The Regents of the University of California

COMMITTEE ON INVESTMENTS
COMMITTEE ON FINANCE

March 18, 1999

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

Members present: Representing the Committee on Investments: Regents Atkinson, Bagley, Bustamante, Davies, Khachigian, Leach, Lee, Parsky, Preuss, and Sayles

Representing the Committee on Finance: Regents Atkinson, Bagley, Bustamante, Connerly, Davies, Johnson, Khachigian, Leach, Lee, Miura, Parsky, and Willmon; Advisory member Taylor

In attendance: Regents Eastin, Espinoza, Hopkinson, Kozberg, Lansing, Montoya, and Nakashima, Regents-designate Pannor and Vining, Faculty Representatives Coleman and Dorr, Secretary Trivette, General Counsel Holst, Treasurer Small, Assistant Treasurers Stanton and Young, Provost King, Senior Vice President Kennedy, Vice Presidents Broome, Darling, Hershman, and Hopper, Chancellors Berdahl, Bishop, Cicerone, and Orbach, and Recording Secretary Nietfeld

The meeting convened at 12:00 noon with Committee on Investments Chair Parsky presiding.

1. **AMENDMENT OF AUTHORIZATION FOR THE REGENTS' COMMERCIAL PAPER PROGRAM**

The Treasurer recommended that the action approved by The Regents in January 1996 to implement the Commercial Paper Program be amended as follows, with the understanding that all other actions approved in January 1996 remain unchanged:

additions shown by shading

(6) The Treasurer be authorized to use the legally available cash balances in the unrestricted portion of the Short Term Investment Pool (STIP) to provide liquidity support for the Commercial Paper Program, subject to the following:

a. Such support may be provided only so long as the Commercial Paper Program maintains an A1/P1 or equivalent rating by the rating agencies rating the program;

b. The investment management strategy of the Treasurer for STIP shall not be changed to meet any liquidity requirements of the Commercial Paper Program;

c. The Commercial Paper Program will be charged the daily STIP rate for any actual usage of STIP and for actual costs incurred; and

d. Funding by legally available cash balances in unrestricted STIP for Commercial Paper Program liquidity support and for all other programs authorized by The Regents shall not exceed 50 percent of such balances.

Assistant Treasurer Stanton recalled that in January 1996 The Regents had authorized the Treasurer to establish a $550 million commercial paper program (the CP Program) to provide interim funding for capital projects approved by The Regents, for working capital advances to the four teaching hospitals, and for equipment financing. The Treasurer was also authorized to negotiate a line of credit in an amount not to exceed the $550 million in order to provide liquidity support.

Assistant Treasurer Young reported that the Office of the Treasurer is seeking authorization to use the legally available cash balances in the unrestricted STIP to provide liquidity support for the commercial paper program. Replacing the external line of credit provided by commercial banks with internal liquidity in the unrestricted STIP will enhance the commercial paper program in the market and is expected to save over $500,000 in bank fees annually.

The Regents' CP Program currently has $430 million outstanding for tax-exempt commercial paper for construction and acquisition financing and $120 million in taxable commercial paper available for hospital working capital, intergovernmental transfers related to transfers for the disproportionate-share funding programs for the medical centers, and for projects that do not meet Internal Revenue Service requirements for tax-exempt financing.

Mr. Young explained that rating agencies and investors in commercial paper require all issuers to provide some form of internal or external liquidity support for their outstanding commercial paper. External support is typically provided by a letter of credit or a line of credit, and the marketing of the issuer's commercial paper program is based on the rating of the banks providing the credit facility. The Regents' CP Program was structured in November 1996 with an external line of credit to facilitate the launching of the program. No use has been made under the line of credit. The CP Program has received and maintained the highest ratings assigned for commercial paper programs by Standard & Poor's and Moody's, at A1+ and P1 respectively. The rating acknowledges the financial strength of the University system and the strong liquidity in the Short Term Investment Pool. The Office of the Treasurer has confirmed with the rating agencies that the commercial paper program will retain the A1+ and P1 ratings when the unrestricted STIP replaces the external line of credit.

At $550 million outstanding, commercial paper represents approximately 16 percent of total University debt, the balance being various revenue bonds which finance housing, research, student facilities, and hospital construction. Certificates of Participation are used primarily to finance telecommunications systems and utility systems. The Regents' public debt and private placements as of March 1, 1999 totaled approximately $3.4 billion. This amount excludes State-appropriated debt, such as State Public Works Board leases and campus- originated leases.

Since the program was implemented in 1996, The Regents has enjoyed rating upgrades for bond sales in November 1997, February 1998, and June 1998. S&P raised the issuer credit rating to AA from AA-. The Issuer credit rating reflects S&P's credit evaluation of the University of California as a system. S&P also upgraded the Research Revenue Bonds issued in February 1998 to A+ from single A and the Multiple Purpose Bonds in June 1998 to AA- from A+. Moody's upgraded the Multiple Purpose Pool Bonds to AA3 from A in November 1997 and rated the research bonds for the first time in February 1998, assigning the rating of AA3. Multiple Purpose Pool Bonds are revenue bonds used to finance housing, parking, student centers, and various administrative projects, while Research Revenue Bonds are used to finance research facilities supported by the indirect cost recovery on federal contracts and grants.

Mr. Young continued that, overall, the ratings for the University of California as a system are very strong at AA/AA3. These ratings recognize the strength of the University as a system, its standing as the number one research university in the United States, and the ability of the University to diversify and strengthen its revenue bases, including federally funded research and private support, while accommodating strong undergraduate and graduate demand, even through periods of sharp reductions in State-funded budget support.

The tax-exempt commercial paper program has $430 million outstanding to provide interim construction funding for construction and acquisition. Using tax-exempt CP is a cost-effective tool to provide interim financing as interest costs have been dramatically reduced. Since November 1996, campuses have saved over $17 million compared to commercial bank interest rates, the main financing vehicle for interim construction prior to implementation of the CP Program. Long-term bonds are issued to provide fixed interest rates for those projects which are completed or nearing completion. In February and June 1998, the Office of the Treasurer issued multiple-purpose revenue bonds to refinance 21 projects for a total of $362 million.

Current commercial paper tax-exempt interest rates are below 2.9 percent, while the weighted average rate since November 1996 has been 3.4 percent.

STIP daily balances for fiscal year averaged $4,758 billion, of which the unrestricted portion of the STIP averaged $2,178 billion. During the past five years, the daily unrestricted STIP has averaged 53.6 percent of the total daily available STIP, with a range of 46 to 60 percent.

During the period November 1996 through February 1999, funding for hospital working capital has been provided by the CP program, which is a lower-cost alternative to funding from the STIP. Since 1996, the teaching hospitals have realized an additional $1.6 million in interest savings. The liability for the CP funding is charged against receivables of those medical centers for which the transfers were advanced. Taxable CP funding for intergovernmental transfers for the medical centers averaged approximately $44 million, ranging from $10 million to $197 million. Because the Treasurer anticipates that most of the hospital working capital needs will continue to be provided by taxable commercial paper, the actual use of the unrestricted STIP will continue to be primarily for funding the Mortgage Origination Program. Since 1996, the teaching hospitals have realized an additional $1.6 million in interest savings.

Assistant Treasurer Stanton reported that the Treasurer's Office manages the commercial paper program with the services of five primary dealers. There is a self-imposed maximum daily maturity limit of $50 million. The Treasurer's Office evaluates the dealers' performance continuously against various indices and against each other within their group. Dealers receive semi-annual informal evaluations and a formal in-person review annually in New York.

Assistant Treasurer Young noted that, if the Treasurer's recommendation is approved as requested, the CP Program will be the third program for which funding has been approved from the unrestricted portion of the STIP. The commercial paper program is not projected to use STIP funding at all. It is extremely rare for liquidity facilities to be used, and then only for unusual communication glitches as trades are confirmed and settled. During the two and one-half years of the commercial paper program, the bank line of credit supporting it was never accessed.

The investment strategy for the Short Term Investment Pool will continue to be geared to maximizing the return on assets coupled with providing liquidity for the daily operating needs of the University. In the unlikely event that STIP funding is required for the commercial paper program, the STIP would be made whole by fully charging the costs of any use to the program. As a result, STIP investment returns for participating funds would not be affected. In the event that the Treasurer feels that the liquidity requirements of the rating agencies would adversely affect the investment management or investment returns of the STIP, the Treasurer would renegotiate an external line of credit.

In response to a question from Regent Leach regarding the make-up of the STIP, Assistant Treasurer Stanton explained that it does contain some foundation funds as well as auxiliary funds under management by the Treasurer. Assistant Treasurer Young confirmed for Regent Leach that if working capital is provided to the medical centers from the STIP, the medical centers are charged the daily STIP interest rate for the use of the funds. Mr. Stanton continued that the cost savings achieved would be passed along to the participants in the STIP. Regent Leach asked whether such a system would be fair to these participants, such as the campus foundations.

Regent Leach stated the assumption that STIP funds will never be called upon to back up the Commercial Paper. Assistant Treasurer Stanton confirmed that such a situation would arise only if a mechanical error occurred. During the time the program has been in operation, that has never occurred. Regent Leach suggested that it might be appropriate before any use of the STIP funds were made that the Chair of the Committee on Investments be notified, along with the date they were used in this way.

Regent-designate Taylor observed that many large firms are moving toward self-liquidity as bank lines of credit become more expensive.

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

2. **AMENDMENT OF AUTHORIZATION ON BORROWING FROM SHORT-TERM INVESTMENT POOL**

The President recommended that, effective upon approval by The Regents, the actions approved at the May 1989 meeting authorizing allocations of funds for Medical Center working capital needs and for the University of California Mortgage Origination Program from legally available cash balances in the unrestricted portion of the Short-Term Investment Pool (STIP) be modified as shown below, with the understanding that all other guidelines and parameters remain unchanged:

deletions shown by strikeout, additions by shading

For Medical Centers' Working Capital Borrowing:

(1) A hospital's working capital borrowings from STIP for a month shall not exceed 60 percent of the hospital's total accounts receivable for that same month, total accounts receivable being defined as patient accounts receivable, net of allowances, plus intergovernmental transfers under SB 855, SB 1255 and Medi-Cal Medical Education programs.

(2) The total working capital borrowing for the medical centers shall not exceed ~~20 percent~~ 15 percent of legally available cash balances of the unrestricted portion of STIP.

For Mortgage Origination Program Loans:

(1) The allocations shall be at levels determined to ensure that the aggregate outstanding balance of the loan portfolio does not exceed ~~30 percent~~ 25 percent of the legally available cash balances of the unrestricted portion of STIP.

Vice President Broome informed the Committee that the amendment to the allocation of funds from the legally available cash balances in the unrestricted portion of STIP for medical centers' working capital needs and Mortgage Origination Program (MOP) loans updates the requirements and restrictions for borrowing for these two purposes. The proposed amendments and the authorization for the Treasurer to use a portion of the legally available cash balances in the unrestricted portion of the STIP to provide internal liquidity support for the commercial paper program will ensure that aggregate use of the unrestricted portion of STIP for the combination of medical center working capital, MOP loans, and the commercial paper program does not exceed 50 percent of the unrestricted STIP balance. The unrestricted STIP represents the cash balances of the University which are not restricted as to use by outside parties. These funds are invested in the STIP while awaiting expenditure, primarily for educational and general purposes and for medical center and self-sustaining auxiliary enterprises. During the past five years, the highest percentage of the hospital working capital from the STIP was 1.7 percent, and the highest balance for the Mortgage Origination Program loans was 10.5 percent.

Medical Center Working Capital Borrowing

At the May 1989 meeting, The Regents approved guidelines limiting borrowing in order to assure that the medical centers' working capital borrowing from STIP was reasonable and prudent. The amendments were due to changes in the business environment. The action being recommended today would amend the definition of total accounts receivable, subject to the 60 percent limitation, to include the amount of intergovernmental transfers in the medical centers' accounts receivable. In 1989, there were no intergovernmental transfer programs related to the Medical centers; therefore, amounts due under such programs have not been included in the receivables borrowing base. Since fiscal year 1991-92, three medical centers – Davis, Irvine, and San Diego – have participated in the California Medi-Cal Disproportionate Share Payment Adjustment Program and the Emergency Services and Supplemental Payments Fund. Since fiscal year 1996-97, the medical centers have participated in the Medi-Cal Supplemental Payment for Medical Education Program. Each of these programs requires the Office of the President, rather than the individual medical centers, to transfer funds to the Department of Health Services, which in turn receives federal matching funds for the Medi-Cal program. Since the inception of these programs, the medical centers have received not only the amounts transferred by the Office of the President on their behalf but also some share of the federal matching funds. Thus, the initial transfer of funds and a portion of the resulting federal matching of funds represents a receivable to the University. These short-term, intergovernmental receivables for these programs should be taken into consideration in the borrowing formula by including them in the definition of total accounts receivable that is then subject to the 60 percent limitation.

In addition, the medical centers have diminished working capital needs since the UC San Francisco Medical Center merged with Stanford University Hospital, and they no longer require that 20 percent of the legally available cash balances of the unrestricted STIP be reserved for such use. This limitation can now be lowered from 20 percent to 15 percent.

These amendments to the guidelines for the Medical Centers have been tested on a retroactive basis to July 1996. They provide for the appropriate combination of flexibility and control.

Mortgage Origination Program Loans

Vice President Broome recalled that In July 1984 The Regents authorized the President to implement the University of California Mortgage Origination Program (program), under which first deed-of-trust mortgage loans could be provided to eligible Academic Senate members. The actions of the July 1984 meeting established the program framework, the program loan parameters, and the initial allocation of $30 million for the first two years of the program from the legally available cash balances in the unrestricted portion of the STIP.

At its meetings of October 1985, September 1987, and May 1989, The Regents approved additional funding for the program. The May 1989 action established a maximum allocation level to ensure that the aggregate outstanding balance of the loan portfolio under the program does not exceed 30 percent of legally available cash balances in the unrestricted portion of the STIP. It is now being proposed to reduce the allocation under the program to limit the maximum aggregate outstanding balance of the loan portfolio to 25 percent of legally available cash balances in the unrestricted portion of the STIP.

As of December 31, 1998, the outstanding balance of the program loan portfolio was $240,950,641, which represents less than 12 percent of the legally available cash balances in the unrestricted portion of STIP. The loan portfolio projection model used to determine the size of each new allocation and to project the outstanding portfolio balance indicates that the anticipated use rate would range from 13 percent to a maximum of slightly over 20 percent through the year 2006. Given these projections and the greatly increased size of the STIP since the early 1990s, the proposed reduction to the limit of the legally available cash balances of the unrestricted portion of the STIP available for MOP loans still provides flexibility to meet the program's needs.

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

The meeting adjourned at 12:15 p.m.

Attest:

Secretary