The Regents of the University of California

COMMITTEE ON GROUNDS AND BUILDINGS
COMMITTEE ON FINANCE
May 14, 2003

The Committees on Grounds and Buildings and Finance met jointly on the above date at UCSF–Laurel Heights, San Francisco.

Members present: Representing the Committee on Grounds and Buildings: Regents Hopkinson, Johnson, Kozberg, Ligot-Gordon, Lozano, Marcus, Moores, and Sainick; Advisory members Seigler and Pitts
Representing the Committee on Finance: Regents Connerly, Hopkinson, Lee, Ligot-Gordon, Lozano, Montoya, Moores, Preuss, and Sayles; Advisory member Pitts

In attendance: Regents Davies and Terrazas, Regent-designate Murray, Faculty Representative Binion, Secretary Trivette, Associate Secretary Shaw, General Counsel Holst, Provost King, Vice Presidents Drake and Hershman, Chancellors Cicerone, Córdova, Dynes, Greenwood, Vanderhoef, and Yang, Vice Chancellor Desrochers representing Chancellor Tomlinson-Keasey, and Recording Secretary Bryan

The meeting convened at 11:05 a.m. with Committee on Grounds and Buildings Chair Marcus presiding.

1. **APPROVAL OF MINUTES**

Upon motion duly made and seconded, the minutes of the meetings of November 14, 2002 and January 15, 2003 were approved.

2. **AMENDMENT OF THE BUDGET FOR CAPITAL IMPROVEMENTS AND THE CAPITAL IMPROVEMENT PROGRAM FOR TOWER II, PHASE 4, DAVIS CAMPUS**

The President recommended that the Committee on Grounds and Buildings recommend that, subject to the concurrence of the Committee on Finance:

A. The 2002-03 Budget for Capital Improvements and the Capital Improvement Program be amended as follows:

Davis: Tower II, Phase 4 – preliminary plans, working drawings, construction, and equipment – $25,794,000 to be funded from hospital reserves.

B. The Committee on Finance concur with the recommendation of the Committee on Grounds and Buildings as described in A. above.

The Committees were informed that the University of California Davis Medical Center's Tower II, Phase 4 project is the final tenant improvement for the previously approved "Tower II" project at the medical center. The build out in the last two shelled floors will provide space for two nursing units and 72 inpatient beds.

Phase 1 of Tower II, officially renamed Davis Tower, opened in May 1999. Of Davis Tower's fourteen floors, only floors 6, 7, and 8 were finished and occupied during the first phase of development. These three floors added 107 licensed beds for general medicine, pediatrics, and oncology/bone marrow transplantation patients, leaving floors 3, 5, 10, 11, 12, and 14 as shelled space. Floors 2, 4 and 9 are mechanical floors.

The unfinished shelled floors were planned to be built out in three phases, with each phase completing two floors at a time, to provide space for the relocation of approximately 200 beds from the seismically deficient North, South, and East Wings. Phase 2 (floors 3 and 14), which opened in September 2002, houses Obstetrics and Orthopedics. Phase 3 (floors 5 and 12) will accommodate the Neonatal Intensive Care Unit/Continuing Care Nursery and the G.I./Pulmonary nursing units.

Phase 4, the subject of this request, will complete the build out of the shelled floors 10 and 11 in the Davis Tower, relocating the Trauma Nursing Unit (TNU) and the General Medicine Nursing Unit (GMNU). The TNU currently resides in a sixteen-year-old temporary modular structure behind the hospital, and the GMNU is located in the seismically deficient and amenities-lacking East Wing of the hospital.

Project Description

The Tower II, Phase 4 project, tenant improvements will be made both to Floor 10 – General Medicine Nursing Unit (14,520 asf) and to Floor 11 – Trauma Nursing Unit (14,520 asf) that consist of a combination of 23 private, semi-private, and isolation rooms that can accommodate up to 36 patients; a patient day room and exam/treatment rooms; and public areas, core support space, staff support space, and floor support space.

Construction on the project will begin May 2004, with completion expected in November 2005.

CEQA Classification

The project is consistent with the March 1989 Long Range Development Plan, is addressed in the LRDP Environmental Impact Report, and was analyzed in the EIR for Tower II that was certified in November 1994.

Financial Feasibility

The total cost of $25,794,000 for the UCDMC Tower II, Phase 4 project is to be funded by hospital reserves.

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

3. **AMENDMENT OF THE BUDGET FOR CAPITAL IMPROVEMENTS AND THE CAPITAL IMPROVEMENT PROGRAM AND APPROVAL OF EXTERNAL FINANCING FOR UCI MEDICAL CENTER REPLACEMENT HOSPITAL, IRVINE CAMPUS**

The President recommended that:

A. The Committee on Grounds and Buildings recommend that, subject to the concurrence of the Committee on Finance, the 2002-03 Budget for Capital Improvements and the Capital Improvement Program be amended to include the following project:

From: Irvine:<u>UCI Medical Center Replacement Hospital</u> – preliminary plans, and working drawings - $27,653,000 to be funded from hospital reserves

To: Irvine: <u>UCI Medical Center Replacement Hospital</u> – preliminary plans, working drawings, construction, and equipment – $336,681,000 to be funded from State lease revenue bonds ($235,000,000), external financing ($32,918,000), Hospital Reserves ($472,000), capitalized leases ($20,791,000), and gift funds ($47,500,000).

B. The Committee on Finance concur with the recommendation of the Committee on Grounds and Buildings as described in A. above.

C. The Committee on Finance recommend that external financing not to exceed $32,918,000 be obtained to finance construction and related costs of the UCI Medical Center Replacement Hospital, Irvine campus, subject to the following conditions:

(1) Interest only, based on the amount drawn down, shall be paid on the outstanding balance during the preliminary plans, working drawings, and construction periods.

(2) Repayment of the debt shall be from hospital revenues.

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

D. The Committee on Finance recommend that standby financing not to exceed $10.6 million and interim financing not to exceed $19.4 million be obtained to finance the gift-funded portion of construction and related costs of the UCI Medical Center Replacement Hospital, Irvine campus, subject to the following conditions:

(1) Interest only, based on the amount drawn down, shall be paid on the outstanding balance during the preliminary plans, working drawings, and construction periods.

(2) Repayment of any financing shall be from gift funds, and in the event such gift funds are insufficient, from income from the Dean's assessment on clinical practice revenue ($15 million) and opportunity funds ($15 million).

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

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

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

The Committees were informed that full budget approval for the UCI Medical Center Replacement Hospital projects is sought. The recommended actions will permit the campus to put the project out to bid upon completion of the design, subject to necessary State approvals. The approval will be contingent on securing and recordation of all land transfers and easements.

It was recalled that the hospital replacement project consists of three elements: construction of a 189,297-asf replacement hospital with an additional increment of shell space that would be built out to provide approximately 13,000 asf at a later date; associated renovations and non-structural bracing in Building 1A; and construction of a new chiller plant and required upgrades to other central plant facilities, as well as mandated improvements in the steam plant, primary electrical facility, and utility tunnel.

The estimated component costs of the replacement hospital and associated work are as follows:

Replacement Hospital		$314,965,000
Building 1A Renovation		3,982,000
Central Plant Improvements		17,734,000
	Total	$336,681,000

The 2000-01 Budget Act authorized $600 million in State lease revenue bonds to provide the University's teaching hospitals with funding to address seismic deficiencies as required to comply with SB 1953. In November 2000, The Regents allocated $235 million of these funds to the Irvine campus to construct a replacement hospital and implement other SB 1953 upgrades at the UCI Medical Center. In March 2001, the State Public Works Board approved the scope and cost of this project. At the May 2001 meeting, the Regents were advised of UCI's plan to use this State funding to construct a new 162,500-asf hospital with 186 beds and ten operating rooms, and to implement other required seismic corrections. At that time, it was explained that the medical center was working to identify other fund sources to expand the project scope to respond to the growing demand for services and other programmatic requirements. Detailed programming was then completed and a plan developed to accomplish the medical center's highest priority goals by supplementing the budget with gift funds, hospital reserves, and external financing. At the March 2002 meeting, The Regents gave approval to proceed with the preliminary plans phase of the project. In January 2003, The Regents approved the project design and authorized the campus to move forward with the working drawings phase.

The campus has identified a total of approximately $23 million in deductive bid alternates to the hospital construction program that can be implemented if necessary at certain stages beginning in the summer of 2003 through the completion of construction in January 2008. Decisions as to which alternates to implement will be made by campus and hospital management on the basis of a detailed schedule that will tie each decision to the availability of funding options that exist following the award of the construction contract. The schedule requires decisions on $14 million in alternates within the first year following contract award, $6 million in the second year, and $3 million in the fourth year.

Bid alternates include several options for shell space, including a 30-bed medical and surgical unit, a 12-bed ICU unit, three operating rooms, three procedure rooms, and administrative space. By outfitting 30 other patient rooms for double occupancy and reconfiguring seven ICU areas to accommodate one additional bed each, the project would still achieve the186-bed capacity approved by the State. Other bid alternates include changing finishes and materials, revising the entry tower, reducing the number of elevators, eliminating growth-related generator capacity, eliminating mechanical screening on the roof, scaling back the entry plaza, and deferring demolition of Building 10.

Funding Plan and Financial Feasibility

In order to move ahead with the preliminary plans and working drawing phases of the project, hospital reserve funds totaling $27,653,000 were pledged for their completion. It is now proposed that the fund sources for preliminary plans and working drawings change to a combination of State lease revenue bond funding, gift funds, and external financing.

Gift Campaign: The funding plan requires a community-based capital campaign of $47,500,000 for the project (excluding $2,500,000 for campaign costs). There is broad community support for a new hospital facility for Orange County's only academic medical center and Level 1 trauma center. As of April 15, 2003, the gift campaign status is as follows:

Cash gifts in-hand	$ 500,000	
Pledges received	10,600,000	(stand-by financing)
Gifts to be raised	19,400,000	(interim financing)
Gifts to be raised	17,000,000	(backstopped by medical center)
Total	$47,500,000	

The levels of stand-by and interim financing are requested to meet The Regents' requirements to have funds in hand at bid award. The Medical Center is backstopping gifts equal to $17 million with additional hospital reserves.

The campus is confident that it will be able to raise the remaining $36.4 million in gift funds for this project. However, in the event the collection is insufficient, the campus has identified the potential to incur debt of up to $15 million with repayment from the ongoing Dean's assessment on clinical practice revenue and $15 million with repayment from Irvine campus opportunity funds generated by School of Medicine research programs. The amount of gifts backstopped by campus and Medical Center funds totals $47 million, equal to $10.6 million pledges received and $36.4 million for gifts to be raised.

To the extent the campus obtains gift funds, the draw down against hospital reserves will be reduced first, then the stand-by and interim loan commitments will be reduced, or outstanding balances will be repaid to the extent remaining gift collections are available.

External Financing: Based on long-term debt of $32,918,000 amortized over 30 years at 6.125 percent interest, the estimated average annual debt service will be $2,423,500. Repayment of this debt will be from hospital operations.

Financial Projections

Beginning in July 2001, the medical center and the College of Medicine created a five-year business development plan to strengthen a range of specialized clinical programs aimed at making UCI the referral center of choice in the region. The key to this plan is the recruitment of 33 new clinical faculty distributed among 17 specialty services, which is the major component of the $35 million investment required to implement this plan over the next five years. Year one of the plan, FY 03, identifies 20 new physicians to be hired, with 12 more added in year two, and the final physician added in year three. Fifteen of the year-one positions are in place, along with two physicians originally scheduled in year two. These 17 new physicians have increased the medical center's services in colorectal surgery, hepatology, pediatric and adult epiliptology, neuro psychiatry, breast imaging, interventional radiology, geriatrics, oncology, spine surgery, and joint replacement surgery.

After the first nine months of the business plan, admissions to the medical center have increased by 5.3 percent over the prior fiscal year period and can be compared to the projected first-year increase of 6 percent. Ambulatory encounters are 3.8 percent greater than during the prior year period, surpassing the original projection of a 1 percent increase in year one. Year-end net income is projected to exceed the business plan projection of $32 million by $1 million, a 9.5 percent gross margin; in addition, ending cash reserves of $30 million are projected to exceed the business plan projection ($23 million) by $7 million.

Patient activity is projected to increase with the full implementation of the business plan over the next five years. Admissions are projected to grow at an average 5 percent annual rate over the period. The projected growth in admissions is the result of a combination of new admissions generated by the 33 new physicians mentioned above and projected population growth in the region. Average daily census is projected to grow from the current year level of 257 to 315 by FY 09. The average daily census growth rate over this period is slightly lower than the growth in admissions, due to an anticipated decline in average length of stay from the current 5.5 days per admission to 5.3 days by FY 07. This reduction is due, in part, to national changes in the delivery of health care that have resulted in shorter hospitalizations. In addition, the medical center's business plan increases growth in minimally invasive surgical cases, thereby resulting in significantly shorter hospital stays. Outpatient encounters are projected to increase by about 4 percent per year for years two through four of the business plan, slowing to a 3 percent growth rate by FY 07 through FY 09, as clinic capacity becomes fully utilized. Encounters will increase from current levels of 580,000 per year to 718,000 by FY 09.

Operating revenues are projected to increase from the planned growth in patient volumes, a continuing improvement in patients' sponsor mix, improvements in managed care contract reimbursement rates, and rate increases. Partially offsetting this growth in revenue are potential reductions in several government programs. Given the State budget crisis, and discussions in Washington regarding Medicare and

Medicaid reform, it is difficult to project whether these reductions will occur, but the financial projections include best estimates of the Office of the President regarding the impact of changes to these programs. The most significant of these reductions will occur over the next two fiscal years, with a projected decrease of $6 million in FY 04, followed by an additional reduction of $14.7 million in FY 05. Including these reductions, operating revenues are projected to increase from the current FY 03 level of $347 million to $498 million by FY 09, an average annual increase of 6.2 percent.

Expenses per adjusted patient day are projected to increase at an annual average rate of 3.6 percent beginning in FY 03 through FY 09. This increase in costs is due to inflation in salaries and benefit costs, supplies, drugs, and other expenses. Projected increases in staff are consistent with the planned growth in patient activity. Total expenses per year increase from $314 million in FY 03 to $473 million by FY 09. This increase is the result of both the inflationary price and business plan volume increases, and, in FY 08 and FY 09, the increase in depreciation associated with the new hospital.

Net income is projected to increase from $33 million in FY 03 to $36.1 million in FY 04, but decrease to $29.8 million in FY 05. Expressed as a percentage of revenue, these gains would result in margins of 9.5 percent, 9.7 percent, and 7.6 percent per year. The decline in profitability during FY 05 is the result of the projected cumulative reduction of $20.9 million over this two-year period in government supplemental programs. Significantly, most of this reduction is offset by improvements in income projected from the business plan. Net income for the remaining fiscal years through FY 07 is projected to be approximately $30 million per year, a gross margin of about 7 percent before College of Medicine support transfers. Net income in FY 09 declines to $24 million with the first-full year increase in depreciation expense for the new hospital.

Capital investments for equipment over the six-year projection period prior to the hospital opening are expected to average about $13 million per year. This includes routine equipment replacement programs, additional investments in computer systems, and radiology equipment. Also included are $2 million in equipment to support business plan initiatives. Capital facility projects are planned at about $8 million per year over the six-year period. Support for College of Medicine programs, including business plan investments, is projected to average $22.7 million per year.

Cash balances are projected to exceed 60 days of unrestricted cash by the end of FY 06, increasing to 62 days by FY 09 with the opening of the new hospital. The debt service coverage ratio is projected to drop from the FY 03 level of 5.8, to a low in FY 05 of 3.2, then increase to 3.9 by FY 09. Debt to capitalization remains less than 20 percent during the projection period.

All of the financial projections described above rely upon the best estimates of the medical center and the Office of the President. Because of the volatility of the healthcare market place, the Medical Center has developed a number of alternative financial projections and sensitivity analyses to provide a range of results given various scenarios. Under each of these variations the financing plan proposed remains viable.

Standby/Interim Financing

Assuming gift-related standby/interim debt of $15 million backed by campus opportunity funds, the average annual debt service is $1.1 million, based on an interest rate assumption of 6.125 percent and a 30-year term. The campus would remain within the prescribed opportunity fund pledge and payment limits.

Assuming gift-related standby and interim debt of $15 million backed by the ongoing dean's assessment on clinical practice revenue, the average annual debt service is $1.1 million, based on an interest rate assumption of 6.125 percent and a 30-year term. The investments in the business development plan are expected to yield positive results for both the hospital and the faculty practice plan. The College of Medicine projects an increase in revenue of 3 percent in FY 2003-04, and as the business development plan progresses, an increase of 5 percent is projected for each fiscal year thereafter. Whereas a few years ago the UCI faculty practice provided care to a largely under-funded patient population, UCI has developed into a major referral center with a mix of patients more representative of the community. In FY 2008-09, the first full year of occupancy of the hospital, $4,703,000 of dean's assessment revenue will be generated. Estimated annual expenses for this revenue source are $3,326,000. With the potential debt service requirement of $1.1 million, the dean's assessment revenue will provide debt service coverage of 1.25.

Chancellor Cicerone invited Mr. Thomas Tierney, an Irvine campus supporter, to address the Committees. Mr. Tierney reported that the community is passionate and enthusiastic about the new hospital and that the gift campaign has raised about 30 percent of the amount necessary to meet the fundraising goal.

Regent Kozberg expressed concern about the size of the contingency in the financial package. Chancellor Cicerone believed that it was adequate. He pointed out that there is an extra program contingency fund of about 5 percent of construction costs that could be made available.

Regent Terrazas reported that the alumni Regents had visited the Irvine campus and had met with campus development specialists with whom they discussed the fundraising campaign. They had been impressed by the momentum and the details concerning the figures.

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

4. **AMENDMENT OF THE BUDGET FOR CAPITAL IMPROVEMENTS AND THE CAPITAL IMPROVEMENT PROGRAM AND APPROVAL OF EXTERNAL FINANCING FOR STUDENT ACADEMIC SERVICES FACILITY, SAN DIEGO CAMPUS**

The President recommended that:

A. The Committee on Grounds and Buildings recommend that, subject to the concurrence of the Committee on Finance, the 2002-03 Budget for Capital Improvements and the Capital Improvement Program be amended as follows:

San Diego: Student Academic Services Facility – preliminary plans, working drawings, construction, and equipment – $29,692,000 to be funded by State funds ($21,708,000), campus funds ($2,984,000), and external financing ($5,000,000).

B. The Committee on Finance concur with the recommendation of the Committee on Grounds and Buildings in A. above.

C. The Committee on Finance recommend that external financing be obtained not to exceed $5 million to finance a portion of the Student Academic Services Facility 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) Repayment of the debt shall be from San Diego campus opportunity funds.

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

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

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

It was recalled that in August 2001, The Regents approved the 2002-03 Budget for Capital Improvements, which included the Student Academic Services Facility at San Diego. With that approval, the project was established with a budget of $29,692,000 comprising preliminary plans ($1,314,000), working drawings ($1,606,000), construction ($26,272,000), and equipment ($500,000), and was incorporated into the 2002-07 State Funded Capital Improvement Program. In February 2003, the Committee on Grounds and Buildings adopted a mitigated negative declaration and approved the design of the project.

Project Description

The Student Academic Services Facility project will construct a 75,000 assignable-square-foot facility to house student academic support and service units. The project will address existing serious space deficiencies, fragmented operations, and poor adjacencies among eleven key units, including departments such as Admissions and Relations with Schools, Office of Graduate Studies and Research, Office of the Registrar, and the Financial Aid Office. The facility will include offices, office support, conference, and assembly space. Construction is scheduled to begin in September 2004 and be completed in August 2006.

Environmental Consideration

In accordance with University of California guidelines for the implementation of the California Environmental Quality Act, environmental documentation was prepared for consideration in conjunction with the project design review. A Notice of Determination was filed with the State on February 27, 2003.

Financial Feasibility

Based on long-term debt of $5,000,000 amortized over 30 years at 6.125 percent interest, the estimated average annual debt service on $29,692,000 will be $368,100. Repayment of the debt will be from San Diego campus opportunity funds. The campus is within the prescribed opportunity fund pledge and payment tests.

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

The meeting adjourned at 11:15 a.m.

Attest:

Secretary