The Regents of the University of California

COMMITTEE ON FINANCE
November 14, 2013

The Committee on Finance met on the above date at UCSF–Mission Bay Conference Center, San Francisco.

Members present:	Regents Flores, Gould, Island, Kieffer, Newsom, and Ruiz; Ex officio members Brown, Lansing, Napolitano, and Varner; Advisory members Jacob, Leong Clancy, and Saifuddin; Staff Advisors Barton and Coyne
In attendance:	Regents De La Peña, Feingold, Makarechian, Pattiz, Schultz, and Zettel, Regent-designate Engelhorn, Faculty Representative Gilly, Secretary and Chief of Staff Kelman, Associate Secretary Shaw, General Counsel Robinson, Provost Dorr, Executive Vice President Brostrom, Chief Financial Officer Taylor, Senior Vice Presidents Dooley and Stobo, Vice Presidents Beckwith, Duckett, Lenz, Mara, and Sakaki, Chancellors Block, Blumenthal, Dirks, Drake, Katehi, Leland, Wilcox, and Yang, and Recording Secretary Johns

The meeting convened at 9:05 a.m. with Committee Chair Ruiz presiding.

1. **READING OF NOTICE OF MEETING**

For the record, it was confirmed that notice had been given in compliance with the Bylaws and Standing Orders for a special meeting of the Committee on Finance to be held concurrently with the regularly scheduled meeting of the Committee for the purpose of considering approval of terms of a facility sublease between the Regents and the Department of Food and Agriculture of the State of California for the South Valley Animal Health Laboratory.

Committee Chair Ruiz introduced Tony Milgram, student observer to the Committee on Finance.

2. **APPROVAL OF MINUTES OF PREVIOUS MEETING**

Upon motion duly made and seconded, the minutes of the meeting of September 18, 2013 were approved.

3. **APPROVAL OF UNIVERSITY OF CALIFORNIA 2014-15 BUDGET FOR CURRENT OPERATIONS AND 2013-14 AND 2014-15 BUDGETS FOR STATE CAPITAL IMPROVEMENTS**

The President recommended that:

A. The Committee on Finance recommend to the Regents that the budget plan included in the document, *2014-15 Budget for Current Operations,* and shown in Attachment 1, be approved.

B. The Committee on Finance concur with the recommendation of the Committee on Grounds and Buildings that the 2013-14 Budget for State Capital Improvements (Attachment 2) be approved.

C. The Committee on Finance concur with the recommendation of the Committee on Grounds and Buildings that the 2014-15 Budget for State Capital Improvements (Attachment 3) be approved.

[Background material was provided to Regents in advance of the meeting, and a copy is on file in the Office of the Secretary and Chief of Staff.]

Executive Vice President Brostrom explained that the 2014-15 budget proposal pertained to the University's core funding, representing about a quarter of the overall UC budget. It did not cover the medical centers, research, and auxiliaries. UC's core budget is supported by State funds, tuition and fees, and lesser sources of revenue such as indirect cost recovery and nonresident tuition. The current proposal was a balanced budget requiring significant efforts on UC's part in leveraging other revenue streams through asset management and private philanthropy, and achieving additional savings through administrative efficiencies, particularly in the systemwide procurement program. The budget proposal also included an additional request for State funding. Mr. Brostrom called attention to the fact that while in previous years the University had relied on growth in indirect cost recovery as an alternative revenue source, this was projected to remain flat for the coming year and possibly several years due to federal budget sequestration. UC does not expect this revenue source to recover in the near future.

The proposed budget addressed mandatory and high priority costs and assumed no tuition increase in 2014-15. It addressed multi-year efforts to reinvest in academic quality – increasing graduate student support, faculty hiring, and classroom technology. Mr. Brostrom stressed the significant challenge of not raising tuition when State funds represent only 40 percent of core funding. He described this as a very spare budget being passed on to the campuses. Many expense items have a higher growth rate than the one percent assumed in the proposal.

Mr. Brostrom expressed the University's gratitude for the passage of Proposition 30 and Governor Brown's multi-year funding plan for UC. These would provide a period of stability during which the University can examine alternative revenue and expenditure scenarios for the future. The funding plan includes base budget increases, debt restructuring, and general obligation bonds as part of the base budget.

Mr. Brostrom presented a chart showing the proportions of State General Funds, UC general funds, and tuition and fees making up UC's core funding, about $6.6 billion in 2013-14. If the State General Fund base is raised by five percent in 2014-15, with a small increase in UC general funds and no increase in tuition, this results in an overall increase of only about 2.5 percent in UC core funding. Nearly half of this increase must be contributed to the UC Retirement Plan (UCRP). The increase in State General Funds and UC general funds would cover mandatory costs, such as the UCRP contribution, health and welfare benefits, faculty merit increases, and compensation increases for represented employees. There was no additional funding to cover high priority costs, and for this reason UC would request an additional $120 million from the State. This $120 million, if added to the five percent State funding increase already secured, would result in an increase in overall core funding of about four percent, not an exorbitant increase, but enough to cover mandatory and high priority costs.

Vice President Lenz observed that State General Funds and UC general funds would account for about two-thirds of the $383 million revenue increase in the 2014-15 budget proposal. He echoed Mr. Brostrom’s appreciation for the Governor’s multi-year funding plan and recalled that UC had experienced a number of years when it adjusted its budget every six months due to State funding instability. The five percent base budget adjustment in 2014-15 was $142.2 million, with another $4 million for annuitant health benefits. In addition, the University would request $64.1 million for UCRP costs. He recalled that the State funds the retirement costs over and above the base budget for the California State University (CSU) and the California Community Colleges.

Additional resources are required for UC to be able to admit more first-time California resident freshmen and increase the number of transfer students from community colleges. The University was proposing an increase of one percent in enrollment growth, or approximately 2,200 full-time equivalent students, a cost of almost $22 million. The University was also seeking $35 million in State funds for reinvestment in academic quality. The overall request for additional State funding above the base was almost $121 million.

The proposed increase to UC general funds would be $26 million, supplied by nonresident supplemental tuition. The University had hoped to make progress in indirect cost recovery, but as a result of federal budget sequestration, the University could not anticipate any additional funding from this source.

Other revenue increases totaling $90 million would come from revenue or savings generated within the University through alternative revenue strategies: $35 million from asset management, moving funds from the Short Term Investment Pool to the Total Return Investment Pool; additional procurement savings of $30 million; and new models of philanthropy that would generate $25 million.

Mr. Lenz then discussed proposed expenditures, divided into the three categories of mandatory costs, high priority costs, and reinvestment in academic quality. Mandatory costs of $168 million were unavoidable: an increased contribution to UCRP, health benefit costs, annuitant health benefits, compensation for which UC has a contractual obligation, academic merit increases, and non-salary price increases. The non-salary price increases, $24.5 million, were assumed to be two percent, with $8 million of this amount for increased electricity and natural gas costs.

High priority costs included a three percent compensation increase for all employees in 2014-15, enrollment growth of one percent, deferred maintenance, and high priority capital facility needs. Mr. Lenz noted that UC had not been able to fund deferred maintenance in past years due to the unpredictable budget situation. Nevertheless, this is a critical need for the campuses, and with each year that UC does not address deferred maintenance needs, these costs increase. The $15 million in high priority capital facility needs is set aside as part of the debt service to address just over $200 million in capital facility projects for the 2014-15 year.

Proposed increases for reinvestment in academic quality would address the University's efforts to reduce the student-faculty ratio, provide start-up funding for new faculty, reduce faculty and staff salary gaps, increase support for graduate students, and enhance undergraduate instructional support.

Mr. Lenz noted that the Regents were being asked to approve funding for the Budget for State Capital Improvements for two fiscal years, 2013-14 and 2014-15. This was based on a change in the State's approach to projects that have historically been eligible for State funding. Assembly Bill 94, a budget trailer bill, provided funding that allowed UC to restructure lease revenue bond debt, with language requiring that this funding be dedicated solely to UCRP costs. The bill freed up some operating budget funds to address capital needs. The State Budget Act had appropriated funding for buildings at the Merced and San Diego campuses. Mr. Lenz identified the classroom and academic office building at UC Merced as the University's highest capital project priority in 2013-14. In addition, UC had submitted seven other projects to the State, totaling $87 million. This amount was small compared to the University's actual capital need, which Mr. Lenz estimated to be close to $790 million. The ten capital projects for 2014-15 would address fire and seismic safety needs. Fifteen million dollars in the operating budget would address just over $202 million of debt financing for these projects. The funding need for 2014-15, over and above the $790 million needed for projects ready in 2013-14, was close to $1.1 billion. Over the next five years, the University would need about $6.7 billion in financing for capital projects.

Tony Milgram, an undergraduate student at UC Santa Cruz and student observer to the Committee, addressed the Regents about issues that students consider critically important for student access and retention. He cautioned that UC's affordability may be slipping away and stressed the importance of the five percent base budget adjustment, which would allow the University to avoid a tuition increase. He reported that many students consider withdrawing from UC due to insufficient financial aid. Affordability will always be an important concern for students. The University's efforts to reinvest in academic quality are critical for student success and to maintain UC's reputation. The construction and repair of UC facilities is essential as well. Student applications to UC are increasing, and if UC has any hope of accommodating them, capital improvements should be matched with increased enrollment.

Regent Makarechian praised the UC administration for having pursued all reasonable means to raise funds in the absence of State support. He observed that of $26 billion in UC revenue, only $6.6 billion represented core funding for instruction, salaries, and administrative and student support. This core funding is supplied by State General Funds, UC general funds, and tuition. Only $2.7 billion, about a third of the core funding, is supplied by the State. He referred to information in the 2012-13 Annual Financial Report that showed a fivefold increase in the University's obligations for pension and retiree health benefits from 2009 to 2013, from about $2 billion to $10 billion. He stressed that this was due to the State not paying its share. UC's debt had also increased. In 2011, the University's net worth was $19 billion; in 2012, this figure had dropped by $2 billion. The University was addressing this shortfall as best it could while the State was not contributing its share. In 2013 UC's net worth declined by another $2 billion. Regent Makarechian cautioned that if the decline in net worth continued at this pace, the University would have zero assets in 16 years. No more increases in tuition more than a few percent were feasible, because UC tuition was reaching the level of private universities. The University had drawn on all other possible resources to refinance its operations. During the same period, 2009 to 2013, the University increased enrollment by 10,000 students, with no additional faculty. Reductions had been made in every area. The only remaining sources of support were the federal and State governments. He noted that between 2007-08 and 2013-14, the California K-12 educational system experienced a reduction in State funding of 4.7 percent, social services had a reduction of 23 percent, the University had 17.3 percent reduction, and the State Department of Transportation had a 37 percent reduction. Over the same period, correctional facilities received a 13 percent increase, State employee salary funding increased by 15.5 percent, and State retirement benefits funding increased by 24.2 percent. Regent Makarechian concluded that he understood the various funding needs the State must address, but emphasized its need to fund UC adequately; otherwise there might be dire consequences.

Governor Brown stated his view that the situation as outlined by Regent Makarechian indicated that the University was facing either a significant tuition increase or a financial crisis. A budget gap was impending. The University had closed this gap rhetorically by referring to real needs that the State should fund. The State government, however, has its own view and responds to different pressures, constituencies, and values in an arena much larger than that of the University. Based on past precedent in Sacramento, the University should be aware that the State government would not perceive the "needs" described by UC in the way they were articulated. Given the political climate of California and the position of the Legislature, the University would not receive more support from the State than the five percent base budget increase already secured. He stated his personal support for the University and his wish that more funding could be provided, but stressed the reality he perceived – that the University's requests for additional funding were an exercise that might make UC feel good about itself but would not produce results. Governor Brown suggested that the University should consider whether it can reshape or resize its activities. He acknowledged that this was a heretical suggestion, because the concept of quality dominates the University's thinking. He stressed his view that "quality" is an abstraction, while the numbers cited earlier by Regent Makarechian were reality, as was the large budget gap the University was approaching. The one significant source to address the gap was tuition increases. Governor Brown acknowledged that students and others blamed the State for current underfunding at UC, but emphasized that the University was not thinking through this problem in a manner that would prevent large tuition increases. Students had been the default financiers of American higher education for the past 30 years. If UC wished to control tuition, it would have to reshape the way it does business. Ideas of quality and greatness would not provide the necessary criteria for decisions and concrete tradeoffs to allow the University to live within its means. He again stressed that the State would not bail out the University at a rate different than at present. The chancellors would be in the front lines in dealing with this difficult situation, and every year that the University avoided a tuition increase, the budget gap would increase. The current proposed budget was contributing to the gap.

Mr. Brostrom respectfully disagreed with some of Governor Brown's statements, emphasizing that in fact the University had been bailing out the State for the previous five years. UC had experienced $900 million in reductions; the only increase in expenses had been in financial aid and pension costs. The University was paying $1.2 billion into the UCRP in the current year, an expense that it did not face five years earlier. This was the reason for the financial deterioration described by Regent Makarechian. Mr. Brostrom recalled that the State pays the full actuarial contribution for California Public Employees' Retirement System (CalPERS), which includes CSU and the California Community Colleges; the University addresses this expense on its own. He expressed the University's appreciation for the debt restructuring in the multi-year funding plan, but stressed that this amount equals only one-tenth of the University's annual UCRP contribution. Mandatory costs were driving UC's financial direction.

Governor Brown observed that State pension costs were a relatively small part of the State budget. Mr. Brostrom responded that these costs were seven percent of the State budget and represented the largest growth area.

Governor Brown remarked that the State, like the University, had made unwise decisions about its pension plan over the years, expanding benefits without expanding contributions. He noted that Mr. Brostrom's and the University's arguments for increased State contributions to the UCRP were based on the justice of this case, but did not provide an indication of how the State could respond. Governor Brown stated his view that agreement would be reached in a few years, but that the University should develop options other than a large tuition increase, which might be imminent. UC did not have to rely on comparisons with the Association of American Universities or Harvard University. UC should examine carefully and sensitively how it can meet California's needs and live within available means. Governor Brown concluded that the resolution of these difficulties would take more than one or two Regents meetings; this required work involving the entire UC community.

Regent Makarechian explained his position that the State was not investing in the correct priorities. He reiterated that certain programs were receiving increases in State funding, while the University was even considering using parking revenues as a UCRP contribution. He expressed the wish for an effective partnership with the State.

Committee Chair Ruiz thanked Governor Brown for his honest discussion of these matters.

President Napolitano stated that the University would work with the State to address funding issues. Even in the context of requesting a tuition freeze, the University must examine its tuition model, costs, and expenditures. This work would require broad cooperation. She stated her belief that the State's intention was to provide the University with a real five percent increase; this would require parity in how the State treats pension contributions at UC, CSU, and the California Community Colleges. Funding was needed for enrollment growth, growth that represented more students and graduates who would make positive economic contributions to the state in the long term. President Napolitano expressed her intention to work with Governor Brown and the Legislature on the long-term future of UC and California higher education. She emphasized the uniqueness of UC. Funding issues would be carefully reviewed, but the University should not consider stark tuition increases to balance the budget.

Regent Island expressed the Regents' willingness to work with Governor Brown to examine and make decisions on the University's priorities. It was a complex and difficult undertaking.

Regent Gould stated that the Regents must recognize that there would be a budget shortfall in the current year, given that the five percent increase was the only increase UC would receive from the State, and make appropriate changes to UC's expenditure plan. A larger question concerned the long-term sustainability, quality, and trajectory of the University. There was a need for an honest dialogue with the State about issues such as a modest and predictable fee policy. The Regents would approve a budget for the current year, but should then turn their attention to a longer, five- to 15-year trajectory.

President Napolitano noted that the current-year tuition freeze would give the University time to study its cost structure closely and develop a vision for the longer term. She stated that she would work with the Office of the President and the chancellors to develop a model for the next decade.

Mr. Brostrom added that for the short term, UC would like to make the additional request to Sacramento, but it has considered other approaches to these costs if State funding is not forthcoming. Many of these expenses lend themselves to one-time revenue solutions. If there are excess State revenues, one-time contributions to the UCRP can help the operating budget.

Regent Pattiz recalled that in the past, UC tuition had remained level because the California and U.S. economies were robust. He emphasized that even in the current difficult environment, UC was outstanding in making education available to students who cannot afford UC tuition. Each time there has been a tuition increase, one-third of the amount goes to student aid. The University should be concerned about accessibility for middle-income students, and in this area, the question of quality is essential. Regent Pattiz expressed concern that UC might make reductions that would affect the institution's quality, while depending on middle- and high-income students to pay higher tuition. Cuts could become very problematic. UC must maintain quality and ensure that it continues to be viewed as it always has been. The Regents must examine priorities with a very focused eye.

Regent Lansing thanked Governor Brown for being a strong advocate for UC, for the passage of Proposition 30, without which the University's budget situation would be much worse, and for speaking with honesty and candor. She stressed that the Regents do not want a tuition increase. The University had always prepared for a potential funding gap, and a shortfall at this point would not be a surprise to the Regents. Some of UC's efforts to address the shortfall had enjoyed modest success, and they would continue – technology transfer, additional philanthropy, and parking revenue. She stressed the need for advocacy by the Board, students, and alumni to address the inequity in how the State treats contributions to the UCRP compared to the pension funds for CSU and the California Community Colleges. She echoed statements by Regent Makarechian that the University should be a higher priority for the State. She expressed the hope that advocacy and negotiation with the Legislature might lead to positive movement on these issues. Advocates for the University should continue to fight and to be specific in their requests.

Regent Newsom stated his understanding that Governor Brown's commitment to a five percent base budget increase was always predicated on the condition that there not be a tuition increase. Mr. Lenz responded that this was the State administration's proposal. He emphasized that the Office of the President strives to achieve a balanced budget every year, without a significant tuition increase in any given year, and without any significant support from the State. The University had this balanced budget goal in mind during its discussions with the State about the multi-year funding plan. UC had suggested a six percent funding increase from the State and a six percent tuition increase. In negotiations, the University lowered the proposed tuition increase to five percent. Governor Brown proposed a five percent base budget increase with no tuition increase. The additional request of approximately $120 million in State funds that UC was now making would not be necessary if the University increased tuition by five percent. Mr. Lenz stressed that this was the budget gap that needed to be filled. The University's assumption had always been that a modest balance between State funding and tuition would address this.

Governor Brown acknowledged that UC was receiving less than it had originally requested, and that the State had set a condition of no tuition increase.

Regent Newsom stressed that the University had been aware for at least a year that it would be facing the current situation. In spite of some progress in alternative revenue sources, UC was not meeting its enormous budget challenge. Mr. Brostrom responded that the figures quoted earlier by Regent Makarechian were correct. UC's net worth had decreased considerably, mostly due to UCRP costs. This situation had developed over a period of 20 years, and the University had a 30-year solution to address it. If the

University achieved the next UCRP contribution level, already approved by the Regents, contributions could remain flat at that level; additional contributions would not be needed. Mr. Brostrom stated his view that the gap in the operating budget was not as worrisome as it might appear, when $2 billion in new liabilities were being added each year, mostly because of the UCRP funding situation. He anticipated an improvement and stabilization in UCRP funding in the following year, explaining that the UCRP has a five-year rolling average, and the University was still working off the significant losses of 2008 in its pension system. UC had weathered the past five years in part because there were no salary increases for staff and none for faculty, other than academic merit increases. In the past six years there had been only two salary increases, while employee contributions to the UCRP had increased from zero to eight percent. Mr. Brostrom expressed his wish that the need to address non-represented staff salaries be moved into the category of mandatory costs. The University's cost structure is largely determined by labor costs, driven by salary, benefits, and pension costs.

Regent Newsom stated that the Regents were being asked to approve a budget proposal that Governor Brown found to be ultimately unrealistic. The University must consider its next steps if the $120 million request for State funding was not granted. He expressed his critical view of contingency budgets and that it was not prudent to take action without examining alternatives. The Regents might not be in a position to discuss reductions that would have to be made if the additional request were not met by the State, and the possibility of a tuition increase might arise again. Mr. Brostrom countered that the University had strategies to avoid a tuition increase in 2014-15. He acknowledged that these strategies were one-time financing techniques designed to bridge through another year and did not address the long-term budget. Low, moderate tuition increases would be in the best interest of students. The situation of no tuition increase helped UC's high-income students, but in fact was more difficult for low-income students, because there would be no new financial aid for them.

Regent Newsom stated that this was an argument for tuition increases. He reiterated his misgivings about approving a budget with so many contingencies that might prove unrealistic. Mr. Brostrom responded that the budget represented UC aspirations, but that the University did not wish to weaken its budget by refraining from requesting items that it should request from the State, such as parity with CSU and the California Community Colleges with regard to pension contributions. It would be unwise not to request the additional funding, and simply to agree to make cuts to programs.

Regent Newsom asked what what alternative reductions or revenues the University might propose if the additional funding request were unsuccessful. Mr. Brostrom responded that he could outline some proposals, but that it would be unwise to do so because this would weaken the University's request in Sacramento. Regent Newsom expressed appreciation for measures taken to navigate the immediate budget situation, but stressed that certain external realities must be recognized. The current discussion seemed to be putting off difficult decisions to a future year.

Committee Chair Ruiz stated his view that the Regents were acting appropriately with regard to the UC budget process. The University understands the economic realities and must address them. The political climate was challenging. All the University's constituencies must work together to advocate for UC and to make clear UC's important role in the growth of the California economy.

Regent Flores expressed concern about the fact that tuition remained the largest funding source for UC and that the UC system relies on tuition for essential functions. The Regents must consider how their present actions would affect tuition in the future, and how tuition affects different sectors in the University.

Chairman Varner emphasized that there was agreement among the Regents and the UC administration to avoid a significant or sharp tuition increase. Any increases would be reasonable and acceptable to students and the Legislature. Difficult choices would have to be made. He expressed the view that there were still opportunities to engage legislators and make the case that the State receives a tremendous return on its investment in UC.

Chancellor Katehi observed that higher education, like health care, has extensive costs due to its highly specialized needs. For example, chemistry laboratories represent a significant cost for the Davis campus, where 80 percent to 90 percent of students study in a chemistry laboratory at some point. As with health care, those with more money must contribute to paying costs for those who cannot afford them. She expressed pride in the University's success in providing access to education for students who cannot afford the cost. Fifty-two percent of UC Davis students pay no tuition, while 68 percent pay less than $27,000 to get a degree. This 68 percent includes middle-income students. The cost of a UC education has remained relatively low, and there is probably no university of UC's quality in the U.S. that has done better in this area. She stressed that this was a point of pride for the chancellors, Regents, and students. She expressed concern about larger budget trends that could not be corrected by small measures. If UC wished to continue providing high-quality, affordable education, someone would have to pay.

Faculty Representative Jacob remarked that in the past decade, the University had witnessed a substantial reduction in State support for higher education and a tremendous increase in the number of low-income and underrepresented minority students in California. Millions of students in California now eligible to enter UC, something that was not possible for their parents' generation, faced the prospect of a State Legislature telling them that it could not afford to pay for the University, and that access was not available as it had been in the past. Mr. Jacob urged the University not to give up on advocacy and not to accept the current situation as normal.

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

4. **UNIVERSITY OF CALIFORNIA FINANCIAL REPORTS, 2013**

The President recommended that the Regents adopt the 2012-13 Annual Financial Reports for the University of California; the University of California Retirement System; and the five University of California Medical Centers.

[Background material was provided to Regents in advance of the meeting, and a copy is on file in the Office of the Secretary and Chief of Staff.]

Associate Vice President and Systemwide Controller Peggy Arrivas called attention to the fact that for the first time, there was a single financial report in one book for all five medical centers. She recognized the work of her staff and staff at the medical centers for accomplishing this.

Ms. Arrivas reported that the University's financial position continues to be strong, as confirmed by UC's bond ratings. However, this year the University's net position had decreased by $1.1 billion, primarily due to accounting for pension and post-retirement health benefits. UC is following accounting rules that require it to record these liabilities on the financial statements. The University's pension contributions for the year were $1 billion, even though the required contributions were approximately $2.5 billion. The contributions still do not meet requirements based on policies adopted by the Regents. UC revenues continue to grow, and additional resources were used to pay for employee salaries and benefits. The University's investment portfolio showed strong performance for the year, reflecting the financial markets.

Regent Zettel noted that while UC's operating revenues increased, its operating expenses increased even more. She expressed surprise at a reduction in expenses, almost $90 million from the previous year, for retiree health care. Ms. Arrivas responded that this was an actuarially determined number, based on a projection of future costs for retiree health benefits. A number of factors accounted for this reduction, including the fact that UC has been able to negotiate improved premiums with insurance companies. Other changes resulted from the Patient Protection and Affordable Care Act and employee eligibility for the retiree health plan in the new pension tier. Together, these changes resulted in a reduction in future estimated liability of $2 billion. Chief Financial Officer Taylor emphasized that the University's future health care obligation is enormous and difficult to address, and he underscored UC's efforts to offer an attractive health care benefit package for faculty and staff, while avoiding double digit increases in health care costs.

Regent Makarechian suggested that future UC financial reports include information on the total number of UC employees and retirees, categories of retirees, the University's obligations to different categories of retirees, numbers of faculty and staff, categories of employees, and average pay for various employee levels. Mr. Taylor responded that this information would be included in the following year's statements.

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

5. **UPDATE ON STATE PUBLIC WORKS BOARD DEBT RESTRUCTURING TO ACHIEVE CASH FLOW SAVINGS**

[Background material was provided to Regents in advance of the meeting, and a copy is on file in the Office of the Secretary and Chief of Staff.]

Chief Financial Officer Taylor recalled that the debt restructuring process had lasted about 18 months, and was the result of the work of Office of the President staff and the support of Governor Brown. The Regents had approved this transaction at the July meeting, and it was completed in early October.

Executive Director Sandra Kim explained that the passage of Assembly Bill 94 in early July 2013 enabled the University to restructure the State Public Works Board (SPWB) debt issued on behalf of the University's projects. The bill directed UC to apply any savings from the debt restructuring to the UC Retirement Plan. The California Education Code was amended to allow the addition of State appropriations to the University's general revenue pledge. In July 2013, the Regents authorized the University to restructure this outstanding $2.4 billion SPWB debt portfolio. The rationale was fairly simple: the strength of UC's general revenue credit, compared to the SPWB credit, allowed for a lower cost of borrowing and greater structuring flexibility, mainly based on ratings and the ability to maximize useful life on projects, something that had been hindered by lease restrictions on the SPWB credit. The execution from the time of approval was completed in about two months. The bonds were priced in late September and the transaction closed on October 2, 2013. The University achieved debt service savings of approximately $100 million annually for the next ten fiscal years. Repayment of future debt service would be from State appropriations. In 2013 dollar terms, using a 7.5 percent discount rate, the benefit to taxpayers was just over $300 million.

Mr. Taylor emphasized that this action resulted in a far more efficient use of taxpayer money that would otherwise have been used to pay debt. These funds were now helping UC to stabilize its overall financial situation, and for the same amount of money that taxpayers are already contractually obligated to spend on behalf of the University through previous SPWB debt. He praised the work of Ms. Kim and the capital markets team for accomplishing this transaction in a short period of time.

Chairman Varner commended this transaction, which represented successful work with existing UC resources.

Governor Brown noted that the State Legislature initially opposed the debt restructuring. He, as an ally of the University, had exerted pressure on the Legislature on this matter. While California's credit rating was on the rise, it was still among the lowest in the nation, the 47th of 50 state credit ratings. The University would save $100 million a year by taking over responsibility for the bonds, and this demonstrated that UC was in a better financial condition than the State. In the minds of bond purchasers, UC was more reliable than the State by $100 million a year. Governor Brown remarked that UC should keep this in mind when requesting financial help from the State. He expressed his hope that the State's financial condition would improve and allow the State to offer bond sales like this one.

Mr. Taylor expressed the University's gratitude to staff at the State Department of Finance and the State Treasurer's Office for their diligent work that was needed to execute this transaction.

6. **REVISIONS AND MODIFICATIONS TO UNIVERSITY OF CALIFORNIA LOAN PROGRAM POLICIES AND PROCEDURES**

The President recommended that the Regents:

A. Amend the Mortgage Origination Program (MOP) Policies, as shown in Attachment 4, to:

(1) Implement an interest rate cap of ten percent over the starting interest rate for MOP, Graduated Payment MOP (GP-MOP), Interest-Only MOP (IO-MOP), and 5/1 MOP loans made after January 1, 2014.

(2) Establish a new 5/1 Adjustable Rate Mortgage loan product (5/1 MOP).

B. Authorize the President to develop and implement 5/1 MOP loan underwriting standards that are consistent with the Regents policies and applicable federal lending regulations.

C. Authorize the President to implement new federal Truth in Lending regulations, effective January 10, 2014, according to Presidential discretion and in the best interests of the MOP and Supplemental Home Loan Program.

[Background material was provided to Regents in advance of the meeting, and a copy is on file in the Office of the Secretary and Chief of Staff.]

Director Ruth Assily explained that major new regulatory changes to the mortgage industry would affect the University's Mortgage Origination Program (MOP); the proposed action would respond to these regulatory changes. The Consumer Financial Protection Bureau was limiting mortgage terms to comply with new federal Truth in Lending guidelines. UC's MOP assists individuals in purchasing homes by easing qualifying parameters. The new federal restrictions would change the nature of MOP. The University proposed to introduce a new 5/1 Adjustable Rate Mortgage loan product that would meet new Consumer Financial Protection Bureau requirements for a qualified mortgage, provide a desirable product for faculty, and continue to assist them in purchasing homes near campus. The University also proposed to implement an interest rate cap for its program, a ten percent cap above the starting interest rate for each borrower. This would be in line with industry practice and meet new Truth in Lending guidelines. The University was pursuing a partial exemption to the regulations, since UC is considered a small creditor. UC's home loan program has been very successful. The University fully documents all its loans. UC does not consider its loans risky, but understands that it must comply with new regulations.

Regent Makarechian noted that interest rates were currently at a very low level. He asked about the possibility that UC employees who currently qualified for mortgages might face foreclosures in three to four years, given that UC faculty salaries would not increase as interest rates might. Chief Financial Officer Taylor responded that the 5/1 Adjustable Rate Mortgage loan product should help to ameliorate this situation. Faculty have requested 30-year fixed rate mortgages, but because the program is funded from the Short Term Investment Pool (STIP), the University was not yet ready to offer a 30-year fixed rate mortgage product. With the 5/1 Adjustable Rate Mortgage, the University was pursuing a middle ground that would offer faculty protection, but also protection for the University should the cost of funding rise and remain high over a long period. Mr. Taylor noted that his office had worked on developing this product with the Office of the Chief Investment Officer, which oversees the STIP.

In response to another question by Regent Makarechian, Mr. Taylor confirmed that the University resells its mortgages. During the recent financial crisis, the University had about $1 billion in mortgages in the STIP; it has been able to sell down this balance. Ms. Assily reported that UC currently had about $80 million in mortgages on its balance sheet. Mr. Taylor added that as the secondary market has improved, the University has been able to place a number of these loans. He stated the University's course of action is appropriate: to make loans, qualify faculty members, continue to service the loans, but sell them in the secondary market, and ensure that UC's liquidity is strong.

Committee Chair Ruiz observed that the home loan program is valuable in faculty recruitment. He asked if the program was exclusively for faculty, or if other UC employees qualify for it. Mr. Taylor responded that about 95 percent of UC's outstanding loans were to faculty; the remaining five percent were to coaches, senior administrators, and others.

Committee Chair Ruiz stated his understanding that this program did not represent a cost to UC, other than processing its paperwork. Mr. Taylor responded that no public monies are used for this program. In addition to the interest rate it charges, the University adds 25 basis points to support the Office of Loan Programs and to build a reserve to protect the University from short sales or foreclosures. The program is entirely self-supporting.

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

7. **ANNUAL ACTUARIAL VALUATIONS FOR THE UNIVERSITY OF CALIFORNIA RETIREMENT PLAN AND ITS SEGMENTS AND FOR THE 1991 UNIVERSITY OF CALIFORNIA-PUBLIC EMPLOYEES' RETIREMENT SYSTEM VOLUNTARY EARLY RETIREMENT INCENTIVE PROGRAM**

[Background material was provided to Regents in advance of the meeting, and a copy is on file in the Office of the Secretary and Chief of Staff.]

Vice President Duckett outlined some highlights of the UC Retirement Plan (UCRP) as of July 1, 2013. The UCRP's overall market value of assets was $45.3 billion and the actuarial accrued liability was $57.4 billion. The UCRP's unfunded liability was $12 billion on a market value of assets basis, with $10.3 billion attributed to the campus and medical center segments. The funded ratio increased from the prior year to 79 percent on a market value of assets basis, while on an actuarial value of assets basis, due to smoothing and acknowledging past performance, it decreased to 76 percent. The total funding policy contribution rate for the following year, 2014-15, would be approximately 30 percent of covered payroll, or $2.7 billion, based on a normal cost of about 18 percent and an amortization of the unfunded liability of 12 percent. The actual contribution rate totaling 18.5 percent of payroll was scheduled to increase the following year to 14 percent for the employer and eight percent for most members, for a total of 22 percent.

Regent Makarechian stressed the importance to the University of not writing off any Department of Energy obligations to the UCRP, a significant amount that the University must pursue. He asked for the total number of UC retirees. Mr. Duckett responded that the number was 61,000.

Regent Makarechian recalled from previous reports that many faculty members were close to retirement age. There was not an appropriate balance in numbers between new hires and faculty preparing to retire. He asked if the University's actuary took account of this factor. Mr. Paul Angelo, a representative of Segal Consulting, the Regents' consulting actuary, responded that when his company carries out the valuation each year, it has census data for all current members including age and assumptions about date of retirement. Assumptions are based on past experience with faculty and staff. The fact that there would be a wave of retirements was not a surprise; this was anticipated and built into the funding of the UCRP.

Regent Makarechian expressed concern about the University's ability to address this situation without being subject to charges of age discrimination in hiring. Mr. Duckett responded that age was not a significant consideration in the University's hiring.

Regent Makarechian reiterated his concern that the number of retirements in the next three to four years would be a significant percentage of the total number of employees. Executive Vice President Brostrom responded that this was truer for UC faculty than for staff. For the new pension tier, the retirement age was moved from 60 to 65. This would have a positive effect on the normal cost, as employees work longer and contribute more to the pension system before drawing on it. In the past, most staff retired at age 60. Mr. Duckett observed that the impending retirements at UC reflected a larger demographic trend in the workforce of "baby boomers," people born between 1946 and 1964, who are approaching retirement age.

Regent Makarechian stated his wish that the University find ways to even out the age range of employees. This was a factor with a significant impact on the cost of health benefits. Mr. Brostrom noted that the shift of the retirement age from 60 to 65 for the new tier would address this concern. The University's most significant retiree health costs fall in the 60-to-65 age range, before retirees become eligible for Medicare. The University's unfunded liability for retiree health benefits had decreased by $2 billion, and a major contributing factor was the new eligibility.

Governor Brown reflected on the difficult and painful nature of pension and retiree health benefit issues for UC and the State. The question of how to pay for retiree health benefits at a time when life expectancy is increasing was a long-term problem affecting the U.S. and the Western world in general. Governor Brown stated his view that Western society was living with a certain unreality and that people would have to learn to live with different paradigms.

Committee Chair Ruiz asked if the expected significant turnover in UC's employee base in the coming five to ten years was built into the UCRP, from an actuarial perspective. Mr. Angelo responded in the affirmative. The actuary regularly reviews demographic assumptions about retirement age and life expectancy. The actuarial assumptions in the report reflected the most current expectations. The actuary monitors these assumptions and developments closely. Mr. Brostrom added that every new employee would cost the University 20 percent less due to the new UCRP tier. This would reduce costs significantly over time.

8. **ANNUAL ACTUARIAL VALUATION OF THE UNIVERSITY OF CALIFORNIA RETIREE HEALTH BENEFIT PROGRAM**

[Background material was provided to Regents in advance of the meeting, and a copy is on file in the Office of the Secretary and Chief of Staff.]

Vice President Duckett noted that the retiree health benefit program's unfunded actuarial accrued liability had decreased by $2 billion to $12.5 billion, from $14.5 billion in the previous year. The single largest factor accounting for this reduction was the re-bidding of UC's entire health benefit program portfolio, which accounted for $1.3 billion of the overall savings. Other factors were the revised eligibility formula for pension and retiree health benefits under the new pension tier, and the move toward a Medicare exchange program for qualifying retirees living outside California. This last factor accounted for approximately $700 million in savings. As a result of these changes, actuarial accrued liability was reduced and program costs were being held at the same level. The retiree health benefit program is a pay-as-you-go program and is part of the University's larger health and welfare program. Mr. Duckett noted that the University was currently engaged in tense, contentious negotiations on post-employment benefits including retiree health. A number of unions have indicated their disapproval of changes to be implemented. UC would continue to work through these issues.

Regent Makarechian referred to UC setting aside $3,000 per covered family member and asked how many employees would have family members covered. Mr. Duckett responded that the University has approximately 300,000 individuals in its health care programs. The $3,000 contribution was part of the Medicare exchange program for covered family members of out-of-state retirees, whose numbers are smaller. He would provide this number.

In response to another question by Regent Makarechian, Mr. Duckett responded that this contribution was funded by the same source used to pay for health care premiums and the employer contribution in the regular program; no extra funds are involved.

Regent Makarechian asked if this program represented savings or an expense. Mr. Duckett responded that moving to extend health benefits for out-of-state retirees would represent savings for the University, a reduction from a cost of $5,000 per member to $3,000. Executive Vice President Brostrom added that this program would also transfer risk. Earlier, a retiree outside California could enroll in any UC plan, with the University covering the cost. The University would now pay out a lump sum for the retiree to use in a Medicare exchange, with the retiree choosing benefits most appropriate for him or her. This move would place a greater obligation on the retiree as a consumer of health care.

In response to another question by Regent Makarechian, Mr. Brostrom clarified that this program was only for out-of-state retirees, former UC employees who have retired in another state. This model would offer savings and transfer risk.

Regent Makarechian asked how net asset value would be affected by the $3,000 contribution. Mr. Brostrom responded that the Medicare exchange program reduced UC's long-term liability not as much as the re-bidding, but by $700 million.

Regent Makarechian asked if the number of out-of-state retirees could be calculated by dividing 700 million by 3,000. Mr. Brostrom responded in the negative, explaining that the program also takes into account employees who will be retiring out of state, a long-term, 30-year liability. Mr. Duckett observed that the Medicare exchanges would offer more services to these retirees; coverage would be better if it came from the state where the retiree lives. He confirmed that the University had implemented this program for all out-of-state retirees.

Committee Chair Ruiz asked how the Patient Protection and Affordable Care Act (PPACA) would affect the University's retiree health benefit program. Mr. Duckett responded that in UC's overall plans including retiree health benefits, the PPACA had accounted for approximately two to three percent in increased costs, due to provisions for pre-natal care, regular check-ups, and longer coverage for children. Mr. Michael de Leon, a representative of Deloitte Consulting, the Regents' consulting health actuary, noted that the PPACA might help reduce future premiums; this consideration was included in Deloitte's analysis of expected future trends.

Regent Makarechian asked why the Medicare exchange program was being implemented only for out-of-state retirees. Mr. Duckett responded that one reason was that retirees would receive better coverage from the exchanges in the states they live in than as nonresidents of California. The implementation would also demonstrate, for a small population, how well the Medicare exchanges function, their quality of service and coverage. Mr. Duckett expressed cautious optimism about this program. He stressed that this was not a pilot program, but it might indicate where this kind of coverage might be preferable for employees in other locations as well.

Regent Makarechian asked about potential savings if all California resident retirees were moved to this kind of program. Mr. de Leon responded that the savings for out-of-state retirees were significant, an almost 50 percent reduction in total liability. Deloitte had not modeled this specifically for the entire UC retiree population, but the impact could be significant. Mr. Brostrom added that there could be an impact of billions of dollars in liability. The University has been examining this issue and found that it would be appropriate to make the change with this cohort of retirees, who would receive better coverage. The University had received criticism for implementing this program, but Mr. Brostrom expressed confidence that it represented an appropriate direction forward in trying to bring down UC health care costs over the long term.

In response to remarks by Regent Makarechian, Mr. Brostrom observed that UC's pension costs had increased dramatically, while retiree health costs had been stable and were beginning to decrease.

Regents De La Peña stated that the University had an opportunity for significant savings with UC Care and UC's self-insurance program. If the University could provide services at its own medical centers, this could help control costs.

9. **APPROVAL OF TERMS OF A FACILITY SUBLEASE BETWEEN THE REGENTS AND THE DEPARTMENT OF FOOD AND AGRICULTURE OF THE STATE OF CALIFORNIA, SOUTH VALLEY ANIMAL HEALTH LABORATORY, TULARE, DAVIS CAMPUS**

The President recommended that she be authorized, following consultation with the General Counsel, to execute a Facility Sublease between the Regents and the California Department of Food and Agriculture (CDFA) in connection with the financing, construction, equipping, and operation of the South Valley Animal Health Laboratory on the same material terms and conditions previously approved in November 2008 and subject to the following additional terms and conditions:

A. The term of the Facility Sublease shall begin on the date of the issuance of the State Public Works Board (SPWB) bonds and shall terminate on the date the SPWB bonds are retired.

B. The Regents are not obligated to pay rent to the CDFA under the Facility Sublease.

C. Pursuant to the terms of the Facility Sublease the Regents shall operate and maintain the South Valley Animal Health Laboratory in support of the California Animal Health and Food Safety Laboratory System.

D. CDFA shall fund all costs associated with the operation and maintenance of the Laboratory.

E. At the expiration of the term of the Facility Sublease, title to the improvements shall transfer to the Regents at no cost.

[Background material was provided to Regents in advance of the meeting, and a copy is on file in the Office of the Secretary and Chief of Staff.]

Vice President Lenz explained that this item requested Presidential authority to execute a facility sublease that would permit the South Valley Animal Health Laboratory project to proceed. The sublease was needed for purposes of the November bond sale. The State Department of Food and Agriculture would be operating this facility at no cost to the University. Once the bonds were paid off, the facility would revert to the University, also at no cost to UC.

Committee Chair Ruiz remarked that there were no drawbacks to this action.

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

Committee Chair Ruiz thanked Office of the President staff for their work in preparing the items just discussed, and for the quality of their work.

The meeting adjourned at 11:05 a.m.

Attest:

Secretary and Chief of Staff

Attachment 1

2014-15 BUDGET PROPOSAL (Dollars in Millions)

2013-14 OPERATING BUDGET

State General Funds	$ 2,844.4
Less General Obligation Bond Debt Service	200.4
State General Funds (excluding GO Bond Debt Service)	$ 2,644.0
Total Core Funds (State General Funds, Student Tuition and Fee Revenue, and UC General Funds)	$ 6,600.0

PROPOSED INCREASES IN REVENUE

State General Funds (as proposed in Governor's multi-year plan)			
2014-15 Base Budget Adjustment (5%)	$	142.2	
Annuitant Health Benefits		4.0	
Subtotal	$	146.2	
Additional State General Funds			
State Share of UCRP	$	64.1	
1% Enrollment Growth		21.8	
Reinvestment in Academic Quality		35.0	
Subtotal	$	120.9	
UC General Funds			
Nonresident Supplemental Tuition (related to new enrollment)	$	26.0	1
Indirect Cost Recovery		-	2
Subtotal	$	26.0	
Alternative Revenues/Cost Savings			
Asset Management (STIP to TRIP)	$	35.0	
Systemwide Contracts		30.0	
Philanthropy		25.0	
Subtotal	$	90.0	
TOTAL NEW REVENUE AVAILABLE FOR 2014-15	**$**	**383.1**	

PROPOSED INCREASES IN EXPENDITURES

Mandatory Costs			
Retirement Contributions	$	73.0	
Employee Health Benefits		20.3	
Annuitant Health Benefits		4.0	
Contractually Committed Compensation		16.3	
Academic Merit Increases		30.0	
Non-salary Price Increases		24.5	
Subtotal	$	168.1	
High-Priority Costs			
Compensation Increases (3% all employees)	$	117.2	3
1% Enrollment Growth		21.8	
Deferred Maintenance		11.0	
High-Priority Capital Needs		15.0	
Subtotal	$	165.0	
Reinvestment in Academic Quality			
Reduce Student-Faculty Ratio		TBD	
Support Startup Costs for New Faculty		TBD	
Reduce Faculty Salary Gap		TBD	
Reduce Staff Salary Gap		TBD	
Increase Graduate Student Support		TBD	
Enhance Undergraduate Instructional Support		TBD	
Subtotal	$	50.0	
TOTAL EXPENDITURES COVERED BY AVAILABLE REVENUES	**$**	**383.1**	

Notes:

1. Assumes revenue from nonresident enrollment growth of 2,000 undergraduate students, net of instructional costs.
2. Assumes no change in 2013-14 levels of indirect cost recovery.
3. Represents a 3% overall compensation increase less 2014-15 increases already committed to under existing collective bargaining agreements.

Attachment 2

2013-14 BUDGET FOR STATE CAPITAL IMPROVEMENTS ($000s)
CCCI 6077

CRITERIA	CAMPUS	PROJECT	PHASE	2013-14 REQUEST	FUTURE STATE FUNDS	NON-STATE FUNDS
Shovel Ready	MC	Classroom & Academic Office Building	C	$ 45,144	$ 4,079	
Equipment	MC	Science & Engineering Building 2	E	4,220		
Infrastructure	SD	SIO Nimitz Marine Facility Berthing Wharf	C	5,000		$ 20,053
TOTAL APPROPRIATED				**$ 54,364**	**$ 4,079**	**$ 20,053**
Capital Renewal	ANR	Ext Centers Renewal & Improvements	PWC	1,850		200
Seismic/Life Safety	DV	Walker Hall Renewal & Seismic Corrections	PW	2,731	28,081	
Shovel Ready	LA	CHS Seismic Correction & Fire Life Safety	C	48,349		
Infrastructure	MC	Central Plant/Telecomm Reliability Upgrade	PW	1,400	15,000	
Seismic/Life Safety	SF	Clinical Sciences Building Seismic Retrofit	W	2,800	21,735	66,933
Shovel Ready	SF	Academic Support Facility	C	26,505		7,395
Previous Growth	SC	Coastal Biology Building	W	3,530	64,443	3.985
TOTAL PROPOSED				**$ 87,165**	**$ 129,259**	**$ 82,319**
TOTAL STATE PROGRAM				**$ 141,529**	**$133,338**	**$102,372**

Note: The State adopted legislation in 2013-14, Assembly Bill No. 94, Chapter 50, Section 8 (AB 94), which adds, among other provisions, sections 92495 et seq. to the Education Code. AB 94 required that the University submit its *2013-14 State Capital Outlay* request by August 1, 2013. The University submitted seven additional projects totaling $87 million; these plus the projects previously approved total $141.5 million.

Attachment 3

2014-15 BUDGET FOR STATE CAPITAL IMPROVEMENTS ($000s)
CCCI 6151

CRITERIA	CAMPUS	PROJECT	PHASE	2014-15 REQUEST	FUTURE STATE FUNDS	NON-STATE FUNDS
Modernization	ANR	Intermountain Research Extension Center	PW	$ 200	$ 1,786	$ 100
Seismic/Life Safety	DV	Walker Hall Renewal & Seismic Corrections	C	27,917	509	
Seismic/Life Safety	DV	Chemistry Seismic & Life Safety	PW	3,482	30,418	
Equipment	IR	Business Unit 2	E	1,094		3,281
Infrastructure	IR	Primary Electrical Improvements Step 4	DC	19,462		
Infrastructure	MC	Central Plant/Telecomm Reliability Upgrade	C	15,183		
Seismic/Life Safety	SD	Campus Life/Safety Improvements	WD	49,010		
Infrastructure	SB	Infrastructure Renewal Phase 1	C	12,136		
Previous Growth	SC	Coastal Biology Building	C	64,127	1,100	
Seismic/Life Safety	SC	Life Safety Upgrades	PWC	10,201		
TOTAL STATE PROGRAM				**$ 202,812**	**$ 33,813**	**$ 3,381**

Additions shown by underscoring; deletions shown by strikethrough

UNIVERSITY OF CALIFORNIA
MORTGAGE ORIGINATION PROGRAM POLICIES

A. ELIGIBILITY AND PARTICIPATION POLICIES

In all eligibility and participation policies described herein, it is understood that any appointee in a position specifically designated by The Regents as requiring Regents' approval for compensation-related matters, must be approved for Mortgage Origination Program participation by The Regents.

<u>All references to MOP loan eligibility, participation policies, and loan policies also apply to GP-MOP, IO-MOP and 5/1-MOP loans unless otherwise described herein.</u>

1. The eligible population for the Mortgage Origination Program (MOP) consists of full-time University appointees who:

   - are members of the Academic Senate or hold academic titles equivalent to titles held by such members;
   - hold the title of Acting Assistant Professor;
   - are members of the Senior Management Group; or
   - will be appointed to any of these eligible positions effective no more than 180 days after loan closing.

2. From the eligible population, the Chancellor or Lawrence Berkeley National Laboratory (LBNL) Director shall designate eligible individuals for participation in MOP based on each location's determination of its requirements for recruitment and retention. Additionally, the Chancellor or LBNL Director may recommend, and the President is authorized to approve, individuals not in the eligible population defined in Section A.1 for participation in MOP, based upon the essential recruitment and retention needs and goals of the institution.

3. Effective with the 2010-2012 MOP allocation and for all subsequent allocations, a minimum of 60% of funds allocated for MOP is designated for participants who are purchasing their first principal place of residence within a reasonable distance of their campus or laboratory. These loans are further designated for participants who have not owned a principal place of residence within a reasonable distance of their campus or laboratory within the 12-month period preceding the closing date of their MOP loan.

4. If, in the judgment of the Chancellor or LBNL Director, individual circumstances warrant the making of a loan that does not meet the intent of Section A.3, up to 40% of the allocation is available to address essential recruitment or retention needs of the campus or laboratory for otherwise eligible appointees for one or more of the following purposes (Limited Purpose loans):

- to refinance existing qualifying housing-related debt secured on a participant's principal residence, including related loan transaction expenses included in the prior loan balance or related to the MOP loan, with the understanding that the MOP loan cannot be used to pay off loans, secured or not secured, used for non-housing-related expenses or for any mortgages on other properties. For any debt secured on a participant's principal residence that was incurred during the five years prior to loan closing, the participant must document the purpose and use of funds as qualifying housing-related indebtedness associated with the subject property;
- to provide a new MOP loan to a current or prior MOP participant at the same campus or laboratory; or
- to provide a MOP loan to a participant who has owned a home within a reasonable distance of the campus or laboratory within a 12 month period prior to the funding of a MOP loan.

5. MOP participation may continue for the term of employment by the University of California, as long as the property securing the loan continues to meet the specifications outlined in Section B.1, it being understood that:

   - if the property securing the loan no longer meets the specifications outlined in Section B.1, the MOP loan shall be reviewed for appropriate disposition; and
   - if University employment is terminated or, in the case of academic appointees, there is a permanent change to an appointment status not considered to be in full-time service to the University, the MOP loan is to be repaid within 180 days of such date of separation or change in status, with the understanding that:

     - participation can continue when separation is due to disability or retirement under the provisions of the University of California Retirement Plan or other retirement plan to which the University contributes on behalf of the participant; or
     - in the event of the death of the participant, participation can continue for a surviving spouse or surviving Domestic Partner or, in the absence of a surviving spouse or surviving Domestic Partner, for a surviving Eligible Child (as the terms Domestic Partner and Eligible Child are defined by the University of California Retirement Plan); or
     - in hardship cases, reasonable forbearance beyond the 180 day period may be granted for repayment, provided all other terms and conditions of the loan are satisfied.

B. MOP LOAN POLICIES

1. MOP loans shall be secured, using a recorded deed of trust for residences that are:

   - owner-occupied single-family residences, including planned unit development and condominium units, which may include one secondary unit that does not comprise more than one-third of the total living area of the home;

- the principal place of residence for the participant, other than during absences for sabbatical leave or other approved leaves of absence;
- used primarily for residential, non-income producing purposes; and
- 50% or more participant-owned.

2. MOP loans may not be used for direct construction loans; however, MOP loans may be used to refinance commercial construction loans upon completion of a new residence or the completion of the renovation of an existing residence.

3. The maximum loan-to-value ratio (LTV) of a MOP loan is to be determined as follows:

   - for loans up to (including) $845,000 (indexed limit as of April ~~2010~~ 2013), the maximum LTV is 90% when the loan does not include any financing of closing costs and 92% with financing of documented closing costs;
   - for loans greater than $845,000 up to (including) the Indexed Program Loan Amount ($1,330,000 as of April ~~2010~~ 2013), the maximum LTV is 90%;
   - for loans greater than the Indexed Program Loan Amount, the maximum LTV is 80%; and
   - MOP loan amounts greater than the Indexed Program Loan Amount shall require the approval of the President and the concurrence of the Chairman of the Board of Regents and Chairs of the Committees on Finance and Compensation.

   An increase to the 80% maximum LTV for loans in excess of the Indexed Program Loan Amount to no more than 85% may be approved upon recommendation by the President, with concurrence of the Chairman of the Board of Regents and the Chairs of the Committees on Finance and Compensation. The value of the residence is, in all cases, defined as the lesser of the purchase price or current appraised value. The above dollar threshold amounts for determining the maximum LTV and for the Indexed Program Loan Amount reflect applicable levels in effect as of April ~~2010~~ 2013, which shall be adjusted annually in April, based upon any increases in the All-Campus Average Sales Price determined by the annual zip code study performed by the Office of Loan Programs.

4. The maximum term of a MOP loan shall be 40-years.

5. The standard mortgage interest rate (Standard MOP Rate) will be equal to the most recently available average rate of return earned by the Short-Term Investment Pool (STIP) for the four quarters preceding the issuance of a loan commitment letter for the mortgage loan, plus an administrative fee component:

   - the President shall determine the level of the administrative fee component of the rate up to an amount not to exceed 0.25%;
   - the Standard MOP Rate will be adjusted annually on the anniversary date of the loan;
   - the maximum amount of adjustment up or down of the Standard MOP Rate will be 1% per year;

- ~~there will be no overall cap on the total amount of adjustment of the Standard MOP Rate over the term of the loan;~~
- for MOP, GP-MOP and IO-MOP loans made on or after January 1, 2014, the overall cap on the adjustment of the interest rate over the term of the loan will be 10% above the initial interest rate for the loan;
- effective with loans approved on or after August 1, 2010 the minimum initial Standard MOP Rate shall be 3.0%, and the annual rate adjustment on these loans will have a floor rate of 3%;
- in the event a loan commitment letter is issued for a MOP, GP-MOP or IO-MOP loan and the Standard MOP Rate subsequently decreases prior to the loan funding, the participant will receive the more favorable rate; and
- the difference between the weighted average rate of return of the UC-Owned MOP, GP-MOP, and IO-MOP mortgage portfolios versus that of STIP will be calculated monthly, with any earnings shortfall in the combined MOP, GP-MOP, IO-MOP portfolios being covered by the Faculty Housing Program Reserve. The rate of return of the 5/1 MOP mortgage loans will not be included in this calculation during the Fixed Rate Term, as defined in this document. Following the Fixed Rate Term, the 5/1 MOP loans will be considered MOP loans for the purposes of the monthly calculation. Any earnings excess will be retained in the Faculty Housing Program Reserve. The Faculty Housing Program Reserve will reimburse STIP for any principal losses resulting from portfolio loan losses.

6. Participants may request an Interest-Only MOP loan (IO-MOP) that has a temporary interest-only repayment feature for up to 10 years (IO-Period) with the following parameters:

- the maximum overall term of the loan is 40 years and the minimum remaining term after the IO-Period is 30 years;
- an additional interest rate margin of 0.25% will be added to the Standard MOP Rate during the IO-Period (IO-Rate);
- the additional 0.25% margin amounts collected during the period of UC-ownership of any such loan shall be held in a separate loss protection account within the Faculty Housing Programs Reserve to offset any losses of principal attributed to this class of loans;
- during the IO-Period, the maximum annual adjustment to the IO-Rate, up or down, is 1%;
- after the IO-Period, the fully amortized payment will be calculated using the remaining loan balance and term at the underlying Standard MOP Rate in effect at the end of the IO-Period, subject to the maximum annual interest rate adjustment of the Standard MOP Rate, up or down, of 1%; and
- the IO-Period is not renewable beyond the maximum 10-year IO-Period term.

Beginning with the 2010-2012 MOP allocation and for all subsequent allocations, IO-MOP loans shall be limited to 15% of the cumulative allocation.

7. Each Chancellor and the LBNL Director is authorized to designate eligible participants for participation in the Graduated Payment Mortgage Origination Program (GP-MOP) option, which provides for a reduction in the Standard MOP Rate in the manner described below:

   - the maximum rate reduction in the Standard MOP Rate is 3.0% and the minimum resulting mortgage interest rate for such loans shall be 3.0%;
   - the rate reduction amount will be decreased by a predetermined annual adjustment (ranging from 0.25% to 0.50%) until the mortgage interest rate equals the Standard MOP Rate;
   - for the time period in which the rate reduction is in effect for each GP-MOP loan, the campus shall provide for a monthly transfer of funds (from available campus funds, including discretionary funds, as well as unrestricted and appropriate restricted gift funds) to STIP or to a third-party investor, if the loan has been sold, to provide the same yield that would have been realized under the Standard MOP Rate; and
   - the President is authorized to approve an initial rate reduction greater than 3.0% and an annual adjustment amount outside the standard range of 0.25% to 0.50% based upon the essential recruitment and retention needs and goals of the institution.

8. <u>Participants may request a 5/1 ARM product (5/1 MOP) that has a temporary fixed-rate period (Fixed Rate Term), after which the loan converts to a standard MOP loan.</u>

   - <u>The initial interest rate (Initial Rate) will remain fixed until the date that the 60th payment is due, resulting in a fixed payment amount for the first 60 monthly payments.</u>
   - <u>The minimum Initial Rate will be 3.5%.</u>
   - <u>The overall cap on the adjustment of a 5/1 MOP loan's interest rate over the term of the loan will be 10% above the Initial Rate for the loan.</u>
   - <u>After the Fixed Rate Term, the interest rate will adjust to the Standard MOP Rate in effect at that time, subject to a 5% interest rate adjustment cap, and a 3% minimum interest rate.</u>
   - <u>After the Fixed Rate Term and the initial rate adjustment at the end of the Fixed Rate Term, the maximum annual adjustment is 1%.</u>
   - <u>There is no Interest-Only option available under the 5/1 MOP.</u>
   - <u>The Fixed Rate Term is not renewable beyond 5 years.</u>

9. The sum of monthly mortgage payments (principal and interest) of the MOP loan and all other loans secured by the residence may not exceed 40% of the participant's household income.

10. When administratively feasible, MOP loan payments shall be made by payroll deduction while on salary status.

11. MOP loans are not assumable.

12. MOP loans carry no prepayment penalty.

13. MOP loans carry no balloon payments.