

The Regents of the University of California

**COMMITTEE ON GROUNDS AND BUILDINGS
COMMITTEE ON FINANCE**

July 21, 2015

A meeting of the Committees on Grounds and Buildings and Finance was held on the above date at UCSF–Mission Bay Conference Center, San Francisco.

Members Present: Representing the Committee on Grounds and Buildings: Regents Davis, Elliott, Makarechian, Oved, Pérez, Ruiz, and Zettel; Ex officio members Lozano and Napolitano; Advisory member Hare; Staff Advisors Acker and Richmond

Representing the Committee on Finance: Regents Davis, Kieffer, Makarechian, Ortiz Oakley, and Ruiz; Ex officio members Lozano and Napolitano; Advisory member Hare; Staff Advisors Acker and Richmond

In attendance: Regent Gorman, Regent-designate Brody, Faculty Representative Gilly, Secretary and Chief of Staff Shaw, General Counsel Robinson, Chief Compliance and Audit Officer Vacca, Executive Vice President and Chief Financial Officer Brostrom, Chancellors Hawgood and Leland, and Recording Secretary McCarthy

The meeting convened at 2:30 p.m. with Committee on Grounds and Buildings Chair Makarechian presiding.

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 on Grounds and Buildings Chair Makarechian commended the UC Merced campus for proposing the UC Merced 2020 Project design-build-finance-operate-maintain delivery method that would be new for a UC project. He recalled that Chancellor Leland had been charged with expanding the UC Merced campus during a time when State funding had been severely curtailed. It would be the task of the Regents to assess the advantages and risks of the proposed delivery model. Financing a large portion of the campus' development at one time would have the advantage of current low interest rates, but would carry the risk of default. Contracting the project to a single developer would have advantages of cost and time savings, but with the risk of possibly having to resolve disputes with the developer while work would continue with that same developer. Committee Chair Makarechian acknowledged that the rewards of the proposed delivery model could be substantial, but the Regents would have to determine if the potential advantages outweigh the risks.

Chancellor Leland recalled that she had updated the Regents on the UC Merced 2020 Project in March. She would respond to questions that had been raised at that meeting and would engage in a discussion about the best way to move forward with the Merced 2020 Project. The 2020 Project would increase the capacity of the UC Merced campus to 10,000 students, which would enable the campus to be financially self-sufficient. If this growth were accomplished successfully, UC Merced would continue its emergence as a competitive UC campus through its focus on six thematic areas of research and education. Chancellor Leland emphasized that the 2020 Project was still in the planning stage and the campus would benefit from the Regents' insight and advice.

Chancellor Leland recalled the background of the Project. UC Merced was established by the Regents in 1995 and the campus opened in 2005 to expand access to the University, particularly to increase University attendance by students in the San Joaquin Valley, which remained one of the two poorest regions in California, and to stimulate economic growth and development in that region. The commitment to establish UC Merced acknowledged that UC could not serve the people of California while leaving its fastest growing and most underserved region behind. Despite severe budgetary challenges during its formative years, UC Merced had made progress in achieving its goals, growing to 6,200 students, well beyond the campus' capacity. Since its founding, applications from San Joaquin Valley high school students to UC have doubled and UC Merced has been responsible for investment of \$1.3 billion into the regional economy. UC Merced is beginning to build a reputation for academic and research excellence that would bring distinction to the UC system as the campus grows. UC Merced recently held its tenth commencement and had graduated 4,000 students since its founding, graduates who were predominantly first-generation, low-income, and minority college students who represent the demographic future of California. Chancellor Leland expressed her passionate commitment to the 2020 Project to increase the capacity of the campus as rapidly and cost-effectively as possible without taking unreasonable business risks, so that UC Merced could continue to provide access to the University for exactly these students. Since it was not yet financially self-sufficient, UC Merced must receive additional monies through the Office of the President to support its student enrollment. The Merced campus has grown in an era in which State and federal support for higher education and capital facilities that existed in previous decades does not exist, with no indication that it would exist in the future. UC Merced was born in a time when it could not build, maintain facilities, or support student-faculty ratios in the same way other UC campuses had. It must develop much more cost-effective ways of operating. UC Merced began planning for the 2020 Project in 2012. Cost-effectiveness included building only those facilities that the campus could afford to maintain. The proposed delivery model was attractive because it would allow the campus to predict costs, including maintenance, over the life of the contract and the buildings' life cycles.

President Napolitano recalled that UC Merced was the first UC campus she visited as President, where she witnessed the campus' enrollment pressures, evidenced, for example, by a biology class scheduled at 10:00 p.m. because of a shortage of laboratory space. She expressed her view that, in order for UC Merced to fulfill its promise of teaching, research, and public service, the University must provide the needed campus facilities. President Napolitano described the role of the Regents as evaluating the risks involved in the Project and taking the necessary steps to mitigate those risks. The discussion of this Project would continue over the upcoming several

years, as it moves ahead. This discussion would engage the Regents in consideration of the campus' preferred approach for the 2020 Project that would use a competitive Request for Proposal (RFP) process to develop facilities that would accommodate 10,000 students by the year 2020, and would focus on limiting life-cycle costs. She advised the Regents to bear in mind two objectives while considering the proposed delivery model. First, the proposed process should enable the Regents to conduct thorough due diligence, including of the financial arrangements with private sector partners and exit options that would be incorporated into the contract to protect the University should the Project not proceed as planned. Second, the Regents must satisfy themselves that the RFP and resulting contract would keep the risks as low as possible. The fundamental question before the Regents was whether the proposed delivery strategy would add value and enable UC Merced to reach a capacity to serve 10,000 students by 2020. President Napolitano expressed her view that the 2020 Project could be an important model for future higher education capital projects. A team at the Office of the President, including Executive Vice President and Chief Financial Officer Brostrom and Associate Vice Presidents Sandra Kim and Deborah Wylie, would review the proposed Project and consult with a team of outside experts with expertise in financial, technical, and legal aspects of the proposed approach.

Vice Chancellor Dan Feitelberg recalled that in 2012 Chancellor Leland directed him and his team to work with the Office of the President to investigate delivery options to achieve UC Merced's goals that the Chancellor had discussed. The long-term financial sustainability of UC Merced's development plans were addressed relating to three aspects: financing of upfront design and construction costs, ongoing costs of operations and maintenance, and the overall risk to the campus. The team's analysis focused on eight factors: delivery of the needed facilities by 2020, reduction of design and construction costs, innovation in design and construction, achievement of good performance of buildings throughout their life cycles including operation and maintenance of major building systems, advancement of the University's sustainability agenda, managing the financial and performance risk of the facilities, total cost of ownership including design, construction, financing, operations, and maintenance, and term of the contractual relationships.

Three primary delivery options were analyzed. In the design-bid-build delivery option, the campus would hold all responsibility including financial and performance risks. The campus would procure design services for master planning and subsequently for design and planning of infrastructure. Following construction of the infrastructure, the campus would then procure design services and construction services separately for the first delivery facilities, meaning the minimum buildings and infrastructure the campus would need to maintain its enrollment trajectory for the fall of 2018. Finally, the campus would separately procure design and then construction services for the second delivery facilities, or the additional buildings and infrastructure necessary to accommodate 10,000 students. With this process, the campus estimated substantial completion of the Project by 2024, four years later than the 2020 target date. In addition, the campus would pay for the construction as it would occur. Other than limited warranties, the contractors engaged would have no retained liability for the quality of their work. The total annual cost of ownership, including amortization of design and construction costs over the life of the bond financing, interest associated with revenue bonds issued by the University, and estimated maintenance and operations costs, would be approximately \$119 million. While the University would receive two-year construction warranties and ten-year

warranties for latent defects, it would otherwise take full responsibility, including financial responsibility for design issues that arise during construction, the need to contract with the private sector for future capital renewal projects, and contracting for potential emergency repairs of building systems. Under this model, the separation of the design and construction of the infrastructure from the design and construction of buildings would not yield scale efficiencies that could reduce costs. The model would not mitigate long-term financial risks after construction, and, most importantly, would not achieve timely delivery of needed facilities.

The campus also considered the design-build delivery model, under which the campus would still bear the financial and performance risks of development. However, this model would allow the campus to procure design and construction of the infrastructure and buildings together, eliminating interface risk and achieving time savings. Within the design-build model, the campus tested two approaches. The first approach would use a single design-build procurement for the entire Project. The first and second delivery facilities would be developed in defined sequences, and the contract would be subject to termination if the first delivery facilities were not completed as agreed upon. In addition, the University would maintain an option to terminate or opt out at any time. Through a single procurement, substantial completion could be achieved by 2020. As a result of design and construction efficiencies gained, the annual cash flow requirement under a single procurement was estimated at \$105 million. The second design-build approach would split the project into two separate procurements. The project site would be divided and the development sequentially phased. At a later time, the campus would begin procurement of the second delivery facilities that it already knows it needs. With the assumption that the second phase would begin upon substantial completion of the first phase, delivery would be anticipated in 2022, two years later than the target date. This delay would increase design and construction costs because of lost efficiencies in design, construction, and project management. Even assuming same interest rate, interest costs would also increase because of higher design and construction costs. The annual cash flow requirement for the two-phased design-build procurement was estimated to be \$113 million. Under either of these design-build variations, the total cost of ownership would be calculated in the same manner as design-bid-build, with similar risk profiles. Construction would be paid for as it occurs and the contractors would have no retained liability beyond limited warranties. Upon completion of construction, the University would have paid the developers in full for the buildings, their contractual relationship would be over, and the University would have to file a claim against the limited warranties in the event of construction defects. As with the design-bid-build model, the University would continue to bear full financial risk should problems arise after construction. The University would need to contract with the private sector for capital maintenance and renewal projects. Since preventative maintenance and facilities' renewal programs would not be included in the initial contract, the campus would miss an opportunity to drive down those costs over the life cycle of the buildings.

The third option, a design-build-finance-operate-maintain (DBFOM) delivery model, would include the advantages of the design-build model and add a capital maintenance and renewal program into the contract, thus reducing the combined costs of design-construction and operations and maintenance. Under this option, the University would make two types of payments, known as milestone payments and availability payments. Milestone payments would be made when specific construction milestones were met. After construction, the University would make predetermined availability payments, subject to the availability and performance of

the facilities as specified in the project agreement, which would hold the developer accountable for the buildings' effective long-term performance. If the buildings fail to meet the contractually required performance standards, the availability payments would be reduced. Availability payments would include repayment of the design and construction costs, and long-term capital maintenance and renewal costs. The amount of the availability payments would be determined through a competitive process. The campus believes that by bundling design and construction together with long-term operation and maintenance, both upfront and ongoing costs could be reduced.

Mr. Feitelberg acknowledged that the DBFOM delivery model differs from delivery models the University had used previously. Under the DBFOM model, the University would not transfer property rights or assign revenue streams to the contractor; the University would receive all revenue associated with implementation of its programs. In order to hold the contractor responsible for the performance of the buildings over their life cycles, the contractual requirements would be in place for a period of 39 years. The cost of capital for the developers retained design and construction costs would be higher than the University's cost of capital through the issuance of University revenue bonds. To make this delivery model worthwhile, the private sector would need to generate design, construction, operations, and maintenance savings of at least five percent to reduce the overall life cycle costs. The campus anticipates that the contractor would be able to achieve even greater savings. The campus designed its procurement process to establish an upset limit, or maximum amount for the contract, to protect the University and ensure it captures value in the procurement process. The DBFOM delivery model would allow the University to hold the developer accountable over the long term, by risk-sharing. Because of this risk incentive, the bundling of capital maintenance and renewal with the initial design and construction offers the opportunity to ensure quality and low-cost preventative maintenance programs, protection not available in design-bid-build and design-build models.

The DBFOM delivery model would incorporate advantages of the design-build model, such as achieving sustainability goals, reducing design and construction costs through economies of scale, and, most importantly, delivering the needed facilities by 2020. The campus' analysis indicated that the University could develop the 2020 Project through a single procurement with two distinct delivery sequences. Following a competitive procurement process, the project agreement would be executed with the developer and, similar to a design-build project, the developer would be contractually obligated to deliver the first set of facilities needed to maintain UC Merced's enrollment trajectory by 2018. The developer would then be charged with completing the second delivery facilities by 2020. After construction, both the developer and debt investors would remain liable for the availability and performance of major building systems for 35 years. Should the buildings not perform well, availability payments would be reduced, resulting in a financial loss for the developer. The University would retain the right to terminate the contract at any time. This model is not a lease; the University would own the land and the buildings, and the lenders would not have a right to the property in the event of a default. Throughout the term of the contract, the campus would monitor performance. UC Merced was working with the Office of the President and the Office of the General Counsel to establish necessary contract administration processes.

The University would maintain two important exit options. First, during the construction period and throughout the term of the agreement, nonperformance could lead to default and financial loss for the lenders. As a result, lenders would monitor performance of the contract along with the University and require the developer to cure subpar performance to protect their investment. In the case of nonperformance leading to a default, the University would step in, lenders would not be fully repaid, and the University would keep the construction and improvements. Second, the University would maintain the right to end the agreement for any reason even if the developer was performing well. If the University chose to opt out, it would need to refinance the debt and equity issued by the developer, including its investment return and breakage costs, likely requiring the University to issue financing at that time. Exercising this option would in effect change the Project from a single-phase project to a two-phase project, increasing the annual cash flow requirement from approximately \$105 million to \$113 million.

Mr. Feitelberg explained that the campus also evaluated a delivery model with an option for a predevelopment agreement for the second development facilities. By separating the work into two contractually distinct phases, the Regents could ensure that the developer was performing well before making the decision to begin phase two. The campus analysis suggested that the two-phase approach would be similar to a two-phase design-build model and would be accomplished at the expense of speed and overall cost. The University would essentially be purchasing the optional termination provision before it was needed.

Mr. Brostrom observed that the DBFOM approach is an extension of the design-build model the University has used, but with additional benefits. His office investigated best practices in structuring a DBFOM contract, phasing the facilities, and managing the projects during and after construction. The campus hired a group of expert legal, financial, and technical advisers to develop a structure tailored to the Project's unique needs. Nossaman LLP, a leading legal advisor to the public sector on this type of procurement, was drafting the project agreement based on similar transactions the firm completed in California, Florida, and overseas. The team also includes the financial advisory firm Ernst and Young, and technical and real estate advisors AECOM, Solomon Cordwell Buenz Architecture, and Jones, Lang, LaSalle. The Office of the President and the campus have examined other complex large-scale social infrastructure transactions in the U.S., Canada, and Europe and have incorporated lessons learned from other University projects. For example, a higher percentage of University bonds would be used to make milestone payments in order to keep the cost of capital lower. The University would structure the agreement to retain responsibility for custodial, groundskeeping, food service, and other day-to-day functions at the campus so the operations and maintenance portion of the contract would be smaller than in most DBFOM contracts.

Regent Ortiz Oakley commented that a developer's business models for construction and maintenance would be quite different. He asked how the campus would review the developer's maintenance revenue model to ensure that the campus would receive good value. Mr. Feitelberg responded that each developer's proposal during the procurement process must provide the qualifications of all major contractors. Mr. Brostrom added that financial conditions would be built into the contract so that the developer would have both equity and debt outstanding. A large handback reserve that would be paid to the developer for handing the facilities over to the campus in good condition would be retained until the end of the contract's term.

Regent Ortiz Oakley anticipated the critical time of delivery of a building, when the judgment of the developer about the readiness of the facility could differ from that of the campus, which could result in a potential dispute or litigation. He asked how the campus had accounted for that risk. Mr. Feitelberg responded that the agreement would contain a process for resolving disputes. The campus would receive notice when beneficial occupancy is established and inspection regimes that must be satisfied before substantial completion would be determined would be built into the contract. Regent Ortiz Oakley asked if disputes would be resolved by binding arbitration. Chief Campus Counsel Elisabeth Gunther responded that the contract contained provisions for a dispute resolution board to resolve disputes as construction goes forward and into the operating period. The presumption of the board would be that work must continue while the dispute was being resolved. If the board could not resolve a dispute, then the normal litigation process could be used. She emphasized the importance of the University's contract with the developer, who would have significant financial incentives to resolve disputes with the design-builder or the operations contractor.

Regent Ortiz Oakley asked if the contract would include any local hire preferences. Chancellor Leland responded that scoring criteria used to evaluate the RFP would include the important component of contribution to the community, including local hiring provisions and workforce development such as apprenticeship programs. The campus anticipates that developers' RFPs would include meaningful local programs.

Regent Ortiz Oakley expressed appreciation for UC Merced's need to devise this creative delivery method, noting that since 99.5 percent of UC Merced's students are Californians, development of the Merced campus presents a unique opportunity for the University to expand enrollment of Californians at a critical time. The University should be making it easier for UC Merced to expand, perhaps by shifting funding from the older, more established campuses that received investment from the State during their formative years. Mr. Brostrom commented that the University was contributing a great deal to the development of UC Merced, but that State support had been lacking. The State has not been issuing lease revenue bonds for UC. If the University received funding from general obligation bonds, it would contribute a significant amount to this Project. In lieu of these, through the AB 94 mechanism the University can contribute a certain percentage of its State appropriations to construction each year, roughly \$15 million. Half of that money over the next five years, a total of \$40 million, would go to UC Merced. Supporting enrollment growth at UC Merced is one of the University's highest priorities. Chancellor Leland acknowledged the support of all UC chancellors for increasing enrollment capacity of UC Merced, even though it required a disproportionate share of funds available to the University for capital projects.

Committee Chair Makarechian emphasized that the 2020 Project was in the early discussion phase. He noted that the source of financing for the Project had been shifted from the developer to the University. He suggested the Project's risk could be spread by dividing the contract into three or four phases with different contractors. Having more contractors and financiers involved could be valuable should a dispute with the developer lead to litigation. Chancellor Leland emphasized that the campus had the right to terminate the contract at any time, although the University would have to pay if the termination were not for cause. The University would not have to pay for the option to terminate if it did not become necessary. Ms. Gunther commented

that under the proposed delivery method, typical construction disputes with contractors or subcontractors would be below the level of the University's contract with the developer. The developer would take the lead in resolving disputes during the course of construction. Lenders would also have step-in rights. Committee Chair Makarechian pointed out that a typical construction dispute would involve only one building, but a dispute under the proposed delivery method for the 2020 Project would involve a single contract with one developer for a large portion of the Merced campus' buildings and infrastructure. In a dispute, the University could have to litigate against the developer, its contractors, and financiers, who would be powerful organizations. He asked how such a dispute would be resolved. Ms. Gunther responded that the contract would contain a dispute resolution process and would specify that construction must continue during the dispute resolution. It would be simpler to resolve a dispute with one developer than with four developers in a phased project. Committee Chair Makarechian said if the Project were divided, a dispute with one developer would stop only that developer's work, not the whole Project. Ms. Gunther expressed her view that the Project's interface risk would be increased by using multiple developers. Under the proposed delivery method, the single developer would be under pressure from its lenders to resolve disputes so they would be paid. Mr. Brostrom said the proposed delivery method was different from a typical design-build project in that the developer would have equity and lenders whose interests would be aligned with the University's, since they would not be paid until the University made availability payments.

Committee Chair Makarechian asked for a clarification of the Project's financing and who the borrowers would be. Mr. Brostrom responded that this would not be known for certain until the developers submitted their proposals that would include their cost of capital. If their proposed financing were at low enough rates, using the developer's financing might be preferable to using the University's financing. He cited a possible scenario in which the University agreed to finance 60 percent of the milestone payments from its own debt and would issue University debt through either general revenue bonds or limited project bonds for the dormitories and other facilities. The remaining 40 percent would be financed by the developer with equity or debt, or a combination of both.

Committee Chair Makarechian observed that the materials presented to the Regents indicated that the University would be obligated to make date-specific progress payments during construction. He asked if the University's financing would be subordinate to the developer's financing, which party would bear ultimate financial responsibility, and which party would lose money first. Mr. Feitelberg responded that the dates of the milestone payments were estimates based on the campus' current assumptions of the construction schedule. The University's obligation to make milestone payments would be contingent upon the developer's achievement of specific construction milestones. The campus anticipates that in roughly 2017 it would make a milestone payment of \$50 million from century bond proceeds allocated to UC Merced upon confirmation that the developer had completed at least \$100 million worth of construction. The campus estimates that first delivery facilities would be completed by fall of 2018. Only upon substantial completion of those facilities would the developer receive the next milestone payment, which would trigger the issuance of additional bonds by the University. The final milestone payment would be anticipated in 2020. Mr. Feitelberg agreed with Committee Chair Makarechian that milestone payments would be made before completion of all facilities, but

noted that they would be linked to completion of specific construction milestones. Committee Chair Makarechian outlined a scenario in which \$100 million worth of construction had been done, construction was not completed, and the University paid \$50 million, and asked who would be at risk should the developer default after that point. Mr. Feitelberg responded that in that case the University would be obligated to pay the debt service, and in the event of the developer's default would receive the construction and improvements completed to date. Committee Chair Makarechian summarized that in such a scenario the University would be at risk for the debt service and project completion costs. Mr. Brostrom added that the University would have step-in rights and the \$50 million in retained liability. At any point, the University would have paid less than the value of the construction that had been completed.

Mr. Feitelberg compared the University's liability in that circumstance under the proposed delivery method with its liability under a design-build delivery method. Under the design-build method, at that point the University would have paid \$100 million for \$100 million of construction and the University would be liable for completion of the construction. Under the proposed DBFOM delivery method, at that point the University would have paid only \$50 million for \$100 million of construction. Mr. Feitelberg added that, should the developer default, the University would also be obligated to pay 80 percent of the debt investment made by the developer. In the scenario described, the University would have to make a debt payment of approximately \$25 million. In sum, the University would assume a liability of \$75 million for \$100 million worth of construction. Mr. Brostrom added that the developer's equity would be gone and a portion of its debt would be repaid; the University would be responsible for its debt and a portion of the developer's outstanding debt.

Committee Chair Makarechian advised that in every instance of design-build delivery projects, the University had a 100-percent payment performance bond. In the proposed DBFOM delivery method, the University could potentially have a \$1.1 billion project, and only a \$275 million payment performance bond. He asked how that would be sufficient. Mr. Feitelberg responded that a \$275 million payment performance bond would be justifiable because that amount exceeded the campus' maximum probable loss based on the construction in progress at all points over the four-year Project. There would never be \$1 billion worth of construction ongoing at any one time and the performance bond would cover only the difference between the milestone payments and the construction at risk. The maximum probable loss was well below \$275 million. Committee Chair Makarechian expressed his view that the payment performance bond should cover the whole amount of the Project. Ms. Gunther cited the example of Mission Bay Hospital, which had bonds for its four-year construction period broken up into the amount at risk at that time period; the bonds totaled the full amount of the project. In the scenario discussed for the Merced 2020 Project, the campus had determined that a \$275 million payment performance bond would represent more than the value of the work that had been performed or what the developer might owe to the subcontractors; the University would have possession of the work that had been completed and then would have to step in and finish the project. Committee Chair Makarechian asked why the campus would assume that a 25-percent payment performance bond would cover the construction on the ground for a \$1.1 billion project. Ms. Gunther replied that amount would cover what was owed on a long-term construction contract for the portion of work in progress. Committee Chair Makarechian stated that if that concept were true, it would also hold true for any design-build contract, but in fact it did not.

Regent Kieffer commented that the major value gained through the proposed delivery method would be the time needed to complete construction and the related savings resulting from the reduced time. He expressed support for structuring incentives for the developer to resolve potential construction problems. Chancellor Leland confirmed that the main reason she and Mr. Brostrom, the executive team for the Project, preferred the DBFOM delivery model was because of the time to delivery and the opportunity to maintain the buildings over their life cycle in a way the campus could afford. Time to delivery is critical for UC Merced, which already has a space shortage, causing it to slow down its planned enrollment growth. The upset limit in the RFP would be less than what it would cost the campus to build and maintain the buildings through a traditional delivery model.

Regent Kieffer asked what criteria would be used to select a developer aside from cost. Mr. Feitelberg said the financial and technical criteria would be significant. In a technical evaluation, potential developers would be assigned points across different categories, including the technical components of academic and student life facilities, the quality of the living/learning environment, integration of the community and workforce, ability to deliver on schedule, operations and maintenance, and sustainability. The campus would not engage a developer who scored well in all technical categories but submitted a much higher bid than other qualified developers. Regent Kieffer inquired how proposed project designs would be evaluated. Mr. Feitelberg responded that the designs would be evaluated for the quality of academic facilities, student life facilities, and the blend of the two. Regent Kieffer asked if the draft RFP would be shared with and commented on by potential developers. Mr. Feitelberg responded that there would be an industry review period during which a draft of the instructions to proposers and the project agreement would be formally reviewed so the campus could receive and evaluate comments to determine if changes should be made.

Regent Kieffer expressed his view that the proposed delivery model would be less risky than a more traditional model, adding that the campus had addressed potential risks and would gain value in saved time and cost. Mr. Feitelberg asserted that the primary benefit of the DBFOM delivery model over the design-build model was the ability to hold the developer accountable over the life cycles of the buildings.

Regent Ortiz Oakley observed that an additional risk is that the universe of potential proposers would be narrowed, given the size of the Project. There would be a limited number of developers capable of completing a project of that size. He asked how the campus would obtain the expertise necessary to evaluate the proposals. Chancellor Leland responded that, during the Request for Quotation process used to select the developers that would participate in the RFP process, the campus used both its internal evaluation teams and also financial, legal, and technical experts who provided detailed, sophisticated analyses of their sections of the proposals. Mr. Feitelberg said that the retained outside experts mentioned earlier were working with the campus team to develop criteria and performance standards that would incorporate all University policies. Those campus and outside teams would create evaluation committees to advise campus senior leadership.

Committee Chair Makarechian expressed his view that the driving force behind the proposal to adopt the DBFOM delivery method was the need to increase UC Merced enrollment to

10,000 students by 2020. He commended Chancellor Leland for devising a way to finance the Project in the current economic environment. However, he expressed concern that the proposed delivery method would put all of the University's eggs in one basket. He agreed with Regent Ortiz Oakley that the field of developers would be limited to the few who could handle the scope of the Project, some of whom were quite litigious. Given the potential risk, Committee Chair Makarechian emphasized the need to do everything possible to mitigate that risk. He expressed his view that the delivery model has merit if the risks could be managed. He asked the campus to provide more detailed information about time and budget savings under the proposed delivery model. He suggested that dividing the project into three distinct parts under the same delivery model might yield greater savings because the developers would compete with one another.

Mr. Brostrom commented that the RFP process would include the upset limit or maximum amount for the contract, which would be based on an analysis of cost using a design-build delivery method. A bid above the upset limit would eliminate that developer. Chancellor Leland asked for feedback from the Committees about what further information they would like from the campus. She expressed the campus' view that, even if a divided Project could be developed at the same cost by three different developers, the risk of problems in the companies' interface would be increased, particularly since the Project would involve construction of multiple buildings simultaneously on a small campus footprint.

Chairman Lozano observed that the Chancellor and her team had addressed the concerns that had been raised at the last discussion. All development projects carry risk, so understanding the risks as much as possible in advance and mitigating them to protect the University is precisely what the campus had been asked to do. She expressed her view that the campus' presentation had been very responsive to the concerns that had been raised. A new suggestion was the possibility of dividing the contract into three parts and the campus could provide more detailed information about this option at a future meeting. Questions that had been posed about financial concerns, default protection, capital outlay, and expert advisors had been addressed. The question for the Regents was whether there were sufficient protections under this model to go forward.

Ms. Gunther observed that the Merced 2020 Project would be similar in size to the initial development of the campus. One important factor in UC Merced's development is its lack of infrastructure. A development project must be large enough to fund the infrastructure necessary for the next set of buildings. The campus examined the option of developing a smaller project that would provide student housing and some gateway buildings, and concluded that the infrastructure costs would overwhelm the cost of the buildings. It would be very challenging to deliver the needed infrastructure of roads and a utility grid in small packages. She recalled that the earliest buildings constructed on the campus by various developers resulted in construction litigation that could occur regardless of the number of buildings being constructed. The campus preferred the proposed delivery model because the structured incentives with the developer would encourage resolution of disputes before litigation; there would be an alignment of interests among the developer, the lender, and the campus.

President Napolitano agreed that the presentation had answered many of the questions that had arisen about the proposed delivery method. She anticipated the need to move the Project forward and said a more precise analysis of the option to divide the contract into three parts would be

helpful. She expressed her view that the Regents' responsibilities were to examine the Project's risks, ensure that every reasonable step had been taken to mitigate those risks, and, given that there is a certain amount of risk in any large construction project, determine whether the cost and value savings of using the proposed delivery system outweigh the risks. The Regents would have the opportunity to review the Project several times as it moves forward.

Committee on Finance Chair Ruiz expressed confidence that the delivery model could work and his view that it would be important to thoroughly answer the questions posed by Committee Chair Makarechian. Committee Chair Ruiz suggested inviting the expert advisors who were consulting with the campus on the Project to address some of the concerns expressed about the proposed delivery model. Chancellor Leland responded that the campus would be happy to make the advisers available and agreed on the importance of fully exploring Regents' concerns. Mr. Brostrom characterized Committee Chair Makarechian's main concern as being about concentrating a project of this size with one developer. Committee Chair Makarechian agreed and stated that much progress had been made, while a few questions remained that must be addressed and considered by the Regents. He requested that the campus address his questions about the payment performance bond, commenting that he could not recall any University construction project for which the payment performance bond was less than the value of the entire project. General Counsel Robinson said he was also unaware of any such projects. Committee Chair Makarechian also requested more detailed information about the financing and clarification of the risk borne by the developer and the University. He also asked who would choose the qualified bidders for the contract. If the campus would make the choice, Committee Chair Makarechian suggested engaging an outside expert to review and support the campus' view. Carefully considering these issues would help protect the campus as it proceeds.

Chancellor Leland thanked the Regents for their comments, noting that their concerns were appropriately directed at protecting the University.

Staff Advisor Acker commented that she had worked on the UC Merced campus for eight years and had experienced the challenges the campus faces because of its limited development. She suggested it would be helpful to consider the effects of not moving forward with the Project.

The meeting adjourned at 4:00 p.m.

Attest:

Secretary and Chief of Staff