The Regents of the University of California

COMMITTEE ON FINANCE
March 13, 2002

The Committee on Finance met on the above date at UCSF–Laurel Heights, San Francisco.

Members present: Regents Atkinson, Connerly, Hopkinson, Kozberg, Lee, Montoya, Moores, Morrison, Parsky, and Preuss

In attendance: Regents Davies, T. Davis, Johnson, Lozano, Marcus, Pattiz, Saban, and Seymour, Regents-designate Sainick and Terrazas, Faculty Representative Binion, Associate Secretary Shaw, General Counsel Holst, Treasurer Russ, Provost King, Senior Vice President Mullinix, Vice President Gurtner, Chancellors Berdahl, Bishop, Cicerone, Dynes, Tomlinson-Keasey, Vanderhoef, and Yang, Interim Chancellor Warren, and Recording Secretary Bryan

The meeting convened at 10:50 a.m. with Committee Chair Preuss presiding.

1. **APPROVAL OF MINUTES**

Upon motion duly made and seconded, the minutes of the meeting of January 17, 2002 were approved.

2. **ESTABLISHMENT OF LOAN PORTFOLIO SALE PROGRAM FOR THE UNIVERSITY OF CALIFORNIA MORTGAGE ORIGINATION PROGRAM**

The President recommended that The Regents authorize the establishment of a program for the periodic sale of all or portions of the Mortgage Origination Program (MOP) loan portfolio to increase the level of MOP liquidity for the purpose of providing additional loans for the recruitment and retention of faculty and other employees in support of projected student enrollment growth, subject to the following:

A. The MOP Portfolio Sale Program shall be conducted to provide additional funding for future MOP loans, within the following parameters authorized by The Regents:

(1) Proceeds from the MOP Sale Portfolio Program shall be deposited in the Short Term Investment Pool (STIP) and shall be available for additional funding for new mortgage loan originations within the limits already established by The Regents for MOP. MOP loans sold shall be deducted from the total MOP funding provided by STIP.

(2) If the sale of any portion of MOP results in proceeds less than the outstanding receivables of the MOP loans sold (par value), a funding

source must be approved by the President if the funding source is within Presidential control or by The Regents if the proposed fund source is not within Presidential control.

(3) No sale of MOP Portfolio loans shall extend the term of any individual MOP loan or modify the interest rate to be charged under MOP parameters.

(4) Purchasers of MOP loans shall have no recourse to Regental funds and shall be repaid only from individual mortgage loan repayments and/or property securing each individual loan, except that any such sale of MOP Portfolio loans may include terms that: (i) provide for The Regents to make monthly remittances of principal and interest to the purchaser for all loans sold which are not in arrears in excess of three months by an agreed time each month, and (ii) provide for the exchanging of any loan sold to the purchaser that becomes non-performing for more than an agreed to time period with another MOP loan of similar size and characteristics at the same discount rate, if any, that applied to the original loan sale.

B. Each sale pursuant to the MOP Portfolio Sale Program shall be reported to The Regents, together with information related to the loans sold, fund source used if the sale results in less than the par value of loans sold, and an update of unused funding for the MOP authorized by The Regents.

C. The President, after consultation with the General Counsel, shall be authorized to execute such documents as may be necessary to effect any sale pursuant to the MOP Portfolio Sale Program.

It was recalled that at the November 2001 meeting The Regents approved four initial recommendations of the UC Housing Task Force designed to strengthen the ability of existing faculty and staff financial assistance programs to address the growing housing affordability gap near most University campuses. Those recommendations made changes to existing mortgage products and created a new graduated payment option under the Mortgage Origination Program to increase the purchasing power of University loan products in the face of rapidly rising housing costs.

The UC Housing Task Force, through its New Financial Programs Subcommittee, continues to explore additional ways to leverage existing University resources to increase the availability of current and/or new financial assistance programs. Increasing the resources available for financial assistance is essential to meeting the demand for housing assistance caused by increased faculty recruitment. Further resources will be required if there is any significant broadening of program eligibility beyond the current Academic Senate and Senior Management Group categories. One approach to increase resource availability is the periodic sale of MOP loans to support increased levels of lending activity. The New Financial Programs Subcommittee completed initial investigation of this option and reported its findings and recommendations to the UC Housing Task Force at its November 2001 meeting. Based upon this report, the UC Housing Task Force recommended that the University pursue a direct sale of a portion of the existing MOP portfolio under the general structure and parameters discussed under Option 1, as further detailed below. As further discussed below, such a sale would more likely than not be at some discount, requiring the identification of a fund source to cover the differential between the discount price and outstanding par value sold to the investor. As of June 30, 2001, the balance of the Faculty Housing Reserve Fund was $18.6 million. If a sale of $100 million of MOP loans could be accomplished at 98 percent of par, the cost to the University would be $2 million plus transaction costs that are estimated at $300,000. Given the balance and obligations of the Faculty Housing Reserve Fund, it could be used as a fund source for such a sale on a one-time basis to test the ability to complete such a sale at an acceptable price. Future sales, if any, would require the identification of other fund sources.

An overview of the MOP portfolio and a summary of the subcommittee's investigation are presented below.

General Analysis of the Mortgage Origination Program Portfolio

MOP lending criteria allow eligible faculty and staff to borrow up to 90 percent of the house value with a loan maturity of up to 40 years. The interest rate is indexed to the most recently available four-quarter average return of STIP plus a 0.25 percent service fee. Interest rates are adjusted annually for each loan on the anniversary of the origination date, with a maximum annual adjustment of 1 percent. MOP loan underwriting permits mortgage payments to be as high as 40 percent of gross family income. Unlike the commercial market, private mortgage insurance is not required for loans above an 80 percent loan-to-value ratio. With the changes approved by The Regents in November 2001, a graduated payment loan option has been added to the program (GP-MOP) that allows campuses to reduce the initial rate paid by the borrower and to provide funds to STIP to cover up to a 3.0 percent reduction in the standard program interest rate. The differential paid by the campus would be reduced by 0.25 percent to 0.50 percent annually, until the borrower is paying the program rate in a 6-to-12-year period depending upon the initial reduction amount and the annual adjustment factor. It is not being proposed that any GP-MOP loans be sold as part of the first MOP Portfolio loan sale.

As of December 31, 2001, 2,396 MOP loans totaling $653.6 million had been funded, and there remained 1,510 active loans with an aggregate outstanding balance totaling $424.5 million and an average outstanding loan amount of $281,117. The MOP loan prepayment rate for the past five fiscal years has averaged 6.63 percent, which is slightly higher than the national average of 6 percent. Of the 886 loans that have been paid off under the program, the average maturity has been 6.65 years. As of June 30, 2001, the balance of the Faculty Housing Reserve Fund was $18.6 million. The principal balance and income of the reserve are dedicated to administrative and program costs relating to faculty lending programs, including covering any principal losses or earnings shortfalls of the MOP portfolio to STIP. The only principal losses for the MOP portfolio occurred in fiscal years 1994-95 through 1996-97, following the severe downturn in the California residential real estate market. The losses, totaling $1,041,153, representing 0.16 percent of the total loans made, were all covered by the reserve through transfers into STIP.

Short-Term Investment Pool

STIP has an average maturity ranging from 18 months to 28 months. On December 31, 2001 it had an average maturity of 24 months and a yield of 5.23 percent. Over the past 10 years, STIP has outperformed indices typically used for commercial real estate loans, but not to the same extent of the spread above the indices that most commercial lenders use for adjustable rate mortgages (ARMs).

Overall, MOP is viewed as being a strong program with low delinquencies. However, because certain MOP loan characteristics are unusual compared to those typical in the market, MOP is seen as having negative value when compared to mortgage programs with traditional underwriting standards such as pricing index, maximum interest rate increase each reset period, and maximum percentage of monthly income committed to mortgage payments. These factors may make it difficult to market MOP loans at the same discounts from par value as are typical for other traditional loans.

Three Options Investigated by the Subcommittee for Increasing Liquidity for MOP Lending

Option 1: Sale of $100 million to an institutional investor through a private placement

Several institutional investors were approached on a "no-name" basis to elicit their interest in purchasing a portion of or the entire MOP portfolio. Based on the investors' analyses of STIP and MOP versus traditional indices and underwriting criteria for ARMs, discounts for a purchase of MOP loans ranged from 92 percent to 98 percent of par value.

Those discussions indicated that the following parameters may either increase interest in a purchase of a portion of MOP loans and/or serve to increase the price bid for the purchase:

- Establish an initial sale of at least $100 million;

- Sell only loans that are below 80 percent loan to value and have a Fair Isaac (FICO) credit score above 600;

- Reduce service fee from 25 basis points to 12.5 basis points (the trade-off of decreased on-going program revenues would detract from the attractiveness of this option);

- Guarantee remittance of monthly payments by the fifth business day of the month for all MOP loans sold;

- Guarantee to take back any loan that becomes more than 30 or 60 days in arrears and substitute another loan of equivalent size and characteristics;

- Sell loans furthest from the date when the interest rate adjusts for the next 12 months;

- Exclude MOP loans with a term of more than 30 years from the sale portfolio;

- Exclude the new GP-MOP product from initial sales.

As required by the actions, the sale of loans will not change individual loan parameters in any way nor pledge any assets of the University for loan repayment. However, as stated in the actions, any such sale of loans may provide for the making of monthly remittances to the purchaser for loans not in arrears for more than three months and the loan substitution outlined in the parameters above in order to increase the price offered for the loans. These guarantees are similar to those assured under the current program structure to STIP and would continue to be assessed to the Faculty Housing Reserve Fund. Sale proceeds will be deposited in STIP to be available for additional mortgage originations within the limits established by The Regents for MOP. STIP will suffer no loss of principal or income as a result of any loan sales.

Option 2. Issuance of bonds secured by mortgages

Under this approach, the University would create an additional pool of funds for mortgage loans through the sale of debt, either in the form of a taxable revenue bond backed by the mortgages or a more complicated vehicle that uses a collateralized mortgage obligation (CMO) or real estate mortgage investments conduits (REMIC) structure. Repayment of debt service would come from payments due from the mortgages comprising the portfolio, which would serve as collateral for the bonds. Most CMOs or REMICs are sold by Fannie Mae and Freddie Mac. “Private label” REMICs are sold by other financial institutions and priced at a spread above Fannie Mae or Freddie Mac securities of similar maturity, weighted average life based on prepayment history, and weighted average coupon. The additional spread for the private label issues is needed to compensate investors for higher risks compared to Fannie Mae or Freddie Mac debt.

While most CMOs and REMICs are done for fixed-rate mortgages, they are also used for variable-rate mortgages. A CMO or REMIC structure is generally far more costly and elaborate to put into compliance with Securities and Exchange Commission rules than the direct sale approach discussed above.

Regardless of the structure, the same MOP program characteristics that could result in the private placement of the MOP portfolio at a purchase price below par also create significant pricing difficulties for this borrowing structure. The two major types of risks to investors under this structure relate to the credit quality of the portfolio and interest rates.

In order to meet the credit quality threshold to sell such debt publicly, a double A rating would be needed for optimum execution. To achieve this, the University could guarantee timely payment on the mortgages, or a portfolio of $100 million could be used as collateral, selling a portion to the public and retaining the payments on the remaining amount.

Covering the interest rate risk is more problematic because the loan rates are not based on a common index. It is likely that investors may insist on variable-rate debt payments based on a standard index. To achieve that outcome, the University would need to take significant interest-rate risk. For example, the University could simply issue taxable revenue bonds with a variable rate based on the two-year Treasury (the proxy for STIP) and reset each month or quarter. The University would then take the risk between such a variable rate and the actual net rate on the loans after servicing. The University could seek to hedge against this risk, but such a hedge would be highly complex because the prepayment speed on the mortgages is uncertain. A fund source would need to be identified to pay the difference between the STIP rate and the borrowing cost. It is unlikely that the University could fully offset this risk without significant cost or remaining exposure.

While such debt approaches are possible, they are likely to be highly complex in terms of disclosure, the risks involved, and the ongoing obligations of the University. The issuance of debt would also involve greater transaction costs and longer lead time than the MOP Portfolio Sale Program discussed earlier.

Option 3: Sale of $100 million to the University of California Retirement System

The Subcommittee reviewed, but did not recommend, an alternative program approach involving the University of California Retirement System's (UCRS) direct purchase of a portion of the MOP portfolio, as described in Option 1. UCRS currently invests in CMOs, which are priced at competitive yields for Ginnie Maes and REMICs. It may be possible to structure a portfolio sale to UCRS, which could be viewed as an arms-length transaction such that it would provide the same liquidity to MOP as Option 1, but with more flexibility for managing the balance of the MOP portfolio in STIP. For example, it may not be necessary to reduce the servicing fee or guarantee payment by the fifth of the month to successfully complete a sale to UCRS. A sale to UCRS would have lower transaction costs, and the pricing of the portfolio, although required to be an equivalent market price, may be priced closer to the private placement in Option 1, as the parameters of MOP are broadly understood and accepted by the UCRS board. Unfortunately, advice from counsel on this matter indicates that such an approach would not fit within the exceptions envisioned under section 72(p) of the Internal Revenue Code, which normally treats loans made to plan participants, except those meeting certain limited exceptions, as distributions from the plan subject to taxation and certain penalties.

Management of the MOP Portfolio Sale Program

The MOP Portfolio Sales Program would be managed by the Office of the President (Faculty Housing Loan Program and External Finance). To the extent necessary, the program will retain financial consulting services and will include the fees as part of the costs of the particular sale.

The documentation necessary for such a sale of loans would include: (1) a prospectus describing the University, its faculty, and the MOP program and portfolio, (2) a Purchase and Service Agreement, and (3) representations and warranties based on authorization by The Regents. All documentation would be drafted by the Office of General Counsel (OGC) or, if prepared by an institutional investor or financial consultant, would be reviewed and approved by OGC. As required by the authorizations contained in the action, the President would provide a report of each sale under the MOP Portfolio Sale Program.

Regent Hopkinson noted that the portfolio to be sold is highly desirable. She asked who would be used to facilitate putting collateralized assets out in the market and why the figure of $100 million was proposed for the sale. Senior Vice President Mullinix responded that the University would hire a consultant to market the assets. He explained that $100 million was thought to be a large-enough size to be of interest to the market.

Regent Davies was interested in the terms on which the University expected to borrow. Mr. Mullinix noted that the terms are sufficiently favorable to make the plan attractive. He believed it was not ideal to continue using STIP for this purpose.

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

3. **APPROVAL OF LIABILITY, STANFORD UNIVERSITY AFFILIATION AGREEMENT, SAN FRANCISCO CAMPUS**

The President recommended that the San Francisco campus be authorized to execute an affiliation agreement with Stanford University Hospital and Clinics that contains liability language that would provide for assumption by each institution of third-party liability for the other's students, residents, and fellows (trainees) when they are performing under the direction and control of that institution's faculty.

The Committee was informed that an affiliation agreement with Stanford has been negotiated in which medical trainees will receive educational opportunities at each other's sites. The proposed agreement with Stanford allows the important educational affiliation between Stanford and UCSF for training to continue following the de-merger. Both UCSF and Stanford provide instruction to over 2,800 health care professionals each year, of which the residents' training pursuant to the terms of the Affiliation Agreement is a very important component.

Stanford insists on defense and indemnity when Stanford trainees are subject to direction and control of UC faculty and extends the same coverage to UCSF trainees under the same conditions. Under Standing Order 100.4(dd)(9), only The Regents can authorize agreements "by which the University assumes liability for conduct of persons other than University officers, agents, employees, students, invitees and guests …."

In order to maintain an accredited educational program, the residents cannot be made to be employees of the University. Stanford has repeatedly rejected all requests to use the language in the University's standard affiliation agreements on this point and will not allow UCSF to continue in its educational partnership with Stanford without executing the agreement to include this provision regarding liability.

Because the University and UCSF benefit from the affiliation with Stanford, it is proposed that The Regents grant the authorization to UCSF to sign the Affiliation Agreement with Stanford that contains the liability language at issue and which will apply to both institutions.

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

4. **PROPOSED CONTINUATION OF TRANSIT FEE, BERKELEY CAMPUS**

The President recommended that effective fall 2002 and continuing for four years through summer 2006:

A. All students enrolled at the Berkeley campus during the regular academic year be assessed a mandatory transit fee of $34.20 per student per semester from fall 2002 through spring 2004, and up to $37.20 per student per semester from fall 2004 through spring 2006.

B. Students enrolled in the summer but not enrolled during the previous spring semester be assessed a mandatory transit fee of $17.10 per student for summer 2003 and summer 2004, and up to $18.60 per student for summer 2005 and summer 2006.

It was recalled that beginning with the fall semester 1999, the Berkeley campus implemented a bus pass program for Berkeley students that allows them free use of the

Alameda-Contra Costa County Transit District (AC Transit) system anywhere it provides service during the academic year. The program is funded from the Berkeley Transit ("Class Pass") Fee, a mandatory student-sponsored fee. The Regents approved a fee of $18 per student per semester to be charged through spring 2002.

An AC Transit analysis concluded that student use of the Class Pass was far greater than had been anticipated. The Universal Class Pass Advisory Committee, which includes representatives from student groups, the Berkeley campus Parking and Transportation Department, and AC Transit, has negotiated a new four-year contract that includes an increase in the Class Pass Fee together with improved services to students. The proposed fee would give Berkeley students unlimited rides during the academic year on AC Transit bus lines in the East Bay and to San Francisco. In addition, students enrolled in the spring semester would be permitted to use the Class Pass throughout the following summer at no additional charge. Half of the semester fee would be assessed to students enrolled during the summer who were not enrolled in the previous spring semester. The new Class Pass agreement will begin in summer 2002, as separately negotiated and authorized under the student referendum.

It is anticipated that the $34.20 per student per semester fee would be distributed as follows: $20 to AC Transit, $2.80 to the Berkeley campus Parking and Transportation Department for program implementation and shuttle bus services, and $11.40 to the campus student financial aid program. The $17.20, $18.60, and $37.20 fee levels will be distributed in similar proportions. Implementation of the fee would result in an increase in total student fees and would affect needy students. The financial aid budgets for student aid recipients would be increased to cover this fee and would be funded by the $11.40 portion of the fee, consistent with University policy that permits campuses to set aside one-third of new revenue from student-sponsored fees for financial aid purposes.

Campus mandatory fee policies require that for a referendum to be valid, at least 20 percent of the registered students must vote in a valid election. Approval of the referendum requires a simple majority of students voting. The referendum was held November 13-15, 2001 through the campus' new computerized, on-line voting method. The campus' official fall 2001 enrollment is 32,128 students, and a valid voting pool was determined to be 6,426 students. The referendum was approved with 29.8 percent of students voting and 88.4 percent of these students voting to approve the fee. These results met the campus' voter turnout and majority approval requirements.

[For speakers' comments, refer to the March 13 minutes of the Committee of the Whole.]

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

5. REPORT ON NEW LITIGATION

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

The meeting adjourned at 11:00 a.m.

Attest:

Associate Secretary