The Regents of the University of California

COMMITTEE ON FINANCE
March 18, 2015

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

Members present: Regents Gould, Island, Kieffer, Leong Clancy, Lozano, Makarechian, Newsom, and Saifuddin; Ex officio members Brown, Napolitano, and Varner; Advisory members Davis, Gorman, Hare, and Oved; Staff Advisors Acker and Coyne

In attendance: Regents De La Peña, Elliott, Engelhorn, Lansing, Ortiz Oakley, Pattiz, Pérez, Sherman, and Zettel, Faculty Representative Gilly, Secretary and Chief of Staff Shaw, General Counsel Robinson, Provost Dorr, Executive Vice President and Chief Financial Officer Brostrom, Executive Vice President and Chief Operating Officer Nava, Executive Vice President Stobo, Senior Vice Presidents Henderson and Peacock, Vice Presidents Brown, Budil, Duckett, and Sakaki, Chancellors Block, Blumenthal, Dirks, Gillman, Hawgood, Katehi, Khosla, Leland, Wilcox, and Yang, and Recording Secretary Johns

The meeting convened at 10:00 a.m. with Committee Vice Chair Kieffer presiding.

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

Upon motion duly made and seconded, the minutes of the meeting of January 22, 2015 were approved.

2. **AUTHORIZATION OF 100-YEAR TAXABLE EXTERNAL FINANCING**

The President of the University recommended that the Regents authorize the President to:

A. Issue a taxable 100-year borrowing (bonds) in one or more series in an aggregate principal amount not to exceed $500 million plus financing costs with an interest rate not to exceed 5.5 percent, to be issued under the University's general revenue bond indenture. As long as the bonds are outstanding, the campuses receiving such proceeds shall satisfy the following requirements:

(1) Campuses receiving proceeds (Davis, Irvine, Riverside, San Francisco, and Santa Cruz) shall maintain general revenues in amounts sufficient to pay the debt service and to meet the related requirements of the authorized financing.

(2) Use of bond proceeds shall comply with all applicable University policies with respect to capital projects and real estate transactions, including, without limitation, environmental review, provided, however, that any specific authorization of the Regents to use proceeds of a borrowing for a specific project shall not be affected by this requirement.

B. Take all necessary actions related to the action approved above, including, but not limited to, approval, execution, and delivery of all necessary or appropriate financing documents.

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

Committee Vice Chair Kieffer explained that this action was a request for authorization to issue a taxable 100-year bond not to exceed $500 million plus financing costs. The bond would be structured as a 99-year interest only bond with a bullet maturity in year 100. The bond would fund strategic, high-priority needs on campuses, such as deferred maintenance, capital renewal, and other strategic objectives where a 100-year instrument would serve as a permanent component of the campus' capital structure. The campuses participating in this issuance would be Davis, Irvine, Riverside, San Francisco, and Santa Cruz. The financing would depend on market conditions at the time of issuance. He recalled that the University has a successful track record of issuing long-dated bonds. In March 2012 the University issued $860 million of 100-year bonds at an interest rate of 4.858 percent.

Executive Vice President and Chief Financial Officer Brostrom announced that the University had made a comprehensive bond issue the previous week of $2.85 billion, both in general revenue bonds and limited project revenue bonds. About $2 billion of this amount was tax-exempt. There was a positive reception to this issuance. Interest rates were near all-time, secular lows. UC financed the tax-exempt series for the general revenue bonds at less than three percent, for a 30-year maturity, and at 3.31 percent for the limited project bonds, for a 35-year maturity. UC generated about $650 million in new money to fund 25 projects, and also almost $300 million in refunding savings, about 13 percent of the refunded par. UC is trying to free up more capacity under its general revenue credit. Projects have been moved from general revenue credit to the limited project credit. UC was downgraded the previous year by Moody's and Fitch, but has reaffirmed its credit ratings. UC general revenue bonds are rated Aa2/AA/AA, and limited project revenue bonds one notch lower. He quoted positive remarks by the rating agencies, who praised UC's debt management team and the timely measures it has taken to mitigate financial pressures.

Mr. Brostrom noted that a number of other institutions of higher education have issued century bonds like the issuance being proposed in this item. The revenue from these bonds would be used mainly for deferred maintenance and capital renewal. Campuses would use this financing to set up revolving loan funds with a term far less than

100 years. He recalled that nearly 60 percent of UC facilities are over 35 years old; there is a substantial backlog in deferred maintenance and capital renewal needs.

Regent Makarechian asked why the Santa Barbara, Merced, San Diego, and Berkeley campuses were not participating in this bond issuance, and about the effect it would have on UC's credit ratings. Mr. Brostrom responded that the University would seek to allocate the proceeds from this issuance to campuses that did not participate in the first issuance in 2012. The University has about three times as much need as capacity in this issuance, but allocated it across both issuances, to ensure that every campus has access to these funds. Several factors contributed to the University's credit downgrade. The main factor was pension and retiree health expenses. One positive feature of century bonds is that they would not count against UC's debt capacity. Because they are long-dated, they are treated by the rating agencies more like equity than debt in UC's capital structure. Every campus is required to set aside an amount to cover the principal when it comes due in 100 years. Due to the effect of compound interest, this is a small amount.

Regent Makarechian observed that the University's debt would increase by the amount being issued. Mr. Brostrom concurred that the amount is counted as debt, but stressed that only the interest on the debt service would count against UC's operational expense. Regent Makarechian countered that this is not a small amount. Mr. Brostrom responded that $500 million, at roughly five percent or less, would amount to $25 million annually. UC has far greater needs in deferred maintenance. The issuance allows UC to accelerate that, to carry out many more of these projects than it could on a pay-as-you-go basis out of the operating budget.

Regent Makarechian again expressed concern about how this issuance might affect UC's credit rating. Mr. Brostrom responded that the University discussed this matter with the rating agencies, who supported this proposal. He stated his view that $500 million, while less than the campuses had wished, is a prudent amount. Associate Vice President Sandra Kim confirmed that the rating agencies, as part of their rating affirmation, reviewed this $500 million issuance.

Regent Zettel praised the administration for its creative approach to debt restructuring. The Regents have consistently been concerned about UC's deferred maintenance needs. She pointed out that the University's internal audit program ensures that funds charged against UC bonds, monies invested in UC projects, are spent appropriately.

Regent Sherman referred to background information to the item according to which the internal loans to the campuses would be amortized over a 15- to 30-year period. However, the bond would not be repaid for 100 years. He asked what would happen to the funds after they had been repaid internally. Mr. Brostrom responded that the funds were meant to be used as a central bank or a revolving loan fund for the campuses. After campuses paid back loans, the money would be recycled into this central bank, which would lend it out again for other deferred maintenance projects.

Regent Sherman asked about the approximate cost of the credit rating downgrade and how it would affect this bond issuance. Ms. Kim responded that UC saw no effect of the downgrade for this bond.

Regent Sherman concluded that effectively, at very little cost, UC had locked in a rate for 100 years. Mr. Brostrom added that this was one reason the University wished to issue these bonds at this time. The 30-year Treasury yield, the pricing benchmark for century bonds, is near all-time lows. The University anticipates receiving a rate similar to the one it received in 2012.

Regent Pérez stated that it was not possible that the credit rating downgrade had no impact on the University. He asked if the University would be paying the same amount if there had been no downgrade. Mr. Brostrom responded that the credit impact was about ten basis points; this was the additional amount UC had to pay due to the downgrade. UC is seeking to free up more debt capacity.

Governor Brown remarked that this bond issuance would be a convenient source of capital. It would generate a large amount of money and add complexity to UC operations. He questioned the dollar amount of approval thresholds for capital projects, emphasizing that the Regents should watch closely how these monies are spent. He expressed uncertainty about proposed projects such as $40 million for a student wellness center at UC Riverside and the consolidation of office space in downtown Merced, and stated his view that the $70 million threshold for Regental review of capital projects was too high. Mr. Brostrom responded that in the delegated process for capital projects, the chancellors have authority to approve projects up to $10 million. Projects in the range of $10 million to $70 million must be reviewed by the Office of the Chief Financial Officer and approved by the President. There are strict guidelines about these projects. If a project is not in the campus' capital plan, it must be approved by the Committee on Grounds and Buildings. The delegated process is still in its pilot phase. A major concern is keeping projects close to budget and avoiding cost overruns. The Regents have the ability to approve every project through the campuses' capital plans, which are brought to the Committee on Grounds and Buildings. He concurred that this bond issuance would result in a great deal of activity in building, capital renewal, and deferred maintenance.

Governor Brown observed that new buildings generate significant operating costs. Greater square footage would imply more employees, and more pension and health care costs. He reflected that much could happen over the next 100 years, including wars, pestilence, plague, and climate change. This bond issuance represented a major commitment. He asked that the difficult task of valuating capital projects be pursued by the Regents more aggressively and in greater detail, suggesting that the Committee on Finance be involved.

Committee Vice Chair Kieffer asked that the Committee on Finance be kept up to date, on a regular basis, on how operational monies are being spent. Mr. Brostrom responded to Governor Brown's observations, explaining that UC's business plans incorporate the growth implied in building new facilities. The current proposed action would address a problem in the University's operating budget, where deferred maintenance has been an ongoing line item, and one of the first items cut when there is not enough revenue. This would be a prudent way of addressing a significant backlog.

Committee Vice Chair Kieffer stressed that the proposed action was a very good idea, accomplishing more with fewer means at a time of tremendous deferred maintenance needs. Projects could be tracked by the Committee on Finance as well as the Committee on Grounds and Buildings.

Regent Gould recalled that the University provides an annual review of its debt capacity. A review of this century bond program could be incorporated in the debt capacity review. Mr. Brostrom responded that this information would be provided, specifically about how the campuses set up revolving loan funds, what funds are used for, and terms.

Regent Ortiz Oakley asked why the University chose to issue taxable bonds and about the source of funds for the 100-year payback, so that the Board of Regents 100 years in the future would not be faced by a dilemma. Mr. Brostrom responded that in the case of tax-exempt bonds, the useful life of a project must match the term of the bond. No UC projects would have a useful life with such a term. Every campus participating in the bond issuance must create a sinking fund, money put aside, discounted at five percent, beginning at the end of the next fiscal year. Due to the power of compound interest, the money the campuses would have to put aside, growing at five percent, to pay out $500 million, would be $4 million.

Regent Ortiz Oakley asked if the sinking fund would be restricted. Mr. Brostrom responded that it would be used only for repayment of the principal.

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

3. **AUTHORITY TO INDEMNIFY THE CITY OF DAVIS IN DURABLE ENCROACHMENT AGREEMENT AND UNION PACIFIC RAILROAD IN PIPELINE CROSSING AGREEMENT, DAVIS CAMPUS**

The President of the University recommended that:

A. The President be authorized to approve the terms of a Durable Encroachment Agreement for Installation and Maintenance of Water Pipeline within Public Right of Way (Encroachment Agreement) allowing the Davis campus to construct and maintain a pipeline to transmit the water from the point of delivery north of the City of Davis through the city to the campus. This agreement includes a provision whereby the University will indemnify, defend, and hold harmless the City of Davis, its officers, agents, and employees, for any injury, damage, or loss arising directly or indirectly out of the installation, maintenance, operation, and the existence of UC Davis pipeline in the City's right of way, excluding claims arising from the City's sole acts of negligence, omissions, or willful misconduct.

B. The President be authorized to approve the terms of a Pipeline Crossing Agreement with Union Pacific Railroad (the UPRR Agreement) that would allow the Davis campus, along with the City of Davis, to install a culvert containing two steel sleeves (one 24-inch diameter and one 14-inch diameter) under the railroad tracks at a location at or near the northern boundary of the City of Davis, travelling from east to west, to enable the City's and the campus' respective water pipes coming from the City of Woodland to travel to delivery points within the City of Davis and on campus. The UPRR Agreement includes a provision whereby the University will indemnify, defend, and hold harmless UPRR, its officers, agents, and employees, and any other railroad company using the area, for any injury, damage, or loss arising out of, resulting from, or related to the work contemplated by the culvert and the UPRR Agreement.

C. The President, or her designee, after consultation with the General Counsel, be authorized to approve and execute any additional documents necessary in connection with the above.

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

Executive Vice President and Chief Financial Officer Brostrom explained that this item requested authority to indemnify the City of Davis in a durable encroachment agreement and to indemnify Union Pacific Railroad in a pipeline crossing agreement. UC Davis has worked with the Cities of Davis and Woodland to acquire a surface water supply that will supplement groundwater supplies for all three entities. The transmission pipeline would deliver treated surface water to the northern limits of the City of Davis, on the opposite side of the city from the campus. The City of Davis and the campus would then enter into an encroachment agreement to allow the campus to locate a pipeline under city streets, in the public right of way. From the end of the UC Davis pipeline, the campus would construct a transmission pipeline and a pumping station on the campus. Because this is a durable encroachment agreement, it requires assumption of third-party liability, which in turn requires approval by the Regents.

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

4. **CONTINUATION OF LIFE-SAFETY FEE, BERKELEY CAMPUS**

The President of the University, at the request of the Chancellor, recommended that the life-safety portion of the Berkeley Campus Fee continue at its current level for five years, from summer 2015 through spring 2020, with the following specifications:

A. All students enrolled at the Berkeley campus during the regular academic year be assessed a mandatory life-safety portion of the Berkeley Campus Fee of $46 per student per term from fall 2015 through spring 2020.

B. Students enrolled in summer sessions be assessed a mandatory life-safety portion of the Berkeley Campus Fee at $23 per student from summer 2015 through summer 2019.

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

Committee Vice Chair Kieffer introduced the item, explaining that the life-safety portion of the Berkeley Campus Fee provides funding for needed seismic and other health and life-safety improvements in student services facilities which are ineligible, in whole or in part, for State-funded maintenance. It was estimated that over five years the fee would generate about $18 million, of which about $6 million would be used for financial aid and about $12 million would be available for projects.

Executive Vice President and Chief Financial Officer Brostrom explained that most campus-based fees are approved by student referenda. The Regents can approve fees involving life-safety issues. Student consultation was not required for this fee, but students were consulted broadly. There was support for the fee by the undergraduate Associated Students of the University of California and the Graduate Assembly. The campus has a life-safety fee committee to monitor and oversee the projects funded by this fee.

Regent Makarechian asked if students were aware that one-third of the fee would be directed to financial aid. Mr. Brostrom responded in the affirmative. Students had advocated for this several years previously. One-third of student fees are set aside for financial aid. In this case, two-thirds of the fee would be used for life-safety projects.

Regent Ortiz Oakley asked how the University would inform students that one-third of the fee would be directed to financial aid. He suggested that the fee might more appropriately be named “life-safety and financial aid fee.” Mr. Brostrom responded that students have been strong proponents of the condition that all fees include a portion to be returned to financial aid. He did not know how this is communicated to students, but could provide this information.

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

Student observer Christopher Kan noted that the University has enrolled more students from underrepresented groups and first-generation college students than ever before, despite the recession of 2008 and reductions in State funding. He expressed concern that the business model of increased tuition and increased return-to-aid had reached its limits. At a certain point a UC education would become too expensive for the middle class, and it was likely that the University had reached or would soon reach this point. The rate at which UC alumni default on student loans was alarming. He urged the Regents to freeze tuition and to freeze enrollment unless State funds were made available. He urged the

University to work toward a new model that would preserve the affordability, access, and quality of education at UC.

Regent Pattiz asked about what the new model might be. Mr. Kan responded that UC should consider more digital education and efficiency measures to increase the total number of students served. At a certain point UC would need more funding from the State or philanthropy to accommodate growing numbers of eligible high school graduates.

Regent Zettel asked if students are aware, when they vote to approve a new fee, that one-third of the fee revenue will be returned to financial aid. Mr. Kan responded that this fact is generally well communicated, and known by student leadership and the student body.

Regent Saifuddin reported the view of many students that one option for UC funding would be an annual designated source of funding to UC, rather than sources left to the discretion of the Legislature, which are a cause of much vulnerability and volatility. A funding source like Proposition 98 funding would be a worthwhile goal to seek in lobbying the Legislature; it would help stabilize the University.

5. **UPDATE ON THE 2020 PROJECT, MERCED CAMPUS**

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

Committee Vice Chair Kieffer began the discussion by reporting that he had recently visited the Merced campus and was impressed with the enthusiasm he found there. He had many conversations with students and campus leadership about undergraduate education, research, and other topics. The development of the campus is remarkable, and it represents a new model of development, different from UC's past methods and approach. The 2020 Project is an innovative approach to developing capital facilities. He acknowledged the important contributions made by Regent Makarechian, who shared his time and expertise and provided invaluable guidance to the campus on this project. Regent Ruiz, who unfortunately was not able to join the meeting that day, wished to inform the Committee that he is in full, enthusiastic support of the Merced campus' efforts to prepare for the future.

Chancellor Leland recalled that the Regents, 20 years earlier, had decided to establish the tenth campus of the University in Merced, in the Central Valley, which was and remains one of the poorest and most underserved regions in the state. That decision was followed by a decade of careful planning and preparation, based on UC's commitment to ensure access for California students who need it the most. UC Merced admitted its first class of 875 students in 2005. As it approaches its second decade of operation, the campus is poised to achieve a distinct identity among UC campuses, in academics, in administrative efficiencies, in services to students, and in delivery of capital projects.

At the beginning, the rationale for establishing UC Merced was clear: first, the anticipated demographic surge of young people seeking public higher education, and the inability of California's mature universities to meet that demand on a large scale; second, the state's growth was entering a new chapter, with projections for population growth in California's inland regions, a population more diverse than ever before; third, the transition to a knowledge economy was by then in full swing. UC Merced's response to this historical situation has been noteworthy. In January, the campus received nearly 20,000 applications for the fall 2015 class, 14 percent more than the previous year, the largest increase in the UC system, and more than twice the system average. Since UC Merced opened, applications to all UC undergraduate campuses from Central Valley high school students have doubled. The campus has grown to more than 6,200 students. Ninety-seven percent of Merced undergraduates are from California, while 62 percent are among the first in their families on the path to a four-year degree. More than half come from low-income families. Fifty-five percent of these students are majoring in science, technology, engineering, and mathematics fields. Chancellor Leland emphasized that Merced students represent the future of the state, as the most diverse campus in the UC system.

UC Merced focuses its research efforts to complement its regional strengths. It serves as both an economic contributor and generator in the Central Valley. The campus has established a path forward for its academic goals, a faculty-driven effort. This framework is based on the reality of time, place, and what the campus can afford. There will always be foundational disciplines, but the campus model is designed to leverage expertise across disciplines in order to focus on a limited number of important areas.

Chancellor Leland observed that space constraints have limited the campus' ability to provide a UC-quality experience for current students. As demands for academic space have grown, most of UC Merced's administrative support has been moved to leased spaces. Even so, space use rates are higher than average, especially for classrooms and lecture halls. Classes must be held late into the evening, office hours are conducted in noisy public spaces, and laboratory space is used as makeshift desk space. The campus infrastructure has been pushed to its limit. Significant additional investment would be necessary to construct even one more building. Campus housing is oversubscribed. The campus is located two miles from city limits, surrounded by pastures. Current on-campus housing is designed for only 1,600 students. Three or four students are squeezed into spaces designed for two or three, but there is still not enough on-campus housing for freshmen and sophomores. This is a particularly undesirable situation for Merced students, since data indicate that retention and graduation rates are higher for students who spend their freshman year on campus.

The 2020 Project addresses UC Merced's current needs and would enable the campus to accommodate 10,000 students. Chancellor Leland explained that the campus could sustain itself financially at this level of enrollment. At the current level, the campus requires support from the UC system. Ten thousand students would also create a critical mass for academic and research programs. Without growth at UC Merced, a pipeline of historically underserved students would be left with no place to go, just at the time when

California demographics are rapidly changing. The 2020 Project ensures that there will be a place in the University for eligible Californians. Given the capital needs of the entire UC system, Chancellor Leland anticipated that the campus could remain at an enrollment of 10,000, if necessary, as a smaller, highly competitive UC campus.

Over the preceding 24 months, the campus worked to determine how to reach these goals in the most rapid and cost-effective manner possible. Through an amendment to the campus' Long Range Development Plan (LRDP) in 2013, UC Merced reduced the amount of infrastructure costs significantly by shrinking its physical footprint for future development by 39 percent. The plan for this smaller site is focused on creating mixed-use, academic, and student-focused spaces on campus. It seeks efficiencies and models for flexible, adaptable spaces that can accommodate interdisciplinary programs. When the 2020 Project is complete, the campus will occupy 219 acres rather than the 355 acres originally envisioned.

UC Merced will provide a different type of public research university. The campus plans to build sustainable, environmentally appropriate facilities, consistent with UC Merced's landmark goal of achieving zero net energy, zero landfill waste, and zero net greenhouse gas emissions by 2020. In order to free up space for students and faculty, administrative space is being moved off campus, to downtown Merced, which would have a positive impact on the community. Importantly, this would allow the campus to avoid spending on unrecoverable capital improvements on temporary leased space. The campus would seek approval for preliminary plans funding for the Downtown Center later that day in the meeting of the Committee on Grounds and Buildings.

Chancellor Leland described the delivery strategy for the 2020 Project, which combines economies of scale with a long-term, life cycle-based financial model. The campus is rapidly approaching its enrollment targets, so that it is imperative to expand facilities. UC has a long history of collaborating with industry to design, build, and sometimes operate its facilities. The 2020 Project would apply a performance-based Design-Build-Finance-Operate-Maintain (DBFOM) structure. The DBFOM model is not new in and of itself, but is new for the UC system. Under the DBFOM structure, the University will own the land and buildings and set standards for operation and maintenance. The main difference from traditional arrangements is that the University will make performance-based payments to a private sector partner over the life of the long-term agreement. The payments will allow the partner to recover its costs related to the facilities. Funds will come from the same sources UC has long used to develop capital projects, such as State General Funds and auxiliary revenue. The Project agreement would also provide protections for the University, ensuring that UC can step in if the partner does not abide by its obligations. The Project envisions a very aggressive construction schedule, building multiple buildings simultaneously. This would result in substantial completion by 2020 of approximately one million assignable square feet of new space for teaching, research, and housing. The campus plans to abide by all its union contracts. This approach would protect every current represented position on the campus.

The campus chose this delivery strategy because it would allow UC Merced to create new spaces rapidly and cost-effectively, to develop adaptable facilities, to unlock private sector innovation, to provide budgetary certainty, to transfer many risks usually borne by the University to the private partner, and to focus on its core missions of teaching, research, and public service.

Executive Vice President and Chief Financial Officer Brostrom explained that procurement for the 2020 Project was proceeding in two stages. First, there was a Request for Qualifications phase, which identified a short list of qualified respondents to participate in the second phase, the Request for Proposals phase. The University would receive proposals from the short list candidates and select a recommended Project partner. The first phase was completed. UC received six statements of qualifications from development consortia. These statements were reviewed by three separate evaluation teams and expert panels, using both qualitative and pass-fail criteria. Mr. Brostrom and Chancellor Leland selected three candidates who would compete over the next 12 months for the right to design and deliver the Project. All the candidates have a history of working with and on UC campuses. Each candidate would develop a proposal for the campus based on detailed performance and programmatic criteria. The criteria are informed by feedback received from students, faculty, and staff. In April, the University would begin what is known as an “industry review period” by releasing a draft Request for Proposals to the three shortlisted candidates, for their review over about six months. The University would have one-on-one meetings and early design discussions with the candidates. This review period might also include consideration of alternative technical concepts and alternative financing mechanisms proposed by the candidates. Under this process, the candidate would ask UC to determine whether an alternative concept would be acceptable. Prior to the release of the final Request for Proposals, the campus would present a progress update to the Regents. The campus would return to seek Regents’ approval of the preferred candidate in 2016. It was anticipated that the 2016 item would include budget, external financing, and design approval for the Project. The University believes that this approach would result in faster and more cost-effective campus growth than with a traditional delivery method.

Chancellor Leland emphasized that this Project was being undertaken for the benefit of students, especially students from underserved, underrepresented, and low-income populations in California. UC Merced would become a model of what research universities would be by the end of the century.

Regent Lozano praised the innovative nature of the proposal. She asked about the key risks of the Project and how they would be mitigated. Mr. Brostrom responded that the Project would entail a much longer relationship with a private sector partner than on other University projects; for certain buildings this might be a term of 25 to 35 years. The University is seeking a private sector partner that will remain strong over two decades. UC wants to ensure that it has definite step-in rights if the partner is not meeting its obligations and wants to ensure that the private sector partner has a sufficient financial incentive to maintain performance over that time. There would be a trade-off between initial payments to keep the cost of capital low and incentives the partner receives during the term of the agreement.

Regent Lozano asked that, as the Project moves forward, the University outline these risks very clearly to the Regents and how it plans to mitigate risk over the long period of the agreement. Chancellor Leland responded that the campus planned to return to the Board in September. At that point the Request for Proposals would almost be ready for release; it would include much of what would be in the contract. The Regents would be able to see in detail how protections would be built into the contract.

Governor Brown asked about the magnitude of the Project, or the range of cost. Mr. Brostrom responded that the University has a preliminary range. This might be discussed later that day in the closed session meeting of the Committee. There is an offset limit. If none of the bids are within this limit, the University will not accept any of them.

Governor Brown asked if the bid process was broken into phases. Mr. Brostrom responded in the affirmative. He stated that the critical phase was creating enough academic and residential space to accommodate 10,000 students. By carrying out construction all at once, the campus believes it can accomplish this task more quickly and cost-effectively.

Governor Brown noted that residential space would provide revenue from rent, while he supposed that other spaces would merely generate costs. Mr. Brostrom concurred, but pointed out that research space would generate indirect cost recovery.

Governor Brown asked about the borrowing costs or percentage to be paid by the University over the term of the agreement. He recalled that former Governor Schwarzenegger had proposed to sell State-owned buildings to raise revenue, and to lease them back. Governor Brown had cancelled this sale because the payments over 20 years would have been equivalent to 11 percent interest. He acknowledged that the design-build process was faster, but stressed that the State has a lower cost of borrowing. He requested further information on the borrowing cost over the term of the agreement. Chancellor Leland responded that this could be discussed in closed session. The campus knows the cost of a traditional approach for the Project. She anticipated that bids would come in lower than the offset limit. Mr. Brostrom explained that there would be two basic types of payments in this model: milestone payments, made to the private consortia upon delivery of a building or completion of specific steps, and performance payments, equivalent to operating leases. The greater the milestone payments, the lower the cost of capital and the lower the debt service payments. On the other hand, the University wishes to ensure that the private sector partner has a sufficient incentive to continue participating with its debt or equity. He estimated the percentage to be paid by UC to be in the range of five percent to 5.5 percent, even on a blended basis. This would be presented with the financing proposals for the Project. The University is examining every way it can lower costs.

Governor Brown asked if there was a provision in case the private sector partner went bankrupt. Mr. Brostrom responded that this was a major risk to be considered. The University must have appropriate step-in rights to remedy such a situation immediately. Even before such a situation arises, if the partner is not meeting performance standards, the payments to the partner would be reduced. The contract would be detailed and would have to be carefully monitored.

Regent Makarechian stated that he was not opposed to the Project, but underscored some of the risks involved. He urged the Board to pay special attention to this item and to proceed with caution. It is easy to draft concepts on paper, but the concept for this Project, with its exceptional magnitude, had not yet been proved or attempted. The University would be acting on faith that its contractor would build an entire campus, with all its buildings and infrastructure. Developers are in business not to serve the public, but to make profits. Development of a specific building with a specific use was straightforward, but it was not straightforward to design a project for 30 years into the future, when one could not know what the University's needs might be in 30 years. Regent Makarechian asked what the University's rights would be in this arrangement, how risks would be mitigated, and how UC could exit the agreement. On the last point, although there might be a step-in provision written in the agreement, in fact, removing a contractor might involve millions of dollars in litigation costs. He cited the UCPath project as an example of a project that has gone over time and over budget. He recalled that UC took on $1 billion in debt the previous year and was downgraded by Moody's and Fitch. The Merced Project would be an enormous obligation on UC's balance sheet. The Regents should not simply assume that this concept would work out. Regent Makarechian also asked why this item was being discussed by the Committee on Finance rather than the Committee on Grounds and Buildings. Chancellor Leland responded that the choice of Committee on Finance for the discussion was not the decision of the campus. She stated that the presentation at the September meeting would provide much more detail. General Counsel Robinson responded that he reviews Committee assignments; this discussion could have been assigned to either the Committee on Finance or the Committee on Grounds and Buildings. Action by either Committee would then be a recommendation to the full Board. Mr. Brostrom responded regarding the rating agencies. He acknowledged that no matter how UC structures the financing of the Project, the University must step in if there is any situation where a contractor fails to perform. It was evident that the Project would count against UC's debt capacity.

Regent Makarechian expressed concern that the University would in effect be spending money it does not have. At this time it could not rely on the State for more funding; the only other source would be raising tuition, and this was not desirable. Increasing the University's debt would affect UC's credit rating, with effects on the entire system, not just the Merced campus.

President Napolitano stressed that innovation would be an element of everything undertaken by the Merced campus. The University must be very attentive to every step in the Merced Project. Responding to Regent Makarechian's earlier remarks about the

UCPath project, she requested that there be a report to the Board on UCPath in May or July.

Regent Ortiz Oakley praised the Merced campus for representing the true demographics of California. He asked how the campus would maintain diversity and how it would maintain an environment like that of a private liberal arts college at a public university. Chancellor Leland responded that the diversity and vibrancy of UC Merced were an essential part of its distinctive character. It would provide a pipeline of talented graduates from underrepresented groups to industry and academia. The smaller, more intimate environment is important to students, and challenging to maintain in a larger university. The University would ask the private sector partner to design spaces that reinforce the sense of community. The built environment of UC Merced would support community and collaboration.

Regent Pérez asked about the assignment of this discussion to the Committee on Finance rather than to the Committee on Grounds and Buildings, and why certain matters would be discussed in closed session. He asked how the proposed model would save more costs for the University and generate more revenue for the private sector partner. He echoed Governor Brown's concerns about the costs to the University over the term of the agreement. He asked how the increased debt taken on through the Project would affect UC's credit. Chancellor Leland responded that any other model, other than a direct State appropriation, would also affect the University's debt. There was nothing special about the proposed model that would have more or less impact on the debt. Mr. Robinson stated that he makes recommendations on whether items are to be discussed in closed session. In this case, he stated his view that it would be appropriate to discuss the details of financing for the Project in closed session. Mr. Brostrom added that building out the Merced campus would have to affect UC's debt capacity, unless there were funding through a general obligation bond. One of the benefits of the proposed design is its integration, with mixed-use facilities. When the Irvine and Santa Cruz campuses were built, State monies were used to build a State building, distinct from non-State functions. Buildings at UC Merced would all have multiple functions. The University is considering a variety of funding sources, including State appropriations. He estimated that 33 percent of the University's capital funding from the AB 94 funding mechanism would be directed to UC Merced for the next several years, at the expense of other campuses' building projects.

Regent Pérez asked about the assignment of agenda items to Committees. Mr. Robinson responded that he reviews these items. Regent Kieffer requested clarification of how often this matter had been discussed earlier. Chancellor Leland responded that the initial amendment of the campus' LRDP was brought to the Committee on Grounds and Buildings a year earlier. Mr. Robinson stated that he was asked in this case about the Committee assignment; his response was that the discussion could take place in either the Committee on Finance or the Committee on Grounds and Buildings. Chancellor Leland reiterated that more detail would be provided in September, including a business case analysis of how the campus believes it can achieve significant cost savings with this delivery method. She stressed that UC Merced had saved millions of dollars in infrastructure costs by shrinking the footprint of the campus. There are always costs involved in setting up construction. By building multiple structures with one developer simultaneously, these costs would be reduced. UC Merced is using a life cycle model which takes into account not just the cost of design and construction, but the life cycle of the building. The private sector partner would have an incentive to design buildings that run efficiently and do not wear out.

Regent Zettel referred to recent concerns about the use of capital appreciation bonds by some public school districts; the districts could not buy out the bonds. She recalled the statement made earlier that UC could reduce the performance-based payments. She asked if the University could buy out the contractor, prior to the end of the agreement, if it wished to do so. Mr. Brostrom responded that this option would be considered as part of the contract.

Regent Zettel asked if there is a demand in downtown Merced for retail space. Chancellor Leland responded that Merced had often been listed among the top ten U.S. cities affected by the recession. Many small businesses in Merced closed during the recession. A more significant presence of UC Merced in the downtown area would help small retail businesses. Moving administrative space downtown allows the campus to focus the core of the campus on students and faculty in a more cost-effective way, obviating the need for an expensive infrastructure expansion. Downtown Merced has a vibrant arts community and performing arts spaces, which the campus does not have. The campus can partner with these community arts organizations to help them thrive and to deliver arts programs for students. At the cost of one dollar, the City of Merced has leased space to UC Merced for an innovation laboratory, for faculty and students as well as entrepreneurs in the community. If there were to be a UC Merced retail component, it would be to serve students, such as an outlet of the campus bookstore.

Regent Zettel asked how much use students would make of the administrative center downtown. Chancellor Leland responded that the campus had carried out a search and considered a number of locations for the campus administrative space. The campus would locate back office functions and community outreach functions in the Downtown Center. The Center would also include a multifunctional space that could serve as a classroom, event space, and place where students can connect to library resources.

Regent Sherman noted that the campus had reduced its planned development by about 500,000 square feet. He asked what had been left out, and if this reduction was sufficient. He estimated that there would be about 100 square feet per student, and asked how this compared to the most efficient college campuses. Chancellor Leland responded that UC Merced would continue to have fewer square feet per student than any other UC campus. A planned basketball arena was removed. Space planning would be efficient, with multi-use shared laboratories and collaborative spaces. The campus is discussing possible development of athletic fields jointly with the County, on County land, outside the scope of the Project. Mr. Brostrom added that the University expects the Request for Proposals process to lead to constructive results, with the Project candidates suggesting ways to reduce square footage even further.

Regent Island expressed his strong support for the mission of UC Merced and the achievement of an enrollment of 10,000 students. He asked what the costs of a more traditional approach to designing the campus would be, and how those costs compared to the risks of the Project as proposed. He requested that the Regents receive specific figures in order to be able to evaluate the risks and to determine the University's tolerance for risk. Chancellor Leland responded that more detail would be provided in September. She provided a cost estimate of $1.1 billion for building the campus in a traditional manner. The campus and the Office of the President were still working on the finance plan. The risks would be magnified by the scale of the Project. Chancellor Leland stated her belief that there would be adequate protections for the University.

Regent Pattiz asked about the assignment of this discussion to the Committee on Finance. Committee Vice Chair Kieffer responded that this concern would be addressed as the Project moves forward.

Regent Gould expressed appreciation for the campus' decision to scale back the Project in recognition of financial and operational realities. He anticipated that feasibility of the Project would be demonstrated when the University receives bids. The development of UC Merced is a remarkable story about service to the current and future generations of California students. The campus provides great benefits to its community and to California.

The meeting adjourned at 12:05 p.m.

Attest:

Secretary and Chief of Staff