The Regents of the University of California

COMMITTEE ON FINANCE
January 15, 2003

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

Members present: Regents Atkinson, Connerly, Hopkinson, Lee, Ligot-Gordon, Montoya, Moores, Preuss, and Sayles; Advisory members Murray and Pitts

In attendance: Regents Blum, Bustamante, Davies, Johnson, Kozberg, Marcus, Pattiz, and Sainick, Regents-designate Bodine and Seigler, Faculty Representative Binion, Secretary Trivette, General Counsel Holst, Treasurer Russ, Provost King, Senior Vice Presidents Darling and Mullinix, Vice Presidents Broome, Doby, Drake, and Gomes, Assistant Vice President Obley representing Vice President Hershman, Chancellors Berdahl, Bishop, Carnesale, Cicerone, Córdova, Dynes, Greenwood, Tomlinson-Keasey, Vanderhoef, and Yang, Laborary Director Anastasio, Interim Laboratory Director Nanos, and Recording Secretary Nietfeld

The meeting convened at 9:15 a.m. with Committee Chair Hopkinson presiding.

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

Upon motion duly made and seconded, the minutes of the meeting of November 13, 2002 were approved.

2. **READING OF NOTICE OF MEETING**

For the record, it was confirmed that notice had been served in accordance with the Bylaws and Standing Orders for a Special Meeting of the Committee of Finance, for this date and time, concurrent with the regular meeting of the Committee on Finance, for the purpose of acting on Item 508, ***Authorization to Enter into an Agreement with the City of Merced to Annex Phase One of Merced Campus to the City***.

3. **REPORT ON 2003-04 GOVERNOR'S BUDGET**

Committee Chair Hopkinson noted that today's discussion of the Governor's proposed budget for 2003-04 would be a preliminary one. It will be important for the Regents to know the intentions of the Legislature with respect to the budget prior to any detailed discussion. An in-depth presentation will be made to the Committee at the March meeting.

President Atkinson commented that Vice President Hershman was unable to be present at the meeting and that he would be calling upon Assistant Vice President Obley to lead the budget discussion. He observed that the University has had a good working relationship with the Governor and the Department of Finance; he believed that the Governor would continue to realize the value of education to the state. At the same time, the President acknowledged that this budget contains painful cuts for the University of California. While UC must participate in the solution to the State's budget crisis, that knowledge does not mitigate the reality that these cuts will have a major effect on programs that are providing valuable services to the people of California. The Governor estimates the budget deficit to be about $34.6 billion over two years, and the Legislative Analyst places the deficit at $21 billion. Both are basing their estimates on a workload budget but have made different assumptions about the character of that workload budget. The budget is based on the assumption that recovery from the current recession will begin in 2003 and that moderate economic growth will occur in 2004. The President observed that one of the primary problems facing the State has been the significant reduction in revenue from capital gains and stock options, which grew sharply in the late 1990s to nearly $18 billion in 2001-02 and then dropped to $8.2 billion in 2001-02 and $5.6 billion in the current year. The Governor proposes to deal with the shortfall through a variety of actions which include a one-cent increase in the State sales tax, an increase in taxes for the wealthiest tax payers, and a $1.10 increase in cigarette taxes. There was no cut in the budget for the prisons.

Assistant Vice President Obley referred to the handout which had been distributed to the Committee outlining the details of the proposed 2003-04 budget. As discussed at the Committee's December 2002 meeting, for the Advanced Placement online program there will be a mid-year, one-time reduction of $4 million based on savings from prior years. The 2003-04 funding includes a permanent reduction of $4.4 million. The amount remaining is sufficient to allow the program to continue to serve at least the same number of students and to offer the same number of courses being offered in the current year. State-funded research is reduced another 10 percent, or nearly $29 million. This is in addition to the 10 percent cut included in the budget act for the current year. Ms. Obley believed that this cut, which is of deep concern to the University, was made by the Governor reluctantly, given his publicly stated recognition of the importance of research to California's economy, but the State's fiscal problems make more cuts to these programs unavoidable. The cuts to outreach remain the same as reported in December: a $3.3 million cut in the current year grows to $33 million in 2003-04, which is a 50 percent reduction in the program. This controversial proposal will be a matter of intense discussion in the upcoming budget process. The reduction to the California Subject Matter Projects was not publicly announced in December. This program provides K-12 teacher training and served as the infrastructure for the California Professional Development Institutes. The $20 million currently budgeted for the subject matter projects will be reduced to $5 million by 2003-04, leaving only the funds used as matching funds for federal money awarded to the science project. With the new reduction proposed for the subject matter projects, almost all State funding for UC professional development programs for K-12 teachers will have been eliminated from the University's budget. Assistant Vice President Obley touched on other reductions to the budget that had been reported at the December meeting, including Cooperative Extension and student services.

Ms. Obley reported that the unallocated reduction of $19 million for 2002-03 will grow to $179 million in 2003-04. While the Governor's budget does not propose a student fee increase to offset this reduction, it does acknowledge that the $19 million will be offset by the current-year student fee increase and anticipates that the remaining $160 million will be similarly addressed through additional student fee increases to be adopted for 2003-04. By increasing student fees to address this reduction, the University avoids cuts that would otherwise be directed to instruction. Undergraduate student fees will have to increase by an additional $795 per year, or 24 percent, over the current year. If this increase is implemented, undergraduate students will pay $1,200 more than they paid in 2001-02, which represents an overall increase of 35 percent over the two-year period. Total fees would still be below the average cost for public universities in the United States. Professional school fees will go up by a similar percentage over the two-year period. Any action on student fee increases will be proposed at the May meeting, following the detailed budget presentation in March.

Assistant Vice President Obley reported that a further unallocated reduction of $35 million for 2003-04 had been implemented late in the budget process. The administration will not propose that this new cut be addressed through further student fee increases. She then turned to some other actions in the 2003-04 Governor's budget, including full marginal cost funding for the enrollment of an additional 13,000 FTE students. This signals the importance the Governor has placed on the University's core instructional mission. One-time funding is also provided to help the Merced campus hire faculty and begin the operations that are needed to open the campus in 2004.

With regard to capital outlay, the Governor's budget includes funding of $310 million in general obligation bonds, consistent with the bond measure approved by the voters in November 2002 and consistent with The Regents' budget request. The Governor has announced his intention to accelerate capital construction for which general obligation bonds have already been approved, and the administration is working with the Department of Finance to determine the degree to which the University may participate in this acceleration.

In concluding her remarks, Ms. Obley noted that the budget process in Sacramento would proceed as usual, with President Atkinson making an overview presentation to both houses of the Legislature in early March. Hearings will continue throughout the spring. The Governor will submit his revised budget plan to the Legislature in mid-May.

Regent Kozberg recalled that prior to the mid-1990s the University's commitment to outreach to K-12 schools had been somewhat erratic, and she expressed the opinion that the severe cuts that will be experienced by the University's outreach programs would send a chilling message to K-12 that the University is not committed to outreach for the long term. Assistant Vice President Obley agreed, noting the success of these programs.

In response to a question from Regent Ligot-Gordon, Ms. Obley explained that the State does not permit the University to hold funds over from one year to the next in order to build a surplus. The University's only reserves are for specific purposes such as capital outlay.

Regent Davies observed that the University's Partnership Agreement with the State seemed to work well only when there is a strong economy. He was surprised by the fact that the Governor had targeted specific programs for budget reductions and asked that the Regents be provided the opportunity to state their opinions as to where the budget cuts should be made. Regent Hopkinson noted that this would be an appropriate topic of discussion at the March meeting.

Regent Connerly suggested that the Partnership Agreement was actually a one-way street under which the University takes upon responsibilities required by the State in exchange for funding when it is available. He asked how The Regents could begin to resume control over the University's destiny in order to avoid being locked into the demands that are placed upon it under the partnership.

In response to a question from Regent Marcus about process, President Atkinson stated that a general discussion would be scheduled for March which would allow the Regents to set their priorities with respect to negotiations with the Governor and the Legislature.

Regent Pattiz asked for comment on the role of the Partnership Agreement. President Atkinson explained that the partnership represents a commitment on the part of the University to ensure quality and access.

Regent Blum suggested that the President should make the case to the Legislature that a certain minimum amount of funding was needed for the University to operate. He believed that, as currently conceived, the Partnership Agreement was unfair to UC. The Board of Regents should take proactive measures to protect initiatives such as outreach. He was concerned that the Regents would not have the opportunity to address these issues until March.

President Atkinson observed that the University's only flexibility under the partnership relates to the quality of the instructional programs and the assurance that the top 12.5 percent of California's high school graduates will be granted admission. The budget will represent a challenge to the University's ability to recruit the caliber of faculty needed to maintain quality. The University also has a public commitment to access. He noted that the University has the ability to leverage the money it receives from the State to obtain contracts and grants from the federal government.

In response to a comment from Regent Blum regarding the need to explore additional sources of funding, the President stressed that the University had greatly strengthened its fund raising efforts over the past ten years, receiving $1 billion in private support in 2001.

He noted that K-12 had been successful in promoting a ballot measure that guarantees a certain minimal amount of State funding for the schools.

4. **FINANCING THE COST OF ATTENDING THE UNIVERSITY OF CALIFORNIA**

It was noted that excerpts from the University's soon-to-be released 2000-01 Annual Report on Student Financial Support had been provided as background for today's presentation.

Provost King recalled that at the Committee's December 2002 meeting several Regents had expressed concern about how students would manage to cover the cost of a student fee increase. Today's presentation on how undergraduate students finance their education was developed to address the questions that were raised. Provost King observed that the Governor's budget for 2003-04 raises the need for more fee increases in the future, and he acknowledged that such new fees cause anxiety and concern for students and their families.

The answer to how UC students finance an undergraduate education rests within the University's education financing model, which serves to guide the University in assisting students and parents to manage the cost of an undergraduate education. The model was developed in response to the budget crisis of the early 1990s, when there was deep concern about how UC students would manage the fee increases adopted at that time. Provost King noted that he was not aware of any other university with such a comprehensive, integrated model which clearly specifies what is expected of the student, the family, and the University for financing an undergraduate education. The model considers financing from the student's point of view, but it reflects the assumption that all students contribute equitably to the cost of attendance. It is built around the goal of keeping a student's borrowing and work load at manageable levels. Finally, the model works differently depending upon the family's income.

Provost King turned to the cost of attending the University of California, noting that fees are a significant component. For undergraduates in 2002-03, the total fees averaged $3,900 prior to the adoption of the mid-year fee increase of $135. Non-fee expenses, however, are significantly higher than student fees. A chart which displayed the cost of attendance based on a student's living arrangement showed that the systemwide average cost is $15,500, 75 percent of which goes to non-fee expenses. If the fees are increased by the $1,200 anticipated in the Governor's 2003-04 budget, 70 percent of the cost of attendance will still be non-fee expenses. Provost King continued that the costs of non-fee expenses such as housing and food, books and supplies, and transportation are based on average actual expenditure levels reported by students in a survey conducted by the University every three years.

Noting that financing a UC education involves a partnership between the student, his or her parents, and the University, Provost King first discussed the student's role in this partnership. The University expects all students to make a manageable contribution to their expenses through some combination of working and/or borrowing. The education financing model attempts to keep work below 20 hours per week during the academic year as data show that the performance and progress of students who work less than 20 hours per week matches that of their counterparts who do not work. The model also attempts to keep borrowing in line with industry standards of loan repayments as a ratio of income, with the goal of keeping student loan payments upon graduation no more than 9 percent of average post-graduation earnings. In 2002-03, the student contribution expected from work and borrowing amounted to an average of $7,905. For purposes of illustration, Provost King described the case of a student who chooses to contribute $3,758 from work. This amount may be generated by working 13 hours per week while in school and full time during the summer months. The student will cover the rest of the $7,905 contribution by borrowing $4,147 annually, graduating with a monthly student loan payment of $226, or less than 7 percent of average UC post-graduation earnings.

The financing partnership turns next to the parents, who are expected to contribute to educational costs to the extent that they are able. The parental contribution is calculated based upon a federal methodology that accounts for such factors as parent income, family size, and asset levels (excluding home equity). Parents with particularly low incomes will have no expected contribution. The parent contribution may be paid through current income, savings, tax benefits, or federally sponsored low-interest parent loans.

The third component in the financing model is the University, which coordinates grant resources for eligible students. The focus is on those students who, even after accounting for their expected contributions, lack the resources to cover the full cost of attendance. The University coordinates grants from State, federal, and UC sources. University grants are used to fill any gaps remaining between resources and the total cost of attendance after accounting for grants from federal and State programs.

Provost King presented a series of slides illustrating how the financing model works at different income levels. The first student has a family income of $120,000, which is just high enough to be ineligible for federal education tax benefits. In this case, the expected parent contribution based on the federal formula is $24,000, which is more than enough to cover the gap between the student contribution and the total cost of attendance. Even with the increased student fees, this family's income remains large enough to finance the higher cost of attendance. The second student described has a family income of $81,000, which falls in the 75th percentile household income in California. This family is eligible for an $800 federal tax credit based on 2002-03 fee levels. In this case the calculated parent contribution is $12,000, which is adequate to address the remaining gap to cover the total cost of attendance. The $405 annual fee increase raises the family's eligibility for a federal tax credit by $81, while the additional $795 fee increase anticipated in the Governor's budget raises the federal tax credit by $120.

Provost King then discussed two sample students from lower-income families. The first family has an annual income of $47,000, which is California's median household income. This family has an expected parent contribution of $3,000, which does not close the gap between the student contribution and the total cost of attendance. In this case, the student receives grant assistance from federal, State, and/or University resources to cover the gap remaining after accounting for the parent contribution. The $405 fee increase will be fully offset with additional grant assistance. The support will come through the Cal Grant program or the University's grant program, which is structured to increase as systemwide fees do. This family also lacks the resources to cover the fee increase anticipated in the Governor's budget and will receive additional grant assistance. The fourth example looked at a student with an annual family income of $24,000, which is California's 25th percentile household income. Because it has particularly few resources, this family has a parent contribution of zero, leaving a large gap between the student contribution and the total cost of attendance. This student will receive assistance similar to that described above, and the fee increase will be fully offset by increased grant funding.

Provost King observed that there are many ways to measure the effectiveness of the education financing model. A study published by the Irvine Foundation in spring 2002 compared the rates at which students at top universities across the country receive a federal Pell Grant. Because Pell Grants are targeted at students from particularly low-income families, the percentage of students receiving a Pell Grant was considered to be an indicator of the rates at which universities enroll low-income students. The study found that UC enrolls a higher percentage of low-income students than any other top university in the country, with an average of 29 percent.

In summarizing his presentation, Provost King observed that the University has an effective student financing model that will allow students to accommodate a fee increase in a number of different ways, depending upon family resources. Most UC undergraduates with family incomes under $60,000 receive grant assistance to fill in the gap between the total cost of attendance and the contribution expected to be made by the student and parents. For these students, the fee increase will be fully offset with grant assistance. For those students with family incomes over $100,000, covering the fee increase from savings or current income should be manageable. The fee increases will not result in increases to student loan and work burdens as long as the parents and the University do their part in helping students cover their educational costs.

President Atkinson noted that it had been the practice of the Regents to invite a representative of the University of California Student Association to address matters of mutual interest, and he called upon Mr. Armando Cervantes, the chair of UCSA's University Affairs Committee, for his comments. Mr. Cervantes discussed his personal financial situation, noting that he works between 25 and 35 hours per week. Mr. Cervantes believed that the fee increase proposed in the Governor's budget for 2003-04 would place an added burden on low-income students who must work to fund their education, some of whom would be forced either to drop out or to take fewer units. Students acknowledge, however, that the Regents need to take steps to address the State's budget crisis. He asked the Regents to take student needs into mind as decisions are made.

In response to a question from Regent Bustamante, Mr. Cervantes estimated that the fee increase being considered for 2003-04 would mean that he would need to work 40 hours per week.

Regent Lee raised the issue of parents who have more than one child in college. Provost King explained that family size is taken into account in the calculation of the parental contribution. Director Jeffery added that such families are expected to contribute the same amount for each child's education. In response to further comments by Regent Lee, Committee Chair Hopkinson suggested that Ms. Jeffery might wish to discuss the annual report on student financial support with Regent Lee.

Regent Montoya raised the issue of a student who is estranged from his or her parents and thus can expect no parental contribution to the cost of attending UC. Director Jeffery commented that in extreme cases the campus financial aid office had limited discretion to treat such a student as independent, with no contribution expected from the family.

Regent-designate Bodine observed that the financing model assumes that students who receive financial aid will not pay the increased fees and asked Mr. Cervantes why he intended to take on a heavier work load to finance the fee increase. Mr. Cervantes explained that the amount of work he had taken on had made him ineligible for a Cal Grant.

Regent Connerly expressed concern about households with earnings of $81,000 that fall into the category of "higher income." He believed that it would be difficult for these families to afford the increased fees, based upon their income level. Associate Vice President Gallagani noted that families with incomes above the federal guideline of $60,000 are not eligible for assistance. Regent Connerly stressed that a family of four with an annual income of $81,000 would have no discretional income that would assist them in saving for college. Provost King noted that the State's ScholarShare Program was intended to assist these families. Director Jeffery added that there were federal loan programs available with low interest rates.

In response to a question from Regent Blum, Director Jeffery reported that UC students receive approximately $125 million in Cal Grants annually. Funds are provided in the Governor's budget to fund the student fee increase for these grant recipients.

Regent Ligot-Gordon believed that students who support their education through the University's work-study program should receive pay increases to fund the additional student fees. Director Jeffery pointed out that these wages are based upon comparable rates of pay for non-work-study jobs. Mr. Ligot-Gordon further suggested that the way in which family income is defined by the University was unfair to some students. Ms. Jeffery responded that financial aid offices do have some discretion to make adjustments in unusual cases. The University is bound by federal guidelines, however, and it would be difficult for the University to adopt a separate financial-aid formula.

Regent Sayles referred to the study by the Irvine Foundation which found that the University of California admits the highest percentage of low-income students and asked for the definition of low income. Director Jeffery explained that low income is defined based upon the Pell Grant eligibility level of less than $35,000. In response to a further question from Regent Sayles, Provost King explained that the annual budget calculation for the University assumes that the marginal cost of instruction is $9,000 per student per year.

In response to a question from Regent Bustamante, Ms. Jeffery reported that the income cut-off for the receipt of financial aid is $60,000. Regent Bustamante suggested that there were many middle-class families who will be substantially affected by any student fee increase. He believed that the University should be able to offer these families some kind of relief. Provost King observed that this had been the logic for the federal government when it adopted tax credits for education. Director Jeffery added that scholarships are another source of funding for families. The application for admission to the University also serves as an application for scholarships.

Referring to the marginal cost of instruction, Regent Sayles suggested that consideration might be given to asking wealthy families to pay a portion of this cost. President Atkinson stressed that the University's financial aid policy, which returns one-third of every fee increase to financial aid, calls upon wealthier families to subsidize low-income students.

5. **AMENDMENT OF THE UNIVERSITY OF CALIFORNIA RETIREMENT PLAN TO ELIMINATE THE THREE-YEAR TIME LIMIT FOR ELECTIONS TO ESTABLISH OR REESTABLISH SERVICE CREDIT**

The Committee was informed that this item had been removed from the agenda.

6. **AUTHORIZATION TO AMEND UC RETIREMENT AND BENEFIT PLANS AND PROGRAMS AS NECESSARY TO SUPPORT RESPONSES TO THE CURRENT BUDGET SITUATION**

The President recommended that:

A. Authority be granted to allow amendments to University of California employee benefit plans and programs, including amendments to the University of California Retirement Plan (UCRP), Tax Deferred 403(b) Plan (403(b) Plan), and Defined Contribution Plan (DC Plan), in support of personnel strategies that respond to the immediate California state budget crisis. Authority is necessary to produce required savings in a timely manner to affect the current and in some cases continuing into the next fiscal year.

B. Authority for these amendments and implementation of these provisions be delegated to the President, with the concurrence of the Chairman of the Board and the Chair of the Committee on Finance, for program changes resulting in a cost not to exceed $25 million per program annually.

The Committee was informed that, in the absence of firm information from the State about the extent of the budget cuts that will be required at the University, a broad range of options will need to be considered in response to the budget challenge. Possible options will include personnel strategies that would necessitate amendments to benefit plans and programs, including UCRP, the 403(b) Plan, and the DC Plan. Such amendments currently require Regental approval. As timing will be critical to implement programs that will produce immediate savings in the current fiscal year (and in some cases extending into the next fiscal year), delegated authority is requested so that amendments necessary to implement initiatives may be approved and communicated quickly.

As an example, an initial response to the current budget situation to generate short-term salary savings could be a voluntary Time Reduction Incentive Plan (TRIP), as was offered in 1992 in response to adverse budget circumstances at that time. Amendments to UCRP would be necessary to ensure that participation in the program would not reduce a UCRP Member's retirement benefit. There may be additional future costs to the extent that any of these programs were to include equivalent deferred vacation. Other actions could include UCRP amendments in order that a UCRP Member is not disadvantaged by a personnel action that would affect his or her eligibility for or reduce the amount of the April 1, 2003 Capital Accumulation Provision Accrual Credit.

Implementation of the necessary plan and program changes, not to exceed $25 million per program annually, would be delegated to the President, with the concurrence of the Chairman of the Board and the Chairman of the Committee of Finance. Programs would be implemented as necessary and when administratively feasible, in accordance with applicable Internal Revenue Code rules and regulations. Any proposed amendment affecting employees represented by a union is subject to notice, consultation, and/or meeting and conferring as appropriate under the Higher Education Employer-Employee Relations Act. Delegated authority under this action is not requested for any type of early retirement program.

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

7. **AMENDMENT OF LEASE WITH THE DEPARTMENT OF ENERGY FOR SIMMONS PLOT PROPERTY, LAWRENCE BERKELEY NATIONAL LABORATORY**

It was recalled that this item had been withdrawn.

8. **INCREMENTAL FUNDING OF FIXED PRICE CONSTRUCTION SUBCONTRACTS FOR THE FY 03 FACILITY AND INFRASTRUCTURE**

RECAPITALIZATION PROGRAM AT LAWRENCE LIVERMORE NATIONAL LABORATORY

The President recommended that, as an exception to Standing Orders 100.4 (dd)(1) and (8), and subject to appropriate University pre-bid concurrence and approval of the Department of Energy, the Lawrence Livermore National Laboratory be authorized to solicit and execute incrementally funded fixed price construction subcontracts at LLNL for the FY 03 Facility and Infrastructure Recapitalization Program made up of the subprojects B298 Roof Replacement, B332 Ductwork Replacement, Support Services Equipment Rehabilitation, B511 Backlog Reduction, Replacement Building, Road Repair/Reroute of 5th Street, Site 300 High Explosives Lightning Protection, B801 Utilities and Support Systems Rehabilitation, B131 Backlog Reduction, HEPA Replacement, B871 Backlog Reduction, B222C&N Demolition, Trailer Demolition, B865 Demolition, and Roofing Assessment. These projects are authorized in connection with work done under the University's master operating contract for LLNL, where the total value of the individual subcontracts would exceed the amount appropriated for project work on a monthly basis.

The Committee was informed that the Lawrence Livermore National Laboratory had proposed awarding an incrementally funded subcontract to obtain cost savings during the construction period of the Facility and Infrastructure Recapitalization Program (FIRP) projects. These projects provide for the design, engineering, and construction of facilities revitalization endeavors at the laboratory, which has a $250 million backlog of old and unreliable facility equipment, components, and systems. These projects are designed to rehabilitate the aging infrastructure, such as replacing roofs, repaving roads, and building replacement office buildings. The goals of the FIRP projects are to increase the operational readiness, to arrest the deterioration and extend the useful life of facilities, and to remove excess structures from the inventory.

The FIRP for FY 03 is authorized at $26 million, with funds being released in a limited fashion. The plan is to begin projects and award construction or design/build contracts with partial funding and to fund fully the contracts upon the termination of the continuing resolution and/or upon the receipt of new funds in FY 04. Incrementally funded contracting, which avoids restraints imposed by the continuing resolution or fiscal year duration of congressional appropriations, has been used previously at the laboratories and does not pose a substantial risk to The Regents.

Incremental funding allows an agency to enter into a contract to have projects constructed for a fixed total price while limiting the agency's obligation to the amount of funds available. The contractor promises to complete construction for a fixed price only if the agency provides the full amount of the requisite funding, in increments, over the term of the contract. The special conditions of the contract spell out in detail the method of funding and the manner in which work may be adjusted, suspended, or terminated in the event later appropriations are reduced or eliminated. The LLNL construction subcontracts would also remain subject to existing pre-bid University review procedures, including approval as to legal form by the Office of General Counsel.

Subcontracts premised on incremental funding cannot be considered completely risk free. Although they provide for termination if funds are curtailed, an absolute limitation on the University's potential liability cannot be assured. Incremental funding is routinely used by federal agencies for construction contracting, and the national laboratories have applied the practice to facilities constructed over the past decade, including several at LLNL. The principal advantage is the opportunity to award a construction contract over continuing resolution or fiscal year boundaries, avoiding the artificial parceling of the project into multiple contracts. Such a contract allows the introduction of cost saving methods and other economies associated with continuous performance. Sufficient amounts would be maintained by LLNL as reserve contingency funds over the financial periods to cover in all material respects contractor termination costs in the event of non-appropriation.

Regental approval is required because the provisions of Standing Orders 100.4(dd)(1) and (8) prohibit construction contract awards in excess of appropriated funds. Approval for the proposed exception to the Standing Order is necessary now in order to provide sufficient time to prepare the necessary contractual documents.

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

9. **AUTHORIZATION TO ENTER INTO AN AGREEMENT WITH THE CITY OF MERCED TO ANNEX PHASE ONE OF MERCED CAMPUS TO THE CITY**

The President recommended that:

A. The President, on behalf of the Merced campus, be authorized to execute, subject to the concurrence of the Chairman of the Board and the Chairmen of the Committees on Finance and Grounds and Buildings, an agreement with the City of Merced which permits the City of Merced to annex the first phase of the Merced campus (102 acres) for the purpose of providing city water and sewer services for Phase 1 of the Merced campus.

B. The President, in consultation with the General Counsel, be authorized to execute all other related documents necessary in connection with the above.

It was recalled that Phase 1 of the University of California, Merced campus is under development. The Regents approved the campus' Long Range Development Plan and Environmental Impact Report in January 2002. The construction schedule is targeted for completion of selected campus buildings by summer 2004, in time for the opening semester of the campus in late August 2004. The campus' central plant and first academic and housing buildings must undergo testing and commissioning of utilities no later than spring 2004.

The opening of UC Merced is contingent on the provision of water and wastewater services by the City of Merced, as provided for in the LRDP. The City plans to deliver such services through extension of water and wastewater lines from its current jurisdiction to the campus. Since the approval of the LRDP by The Regents, the campus and the City have been developing a contract for the provision of such services for Phase 1 of the campus development (Water and Sewer Contract). This contract is limited to Phase 1 of the campus so that other approaches may be considered for the remainder of the campus build out. This flexibility will allow UC Merced to consider technologies that emerge over the next decade and includes the possibility of establishing its own utility services on the campus or in conjunction with the University Community.

Financing Provisions of the Water and Sewer Contract

The anticipated cost of the water and wastewater line extensions is $8.5 million, including interest capitalized during the construction period. Through the assistance of the Governor's Red Team, the California Infrastructure and Economic Development Bank (CIEDB) will finance the construction and provide a low-cost, 30-year loan at completion of construction. UC Merced will pay user fees and capital charges which will amortize the cost of the CIEDB loan over the loan period, with the capital charge tailored to match campus growth in the early years.

As development in the areas surrounding the campus occurs, other users will begin to connect to these extensions. When connected, such developments will pay user charges and thereby reduce the charges to the University. This policy of reimbursement to the University has been extended by the City of Merced from an initially proposed 10-year period to the full 30-year period of project financing. Over this period, the University's cost for the line extensions could be reduced by up to 80 percent if full development of the surrounding community occurs.

In addition to agreeing to be the borrower on the CIEDB loan, the City of Merced has agreed to carry the full costs of building the water well ($1.6 million) on the campus site. In return for these services and the agreement to reduce costs, the City is requiring that UC Merced enter into an agreement to annex Phase 1 of the campus.

Annexation Background and UCM Proposal

Some UC campuses or portions of campuses are annexed to their cities, including UC Irvine, part of UC Santa Cruz, and Aggie Village at UC Davis. Most University of California campuses are within city boundaries, but local relationships and history vary widely. In Merced's case, the campus was re-sited to the Lake Yosemite location, which brought the campus much closer to the City boundary and provided the opportunity to acquire needed water and wastewater services from the City. No provision was made by the State for these services, and the County of Merced does not provide such services. By locating closer to available infrastructure, the campus has saved millions of dollars in infrastructure costs.

To provide water and wastewater services to a site outside the City boundaries, the City requires the campus to enter into an agreement to annex, and the Local Agency Formation Commission (LAFCO) must approve the provision of services. Actual annexation, however, occurs only after the City has satisfied all legal requirements for annexation, the annexation of any intervening properties has been completed, the revenue sharing plan between the City of Merced and Merced County has been revised, and LAFCO has approved the annexation proceeding, including the "Provision of Services Plan."

Thus, annexation is not likely to be accomplished for several years. As development occurs beyond Phase 1, additional annexation may be considered only if the campus wishes to extend the City water and sewer (or other services) to a larger campus area.

The proposed agreement to annex also provides that if in the intervening period between signing this agreement and actual annexation the University concludes that the long-term build out of the campus is better served with an alternative water and/or wastewater strategy, the University may cancel the agreement as long as all financial obligations are met by the University on the line extensions. The proposal further provides that should annexation have occurred, but the University still wishes to implement a different water-wastewater strategy, the University may do so as long as all financial obligations for the line extensions are met by the University.

It was noted that if the University agrees to annexation of Phase I of the Merced campus on the terms proposed, it may lose leverage in subsequent discussions with the City with respect to matters of mutual interest which could range from the overall relationship between the University and the City to matters such as joint planning efforts, provision of additional City services, fiscal issues of mutual interest, and other issues which may affect the life of the campus community as a result of Phase I being part of the City of Merced.

<u>Other Services</u>

The Water and Sewer Contract covers only water and wastewater services. All other services will be provided initially by the County or the campus itself. County services include fire protection, sheriff's services, waste disposal, county transportation services, and park and recreational services.

Limiting the agreement to annex to Phase 1 of the campus development provides an opportunity for the campus to negotiate further with the City on other services and issues of interest to the campus. As the City brings forward an annexation action to LAFCO it will also present a "Provision of Services Plan" that the University and City will negotiate.

(For speaker's comments, see the minutes of the January 15, 2003 meeting of the Committee of the Whole.)

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

10. **REPORT ON NEW LITIGATION**

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

The meeting adjourned at 10:45 a.m.

Attest:

Secretary