The Regents of the University of California

**COMMITTEE ON FINANCE**
March 18, 1999

A Special Meeting of the Committee on Finance was held on the above date at UCSF-Laurel Heights, San Francisco.

Members present: Regents Atkinson, Bagley, Bustamante, Connerly, Davies, Johnson, Khachigian, Leach, Lee, Miura, Parsky, and Willmon; Advisory member Taylor

In attendance: Regents Eastin, Espinoza, Hopkinson, Kozberg, Lansing, Montoya, Nakashima, Preuss, and Sayles, Regents-designate Pannor and Vining, Faculty Representatives Coleman and Dorr, Secretary Trivette, General Counsel Holst, Treasurer Small, Provost King, Senior Vice President Kennedy, Vice Presidents Broome, Darling, Gurtner, Hershman, and Hopper, Chancellors Berdahl, Bishop, Carnesale, Cicerone, Dynes, and Orbach, Executive Vice Chancellor Grey representing Chancellor Vanderhoef, and Recording Secretary Nietfeld.

The meeting convened at 11:25 a.m.with Committee Chair Johnson presiding.

1. **CONSENT AGENDA**

A. ***Increase in Project Cost and Revised Financing for Mesa Court Residence Hall and Verano Place Apartment Renovation Program, Irvine Campus***

The President recommended that the financing actions approved by The Regents in June 1996 with respect to the Mesa Court Residence Hall and Verano Place Apartment Renovation Program, Irvine campus, be amended as shown below, with the understanding that all other financing actions of The Regents regarding said project remain unchanged:

**deletions shown by strikeout, additions by shading**

(1) Funding for the Mesa Court Residence Hall and Verano Place Apartment Renovation Program be approved as follows:

| Fund Source | Amount | |
|---|---|---|
| External Financing | ~~$10,020,000~~ | $12,120,000 |
| UC Housing System Net Revenue Fund | ~~9,000,000~~ | 8,500,000 |
| Total | ~~$19,020,000~~ | $20,620,000 |

(2) The Treasurer be authorized to obtain external financing not to exceed ~~$10,020,000~~ $12,120,000 for the Mesa Court Residence Hall and Verano Place Apartment Renovation Program, Irvine campus, subject to the following conditions:

* * *

B. ***External Financing for Residential Housing Telecommunications Upgrade, Irvine Campus***

The President recommended that:

(1) Funding for the Residential Housing Telecommunications Upgrade, Irvine campus, be approved as follows:

| Fund Source | Amount |
|---|---|
| External Financing | $2,979,000 |
| UC Housing System Net Revenue Fund | 658,000 |
| Total | $3,637,000 |

(2) The Treasurer be authorized to obtain external financing not to exceed $2,979,000 for the Residential Housing Telecommunications Upgrade, Irvine campus, subject to the following conditions:

a. Interest only, based on the amount drawn down, shall be paid on the outstanding balance during the construction period;

b. As long as this debt is outstanding, University of California Housing System fees for the Irvine campus shall be established at levels sufficient to meet requirements of the UC Housing System Revenue Bond Indenture and to provide excess net revenues sufficient to pay the debt service and related requirements of the proposed financing; and

c. The general credit of The Regents shall not be pledged.

(3) The Officers of The Regents be authorized to provide certification to the lender that interest paid by The Regents is exempt from gross income for purposes of federal income taxation under existing law.

(4) The Officers of The Regents be authorized to execute all documents necessary in connection with the above.

Upon motion duly made and seconded, the Committee approved the President's recommendations and voted to present them to the Board.

2. **EXTERNAL FINANCING FOR UNDERGRADUATE STUDENT HOUSING EXPANSION, RIVERSIDE CAMPUS**

The President recommended that, subject to the amendment of the 1998-99 Budget for Capital Improvements and the 1998-2001 Capital Improvement Program to include the Undergraduate Student Housing Expansion project:

A. Funding for the Undergraduate Student Housing Expansion project be approved as follows:

| Fund Source | Amount |
|---|---|
| External Financing | $25,919,000 |

B. The Treasurer be authorized to obtain external financing not to exceed $25,919,000 to finance construction of the Undergraduate Student Housing Expansion project, subject to the following conditions:

(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, University of California Housing System fees for the Riverside campus shall be established at levels sufficient to meet requirements of the University of California Housing System indenture, and to provide excess net revenues sufficient to pay the debt service on, and meet the related requirements of, the proposed financing.

(3) The general credit of The Regents shall not be pledged.

C. The Officers of The Regents be authorized to provide certification to the lender that interest paid by The Regents is exempt from gross income for purposes of federal income taxation under existing law.

D. The Officers of The Regents be authorized to execute all documents necessary in connection with the above.

The Committee was informed that, in response to the high demand for undergraduate on-campus housing related to rapidly increasing enrollment, the Riverside campus proposes to expand undergraduate student housing adjacent to existing resident hall housing for an increase of 402 student beds. A new residence hall with approximately 99,469 assignable square feet will be constructed.

In fall 1998 the Riverside campus housed 24 percent of students in University-controlled housing. Since the last residence hall addition in 1990, general campus enrollment has increased by 22 percent, from 8,660 in fall 1990 to 10,551 in fall 1998. The campus projects that between fall 1998 and fall 2000, when the project will be completed, enrollment will grow by 1,150 students, including an increase of over 450 freshmen. This rapid growth trend is expected to continue into the foreseeable future, as the campus' enrollment is projected to increase approximately five percent per year over the next decade.

Currently, vacancy rates in the surrounding community are approximately three percent and dropping, and off-campus rents are increasing. Much of this change is due in large part to rapid enrollment growth. The rent at the Undergraduate Student Housing project will be $7,924 per academic year, compared with equivalent off-campus housing rates averaging $8,100 per academic year.

The campus has historically housed 70 percent of its incoming freshman class. Last year, residence hall demand exceeded bed capacity by 105 students; the shortfall would have been over 165 students (8 percent) had not 60 temporary beds been created by boarding 3 students in rooms designed for double occupancy, as well as by boarding students in former lounge spaces. For fall 1999, the bed shortfall was 14 percent, even after doubling temporary bed capacity.

The Undergraduate Student Housing project will allow UC Riverside to reduce the growing residence bed shortfall in fall 2000. Additionally, the project will eliminate temporary beds that detract from an effective live-learn environment. Without the project, approximately 378 students (16 percent of applicants) would be forced to non-campus housing; also, an additional 112 students (5 percent) would continue to be boarded in temporary space. The need for the project is supported by the campus' Long Range Development Plan assumption that 35 percent of the student population and 70 percent of freshmen and transfer students would be housed on campus. A recent survey indicates that 54 percent of current residents would return to student housing the subsequent year if space were available.

Project Description

The project will provide a total of 402 beds in eight clusters of residential suites. Each cluster will consist of 48 residential suites which will include a commons area to provide a kitchen, living room, study and meeting room, utility closet, and laundry area. Resident advisor and program assistant spaces will occupy approximately 1,860 asf.

The community commons area serving all the residential suites will include approximately 10,259 asf providing a variety of spaces, including a retail store, vending area, copy area, poster and music rooms, kitchen/service area, exercise room, lounges and game rooms, ice machine room, bike storage, and other storage areas. Separate administration space to house the resident director will consist of approximately 2,310 asf. An educational and conference area of approximately 6,020 asf will include small and large conference rooms, an office, a computer room, and storage.

Financial Feasibility

The total project cost of $25,919,000 is to be funded from external financing. Based on a debt of $25,919,000 amortized over 27 years at 6.5 percent interest, the average annual debt service is $2,061,000 and operating expenses are estimated at $1,666,000, for an estimated annual expense of $3,727,000. Repayment of the debt will be from student rents generated by the project and by subsidies from existing residence hall bed spaces. It is assumed that rates for the existing residence hall bed spaces will be increased on average by $825 per year to help support the new facility.

Upon motion duly made and seconded, the Committee approved the President's recommendation and voted to present it to the Board.

3. **ADOPTION OF ENDOWMENT ADMINISTRATION COST RECOVERY RATE**

The President recommended that an endowment administration cost recovery rate of a maximum of 15 basis points (0.15 percent) be adopted to apply to the distributions beginning July 1, 1998 made from eligible assets invested in the General Endowment Pool.

Vice President Darling informed the Committee that the recommendation that the endowment administration cost recovery rate applied to Regental assets invested in the General Endowment Pool (GEP) be set at actual and reasonable costs up to a maximum of 15 basis points (0.15 percent) effective July 1, 1998 is made pursuant to the March 1998 action of The Regents, in which the endowment administration cost recovery policy was adopted, as permitted by California trust law, to allow recovery from the endowment payout of reasonable and actual administrative costs for gift assets invested in the GEP. Such costs include compliance with gift terms, reporting, and other related activities at the campuses and the Office of the President. The actual costs for Regental endowment investment management and endowment accounting are currently recovered from endowment gross earnings at a rate of approximately four basis points (0.04 percent) prior to the payout distribution to the campuses.

The endowment administration cost recovery policy is based on a December 1996 opinion from the Attorney General, in which he stated "...that Probate Code section 15684 specifically authorizes the reimbursement for all costs properly incurred in the administration of (endowment) funds. All such reimbursements must, however, come from income and not from principal (Probate Code section 16312)." In addition, he said "...that all such expenses must be properly documented and accounted for and reimbursements subjected to independent audits. To the extent the University has pooled funds and incurs expenses on a pooled basis, it may allocate such expenses among the (endowment) on a proportionate basis."

In designing the endowment administration cost recovery program, steps have been taken to ensure that the reimbursement will be spent for actual and reasonable costs for endowment administration to a maximum of 15 basis points (0.15 percent). This will provide the campuses with a new source of funds from which endowment administration costs will be paid and will thus have the effect of releasing the funds currently used to cover endowment administration expenses. The chancellors have committed to use the funds released by this fund source for incremental fundraising support, not as an offset of existing fundraising expenses. The cost recovery program will be reviewed regularly by the Office of the President, as will the impact of the additional funds released for fundraising activities.

At the October 1998 meeting, The Regents approved a phased approach to an endowment expenditure rate of 4.75 percent of a five-year (sixty-month) moving average of the market value of a unit invested in the GEP. At the same time, The Regents approved a payout associated with the fiscal year-end distribution to the campuses in August 1999 of 4.35 percent of a five-year (sixty-month) moving average. The dollar amount of the payout will be reviewed annually.

As part of the fiscal closing activities each year, campus accounting officers will be required to capture the appropriate endowment administration cost data using a consistent methodology. The Vice President--Financial Management has conducted and will conduct on a regular basis a review of each year's cost recovery program to assure that the costs involved are reasonable and directly related to the endowments' administration. In addition, Internal Audit will conduct reviews as appropriate. The endowment administration costs may vary by campus. Each campus and the Office of the President will be permitted to recover its reasonable and actual endowment-related expenses up to a maximum of 15 basis points (0.15 percent). The balance of each year's distribution will support the individual endowments and their related program activities. Following approval of the President's recommendation, campuses will be permitted to recover 1997-98 endowment-related administrative costs from the portion of the 1997-98 endowment payout that was held in suspense until approval by The Regents of the endowment administration cost recovery rate.

Regent Connerly asked for a clarification of the following statement: "The Chancellors have committed to use the funds released by this fund source for incremental fundraising support, not as an offset of existing fundraising expenses." Vice President Darling explained that there was a desire on the part of the Regents and the University to see that any monies taken out of the endowments to use for endowment cost administration be used to increase the amount of private support for the University. Regent Parsky recalled that it was also the intention that the success of the program would be monitored and asked that this information be contained in the annual report to The Regents.

At President Atkinson's request, Vice President Darling informed the Committee that economists have forecast that approximately $10.3 trillion will be transferred from one generation to the next over the coming decade. There is a strong incentive in the tax code to make charitable contributions. As a result, the University is seeking to increase its investment in its private support infrastructure to capture its fair share of the $10.3 trillion.

In response to a question from Regent-designate Vining, Vice President Broome reported that approximately $4 million would be distributed systemwide during the first year of administrative cost recovery.

Upon motion duly made and seconded, the Committee approved the President's recommendation and voted to present it to the Board.

4. **Y2K UPDATE**

Senior Vice President Kennedy noted that today's presentation would be the third in a series of reports on the Y2K problem. Since the November meeting, the State Auditor has issued his report, and a letter from the President discussing the report was mailed to the Regents. In addition, University Auditor Reed and his staff have been reviewing Y2K compliance at the University of California.

Associate Vice President Lynn began his remarks by emphasizing that the University is taking the Y2K problem seriously and is devoting considerable effort to it. The campuses are putting accomplishment ahead of process and getting the job done. Mr. Lynn discussed what may be expected to occur in January 2000. He noted that for mission-critical systems, such as payroll, there can be zero tolerance for error. Non-mission-critical systems are local departmental or individual systems whose failure, while locally important, will have little effect on the University as a whole. Associate Vice President Lynn stated that he was confident that the University would experience no operational problems in the zero-tolerance category.

Turning to the methodology used to address the Y2K problem, Mr. Lynn recalled that strategies include vendor certification, system modification, and system replacement. The campuses are following realistic schedules developed internally rather than following arbitrary schedules suggested from the outside. The remediation and testing period is well under way. Testing will be continuous, particularly for zero-tolerance systems.

Mr. Lynn reported that the Office of the President is monitoring the campuses on the mission-critical problems in five key categories: administrative information systems, hospital information systems, medical instruments, communications systems, and facilities. The campuses and medical centers are also paying attention to the non-mission-critical categories and are providing information and education to departments. Central information technology organizations are providing consultation and advice to faculty, staff, and students, and are providing informational websites. At the Office of the President, the primary focus is on mission-critical situations. The administrative information systems include campus financial, student, human resources, and other business systems. The category also includes the University's payroll and retirement systems. At the application level, the University is essentially on target as of December 1998, with 53 percent of applications tested. More integration testing will occur during the spring, with the expectation of 90 percent completion by June 30. Some systems which are not tied to the academic year will not complete testing until the end of September. Payroll and retirement systems have been tested, but the University continues to test and retest as zero defects may be tolerated. The Office of the President is working with outside firms to do independent verification and validation.

Hospital information systems include financial and human resources systems as well as specialized systems related to patient care and physician support. Some of the departmental systems are mission critical, such as those associated with clinical laboratories. About 38 percent of the hospital systems have been tested. The hospitals are on a schedule that is three months behind the campuses because they depend to a greater extent on purchased systems and thus are dependent on their suppliers' schedules. In addition, they are not so tied to the academic year. They plan to complete testing by September. Fewer than 10 percent of all medical instruments are rated as high risk to patient care. About one-third of these instruments contain no date reference. Approximately 91 percent of all high-risk instruments have been tested as compliant, upgraded to be compliant, or replaced. The medical centers test all instruments and do not rely solely on vendor certification. Mr. Lynn pointed out that there are very few instruments where date sensitivity affects patient care. Most date references are for time stamping and management reporting but do not affect control, the essential area of concern for patient care. One hospital, for example, reports that none of its high-risk instruments has a date problem that could affect patient care. While it is expected that the remaining instruments will be tested shortly, any high-risk instrument not tested as year 2000 compliant by the appointed date will be withdrawn from service.

Communications systems are well under way, with a 64 percent completion rate, including integrated testing. Testing will be completed by September.

Associate Vice President Lynn reported that, in conjunction with Associate Vice President Bocchicchio, facilities compliance is being monitored at the campuses. This monitoring includes HVAC, security, power, fire alarm and suppression, and elevators. The University has received compliance letters from many of its external suppliers, particularly energy suppliers, although they cannot make any ironclad guarantees. While facilities compliance is harder to summarize, all systems have been inventoried and assessed. For the most part, remediation has been completed, and plans are well in hand where this is not the case. Contingency planning is under way. In most cases, this planning draws on existing emergency preparedness plans. Campuses are evaluating their backup generator capacity to ensure that they can handle mission-critical operations for several days. The proper functioning of the vast majority of building control systems will not be affected by date errors.

In concluding his report, Mr. Lynn noted that much remediation and testing work remains to be done, but the University is on target. Contingency planning will focus on zero-tolerance systems as an absolute requirement and on those systems where there is any likelihood of failure within the window of criticality. The administration is working with the General

Counsel to take steps to minimize any potential liabilities that may arise from failures or alleged failures.

University Auditor Reed recalled that during the last discussion of the Y2K issue in November, Senior Vice President Kennedy made reference to an audit in progress at the time by the State Auditor's Office. The State Auditor's report was issued at the end of February, and President Atkinson provided the Regents with information on the report by letter. Fundamentally, the report did not take issue with the University's approach to resolving Y2K issues or the University's progress to date. It did cite the University as being among State agencies that had not met Governor Wilson's executive order calling for full Y2K compliance by December 31, 1998. The President's letter pointed out, however, that this order did not apply to the University and was an inappropriate yardstick. The State Auditor's report does conclude that the University has a comprehensive plan for addressing Y2K issues, has assigned responsibility for execution of the plans, and is making periodic reports of progress. There were no recommendations for the University from the State Auditor as a result of that report.

In January, Internal Audit commenced an audit of the University's Y2K preparedness. The objective of the first phase of this work was to review the overall strategy for Y2K compliance and progress to date. This is a systemwide review under the direction of Internal Audit being undertaken by each local internal audit department and therefore covering each campus, medical center, Department of Energy laboratory, and the Office of the President. As Phase I represents a high-level review, the procedures relied mostly on discussions with people responsible for various aspects of Y2K compliance at each location and reviews of documents prepared for tracking purposes.

Based on the work done to date, the following conclusions were made:

- Each location has carried out a comprehensive assessment of its central administrative systems and identified those considered to be mission critical. These are the systems that are then being tracked and reported to the Office of the President and in summary fashion to the Regents.

- The auditors did not identify any centrally administered systems that appeared to be mission critical but had not been so designated. As a result of the review, however, at two locations a system was added to the list of systems to be tracked and reported centrally.

- Outside of central administrative systems, departmental operating personnel have responsibility for Y2K issues in their systems, and they appear to be generally well aware of this responsibility and actively addressing their compliance issues. The areas outside of central administrative systems include principally academic departments and research activities. In addition, the Treasurer's Office is undertaking its own Y2K compliance efforts.

- The auditors found that each location has a comprehensive plan to bring mission-critical systems into compliance and is actively carrying out those plans.

- Among people responsible for executing the Y2K compliance plans, individual roles and responsibilities are well defined and understood.

- Each location has devoted resources that are believed to be sufficient to complete the compliance plan in a timely manner.

- Each location has made progress against the plans consistent with the reports provided to the Office of the President and summarized today.

- The auditors concluded that each location has reasonable prospects for the timely execution of the plans, although admittedly some elements of the plans will not be completed until the third calendar quarter, meaning that there will be limited time for contingency planning.

The auditors do have certain concerns as a result of these audits, but all are being addressed. Principal among these is the assurance of power supplies. As Associate Vice President Lynn commented, the University is working to gain Y2K compliance assurances from utility providers.

Internal Audit is continuing the Y2K preparedness audits with a second phase being conducted between now and June 30. In this phase selected compliance strategies and related documentation will be tested. Throughout this process, the auditors will be reviewing contingency plans and emergency preparedness measures.

In response to a question from Regent Bustamante, Associate Vice President Lynn stated that one HVAC system had been identified that would not function on January 1, 2000 if it were not fixed or replaced, but this is not a common occurrence. In response to a further question, Mr. Lynn explained that mission-critical systems are those whose failure within the window of criticality could cause serious interruption to the operations of the University, could cause financial loss, or could cause harm to life or limb. An example of a non-mission-critical problem which could occur would be the nonfunctioning of a faculty member's personal computer on January 1, 200 or the failure of a departmental machine.

5. **REPORT OF NEW LITIGATION**

General Counsel Holst presented his routine **Report of New Litigation**. By this reference the report is made a part of the official record of the meeting.

The meeting adjourned at 12:00 noon.

Attest:

Secretary