1) Interest only, based on the amount drawn down, shall be paid on the outstanding balance during the construction period.
 - (2) As long as the debt is outstanding, general revenues from the San Diego campus shall be maintained in amounts sufficient to pay the debt service and to meet the related requirements of the authorized financing.
 - (3) The general credit of the Regents shall not be pledged.
- D. The President be authorized, in consultation with the General Counsel, to execute all documents necessary in connection with the above.

Committee vote: Regents Blum, Lemus, Makarechian, Sherman, and Zettel voting "aye."

Board vote: Regents Anguiano, Blum, De La Peña, Elliott, Guber, Kieffer, Lansing, Lemus, Lozano, Makarechian, Mancina, Monge, Napolitano, Ortiz Oakley, Park, Pérez, Sherman, and Tauscher voting "aye."

5. **APPROVAL OF PRELIMINARY PLANS AND WORKING DRAWINGS FUNDS, RIDGE WALK ACADEMIC COMPLEX, SAN DIEGO CAMPUS**

The Committee recommends that:

The 2017-18 Budget for Capital Improvements and the Capital Improvement Program be amended as follows:

From: San Diego: North Torrey Pines Living and Learning Neighborhood – preliminary plans – \$22,250,000 to be funded from housing reserves (\$13,350,000) and campus funds (\$8.9 million).

- To:
- (1) Upon Regents' approval of the related concurrent item, *Approval of Budget and External Financing, North Torrey Pines Living and Learning Neighborhood, San Diego Campus, San Diego: North Torrey Pines Living and Learning Neighborhood* – preliminary plans, working drawings, construction, and equipment – \$509,450,000 to be funded with external financing (\$494,950,000), gift funds (\$8 million), and housing reserves (\$6.5 million); and
 - (2) San Diego: Ridge Walk Academic Complex – preliminary plans and working drawings – \$12 million to be funded from campus funds.

Committee vote: Regents Blum, Lemus, Makarechian, Sherman, and Zettel voting “aye.”

Board vote: Regents Anguiano, Blum, De La Peña, Elliott, Guber, Kieffer, Lansing, Lemus, Lozano, Makarechian, Mancina, Monge, Napolitano, Ortiz Oakley, Park, Pérez, Sherman, and Tauscher voting “aye.”

6. APPROVAL OF FUNDING REALLOCATION FOR HOUSING ASSISTANCE

The Committee recommends that:

- A. A one-time allocation of \$27 million be provided as a source of funding for housing assistance for students, faculty, and staff.
- B. These funds will be reallocated from the Faculty Housing Programs Reserve, and will provide \$3 million to each of the following campuses: Berkeley, Davis, Irvine, Los Angeles, Riverside, San Diego, San Francisco, Santa Barbara, and Santa Cruz.

Committee vote: Regents Blum, Kieffer, Lemus, Makarechian, Sherman, and Zettel voting “aye.”

Board vote: Regents Anguiano, Blum, De La Peña, Elliott, Guber, Kieffer, Lansing, Lemus, Lozano, Makarechian, Mancina, Monge, Napolitano, Ortiz Oakley, Park, Pérez, Sherman, and Tauscher voting “aye.”

7. AUTHORIZATION TO INCREASE THE UNIVERSITY EMPLOYER CONTRIBUTION RATE AND MAKE ADDITIONAL CONTRIBUTIONS TO THE UNIVERSITY OF CALIFORNIA RETIREMENT PLAN

The Committee recommends that the Regents:

- A. Approve increases in the University contribution rate for the Campus and Medical Centers segment of the University of California Retirement Plan (UCRP), effective July 1, 2018, to 15 percent (from 14 percent) for all member

classes other than Tier Two and 7.5 percent (from seven percent) for Tier Two members¹, and an increase in the employer assessment to seven percent (from six percent) for Savings Choice Participants in the Defined Contribution Plan, to help pay down the UCRP unfunded liability.

- B. Add Sections H, I, J and K to the Regents' November 2015 action, *Authorization to Fund University of California Retirement Plan Annual Required Contributions for Fiscal Year 2015-16, Fiscal Year 2016-17, and Fiscal Year 2017-18 with Contributions from Short Term Investment Pool*, as follows:

Additions shown by underscoring

- H. Transfer funds from STIP to UCRP in FY 2018-19, FY 2019-20, FY 2020-21, and FY 2021-22 in amounts equal to the difference between the approved total UCRP contribution and the ARC. Should STIP have insufficient funds, funds will be transferred from the Total Return Investment Portfolio (TRIP) to STIP. These transfers shall satisfy the requirements below and will not exceed \$500,000,000 in FY 2018-19, \$500,000,000 in FY 2019-20, \$600,000,000 in FY 2020-21, and \$700,000,000 in FY 2021-22:
- (1) Maintenance of a minimum balance of STIP and TRIP liquidity of \$5 billion at all times. STIP and TRIP liquidity is the sum of STIP and up to \$1 billion of STIP-like investments in TRIP.
 - (2) The creation of an internal note receivable (“STIP Note”) for the amounts above, owned by STIP participants.
 - (3) The ability to set the repayment terms on the STIP Note, which will have a final maturity no later than FY 2041-42.
 - (4) Assessment of all University fund sources making UCRP payments to include an additional amount for principal and interest payments on the STIP Note, divided proportionally based on covered compensation.
 - (5) For funding sources, such as federal contracts and grants, where interest payments for the STIP Note are not billable as direct program costs, the campuses will be required to pay these charges using non-federal sources.
- I. Obtain external financing not to exceed \$2,300,000,000, plus additional related financing costs in lieu of or in addition to the STIP transfers, for the purpose described above if it is expected that this option could be accomplished at a lower cost or is more practical for the University. The repayment of external financing shall be from the same University fund sources that would be responsible for making payments on the STIP Note as outlined above.

¹ The UCRP member class known as “Tier Two” is a frozen group. As of July 1, 2016, it had six active members.

- J. The total amount of the STIP transfers and external financing shall not exceed \$2,300,000,000 plus additional related financing costs.
- K. Take all actions and execute all documents necessary in connection with Sections H through J above.

Committee vote: Regents Blum, Kieffer, Lemus, Makarechian, Sherman, and Zettel voting “aye.”

Board vote: Regents Anguiano, Blum, De La Peña, Elliott, Guber, Kieffer, Lansing, Lemus, Lozano, Makarechian, Mancina, Monge, Napolitano, Ortiz Oakley, Park, Pérez, Sherman, and Tauscher voting “aye.”

Additions shown by underline; deletions shown by strikethrough.

APPENDIX 1

Effective: July 1, 2017

Replaces Version Effective: May 12, 2016

ASSET ALLOCATION, PERFORMANCE BENCHMARKS, AND REBALANCING POLICY

Based on the risk budget for the GEP, the Committee has adopted the following asset allocation policy, including asset class weights and ranges, benchmarks for each asset class, and the benchmark for the total GEP.

Criteria for including an asset class in the strategic policy include:

- Positive contribution ~~positively~~ to the investment objective of GEP
- Widely recognized and accepted among institutional investors
- ~~Has~~ Low ~~cross~~ correlation with other accepted asset classes
- ~~Has a~~ Meaningful performance history
- ~~Involves a unique set of investors~~

The allowable ranges for each asset class and in total have been chosen to be consistent with budgets and ranges for total and active risk.

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INVESTMENT POLICY STATEMENT**

A. Strategic Asset Allocation and Ranges

	<u>Target Allocation</u>	<u>Allowable Ranges</u>	
		<u>Minimum</u>	<u>Maximum</u>
Global Equity	30.0%	20.0	52.5
US Equity	15.7		
Developed Non US Equity	11.0		
Emerging Mkt Equity	3.3		
Private Equity	22.5	10.0	32.5
Absolute Return (Strategic Opportunities)	25.0	15.0	32.0
Real Assets	12.5	3.0	17.5
Liquidity <u>(Income)</u>	10.0	0.0	17.5
TOTAL	100%		

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B. Asset Class Performance Benchmarks

The Committee has adopted the following performance benchmarks for each asset class. Criteria for selection of a benchmark include:

- Unambiguous: the names and weights of securities comprising the benchmark are clearly delineated
- Investable: it is possible to replicate the benchmark performance by investing in the benchmark holdings
- Measurable: it is possible to readily calculate the benchmark’s return on a reasonably frequent basis
- Appropriate: the benchmark is consistent with The Committee’s investment preferences or biases
- Specified in Advance: the benchmark is constructed prior to the start of an evaluation period
- Reflecting Current Investment Opinion: investment professionals in the asset class should have views on the assets in the benchmark and incorporate those views in their portfolio construction

Asset Class	Benchmark
<u>Public Equity</u>	<u>MSCI All Country World Index IMI Tobacco Free</u>
<u>US Equity</u>	<u>Russell 3000 Tobacco Free Index</u>
<u>Non-US Eq. Devel.</u>	<u>MSCI World ex-US Net Tobacco Free</u>
<u>Emerging Mkt Eq.</u>	<u>MSCI Emerging Market Free Net</u>
<u>Fixed Income</u>	<u>Barclays US Aggregate Bond Index</u>
<u>High Yield Fixed Income</u>	<u>Merrill Lynch High Yield Cash Pay Index</u>
<u>Emg Mkt Fixed Income</u>	<u>Dollar Denominated: JP Morgan Emerging Markets Bond Index Global Diversified</u>
<u>TIPS</u>	<u>Barclays US TIPS Index</u>
<u>Private Equity</u>	<u>N/A – Russell 3000 Index + 300 basis points (See below note 2.)</u>
<u>Absolute Return</u>	<u>Diversified: HFRX Absolute Return Index HFRI Fund of Funds Composite</u>
<u>Real Assets (non-Real Estate)</u> <u>Real Estate (Real Assets)</u>	<u>N/A (See below note 3.) Actual Real Assets Portfolio Return NCREIF Funds Index – Open End Diversified Core Equity (ODCE), lagged 3 months</u>
<u>Real Estate</u>	<u>NCREIF Funds Index – Open End Diversified Core Equity (ODCE), lagged 3 months</u>
<u>Liquidity (Income)</u>	<u>Barclays US Aggregate Index</u>

Notes on asset class benchmarks:

1. Global Equity: The Chief Investment Officer will determine what constitutes a tobacco company based on standard industry classification of the major index providers (e.g., Russell, MSCI) and communicate this list to investment managers annually and whenever changes occur.

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2. Private Equity: As we transition the benchmark into the portfolio we will use 150 basis points illiquidity premium for the first year. ~~Long term portfolio returns will be compared to investable public equity alternatives as well as non-investable peer group indices. There is no appropriate market benchmark to use for short term performance evaluation or decision making.~~
3. Real Assets (all strategies ex commodities): similar to Private Equity

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C. Total GEP Performance Benchmark

This is the composition of the total GEP performance benchmark referred to in the Investment Policy Statement, Part 4(b). The percentages below add to 100%. Until GEP reaches its long term targets the performance benchmark will reflect the glide path framework and interim weightings, which will differ from the long term policy approved in the Strategic Asset Allocation and as noted below

Percentage	Benchmark
30.0% <u>30.0%</u>	× <u>MSCI All Country World Index IMI Tobacco Free</u>
21.0% <u>21.0%</u>	× <u>Russell 3000 Tobacco Free Index</u>
14.0% <u>14.0%</u>	× <u>MSCI World ex US Net Tobacco Free</u>
7.5% <u>7.5%</u>	× <u>MSCI Emerging Market Free Net</u>
5.0% <u>5.0%</u>	× <u>Barclays US Aggregate Bond Index</u>
2.5% <u>2.5%</u>	× <u>Merrill Lynch High Yield Cash Pay Index</u>
2.5% <u>2.5%</u>	× <u>JP Morgan Emerging Market Bond Index Global Diversified</u>
2.5% <u>2.5%</u>	× <u>Barclays US TIPS Index</u>
11.5 <u>22.5%</u>	× <u>Actual return of private equity portfolio-Russell 3000 Index +300 basis points</u>
23.0 <u>25.0%</u>	× <u>HFEX Absolute Return Index-HFRI Fund of Funds Composite</u>
3.0 <u>12.5%</u>	× <u>Aggregate Real Assets benchmark (see section B), with components weighted by their actual weights within the total real assets portfolio</u> NCREIF Funds Index – Open End Diversified Core Equity (ODCE), lagged 3 Months <u>Actual Other Real Assets Portfolio Return</u>
7.5 <u>10.0%</u>	× <u>Barclays US Aggregate Index</u>

Notes on Total Fund benchmark:

~~1. The benchmark for private equity is replaced by the private equity portfolio's actual performance. This has the effect of neutralizing the active performance of this class for purposes of total fund performance evaluation.~~

~~1~~ 2. The calculation of the Total Fund benchmark will assume a monthly rebalancing methodology.

~~2~~ 3. In the event of a significant change in asset allocation, the Chief Investment Officer in consultation with the Subcommittee may specify an alternative weighting scheme to be used during a transition period.

D. Rebalancing Policy

There will be periodic deviations in actual asset weights from the long-term/current policy asset weights specified above. Causes for periodic deviations are market movements, cash flows, and varying portfolio performance. Significant movements from the asset class policy weights will

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alter the intended expected return and risk of the GEP. Accordingly, the Investment Committee authorizes the Chief Investment Officer to rebalance the GEP when necessary to ensure adherence to the Investment Policy.

The Chief Investment Officer will monitor the actual asset allocation at least monthly. The Committee directs the Chief Investment Officer to take all actions necessary, within the requirement to act prudently, to rebalance assets to within the policy ranges in a timely and cost effective manner when actual weights are outside the prescribed ranges. The Chief Investment Officer may utilize derivative contracts [in accordance with Appendix 4] to rebalance the portfolio such that the portfolio's net exposures are consistent with policy ranges.

The Chief Investment Officer shall assess and manage the trade-off between the cost of rebalancing and the active risk associated with the deviation from policy asset weights. With approval from the Chair of the Committee, the Chief Investment Officer may delay a rebalancing program when the Chief Investment Officer believes the delay is in the best interest of the GEP. Results of rebalancing will be reported to the Committee at quarterly meetings.