The Regents of the University of California

COMMITTEE ON FINANCE
May 18, 2006

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

Members present: Regents Dynes, Gould, Hopkinson, Juline, Parsky, and Preuss; Advisory members Ledesma, Schreiner, and Oakley

In attendance: Regents Island, Kozberg, Moores, Pattiz, Rominger, Rosenthal, Ruiz, and Schilling, Regent-designate Coombs, Faculty Representative Brown, Associate Secretary Shaw, University Counsel Thomas, Interim Treasurer Berggren, Acting Provost Hume, Senior Vice President Darling, Vice Presidents Foley, Gomes, and Hershman, Chancellors Carnesale, Córdova, Fox, Tomlinson-Keasey, and Vanderhoef, and Recording Secretary Bryan

The meeting convened at 2:20 p.m. with Committee Vice Chair Preuss presiding.

1. **APPROVAL OF MINUTES OF PREVIOUS MEETINGS**

Upon motion duly made and seconded, the minutes of the meetings of January 18 and March 15, 2006 were approved.

2. **CONSENT AGENDA**

A. ***Authorization of Leases and Agreements for Seismic Corrections, San Francisco Campus Medical Center Facilities***

The President recommended that, subject to adoption by the State Public Works Board of a resolution authorizing the issuance of State Public Works Board (SPWB) Lease Revenue Bonds and authorizing interim loans from the State's Pooled Money Investment Account or General Fund for the UCSF Medical Center SB 1953 Moffitt/Long 2008 project at the San Francisco campus:

(1) The President or the Secretary be authorized to:

a. Execute an unsubordinated site lease from The Regents to the SPWB for the project named above, said lease to contain provisions substantially as follows:

i. The site shall comprise the approximate size of the footprint for the building named above. Said lease shall also include a license to the SPWB for access from campus roads to the site during the term of the lease.

ii. The purpose of the lease shall be to permit construction of the project.

iii. The term of the site lease shall commence on recordation of the lease or the first day of the month following the meeting of the SPWB at which the resolution is adopted authorizing the lease, the issuance of bonds, and interim financing for the project, whichever is earlier, and shall terminate on the date the bonds issued by the SPWB are paid in full, subject to earlier termination if such bonds have been retired in full.

iv. The rental shall be $1 per year.

v. The Regents shall have power to terminate the site lease in the event of default by the SPWB, except when such termination would affect or impair any assignment or sublease by the SPWB and such assignee or subtenant is duly performing the terms and conditions of the lease.

vi. Regents shall provide to the SPWB and any assignee of the SPWB access to the site and such parking and utility services as are provided for similar facilities on the campus.

vii. The Regents shall waive personal or individual liability of any member, officer, agent, or employee of the SPWB.

viii. The Regents shall agree to pay assessments or taxes, if any, levied on the site or improvements attributable to periods of occupancy by The Regents.

ix. In the event any part of the site or improvements is taken by eminent domain, The Regents recognizes the right of the SPWB to retain condemnation proceeds sufficient to pay any outstanding indebtedness incurred for the construction of the project.

b. Execute an agreement between the State of California, as represented by the SPWB, and The Regents for the project named above, said agreement to contain the following provisions:

i. The SPWB agrees to finance construction of the project, as authorized by statute.

ii. The Regents agrees to provide and perform all activities required to plan and construct said project.

c. Execute a facility lease from the SPWB to The Regents for the project named above, said leases to contain provisions substantially as follows:

i. The purpose of the building's occupancy shall be to use it as a facility for acute care in-patient service and support-related functions in furtherance of the University's mission related to instruction, research, and public service.

ii. The SPWB shall lease the financed facility, including the site, to The Regents pursuant to a facility lease.

iii. The terms of the facility lease shall commence on recordation of the lease or the first day of the month following the meeting of the SPWB at which the resolution is adopted authorizing the lease, the issuance of bonds, and interim financing for the project, whichever is earlier, and shall terminate on the date the bonds issued by the SPWB are paid in full, subject to earlier termination if such bonds have been retired in full.

iv. If the SPWB cannot deliver possession to The Regents at the time contemplated in the lease, the lease shall not be void nor shall the SPWB be liable for damages, but the rental payment shall be abated proportionately to the construction cost of the parts of the facility not yet delivered.

v. In consideration for occupancy during the term of the lease and after the date upon which The Regents takes possession of the facility, The Regents shall pay base rent in an annual amount sufficient to pay debt service on the bonds or other obligations of the SPWB issued to finance or refinance the facility and additional rent for payment of all administrative costs of the SPWB.

vi. The Regents covenants to take such actions as may be necessary to include in the University's annual budget amounts sufficient to make rental payments and to make the necessary annual allocations.

vii. During occupancy, The Regents shall maintain the facility and pay for all utility costs and shall maintain fire and extended coverage insurance at then current replacement cost or an equivalent program of self-insurance, and earthquake insurance if available on the open market at a reasonable cost.

vii. During occupancy, The Regents shall maintain public liability and property damage insurance, or an equivalent program of self-insurance, on the facility and shall maintain rental interruption or use and occupancy insurance, or an equivalent program of self insurance, against perils covered in (c)vii. above.

viii. In the event of default by The Regents, the SPWB may maintain the lease whether or not The Regents abandons the facility and shall have the right to re-let the facility, or the SPWB may terminate the lease and recover any damages available at law.

ix. The Regents shall be in default if the lease is assigned, sublet, or transferred without approval of the SPWB, if The Regents files any petition or institutes any proceedings for bankruptcy, or if The Regents abandons the facility.

x. The Regents shall cure any mechanics' or materialmen or other liens against the facility and, to the extent permitted by law, shall indemnify the SPWB in that respect.

xi. The Regents, to the extent permitted by law, shall indemnify the SPWB from any claims for death, injury, or damage to persons or property in or around the facility.

xii. Upon termination or expiration of the lease, other than for breach or because of eminent domain, title to the facility shall vest in The Regents.

(2) The President be authorized to identify assets to be leased in lieu of facilities constructed pursuant to a. and c. above, and the President or the Secretary be authorized to execute documents necessary to lease such assets.

B. ***Authorization to Establish Indenture for Academic Medical Center Pooled Revenue Bonds to Finance and Refinance Debt for UC Medical Centers and, Subject to the Concurrence of the Chairman of the Board and the Chair of the Committee on Finance, to Execute Interest Rate Swaps Where Appropriate to Reduce Interest Rate Expense of Such Bonds***

The President recommended that:

(1) The President be authorized to establish an indenture to refinance existing debt of the University of California medical centers and to finance and refinance debt for new medical center projects, subject to the following:

a. Revenues of all UC medical centers be pooled and used to pay debt service on bonds issued under the indenture, regardless of which medical center uses proceeds of borrowing.

b. Bonds may be issued as fixed rate bonds or variable rate bonds, or as taxable or tax-exempt bonds or with such other terms and conditions as may be determined in supplemental indentures.

(2) The President be authorized, where appropriate and subject to the concurrence of the Chairman of the Board and the Chair of the Committee on Finance, to execute interest rate swaps based on receiving either a percentage of the Bond Market Association Tax-exempt Index, the taxable LIBOR index, or similar indices to achieve a lower synthetic fixed rate for the bond issue or otherwise to achieve the desired interest rate risk profile.

(3) The Officers of The Regents be authorized to execute all documents, including the indenture, 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.

3. **UPDATE ON THE GOVERNOR'S MAY REVISION AND LEGISLATIVE HEARINGS FOR THE STATE BUDGET, INCLUDING AN UPDATE ON THE FEDERAL BUDGET**

Vice President Hershman reported that the Governor and the Legislature had agreed to a series of bond issues for the November ballot. The Governor is planning to sign the education bond soon, the money from which will go mainly to K-12, with the University's share being about $345,000 per annum for the normal capital budget and $200,000 for the expansion of the University's medical education programs. The bond issue meets the commitment of the Governor in the Compact and goes beyond it in terms of the medical education bond. Although it is only a two-year bond, it is welcome in many respects.

Mr. Hershman recalled that the Governor had issued his May Revision to the Budget. State revenue is about $5 billion higher in the current year and $2.5 billion in the budget year. Much is one-time money related to capital gain and stock option revenue. The Legislative Analyst generally agrees with the Governor's revenue estimates and acknowledges that the Governor has been cautious in these. The State's reserve account will be replenished, and K-12 will receive its full funding under Proposition 98 and will be repaid for previous years' under-funding. All of the expenditures that the Governor is proposing are one-time in nature. The structural deficit, which was $16 billion when Governor Schwarzenegger took office, is estimated to be about $2.5 billion next year. The Legislative Analyst has calculated that the way in which the State is paying off the debt will reduce the deficit to $1 billion by 2009-10. That creates a possibility that the 2007 commitments made by the Governor in the Compact will be honored.

Many Regents have been engaged in Legislative hearings, with positive results. A final hearing in the Senate Budget Committee raised issues about salary increases, the fee buyout, enrollment growth, and the amount of funds per student, all of which were settled favorably for the University. Funds for student academic preparation were restored to $17.3 million in the Senate version, but this remains to be negotiated between the Legislature and the Governor. About $11 million was added for research, but it is targeted for Legislative priorities.

Mr. Hershman reported that, concerning the operating budget, there has been a struggle between the Department of Finance and the Legislature concerning how much money per student should be provided as students are added. The Governor and the Legislature arrived at the same number, but their differing methodologies have caused contention. He confirmed that the capital budget has been passed on both sides, with all the projects being funded.

Final negotiations on the budget will take place in the coming weeks.

Vice President Hershman recalled that there had been a series of Legislative hearings during which Regents and President Dyes had testified on issues related to the University's compensation practices. Following the hearings in the Education Committee and the budget subcommittee, Former Speaker Hertzberg testified on the recommendations of the Hertzberg-Kozberg Task Force, which received strong support from the committee. It is expected that the Assembly will adopt language approved on May 17 by The Regents with respect to the recommendations. Most of the Legislators have been very responsive and supportive in trying to find solutions acceptable to them and the University.

Regent Juline asked whether there had been any indication as to how the Governor would respond to the attempt to restore budget funds for student academic preparation. Mr. Hershman believed the matter was a political one that would be resolved through negotiation.

In response to a question asked by Regent Gould, Mr. Hershman expressed confidence that the University had received its fair share of the bond money.

Regent Moores emphasized that the upturn in the State's fiscal situation has been driven by capital gains and stock options. He asked how the University plans to address the inevitable return of budget problems when the state's economic cycle takes a downturn. Mr. Hershman responded that the Governor is endeavoring not to spend one-time money for permanent purposes, which is what caused budget problems in the late 1990s. He believed that if legislators go along with this, they will not be spending the current bubble for permanent purposes and the deficit will be manageable. If it turns out to be larger, the University would have to renegotiate, starting from scratch with the Governor's Budget.

Regent Gould acknowledged that the business cycle is in a positive trend. General fund revenue growth has grown by12.5 percent. The Governor's forecast is 1.5 percent for next year, so he has dramatically scaled back. The Legislative Analyst commented that the Governor's estimate may be too conservative. The challenge, however, is that there is still a gap to be dealt with.

Regent Moores noted that when the bubble that has been driven by capital gains in real estate bursts, the Legislature will feel compelled to respond by cutting the University's budget. Mr. Hershman acknowledged economic cycles have always caused this same dilemma. The University tends to suffer more than other sectors, which are funded automatically through statute. The University must be prepared to take tougher actions in bad times and hope to recover in good times. In the past, the University has recovered over time. It has not kept its share of the overall budget, but funding, enrollment growth, and keeping up with inflation have been possible until recently. All the constitutional and statutory provisions give the State very little discretion, and the University tends to lose ground. Regent Moores recalled that when times had improved, the Regents had failed to lower student fees. The response during the last budget pinch was to impose fees on students who were unprepared for them. He was concerned that the University will be as ill-prepared for the next inevitable financial meltdown and will be left with few options. Mr. Hershman observed that, while fees have not been stable, they are not seriously out of line. He was hopeful that the State could buy out fee increases for more than one year.

Regent Kozberg noted that over time the University had slipped relative to other sectors of higher education in its percentage of the bond allocation. She was hopeful that this year those regulatory and legislative cost drivers that are not promoting good policy and are costing the University millions of dollars could be addressed with a view toward enabling the University to recover economically and plan for the down cycle. Mr. Hershman believed that it would be timely for the University, in collaboration with the California State University, to propose changes to the Governor and Legislature that go beyond the recommendations of the consultants.

Regent Rosenthal asked about the status of legislation that the students have helped support related to a student compact and how the administration intended to work with the students. Mr. Hershman responded that the University's position has been that decisions on fees cannot be made outside of the context of the total budget. As long as that is the understanding, the University will be supportive. Fees must be linked to State support: the Regents cannot make a guarantee without receiving a guarantee from the State.

Faculty Representative Oakley hoped to dispel any impression that the State is in a boom time. He reported that the Academic Senate had devoted substantial time to the financial planning document "Our Futures Report," which finds that the University is still $1.5 billion behind what its funding level was before 2001. He pointed out that there will be even greater pressure if the trend reverses. Mr. Hershman believed it would take time to recoup that money under the current budget scenario.

Senior Vice President Darling provided an update on the federal budget. He reported that the federal FY 2007 budget is constrained and will continue to be for some years. Since 2000, the federal government has shifted from a $200 billion surplus to a $300 billion deficit. Most of the budget is either federal entitlement spending or defense spending. Because Congress is unlikely to make major cuts in the mandatory spending and there is unlikely to be a tax increase this year, and defense and homeland security spending are increasing, what is left for the federal government to reduce is the non-defense discretionary spending, which accounts for about one-fifth of the budget. Most of the programs that benefit the University are in agencies within this category of funding. Congress will face difficult tradeoffs between education and research on one hand and things such as veterans' medical care, hospitals, housing, job training, and environmental protection on the other. The University receives about $4.7 billion in federal funding, excluding the national laboratories, which would add $4.1 billion. This critical funding provides about two-thirds of the University's funding for research and about 60 percent of student aid funding and 40 percent of medical center funding.

Mr. Darling reported that this year's President's budget contains substantial reductions. The National Institutes of Health's budget, which provides about one-half of the University's research funding, would remain flat. The University will be seeking a 5 percent increase. The President's budget proposes cuts of about 7.5 percent to student financial aid. The University will seek to increase that, particularly with regard to academic preparation programs. Lastly, although the President is unlikely to propose reductions in Medicaid, by administrative rule-making avenues he will seek an approximately 7.3 percent reduction, which will affect the University's hospitals. One bright spot is that there is growing bipartisan support for a significant increase in spending for the physical sciences. President Bush has proposed the American Competitiveness Initiative, which would double the budgets for the National Science Foundation and the Office of Science in the Department of Energy by 2016. He has also proposed strengthening education – pre-collegiate, collegiate, and graduate student support – in these areas.

Assistant Vice President Sudduth reported on the University's efforts to assure that it can achieve its budget objectives. Mr. Sudduth reported that the University has a comprehensive advocacy program under way in Washington. President Dynes, as well as various chancellors, have traveled to the capital to seek support for increased funds for financial aid and research.

Mr. Sudduth observed that alumni are an untapped resource that has been targeted through grassroots advocacy in California as well as through the AAUC, which has been engaging alumni to reach out to members of the delegation, recognizing those who have been supportive of higher education and the University and encouraging others to help with its needs in Washington.

Mr. Sudduth noted that, while State funding has been decreasing for a number of years, over the past decade federal funding has increased substantially to all universities. For the next decade, however, that funding will be flat, requiring the University to fight for its fair share for the foreseeable future.

President Dynes invited Ms. Anu Joshi, President of the UC Student Association, to present her remarks. Ms. Joshi discussed the main features of the Student Compact. Students believed that creating this resolution in the Legislature was important for starting a dialogue with the Governor and Legislature regarding long-term affordability and access to UC. The quality of the degree the students are receiving is important, but it is important also to have a balance between quality and access and affordability. The Student Compact received bipartisan support in the Assembly Higher Education Committee, which passed it unanimously and forwarded it to the Assembly Appropriations Committee.

Ms. Joshi stated that the Student Compact challenges the notion that the cost of higher education to California families should be based on the cost of instruction or on the need to fill revenue gaps in the State budget; instead, the cost of higher education should be based on what families in California can afford to pay. Projections for future negotiated fee increases show that if fees continue to rise at 8 percent a year for the next four years, by 2010 California resident undergraduate students will be paying well over $8,000 in systemwide fees. This does not include campus-based fees, which are growing in number and size to pay for cuts to student services. The graduate students will experience an even more dramatic increase in the next four years, paying more than $10,000 a year in systemwide fees.

Ms. Joshi reported that the second area of the Student Compact is financial aid. UCSA is supporting an Assembly bill to raise the cap on the Cal Grant B stipend from 11 percent to 20 percent. UCSA hopes the Regents will support this bill in the Legislature. Although the Governor has agreed to buy back fees in the proposed budget for undergraduate and graduate students, due to the increases in the cost of living the amount of money that students must contribute to the cost of their education through work and loans is set to increase by $520 next year. This means that the expected student contribution of $9,650 will be at the 60 percent mark of the manageable range when in 2000 it was at the 29 percent mark of that range. The UC Student Association is asking

The Regents to pass a policy ensuring that the expected student work loan contribution remains at or below the midpoint at the manageable range.

Ms. Joshi cited access as another critical area of interest in the Student Compact. Since 2000, State funding for academic preparation programs has decreased by over $60 million. Student initiated outreach programs are an important component of academic preparation. These programs not only benefit the students they are intended to serve but also provide tremendous civic engagement opportunities for the student leaders of UC.

Ms. Joshi believed that the UC Student Association is an asset to the University's quest to restore its presence in the Legislature and State budget negotiations. Students have shown that they can handle responsibility with respect to working collaboratively with representatives in Sacramento and deserve to be included in the decision-making aspects of setting priorities for the University.

4. **AUTHORIZATION AND APPROVAL OF UNIVERSITY CO-GUARANTEE OF WORKERS' COMPENSATION OBLIGATIONS OF LOS ALAMOS NATIONAL SECURITY LLC**

The President recommended that he or his designee be authorized to take such actions and execute such documents as are necessary for the University to act as co-guarantor, along with Bechtel National, Inc., of the workers' compensation obligations of Los Alamos National Security, LLC arising from its management of the Los Alamos National Laboratory under contract with the United States Department of Energy, National Nuclear Security Administration.

It was recalled that on June 1, 2006, management responsibilities for the Los Alamos National Laboratory (LANL) will be transferred from the exclusive control of the University to the partnership known as Los Alamos National Security, LLC (LANS), of which the University is one member.

This transfer entails extensive changes to the payroll, pension, and benefits programs at LANL. One particular change involves a petition by LANS to operate in a self-insured capacity with regard to workers' compensation obligations in the State of New Mexico. This is considered the most cost-effective approach to workers' compensation obligations at LANL and has been approved by the Department of Energy National Nuclear Security Administration. Because LANS is a new legal entity with no employment history, the State of New Mexico requires a performance guarantee from one or more members of LANS. Bechtel has offered to provide such a guarantee, provided that the University considers acting as a co-guarantor.

Because this would amount to a guarantee of the obligations of a third party, namely LANS, Regental approval is necessary.

Guaranteeing this obligation will not involve any significant financial risk to the University. Workers' compensation costs have long been reimbursed by DOE/NNSA, without question, as an ordinary cost of doing business at LANL. For decades, the University has operated in a self-insured capacity at LANL without any financial consequence to the University. With this action, the University will continue to bear part of this risk as a co-guarantor; however, in contrast with the past, the risk to the University that will exist in future years will be even smaller than in the past, since henceforth it will be shared with Bechtel.

Regent Hopkinson sought assurances that this would be a finite guarantee; that once LANS has an employment history in New Mexico, there would be no need to continue it. Chairman Parsky responded that the guarantee would remain in place as long as the University is a member of the LLC; it is part of the conditions of being an LLC member. Vice President Foley noted that the arrangement ensures that the University has less risk than it did under the previous management contract. Chairman Parsky agreed with the suggestion to revisit the matter later on.

Regent Juline suggested it may be appropriate in future in such arm's-length business transactions for the University to be compensated for the guarantee it is providing. Chairman Parsky agreed that it would be appropriate to review the issue, but he emphasized that in approving this recommendation the Regents should not assume that in the foreseeable future this guarantee would be removed. He noted that the University has been providing the equivalent to support the employees who have been working at the Los Alamos laboratory. This represents the same obligation in a different form. Faculty Representative Oakley commented that there is a market for performance bonds for insurance obligations. He asked why LANS does not simply pay whatever the market demands in order to have a commercial guarantee of a financial obligation. Chairman Parsky believed that the question would be one of cost. He suggested that the matter be reconsidered for future such arrangements.

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

5. **REPORT OF NEW LITIGATION**

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

6. **AMENDMENT OF POLICY ON SETTLEMENT OF CLAIMS AND LITIGATION**

The General Counsel recommended the amendment of the Policy on Settlement Claims and Litigation and its renaming as the Policy on Settlement of Litigation and Non-Employee Claims, as set forth in the Attachment.

It was recalled that the proposed amendment of the Policy on Settlement of Claims and Litigation (to be renamed the Policy on Settlement of Litigation and Non-Employee Claims) originally adopted in September 1995 would transfer authority for non-litigated employee claims to the Interim Policy on Separation Agreements and Settlement of Employee claims.

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

The meeting adjourned at 3:10 p.m.

Attest:

Associate Secretary