The Regents of the University of California

COMMITTEE ON GROUNDS AND BUILDINGS
COMITTEE ON FINANCE
July 19, 2001

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

Members present: Committee on Grounds and Buildings: Regents Atkinson, Connerly, T. Davis, Hopkinson, O. Johnson, S. Johnson, Kozberg, Morrison, and Seymour; Advisory member Sainick
Committee on Finance: Regents Atkinson, Connerly, Hopkinson, S. Johnson, Kozberg, Lee, Montoya, Moores, Parsky, and Preuss

In attendance: Regents Bagley, Davies, Lansing, Marcus, and Sayles, General Counsel Holst, Faculty Representatives Cowan and Viswanathan, Secretary Trivette, Provost King, Senior Vice Presidents Darling and Mullinix, Vice Presidents Broome, Drake, Gomes, and Hershman, Chancellors Berdahl, Carnesale, Cicerone, Dynes, Greenwood, Orbach, Tomlinson-Keasey, Vanderhoef, and Yang, Vice Chancellor Bainton representing Chancellor Bishop, and Recording Secretary Bryan

The meeting convened at 8:50 a.m. with Committee on Finance Chair Preuss presiding.

1. **APPROVAL OF MINUTES OF PREVIOUS MEETING**

Upon motion duly made and seconded, the minutes of the meeting of May 16-17, 2001 were approved.

2. **AMENDMENT OF THE BUDGET FOR CAPITAL IMPROVEMENTS AND THE CAPITAL IMPROVEMENT PROGRAM, HEARST MEMORIAL MINING BUILDING SEISMIC AND PROGRAM IMPROVEMENTS, BERKELEY CAMPUS**

The President recommended that:

The Committee on Grounds and Buildings recommend that, subject to the concurrence of the Committee on Finance, the 2001-02 Budget for Capital Improvement and the 2001-04 Capital Improvement Program be amended to reflect the following changes:

From: Berkeley: Hearst Memorial Mining Building Seismic and Program Improvements – preliminary plans, working drawings, construction, and equipment – $67,600,000 to be funded from State funds ($34,442,000) and gifts ($33,158,000).

To: Berkeley: Hearst Memorial Mining Building Seismic and Program Improvements – preliminary plans, working drawings, construction, and equipment – $80,615,000 to be funded from State funds ($34,442,000), gifts ($33,158,000), and campus funds ($13,015,000).

The Committees were informed that the augmentation comprises an increase of $10,000,000 in construction-related costs and $3,015,000 in other project costs that have resulted from a combination of factors encountered during the construction phase.

Planning Approval

It was recalled that The Regents first approved the project in October 1993 to renovate the Hearst Memorial Mining Building (HMMB), for a total budget of $51,210,000. The project was proposed to correct seismic deficiencies and provide modern teaching and research facilities for the Department of Materials Science and Engineering within the College of Engineering. It included the application of the base isolation method to reduce the effect of seismic forces. The project was initially identified as having average complexity and was expected to address preservation of the historic fabric of the building in a limited way, restricted to preservation of the lobby and exterior elements.

During the preliminary planning of the project, it was necessary to develop a revised approach to the design, giving greater weight to preservation issues and returning much of the building to its original form and character. With the concurrence of the College of Engineering, modern teaching and research functions were accommodated within the spaces provided by the original building, with total replacement of the building's mechanical and electrical systems assuring future capacity for evolving program needs. In order to return the building's light courts to their original function, additional program space will be provided by two three-story additions on the north side of the building. Largely as a result of the emphasis given to preservation issues, in June 1997 The Regents approved a $67.6 million budget increase.

Working Drawings and Construction

The complexity of the project was more fully revealed in the working drawings phase. The use of base isolation requires the complete replacement of the foundation and ground floor of the building in an engineered sequence such that the overall stability of the structure is maintained throughout construction. The project also entails selective demolition of non-structural elements, structural strengthening of the upper levels, and installation of new architectural, mechanical, and electrical elements. This work on the upper levels must proceed concurrently and in full coordination with the replacement of the foundation by the base isolation system.

The project approached the construction phase in 1998 during a period when the construction market came under extreme pressure generally owing to the demand for construction services. This phenomenon is especially notable in the San Francisco Bay Area, where concurrent public works, seismic, and private sector projects have had a profoundly inflationary effect on construction bids in most trades. The uncompetitive market conditions have resulted in bid submissions that were greater than original estimates.

Need for Augmentation

The HMMB project is an integral part of a sequence of major capital projects now in construction or being planned by the campus. The completion of the project in the summer of 2002 is vital to the progress of other projects as well as to the program goals of the campus.

Basis of July 2001 Augmentation

In an effort to manage both the technical complexity of the project and the dynamic construction cost environment, the campus worked with the Office of the President and the State Department of Finance to define a contracting approach best suited to the needs of the project. The general contractor was selected on the basis of competitive bidding for fee and staff costs. Specialty trade packages were then bid on a competitive basis from among pre-qualified subcontractors. This process allowed the campus access to bid data that are not typically available in the historically dominant lump-sum general contracting approach. The General Contractor is compensated on the basis of the fees established at the time of selection.

With the exception of certain specialized trades and the mechanical and plumbing trades, subcontract bids were generally in line with pre-construction cost estimates. Among trades specializing in work related to historic preservation, such as woodworking and masonry, limited competition and the complexity of the project resulted in bids in excess of cost estimates, and market conditions resulted in mechanical and plumbing bids in excess of those estimates as well. In several subcontract trade areas bids were below estimates. In the aggregate, however, trade subcontract bids substantially exceeded the pre-construction cost estimates, cutting into the project's contingency.

In addition to variations between bids and estimates, the contracting process revealed that for some scope described in the project specifications, the extent of the work had not been fully defined in the architect's contract documents. Examples of such scope components are cleaning and repair of the existing concrete floors, cleaning and restoration of existing exposed brick work, and preparation of existing plaster, concrete, and masonry surfaces for painting.

Despite extensive pre-design and pre-construction investigation of existing building conditions, as construction has proceeded, numerous unforeseen conditions related to the historic fabric of the building and decades of undocumented modifications have become apparent. This has required rapid design response and, in many cases, has resulted in non-discretionary changes in contract scope. Examples of such concealed existing conditions are the deficiencies of the existing roof slabs, which lay beneath the original clay tile roof, and the unpredictable quality and strength of the existing floor slabs. These conditions have required remedial work in many areas to provide structural stability and adequate support for non-structural elements. The attachment of mechanical and electrical systems to existing floor slabs required modification of details. The original project contingency has proved to be inadequate for conditions encountered in construction. In addition, rainfall greatly in excess of the norm delayed early excavation work that was on the critical path of the construction schedule, and throughout the foundation construction, the contractor encountered sub-surface rock beyond that anticipated.

As a consequence of these factors, an increase of $13,015,000 to the project budget is needed. Approximately 77 percent of the increase is in construction-related costs, and the balance is related to items such as additional fees for the executive architect during construction, internal project staffing, material testing and inspection, and an increase in equipment costs.

Financial Feasibility

The revised project is proposed for funding from the State, gifts, and campus funds. As of June 1, 2001, the campus has raised or designated gifts totaling $26,757,000 to fund the facility. The fundraising status is as follows:

Cash gifts received	$25,416,000
Pledges to be collected	1,341,000
Gifts to be raised	6,401,000
Total	$33,158,000

The campus has advanced discretionary funds to the project in the amount of $7,742,000 to cover pledges to be collected and gifts to be raised. The campus will be repaid as additional gifts are received.

It is likely that additional campus funds beyond the budget increase currently requested will be required to sustain construction progress to completion under the conditions of dispute now prevailing. Should completion of the project require expenditure of funds beyond the University's obligations in contract or in law, the campus will aggressively pursue recovery and seek appropriate Regental approval.

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

3. **AMENDMENT OF THE BUDGET FOR CAPITAL IMPROVEMENTS AND THE CAPITAL IMPROVEMENT PROGRAM, SCIENCES LABORATORY BUILDING, DAVIS CAMPUS**

The President recommended that, with the concurrence of the Committee on Finance, the Committee on Grounds and Buildings recommend that the 2001-02 Budget for Capital Improvements and the 2001-04 Capital Improvement Program be amended as follows:

> From: Davis: Sciences Laboratory Building – preliminary plans, working drawings, construction, and equipment – $48,850,000 to be funded from State funds ($48,510,000) campus funds ($170,000), and funds available to the President ($170,000).
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> To: Davis: Sciences Laboratory Building – preliminary plans, working drawings, construction and equipment – $56,715,000 to be funded from State funds ($48,170,000), campus funds ($4,871,000), gift funds ($3,504,000), and funds available to the President ($170,000).

The Committees were informed that the project will construct a laboratory facility for biological and physical sciences instructional programs; replace obsolete and unsafe class laboratories; and provide needed space for projected increases in enrollment, consolidating all biological sciences and introductory chemistry class laboratories in one building. The new Sciences Laboratory building will be located in the immediate proximity of the UC Davis Herbarium, one of the largest biological collections on the campus and the second largest university herbarium in California.

It was recalled that at the November 1999 meeting The Regents approved the 2000-01 Budget for Capital Improvements, which included the Davis campus Sciences Laboratory Building project. State funds for preliminary plans and working drawings were included in the 2000 State Budget Act in the amount of $4,174,000. At the November 2000 meeting, The Regents approved the 2001-02 Budget for Capital Improvements, which included construction funding for the project in the amount of $44,336,000. This was based on a total project cost of $48,510,000 to be funded from State funds, campus funds, and funds available to the President.

As currently approved, the Sciences Laboratory project includes 81,384 asf of space, including 34 teaching laboratories and related support space for programs in the biological and physical sciences disciplines on the campus. The project also includes a 500-seat lecture facility.

Need for July 2001 Augmentation

The two related academic programs which will support operations in the laboratory building include the Division of Biological Sciences Undergraduate Educational Enrichment and Outreach Program and the UC Davis Bioinformatics Program. During initial project planning, the campus determined that co-locating the two academic programs with the teaching laboratories would be highly desirable and the basis for a future building proposal. However, it became clear that due to site constraints any such space must be designed as part of this project. This results in a project scope increase of 7,796 assignable square feet, which will be offset by $3,504,000 of gift funds.

During the preparation of preliminary plans, cost estimates for the project escalated substantially over the amount budgeted as the construction market came under extreme pressure owing to the demand for construction services. Although the project size and scope are consistent with the approved project planning guide, the project cost estimators indicate that the uncompetitive market conditions have resulted in a projected bid greater than original estimate for this project. The campus will offset this anticipated deficit of $4,701,000 with campus funds.

Before State funds became available, the campus and the Office of the President decided it would be prudent to accelerate preparation of the project design. In late 1999, $340,000 in non-State funds ($170,000 in funds available to the President and $170,000 in campus funds) were allocated for this purpose. However, the State Budget Act of 2000-01 included an appropriation for the full cost of the preliminary plans and the $340,000 offset by the non-State funds.

<u>Project Cost</u>

The total project cost of $56,715,000 will be funded from State funds, campus funds, gift funds, and funds available to the President. The gift campaign is in progress, and the current status is as follows:

Gifts in hand	$ 404,000
Gifts pledged	6,000
Gifts to be raised	3,094,000
Total	$3,504,000

In compliance with Regents policy, all gifts will be collected and will be in hand prior to issuing the project for bids.

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

4. **AMENDMENT OF THE BUDGET FOR CAPITAL IMPROVEMENTS AND THE CAPITAL IMPROVEMENT PROGRAM AND APPROVAL OF EXTERNAL FINANCING FOR SEGUNDO COMMONS REPLACEMENT, DAVIS CAMPUS**

The President recommended that:

A. With the concurrence of the Committee on Finance, the Committee on Grounds and Buildings recommend that the 2001-02 Budget for Capital Improvements and the 2001-04 Capital Improvement Program be amended to include the following project:

Davis: Segundo Commons Replacement – preliminary plans, working drawings, and construction – $22,843,000 to be funded from campus UCHS Net Revenues ($9,500,000) and external financing ($13,343,000).

B. The Committee on Finance recommend that the Treasurer be authorized to obtain financing not to exceed $13,343,000 to finance the Segundo Commons Replacement, subject to the following conditions:

a. Interest only, based on the amount drawn down, shall be paid on the outstanding balance during the construction period;

b. As long as the debt is outstanding, University of California Housing System fees shall be established at levels sufficient to meet all requirements of the University of California Housing System Revenue Bond Indenture, and to provide excess net revenues sufficient to pay the debt service and to meet the related requirements on this proposed financing; and

c. The general credit of The Regents shall not be pledged.

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

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

The Committees were informed that the new facility will serve as a dining commons and a central kitchen serving the Segundo Commons and other campus dining facilities. It will be the first of four major capital projects planned for this area. Future projects include a new Segundo residence hall, a new residential services building, and a utilities upgrade project. These projects are needed to meet the current needs of student residents as well as those to be housed in this complex as a result of future enrollment growth.

The Segundo housing complex is located at the northwest corner of the central campus and consists of four student residence buildings (Ryerson, Malcolm, Bixby, and Gilmore Halls). The existing one-story dining commons was built forty years ago and is located in the center of the complex. A 1998 UC Davis Facilities Department study indicated that many of the building systems of the Segundo Commons building are obsolete or near the end of their useful lives, and the building does not meet access and fire safety code requirements.

A majority of the building provides food service and was designed to serve approximately 800 students using straight-line cafeteria-style food service where food is produced in the kitchen and placed on the serving line until served. The facility now serves approximately 1,700 students and is extremely crowded. Moreover, student food service expectations cannot be met because the building does not accommodate modern food service technology. A committee was appointed in 1999 to study how best to achieve goals to reduce food costs, improve food quality, and increase customer satisfaction. The study indicated that the most efficient and economical way to meet these goals would be to replace the existing dining commons, which will remain in use while the new facility is constructed. The expected efficiencies in the new operation and the cost savings to the campus residential dining program are anticipated to offset the higher costs associated with the larger facility. The expected result would be that the total operating costs for Davis' new dining operations will not change.

A minor portion of the existing building houses several student programs, including a computer lab, video control and production studio, and a games area, that will remain in the facility until they can be relocated to a new residential services building. The existing Segundo Commons will then be demolished as part of that project.

The Segundo Commons will open in fall 2003 and be designed to meet the needs of 2,100 students. Besides accommodating the 1,700 students from the existing Segundo Residence Halls and Regan complex, the new facility will accommodate a new 300-to-400-bed Segundo residence hall also to open in fall 2003. The campus' plans to meet enrollment pressures also include a utilities upgrade project and the development of a new residential services building in the area. The new housing, student services and utilities projects will be submitted for approval at a future date.

<u>Project Description</u>

The Segundo Commons building will contain four distinct functions: dining room, food service management space, production kitchen, and cook-chill kitchen. The dining room will seat 828 diners. The facility will include office and related space for service professionals, including the service manager, director, chefs, accountants, and supervisors.

CEQA Classification

In compliance with State guidelines for implementation of CEQA and the University of California environmental procedures, an Initial Study will be prepared to consider the potential environmental effects of the project. This Initial Study will be tiered from the 1994 Long Range Development Plan Environmental Impact Report, as amended. All applicable LRDP mitigation measures described in the LRDP EIR as amended will be incorporated into this project.

Financial Feasibility

The total project cost of $22,843,000 will be funded from external financing and Davis campus University of California Housing System Net Revenue Fund Reserves. Assuming 27-year financing of $13,343,000 at 6.5 percent interest, the average annual debt service for the project will be $1,060,000 per year. Repayment of the external financing will be from the Davis campus' share of UCHS annual net revenues.

As a result of the new obligation, student residence hall rents will increase an average of $334.09 per year. The new average annual (9.5 month) rent will be approximately $5,169 per bed. This includes housing, utilities, cable TV, Internet conductivity, and custodial and student services. There is no housing in the community that can provide a direct comparison to the residence halls; however, housing alternatives in the local market for the same period and similar amenities average approximately $7,885 per bed (two bedroom apartment shared by two tenants).

Due to streamlining, operating expenses in the residential dining operation will shrink nominally, while the costs associated with the larger facility would have increased. The net result will be a zero change to operating expenses.

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

5. **AMENDMENT OF THE BUDGET FOR CAPITAL IMPROVEMENTS AND THE CAPITAL IMPROVEMENT PROGRAM AND AMENDMENT OF EXTERNAL FINANCING AUTHORIZATIONS FOR WESTWOOD REPLACEMENT HOSPITAL AND SANTA MONICA/ORTHOPAEDIC REPLACEMENT HOSPITAL AND PARKING STRUCTURE, LOS ANGELES CAMPUS**

A. The President recommended that, with the concurrence of the Committee on Finance, the Committee on Grounds and Buildings recommend that the 2001-02 Budget for Capital Improvements and the 2001-04 Capital Improvement Program be amended as follows:

From: Los Angeles: <u>Westwood Replacement Hospital</u> – preliminary plans, working drawings, construction, and equipment – \$672.7 million to be funded from federal funds (\$432.9 million), State matching funds (\$44.1 million), and gift funds and State lease revenue bond funds (\$195.7 million).

To: Los Angeles: <u>Westwood Replacement Hospital</u> – preliminary plans, working drawings, construction, and equipment – \$672.7 million to be funded from federal funds (\$432.9 million), State matching funds (\$44.1 million), State lease revenue bond funds (\$125 million), and gift funds (\$70.7 million).

From: Los Angeles: <u>Santa Monica/Orthopaedic Replacement Hospital and Parking Structure</u> – preliminary plans, working drawings, construction, and equipment – \$230,861,000 to be funded from federal funds (\$72,200,000), hospital reserves (\$14,900,000), and gift funds and State lease revenue bond funds (\$143,761,000).

To: Los Angeles: <u>Santa Monica/Orthopaedic Replacement Hospital and Parking Structure</u> – preliminary plans, working drawings, construction, and equipment – \$230,861,000 to be funded from federal funds (\$72,200,000), hospital reserves (\$14,900,000), State lease revenue bond funds (\$55,000,000) and gift funds (\$88,761,000).

B. The President recommended that the Committee on Finance recommend that the Treasurer be authorized to obtain stand-by financing not to exceed \$25 million, and interim financing not to exceed \$66.1 million, for a total of \$91.1 million for gift funds not received at this time and subject to the following conditions:

(1) Interest only, based on the amount drawn down, shall be paid on the outstanding balance during the construction period.

(2) Repayment of any financing shall be from gift funds and in the event such gift funds are insufficient, from the Los Angeles campus' share of the University Opportunity Funds.

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

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

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

It was recalled that the new hospital on the Westwood campus will replace the existing medical center, Mattel Children's Hospital, and the Neuropsychiatric Hospital facilities, which suffered significant structural damage as a result of the 1994 Northridge earthquake and do not meet life-safety standards. To comply with California Law and current Office of Statewide Health Planning and Development (OSHPD) life-safety requirements, the inpatient care services located in these existing facilities must be repaired, renovated, or replaced by 2008.

Background

The Westwood Replacement Hospital was the first project proposed for development as part of the multi-phase seismic reconstruction plan presented to The Regents in May 1997, at which time The Regents approved an amendment to the Capital Improvement Program to include preliminary plans funding for the Westwood Replacement Hospital.

In November 1998, The Regents approved an amendment to the Capital Improvement Program to include the Westwood Replacement Hospital at the total project cost of $597.7 million and certified the Final Environmental Impact Report for the project, approved the project design, and approved external financing in the form of hospital revenue bonds to be repaid from operating revenues of the hospital system.

In September 2000, The Regents approved an augmentation to the Capital Improvement Budget for the Westwood Replacement Hospital to include $75 million in medical equipment costs previously anticipated to be funded separately from hospital reserves in the two years prior to the completion of the new hospital. With the inclusion of these equipment costs, the project cost for the Westwood Replacement Hospital was estimated to total $672.7 million.

Concurrent with the budget augmentation approval, The Regents approved changes in the funding sources for the project consisting of the addition of gift funds and of State-sponsored lease revenue bonds and the removal of hospital reserves and of long-term external financing in the form of hospital revenue bonds. The exact allocation of the State lease revenue bonds funds and gift funds between the two hospital projects was subject to adjustment pending the completion of discussions with the Department of Finance regarding the approval of the $180 million in funding for the two projects. In February 2001, the State Public Work Board approved the allocation of $125 million in State lease revenue bonds to the Westwood Hospital.

Construction of the Westwood Replacement Hospital commenced in fall 1999 with the award of the site demolition and site utilities relocation contract. The work on that contract was completed in November 2000. The core and shell construction contract was awarded in November 2000 and work commenced in December 2000 and is anticipated to be completed in the summer of 2003. Bids are being solicited for the tenant improvement work, which will start in fall 2001 and be substantially complete in mid-2004. Full occupancy of the building is scheduled for fall 2004.

The Los Angeles campus will also construct a new hospital on the Santa Monica Medical Center campus to replace the existing West Hospital Tower and the Nethercutt Emergency Center facilities, which suffered significant structural damage during the earthquake and do not meet life safety standards. The inpatient care services located in these facilities must be repaired, renovated, or replaced no later than 2008. In addition, approximately 83,980 asf will be retained in the Merle Norman Pavilion, which will undergo partial renovation and refurbishment.

The Santa Monica/Orthopaedic Replacement Hospital Project was the second project proposed for development as part of the multi-phase seismic reconstruction plan presented to The Regents in May 1997, when The Regents approved an amendment to the Capital Improvement Program to include preliminary plans funding for the Santa Monica Replacement Hospital.

In March 1999, The Regents approved an amendment to the Capital Improvement Program to include the Santa Monica/Orthopaedic Replacement Hospital at the total project cost of $205.86 million and certified the Final Environmental Impact Report for the project, approved the project design, and approved external financing in the form of hospital revenue bonds to be repaid from operating revenues of the hospital system.

In September 2000, The Regents approved an augmentation to the Capital Improvement Budget for the Santa Monica/Orthopaedic Replacement Hospital to include $25 million in medical equipment costs previously anticipated to be funded separately from hospital reserves in the two years prior to the completion of the new hospital. With the inclusion of these equipment costs, the project cost for the Santa Monica/Orthopaedic Replacement Hospital was estimated to total $230.86 million.

Concurrent with the budget augmentation approval, The Regents approved changes in the funding sources for the project consisting of the addition of gift funds and of

State-sponsored lease revenue bonds and the removal of long-term external financing in the form of hospital revenue bonds. Also approved was a reduction in the use of the cash reserves of the hospital system, except for $14.9 million in earthquake insurance proceeds. At that time, the exact allocation of the State lease revenue bond funds and gift funds between the two hospital projects was subject to adjustment pending the completion of discussions with the Department of Finance regarding the approval of the $180 million in funding for the two projects. In February 2001, the State Public Works Board approved the allocation of $55 million in State lease revenue bonds to the Santa Monica /Orthopaedic Replacement Hospital.

Construction of the Santa Monica/Orthopaedic Replacement Hospital commenced in fall 1999, with the first phase of renovation of the Merle Norman Pavilion completed a few months later. Construction of the parking structure started in March 2000 and was completed in April 2001. Construction of the replacement central plant started in July 2000 and is scheduled for completion in early 2002. The construction documents for the replacement hospital contract received the OSHPD permit in May 2001. Bid solicitation is under way, with award of the contract expected in September 2001. Construction work will start in fall 2001 and will be substantially complete in mid-2005.

Financial Feasibility

The 2000 State Budget Act included $600 million of lease revenue bonds to be issued by SPWB to provide the medical centers of the University of California with funding for the reconstruction projects that will be required to comply with SB1953. At its January 2001 meeting, SPWB approved a resolution declaring the board's official intent to use proceeds from the sale of lease revenue bonds to pay up to $180 million in eligible project expenses for the Santa Monica/Orthopaedic Replacement Hospital ($55 million).

Although external financing in the form of hospital lease revenue bonds was removed as a fund source in September 2000 and replaced with gift funds or State lease revenue bond funds, the financing authorizations approved in November 1998 and March 1999 for the two hospitals remained in place. It was anticipated that University financing would continue to fund construction expenditures until the SPWB authorized the allocation of State bonds funds.

With the confirmation of the allocation of lease revenue bonds funds, the gift funds requirements for the two projects have been established at $70.7 million for the Westwood Replacement Hospital and $88.76 million for the Santa Monica/Orthopaedic Replacement Hospital, for a total of $159.46 million.

The financing authorizations for the two projects must be amended to authorize the Treasurer to provide stand-by and interim financing for the gift funds not currently in hand. The campus is still in the midst of the gift campaign, the status of which is as follows:

Cash gifts received	$68,370,000	
Pledges received	25,000,000	(subject to standby financing)
Subtotal	93,370,000	
Gifts to be raised:	66,091 ,000	(subject to interim financing)
Total	$159,461,000	

On June 29, 2001, gift funds totaling $40 million were used to reimburse interim financing for Westwood Replacement Hospital ($26 million), Santa Monica Replacement Hospital ($8.2 million), and the Santa Monica parking facility ($5.8 million). Approval of stand-by financing not to exceed $25 million and interim financing not to exceed $66.1 million, for a total of $91.1 million, will allow for awarding construction contracts and obtaining funds to make the progress payments required during the construction period should gift receipts not be sufficient to do so. The balance of gifts to be raised is anticipated to be obtained through the completion of the $150 million campaign initiated for the naming of the Westwood Replacement Hospital in honor of former President Ronald Reagan. To the extent that the campus obtains additional gift funds prior to the completion of the project, the draw down against the interim financing commitment will be reduced or outstanding balances will be prepaid.

The campus anticipates that it will be possible to collect the pledges received for this project, but in the event the collection is insufficient, the campus has pledged campus Opportunity Funds as an additional source of repayment.

In the event that gifts are insufficient and interim financing needs to be converted to long-term financing, the potential annual debt service on $66.1 million at 6.5 percent for 27 years is $5,256,000. The campus is within the prescribed Opportunity Fund pledge and payment tests. In fiscal year 2005-06, the first full year of occupancy, 56.3 percent of Opportunity Funds are pledged for debt service.

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

6. **ADOPTION OF FINAL 2001-02 BUDGET FOR CURRENT OPERATIONS AND THE BUDGET FOR CAPITAL IMPROVEMENTS**

Adoption of the budget was postponed until such time as the State's Final Budget Act has been approved.

Vice President Hershman reviewed the status of the State budget and commented on its implications for the University. He recalled that at the previous meeting he had discussed the Governor's May revision and the actions that had to be taken to bring the budget into balance, including the Governor's decision to keep $1 billion in reserve because of current economic conditions and the fact that general fund revenue from capital gains and stock option income was expected to decline by $5.5 billion from last year. The Governor's original proposal was cut by $1.2 billion, and further cuts are expected before the budget becomes final. The State is optimistic about its ability to sell revenue bonds to cover excess energy costs. Economists forecast another year of tight budgets, with some relief possible at the beginning of next year.

Mr. Hershman reported that education fared well amidst the budget cutting, despite threats from certain legislators. By the time the Governor finishes his vetoes, the overall State general fund budget will have decreased by 2 percent from last year. Education, however, will get about a 5 percent increase. It is expected that the State will spend about $3.5 billion more in the budget year than it will take in, which will bring the reserve down from $6 billion to $2.5 billion.

Mr. Hershman reported that before a meeting is held to adopt the University's budget, background information will be distributed to all Regents. The most serious problem confronting the budget is the fact that funding through the partnership agreement with the Governor continues to diminish. Originally, it was anticipated that a 4 percent increase would be available for salaries, plus a 1 percent increase for instructional equipment, instructional technology, maintenance, and libraries. That 1 percent was cut, and the salary money was decreased to 2 percent.

Mr. Hershman noted that enrollments for an additional 7,100 students were funded in the budget, $20 million in funds was allocated to support full-year operation at the Berkeley, Santa Barbara, and Los Angeles campuses, and $20 million was provided to ensure that there would be no increase in educational fees, registration fees, or professional school fees. The Governor had included in his May revision an extra $100 million for the University's increased energy costs, but this was reduced to $75 million. Funds for outreach were reallocated so that $5 million that was to be spent on long-term school partnerships will be spent on efforts that are expected to yield short-term gains. Regent Preuss observed that this shift reflects a politicization of the budget process in that politicians mindful of term limits are motivated to sacrifice long-term commitments in an effort to produce visible gains during their tenures.

Regent Connerly observed that the University has put into place initiatives triggered by the partnership agreement that will be its responsibility to uphold regardless of the availability of State funds to support them. He believed it was important to underscore the fact that the University has been put in a position of having to honor a partnership that the State seems to have abandoned. He pointed out that some segments of the legislature have asserted their political power to exact concessions from the University. Mr. Hershman emphasized that all of the University's base budget was funded this year, but he believed that if State funds are not provided in the next two years to close the gap in salaries between the University and its competitors, the

University will be forced to rearrange its budget priorities and renegotiate with the State. Chairman S. Johnson believed that the State's lack of support for faculty and executive salaries, which hampers the University's ability to compete in the marketplace and maintain its high quality, has been one of the most disturbing things about the trend toward politicization of the budget process.

Mr. Hershman recalled that this year's $530 million budget for capital outlay is the most generous within memory. Money from existing bonds for UC Merced will be augmented by additional funds, and the four new science institutes will receive generous funding, along with several individual campus projects and facilities.

Regent Kozberg asked for more information about the budget for deferred maintenance. Mr. Hershman recalled that the original Regents' budget proposal included $6 million to finance deferred maintenance in the fourth year of a program to deal with the $500 million backlog in high-priority deferred maintenance projects. Because of the loss of some of the partnership money for salaries, the Regents decided to reduce that $6 million to $4 million so as to use $2 million to pay for commitments made under collective bargaining to reduce fees for teaching and research assistants.

Chairman S. Johnson inquired about funds that were to have supported teaching quality and graduate students. Mr. Hershman reported that money to support a decrease in the student-faculty ratio was cut, as were funds to support graduate students. He emphasized that money remains to reduce fees for teaching assistants and to develop the four science institutes. He noted that graduate student enrollment is expected to increase by 1,500 this year on a base of 25,000 but that there has not been an increase in the overall percentage of graduate students. President Atkinson pointed out that because of a State policy change four years ago the University is free to increase graduate enrollments without State approval, but he noted that financial considerations have prevented its graduate enrollment goals from being met.

Regent Davies believed it was essential that, when there are insufficient funds to allow the Governor to uphold the partnership in its entirety, the Regents, and not the Governor or the legislature, should have the choice of deciding where cuts should be made to the University's budget to accommodate shortfalls. Regent Parsky agreed with this sentiment. Mr. Hershman informed him that the University will not receive about $90 million that would have been tied to the partnership agreement.

In response to questions by Regent Lee, Mr. Hershman explained that, without sufficient funds, it will not be possible to lower the student-faculty ratio this budget year. It will remain at about 18:1. He explained further that $600 million in State lease revenue bond monies have been made available for seismic corrections to the University's hospitals. Regent Lee urged him to continue to focus on limiting cost increases for out-of-state and foreign students, many of whom remain in California and contribute to the economy.

Chairman S. Johnson requested details about what the State provides for the University's hospitals. Mr. Hershman responded that it provides core educational money to the medical schools and clinical teaching support for the hospitals.

Regent Kozberg asked how the partnership addresses student fees. Mr. Hershman responded that under the partnership agreement either fees will be increased at the rate of per capita personal income growth, which is about 5 percent per year, or the State will buy out the fee increases, which is what has happened for the past six years. This year the State provided money to buy out fees but did not provide money to increase salaries, which was also meant to be covered under the partnership agreement.

Regent Marcus believed that the Regents should not lose sight of the fact that, given the State's economic condition, the University's budget is generous. Regent Hopkinson congratulated Mr. Hershman for getting as much money for the University as he did in the face of general statewide reductions in the budget. President Atkinson agreed and noted that the Governor and the leadership of the legislature had done their best for the University.

Regent T. Davis noted that because of the economic downturn there has been an increase in the number of graduate students intending to register in the coming fall. She was concerned that it would be difficult to continue supporting increased enrollments without significant increases in State support.

Regent Bagley recalled that when he was attending the University in 1945, the State was supporting the institution almost entirely. He was puzzled as to why governmental support for higher education has diminished to such a large degree since then.

Regent Hopkinson believed that when The Regents adopt the budget, it should be the entire budget and not just the State portion. Mr. Hershman recalled that in November the Regents had discussed the complete budget document. His comments at this meeting had pertained only to elements that had changed since then. He agreed to provide the appropriate background information prior to asking the Board to adopt a 2001-02 budget.

7. **POLICY CONSIDERATIONS GUIDING THE DEVELOPMENT OF THE 2002-03 UNIVERSITY OF CALIFORNIA BUDGET**

It was recalled that the discussion of the policy considerations guiding the development of the budget for 2002-03 was initiated at the May Regents meeting and will continue through the September meeting. The budget for 2002-03 will be presented to The Regents for approval at the November meeting.

Operating Budget

The May Regents meeting discussion on policy considerations guiding development of the budget for 2002-03 took place before release of the Governor's May Revision, which proposed a 3 percent (or $90 million) reduction in the Partnership funds provided in 2001-02. It is recommended that the University's highest priority in 2002-03 should be full funding of the Partnership Agreement for next year, including the 4 percent basic budget adjustment, 1 percent for core needs, funding for enrollment growth, State support for summer instruction at the five remaining general campuses, and funding for cost adjustments to fee-funded programs in order to avoid fee increases, as well as restoration of the Partnership funds eliminated from the 2001-02 budget. Those priorities alone could require an 11 percent increase over the current year budget.

The Partnership also recognizes that each year the University may request funding above the basic budget for research, public service, and other initiatives that are of importance to the State. However, given the State's fiscal situation, full funding of the Partnership and restoration of Partnership funds eliminated in 2001-02 will present a significant challenge, making the possibility of funding for other initiatives problematic.

As the budget is developed for 2002-03, the document will reflect changes suggested at the May meeting, such as including the need for graduate enrollments as part of the discussion on maintaining quality. Also consistent with the discussion at the May Regents meeting, a report will be provided to The Regents every six months that reviews the University's funding needs and the resources provided to meet those needs.

Capital Outlay

The Partnership Agreement acknowledges the Administration's support for GO bond funding and/or lease revenue bonds for capital needs beyond 2001-02. However, specific funding levels for future bonds have not yet been resolved. The University's goal will be to achieve adequate funding for capital needs related to enrollment growth as well as those related to life-safety, modernization, and infrastructure. The previous bond provided the University with $210 million per year for four years.

Vice President Hershman emphasized that it will be unlikely that the University will be able to get a 2002-3 budget that fulfills the promise of the partnership and provides any extra money. He believed that the 2002-03 budget should focus on basics and not extras. Increasing salaries so as to maintain quality is mandatory. He observed that the level of capital outlay will depend on the new bond issue. The University is working with the other segments of higher education to ensure that the amount of the bond issue on the March ballot will be large enough to meet the needs of all the segments of the State's educational system. He hoped that individual Regents would help with the lobbying effort in Sacramento.

Regent Hopkinson believed that the 2002-03 budget proposal should be approached with the idea of asking for the actual amount of support the University needs, without regard to the health of the State's economy. She suggested that the budget should reflect what the Regents believe are the elements that are key to preserving quality. She asked that the policy considerations be revised based on comments by Regents and submitted to the Board for approval. She commented further that there was not sufficient discussion in the proposal about new capital requirements, and she suggested that the section on graduate students be moved under the heading of continuing quality and be revised to emphasize the University's research mission and the need to attract high-quality graduate students and teaching assistants. She believed that it would be helpful to have a one- or two-page summary of the University's priorities that states exactly how much money it will take to support them.

Committee Chair Preuss agreed with her suggestions, but he noted that some of her concerns would be addressed in future administrative reports to the Regents concerning the University's needs up to 2010 in the categories of operating revenue, capital planning, and housing. He agreed that it would be beneficial to have a short document in conjunction with the 2002-3 budget proposal that shows the implementation of the first year of the ten-year plan.

Regent Kozberg asked for specifics about the bond proposals. Mr. Hershman reported that all bond bills being considered would be split between K-12 and higher education. The amount of the bond is at issue, but he expected that it would be between $10 billion and $17 billion. He recalled that in the past the apportionment between K-12 and higher education was left to the Governor and legislature and was not part of the bill. The community college leadership would prefer that the amounts were spelled out in the bill. He believed it was likely that it would be divided mainly by thirds, with a portion reserved for projects involving more than one segment.

Chairman S. Johnson noted that she was anxious to receive in September a report from a commission headed by Provost King concerning graduate students that will spell out specific funding needs. She hoped that it would be distributed widely.

The meeting adjourned at 10:15 a.m.

Attest:

Secretary