The Regents of the University of California

FINANCE AND CAPITAL STRATEGIES COMMITTEE
September 14, 2016

The Finance and Capital Strategies Committee met on the above date at the Luskin Center, Los Angeles campus.

Members present: Regents Blum, Elliott, Gould, Kieffer, Makarechian, Schroeder, Sherman, Varner, and Zettel; Advisory members Lemus and White; Chancellors Blumenthal and Hawgood

In attendance: Acting Chancellor Hexter, Assistant Secretary Lyall, Executive Vice President and Chief Financial Officer Brostrom, Executive Vice President and Chief Operating Officer Nava, Chief Deputy General Counsel Petrulakis, and Recording Secretary Johns

The meeting convened at 10:20 a.m. with Committee Chair Makarechian presiding.

1. APPROVAL OF MINUTES OF PREVIOUS MEETING

Upon motion duly made and seconded, the minutes of the meeting of the Committee on Grounds and Buildings of July 19 and 21, the meeting of the Committee on Finance of July 20, and the joint meeting of the Committees on Grounds and Buildings and Finance of July 21, 2016 were approved.

2. OVERVIEW OF COMMITTEE RESPONSIBILITIES AND REVIEW OF COMMITTEE CHARTER

[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 expressed pleasure at the formation of this new committee. Capital planning cannot be separated from finance, and merging the Committee on Finance and the Committee on Grounds and Buildings was a wise governance move. The University’s business was increasing in both scope and complexity. The new Finance and Capital Strategies Committee would examine the expenditure and appropriation of funds, cash management, external financing, ten-year capital financial plans, campus budget requests, UC’s State funding, UC budget and planning, indirect cost recovery, the University’s captive insurance program, procurement, asset management, UCPath and other UC enterprise systems, and the UC Retirement Plan and retiree health benefits, among other topics. The administration would seek to have routine, pro forma transactional items approved by consent or delegation, allowing the Finance and Capital Strategies Committee to focus more on the strategic aspects of UC business operations.
3. **UNIVERSITY OF CALIFORNIA DEBT POLICY**

[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 observed that discussion and eventual adoption of a debt policy for the University of California would represent good fiscal management. In its latest ratings report, Moody’s Investors Service cited UC’s work on developing a debt policy as a best practice among universities. Development of a debt policy was also motivated by UC’s fiscal situation. The State had not issued a general obligation bond for the University since 2006, and State lease revenue bonds were effectively ended in 2010, leaving UC to carry all its capital and facility financing on its own balance sheet, at a time when UC has tremendous needs in accommodating enrollment growth and for seismic and life safety improvements and deferred maintenance. UC has been actively managing its portfolio to maximize affordability and flexibility and to ensure continued access to capital markets. A debt policy would provide guidelines for use and management of debt in the future. In July 2011, the University established guidelines for interest rate swaps, and this debt policy would complement those guidelines.

The University maintains AA category ratings in its three primary credits. To achieve this, the University continuously monitors its portfolio for opportunities to refinance debt at lower rates. In the past two calendar years, UC had refinanced debt that resulted in over $500 million in debt service savings over the life of the bond issue, roughly $15 million in average annual savings. This has occurred across all three of UC’s general credits, its general revenue bond credit, medical center pooled revenue bond credit, and limited project revenue bond credit. UC has maintained and tried to optimize this diversified credit structure; in its 2015 bond issues, UC moved over 80 auxiliary projects, which had originally been on the general revenue bond credit, to limited project revenue bonds. This opened capacity in the general revenue bond credit, and it more closely aligned core operations with the two credits. UC manages debt across the full yield curve to finance a variety of projects to meet the University’s needs and constraints. UC’s maturities range from short-term debt, like the $2 billion commercial paper program, to two series of century bonds, issued in 2012 and 2015. UC issues tax-exempt and taxable debt. UC issues variable-rate debt that requires liquidity support. Active management provides flexibility, manages risk, and uses liquidity effectively.

The University currently had $17.2 billion in long-term outstanding debt. The bulk of this amount was in general revenue bonds, $10.3 billion. This is UC’s primary borrowing vehicle, used to finance core projects related to education and research. There has been substantial growth in limited project revenue bonds, used to finance housing and parking. Most growth since 2008 has been in housing; UC has added 12,000 beds, with 2,000 more to be added in the coming year. Growth in medical center pooled revenue bonds reflected the growth in opening of new hospitals and seismic work required by the State. At times UC has also used third-party debt through vehicles such as a financing trust structure. The University’s core debt had increased by $6.5 billion since 2008.
About 75 percent of that amount has been spent for strategic financial purposes. From this $6.5 billion, UC refinanced the State Public Works Board debt for the State, $2.4 billion in 2011. That resulted in annual operating impact to UC’s budget of $100 million. Even though this is now on UC’s balance sheet, this financial engineering move helped the University. UC has used about $1 billion in external financing for the UC Retirement Plan (UCRP), in addition to borrowing from the Short Term Investment Pool (STIP).

Regent Blum asked about the percentage of debt used for new buildings. Mr. Brostrom responded that this was about $1.6 billion of the general revenue bonds, or 25 percent of new borrowing.

Although UC has experienced an increase in debt, its debt levels remain at a manageable level. In the last fiscal year, debt service to operations, or annual debt service divided by operating expenses, a key criterion for rating agencies, was 3.7 percent. The median for public colleges and universities with AA ratings was four percent. The University’s debt service coverage was 2.35 times, slightly below the median of 2.75 times, but well within the range of public universities with similar ratings.

Committee Chair Makarechian requested clarification of the current total debt amount. Associate Vice President Sandra Kim explained that the University had issued a medical center revenue bond close to $1 billion during the past month; $700 million for refunding, and the balance for new money projects. This bond issue closed on August 17.

Mr. Brostrom stated that this bond provided an example of the interest rate environment, a 35-year maturity at 3.12 percent interest.

Regent Zettel asked if the Patient Protection and Affordable Care Act had affected future earnings projections. Mr. Brostrom responded that the Office of the President asks the medical centers to produce ten-year financial projections. Increasing volume and adding patient beds was one strategy for improving the medical centers’ financial outcomes. Much of the medical center revenue bond funding is used for seismic work required by State law.

Regent Varner asked if medical center revenue bond support for a specific medical center would be secured from the revenue of that medical center. Mr. Brostrom responded in the affirmative.

Regent Sherman noted that the amounts the University holds in STIP and the Total Return Investment Pool (TRIP) have an effect on bond ratings. He asked about desirable levels for investments in STIP versus TRIP, or the GEP. Ms. Kim responded that the rating agencies view STIP and TRIP positively, compared to UC’s leverage points. UC has $17 billion in liabilities. UC’s annual debt service on these credits is approximately $900 million. Given the other operating challenges faced by UC, STIP and TRIP are viewed as a positive mitigating factor. The rating agencies have not put forward specific numbers, but do cite ratios of cash and investments compared to leverage levels. The
agencies cite any deterioration to liquidity as a credit challenge; this was noted as a challenge during the past year.

Regent Sherman asked if the rating agencies differentiate between the amounts in STIP versus TRIP. Ms. Kim responded that they do differentiate between the two funds to some extent, in terms of working capital and liquidity. STIP is considered the base case money market fund for UC; STIP investment policies are familiar to the rating agencies. TRIP has a different investment profile.

Regent Sherman suggested that it would be helpful to receive an indication from the rating agencies about what an appropriate balance would be between STIP and TRIP. Mr. Brostrom added that one of UC’s strategies is to work with the rating agencies to determine if UC can receive credit for some of its near-liquid investments in TRIP. TRIP has 50 percent fixed income. Even if the rating agencies gave UC a discount on that, it would still help UC meet liquidity requirements.

Regent Sherman referred to the 2.35 debt service coverage. He asked if this had been a static figure. Ms. Kim responded that this figure had been slightly volatile, noting that the rating agencies are attentive to changes in debt service coverage.

Committee Chair Makarechian asked about the University’s own requirement for liquidity, not the requirements of the rating agencies. It might be desirable to move funds from TRIP to STIP. Ms. Kim responded that the fiscal crisis of 2008 was a bellwether issue for the rating agencies. Harvard University carried out a major taxable borrowing at the end of 2008 because its endowment was frozen. Rating agencies began citing operational liquidity as a particularly important issue, measured by days’ cash on hand. The UC system has 170 days’ cash on hand, compared to a median of 150. This has helped to mitigate challenges to UC’s credit rating. Various factors are used to determine ratings. The University’s ratings had been stable for the last few years. There had been a negative outlook and downgrade in early 2014 by Moody’s Investors Service and Fitch Ratings; since then UC has had a stable outlook.

In response to another question by Committee Chair Makarechian, Ms. Kim explained that the Office of the Chief Financial Officer developed UC’s Debt Affordability Model in 2008-09. Prior to this, when requests for external financing came forward, they included requests for a specific fund source. In 2008-09, the approach was changed to examine a campus’ ability to afford the debt service and future incremental debt. The specific criteria, percentages and amounts, required by the Debt Affordability Model are based on best practices at other universities. UC examined debt thresholds in use by institutions such as the University of Texas and decided on an upper threshold of six percent debt service to operations.

Committee Chair Makarechian suggested that the threshold of 1.25 times for auxiliary debt service coverage might be risky. Mr. Brostrom observed that student housing income is relatively secure and treated on a pooled basis. Ms. Kim added that campus auxiliary projects must demonstrate this 1.25 debt service coverage; the Executive Vice
President and Chief Financial Officer has the authority to grant exceptions to this requirement for essential projects.

Mr. Brostrom referred to data showing that relative to comparator institutions, UC was low in the area of adjusted unrestricted net assets to debt. This reflected the unfunded liabilities in the UCRP and retiree health programs. Many comparator institutions do not have defined benefit plans, and their retiree health programs may be covered by State funding.

Chancellor Hawgood asked about the interrelationship and integration of campus and systemwide debt capacity. Ms. Kim responded that the Debt Affordability Model provides guidelines for each campus when requesting external financing approval. This model should result in UC’s ability to afford incremental debt service for all new projects. The system as a whole helps maintain the strength of UC’s debt ratings. The debt policy provides a process for campuses that need support from the system.

Chancellor Hawgood asked if an opposite scenario was conceivable, in which a campus meets debt requirements but is constrained by the system. Mr. Brostrom responded that this situation had not yet arisen but acknowledged that it could be possible. The pooled nature of the UC system is its strength, as demonstrated by the University’s ability to borrow for UC Merced. On its own, the Merced campus would never have had access to certain funds and rates.

Regent Gould asked how the University’s borrowing to support the UCRP was reflected in the UC debt strategy and the implications of this borrowing, which he described as a major vulnerability. Committee Chair Makarechian underscored the need to ensure that the UCRP does not fall below a 70 percent funding level. Mr. Brostrom responded that UCRP had not dropped to that level; at one point it was 76 percent funded on a market basis. He recalled that in 2010 the Task Force on Post-Employment Benefits had devised a plan to increase contributions with a cap of 14 percent for employer contributions. While a financial model suggested that contributions should have been increased to about 20 percent, this would have affected campuses in a detrimental way. The contribution was limited to 14 percent, and the University borrowed for the remainder up to the Annual Required Contribution. This has been done through external financing. Ms. Kim noted that this was accomplished in 2011 with a mix of short-term debt instruments to fund the $935 million. Mr. Brostrom also recalled that UC has made a number of successive borrowings from the STIP. If the University borrows at 0.8 percent as in 2011, or at the current STIP rate of 1.4 percent, and earns seven percent or 7.25 percent, this is legal arbitrage which helps support the system. The University is borrowing from itself and thus has no restrictive covenants from outside lenders. Borrowing of $3.3 billion has raised the UCRP’s funding ratio by five points, so that UCRP was 83 percent funded in the previous year, but would have been 78 percent funded if this borrowing had not been carried out. In the current year, UCRP performance was below that of STIP, so a STIP borrowing would not have been helpful, but over the long term this approach makes sense. The current year would be interesting because the University would have to balance the need for liquidity with the need to borrow an increased amount for the UCRP.
Mr. Brostrom expressed his preference that the University not pursue more external borrowing, in order to maintain debt capacity for capital projects.

Regent Varner asked how often the liability estimate for the University is adjusted. Mr. Brostrom responded that an annual valuation is reported in November. The previous year, the UCRP had performed relatively well, but the liability increased because the discount rate was adjusted downward. In addition, actuarial assumptions regarding mortality increased UC’s liability by about $2 billion.

Regent Varner asked if a valuation would be carried out more frequently in case of a catastrophic change. Mr. Brostrom responded that UCRP performance is only marked by the actuaries every June 30. Regent Gould observed that future discussions would encompass a framework for financing, and how it affects UC’s credit rating, liquidity, and debt capacity.

Chancellor Blumenthal shared his impression that most of the campuses were currently running up against their debt limits. He asked if this impression was accurate and if it was possible to quantify how close campuses were to these limits. He also asked about maintenance of the AA rating and what the cost in increased interest rates would be if the University were to lose one rating point. In response to the first question, Ms. Kim noted that the administration considers a ten-year horizon for the campuses. The limiting factor for new debt requests is often the requirement for an upper threshold of six percent debt service to operations. Within the ten-year horizon, some campuses are close to reaching the six percent threshold. The University has been able to provide financing at low interest rates. The Office of the President asks for a planning rate assumption when projects are requested. In response to Chancellor Blumenthal’s second question, Ms. Kim recalled that there were currently historically low interest rates. For medical center revenue bonds there was no risk premium. UC was borrowing at three percent for the medical centers. The cash in the market and the general market trend was to chase yields, with little risk premium for medical center credit or for credit differentiation. A few months earlier, the University refinanced a third-party housing project for the Irvine campus, with close to 30-year amortization at 3.5 percent for BBB+. Ms. Kim anticipated that this environment, which has been favorable for the University, would not last. UC has structural operating deficits but positive cash flow. Mr. Brostrom added that in normal markets, the credit differential was much greater, and moving from an AA to an A rating would equal 40 to 50 basis points.

Regent Kieffer asked about the University’s expectations concerning continued borrowing for the UCRP. Mr. Brostrom responded that this would be an annual topic of discussion for the Regents. The University was on a good trajectory, with the UCRP expected to be 90 percent funded by 2025. UC anticipated continuing to borrow in smaller amounts to reach the Annual Required Contribution. The University would have to decide whether it would continue to borrow that amount, and if this would have an
effect on how much the campuses can invest in the TRIP, which represents a significant part of their operating budgets. Mr. Brostrom stated that in theory it would be desirable to borrow every year, but it was not certain the University would have the capacity for this borrowing. UC should continue to advocate for about one-third of the unfunded liability from the State, as has been provided under Proposition 2.

Regent Kieffer asked if the University would decide to stop borrowing at a certain point in the future. An annual review is not a long-term perspective. Mr. Brostrom observed that this was internal borrowing. One of the University’s overarching objectives is to move as much as possible from the STIP into higher-earning pools, whether UCRP or TRIP. There is a question of whether the campuses would rather have operating income or a potential reduction in the employer contribution to UCRP.

Regent Sherman asked about the level of UC’s off-balance sheet financing. Mr. Brostrom responded that UC has a financing trust structure. Ms. Kim explained that this is just under $400 million, as well as other borrowings that count as third-party debt.

Regent Sherman asked if a portion of UC Merced’s debt would be off-balance sheet debt. Mr. Brostrom responded in the affirmative. The availability payments were off the balance sheet but not off credit. Rating agencies consider these payments as a “quasi-obligation” of the University.

Committee Chair Makarechian noted that when UC builds in partnership with developers, the developer may be the controlling partner and responsible for the debt, but based on government requirements, he expressed concern that UC might be obligated to count that debt on its balance sheet, such as for student housing. Mr. Brostrom concurred that student housing was a good example of this.

In response to a question by Faculty Representative White, Mr. Brostrom confirmed that the University was borrowing at 7.25 percent for every dollar the UCRP was underfunded, and that the University was making progress if it could backfill that liability at less than 7.25 percent.

Committee Chair Makarechian noted that a large number of UC professors, some of the most highly paid employees, were nearing retirement age. He stressed the need for an accurate assessment of payout amounts due to these retirees in the accounting for future liabilities, not just an averaging of salaries. He requested a report on this subject. Mr. Brostrom responded that the University has these records in the UCRP, separate from the work done by the actuaries. The administration could bring a report on the profile of UC retirees.

Ms. Kim summarized key elements of the proposed debt policy. The University would maintain AA category ratings for its general revenue bond credit. This is a fairly strong credit rating that allows UC to obtain access to capital markets at favorable rates. The University would continue to use a differentiated credit strategy; using medical center credit, limited project revenue credit, and third-party credit leaves UC with more debt
capacity to issue general revenue credit, critical for projects that further the core mission of UC. The University has put in place a process to provide guidance for campus and medical center requests for future debt financing, using debt criteria aligned with how the capital markets and the rating agencies assess UC’s credit profile. Requests for external financing would include a summary of financial feasibility and show the ability of the campus or medical center to service the debt. In light of accounting changes that have and will increase the size of UC’s reported pension and other post-employment benefit liabilities, as well as the capital markets’ focus on the size of these liabilities, the University would undertake no additional systemwide borrowing if the UCRP funded ratio falls below 70 percent. An example of systemwide borrowing would be the borrowing undertaken for the State Public Works Board. At the direction of the Regents, external financing that would improve the UCRP funding status may be excluded from the policy. The University would delay systemwide borrowing so long as unrestricted net assets remain negative. The Executive Vice President and Chief Financial Officer, at the direction of the Regents or the President, may enact this delay. The campuses would execute third-party financing in close partnership with the Office of the Chief Financial Officer. Ms. Kim concluded by emphasizing that debt is a precious and finite resource. The proposed policy would provide a framework within which to evaluate and manage trade-offs between cost of capital and financial flexibility. The debt policy and the active management of the University’s credit profile help ensure that UC maintains ready access to debt capital markets to meet its financing needs. An action item to approve this policy would be brought to the November meeting.

Committee Chair Makarechian asked if the following were the overall criteria or tests for financing: the 70 percent funded ratio of the UCRP, positive unrestricted net assets, and six percent debt service coverage. Mr. Brostrom responded in the affirmative and added that every campus would produce a debt affordability model. The campus must first meet this threshold; then systemwide criteria are considered.

Committee Chair Makarechian requested clarification of unrestricted net assets. Mr. Brostrom responded that restricted assets are research contract and grant payments, restricted philanthropy, and restricted endowment payouts. Unrestricted net assets could be negative due to the UCRP liability, about $11 billion, and the retiree health benefit liability, which might amount to $20 billion. The University would need $30 billion to have positive unrestricted net assets.

4. DISCUSSION OF UNIVERSITY OF CALIFORNIA 2017-18 BUDGET FOR STATE CAPITAL IMPROVEMENTS AND PLANS FOR CAMPUS PROJECTS REQUIRING BUDGET APPROVAL

[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 recalled that in 2013-14, through AB 94, the State Legislature provided UC with the ability to use its own State General Fund allocation, under certain conditions, to finance design, construction, and
equipping of academic facilities, particularly to address seismic and life safety needs, enrollment growth, and modernization. In the past year, SB 81 was enacted, expanding this use of the allocation to include availability payments, lease payments, and installment payments, and in this way UC funded its portion of the Merced 2020 Project. The Education Code stipulates that UC manage its programs such that not more than 15 percent of the annual State General Fund allocation be used for debt service, and UC has historically kept well below this threshold. The provisions of the Education Code authorize UC to use State General Fund support to make debt service payments on general revenue bonds that have been approved by the State. Since 2013, the University has received approval from the Department of Finance and the Legislature for 26 projects totaling $1.2 billion. For the 2017-18 Budget for State Capital Improvements, the University would take a three-year approach totaling $600 million, targeting deferred maintenance, seismic and life safety, and enrollment growth needs. One hundred and fifty million dollars would be used for deferred maintenance to match one-time State funds, and $450 million for capital projects. The University was seeking to use State funds for projects that cannot be funded through private philanthropy or other forms of financing.

Regent Varner requested an estimate of the University’s overall deferred maintenance obligation. Mr. Brostrom responded that UC was considering a systemwide assessment of facilities. Every campus had pursued this on its own, using its own criteria. It would be helpful, especially if the University pursues a general obligation bond for deferred maintenance, to have one systemwide number. In response to a question by Regent Blum, Mr. Brostrom acknowledged that some estimates of deferred maintenance needs have been far too low. UC Davis’ needs in deferred maintenance were above $1 billion. The University needs a realistic basis for comparison among types of deferred maintenance. This is a critical need because it is more costly to replace facilities. Regent Gould observed that an aggregate number for deferred maintenance would be useful in negotiations with the State about allocation of Proposition 2 funds. Committee Chair Makarechian added that it would be helpful to have deferred maintenance stated as a percentage of UC’s total assets.

Associate Vice President Sandra Kim explained that the 2017-18 Budget for State Capital Improvements included the first phase of a systemwide deferred maintenance program, $50 million to fund existing deferred maintenance work, with matching one-time State funds, and to begin facility condition assessments on State-eligible space. The 2017-18 capital projects prioritize and target seismic and life safety corrections at the Berkeley, Los Angeles, and San Francisco campuses. Ms. Kim emphasized that this proposal represented only a small portion of the University’s total funding need for State-eligible capital improvement projects in 2017-18. UC maintains a commitment to pursue gifts and other non-State funding sources to supplement State funding for construction. There continues to be a significant need for capital project funding, but the debt service for these projects competes with other demands for State General Funds. The 2017-18 Budget for State Capital Improvements included four projects utilizing State and non-State funds that would be presented for approval at the November meeting: the Interdisciplinary Sciences Building at UC Irvine, the Franz Tower Seismic Renovation and the Center for the Health Sciences Neuropsychiatric Institute (CHS-NPI) Seismic
Correction at the Los Angeles campus, and the Mission Center Building Seismic Life Safety Improvements at the San Francisco campus.

Chancellor Hawgood requested definition of a “State-eligible” building. Ms. Kim responded that this status, and the ability to request State funding for such a building, is based on criteria of seismic, life safety, and enrollment growth needs. Housing and self-supporting auxiliary projects are non-State-eligible.

Committee Chair Makarechian asked how projects in the 2017-18 Budget for State Capital Improvements were selected. Ms. Kim responded that this budget was part of a three-year request. Proposals would be presented for 2018-19 and 2019-20. The allocation methodology was straightforward, $50 million per campus. Besides the campus projects being discussed that day, other campus projects would be presented in the next two budget cycles. The only campus excluded from this budget was UC Merced, because the Merced 2020 Project had recently been approved.

Regent Schroeder asked if mixed-use buildings would be in the non-State-eligible category; for example, an academic building that also had a café or some revenue-generating activity. Mr. Brostrom responded that funding sources can be mixed in such situations. Most commonly, a building with classrooms that are supported by State funds also has research laboratories, supported by indirect cost recovery. Ms. Kim added that in the University’s ten-year capital financial plan, the request for State-eligible space, $50 million per campus, was only a tiny percentage of the real need of $4 billion to $5 billion.

Ms. Kim outlined the steps in the capital budget approval process. Historically, the request for approval of the Budget for State Capital Improvements was presented along with the Capital Financial Plan at the Regents’ November meeting. The State now required the submission of capital projects by September, so the Budget for State Capital Improvements was being reviewed at the current meeting and would be brought forward for approval in November. The Capital Financial Plan would be presented in November as well; it represents the annual update of the campuses’ ten-year plans, and presents information about the University’s multi-year program of proposed capital construction and renovation. The earliest date by which the University would receive final approval from the State for its Budget for State Capital Improvements would be April 1. Approval of the external financing associated with the State General Funds would be subject to a future Regents’ action in spring 2017.

UC Irvine Vice Chancellor Wendell Brase discussed the context for the Interdisciplinary Sciences Building project, in particular student enrollment growth and the campus’ plans to hire 250 new faculty. The campus wishes to promote increased interdisciplinary problem-based scholarship, especially in the sciences. The Interdisciplinary Sciences Building would provide space for three of UC Irvine’s fastest-growing programs. During the past decade, undergraduate enrollment in engineering, physical sciences, and computer sciences had increased by 63 percent. Only 37 ladder-rank faculty members were hired in these schools over this period, an increase of just 13 percent. Of the planned
250 new faculty, 88 would be hired in these schools to catch up with previous student enrollment growth and to accommodate anticipated increases. Lack of space was a serious obstacle in achieving these goals. The last new building that provided space for any of these schools was Engineering Hall, completed in 2009. The campus has sought to maximize use of existing space to meet its most urgent needs, but space was now close to maximum capacity. As an interim measure, the campus was considering leasing space until permanent space could be constructed.

The proposed Interdisciplinary Sciences Building would consist of 133,000 gross square feet, with wet and dry laboratory research space, teaching laboratories, and office space, and accommodate 50 faculty. The interdisciplinary nature of the building would facilitate collaborative research. Several fund sources would be applied to the project. In addition to requested State funds, the campus had received a major gift, and the balance would be funded by external financing and campus indirect cost recovery funds.

Regent Gould requested real dollar amounts for the various funding sources. Provost Enrique Lavernia responded that the campus’ gift amounted to $30 million; the cost of the building would be approximately $120 million. The gift was pledged over a period of three to five years.

Committee Chair Makarechian asked why UC Irvine would consider leasing outside space rather than building on its own land. Mr. Lavernia responded that the campus was currently assessing the costs of building on campus versus using existing space in the University Research Park. One opportunity for the campus is to move some programs that do not require expensive laboratory space while it converts some existing space into laboratory space.

Regent Blum urged UC Irvine to make use of its own land resources. Mr. Brase responded that UC Irvine was examining all options. He then briefly described the project site, located in the campus’ physical sciences zone.

UCLA Vice Chancellor Steven Olsen recalled that over the past three decades UCLA had completed the repair or replacement of 58 seismically deficient buildings. Nine such projects were currently in progress. The Franz Tower Seismic Renovation and the CHS-NPI Seismic Correction were the last two projects in UCLA’s overall seismic repair plan. The two projects were similar, involving Level Five or seismically “poor” buildings. The campus planned to raise them to a Level Three or “good” rating. Franz Hall is a three-building complex in the central campus, and the Franz Tower is occupied by the Department of Psychology. Mr. Olsen then commented on the extensive scale of the CHS-NPI Seismic Correction. As in the case of the Franz Tower project, UCLA would seek opportunities, in addition to seismic repair, to bring the building into compliance with other Code issues triggered by the seismic repair. The building is occupied mainly by the Semel Institute for Neuroscience and Human Behavior.

Committee Chair Makarechian asked why the campus had decided to renovate these buildings rather than construct new buildings. Mr. Olsen responded that these projects
were cost-effective. As part of its business case analysis for both projects, UCLA examined the possibility of demolition and concluded that demolition would be far more expensive than renovation. In both cases, seismic repair is relatively straightforward, and the campus would make use of this opportunity to make programmatic improvements. These are not laboratory buildings.

Regent Zettel remarked on UCLA’s space constraints. She suggested that the campus might add floors to the other two buildings in the Franz Hall complex to increase capacity. Mr. Olsen pointed out a construction site near Franz Hall, a focus for future expansion. At some point the campus might consider adding density to the legacy buildings as well.

Regent Sherman asked if the buildings would have to be vacated completely in order for the projects to proceed. Mr. Olsen responded that there would be some staging impact, and that this would occur in phases. The campus has acquired space on and off campus to accommodate this staging. He described the repair work as not unduly disruptive. Mr. Brostrom underscored that these were the last two major seismic projects at UCLA. UCLA had upgraded the entire campus to seismically stable conditions. He praised UCLA for its thoughtful and well-executed seismic plan.

UCSF Associate Vice Chancellor Michael Bade explained that the Mission Center Building is a 300,000-square-foot former glass factory built in 1927. UCSF has owned the building for about 40 years. He described the brick envelope of the building and its steel lintels, which were rusting, expanding, and damaging the brick. The windows were not watertight and needed to be replaced. The work could be accomplished mostly from the outside of the building. He briefly noted the site location.

Committee Chair Makarechian emphasized that most elements of this 1927 building would have to be replaced and asked about the rationale for keeping the building. Mr. Bade responded that UCSF had considered a range of options. The structural frame of the building was quite robust.

Regent Sherman asked the campus to return with discussion of the various options it had considered, and why it had chosen renovation rather than new construction. Mr. Brostrom responded that the campus would present its rationale for this project.

Regent-designate Lemus asked about criteria used by campuses for considering project alternatives. Mr. Brostrom responded that the Office of the President asks every campus, for every project, to carry out a business case analysis of different options and to determine the best option in terms of cost and the campus’ mission. Costs and life cycle costs are important criteria; the use or mission of a building is another important criterion. Campuses pursue a number of different strategies in their capital projects.
5. **VETERINARY MEDICAL CENTER VISION AND PLANS FOR SMALL ANIMAL CLINIC EAST WING PROJECT, DAVIS 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.]

Acting Chancellor Hexter heralded the ambitious vision for the UC Davis Veterinary Medical Center, which would provide the facilities necessary to continue to build on the Davis campus’ excellence in patient care, instruction, and research in veterinary medicine. A strategic fundraising approach would be used.

Dean Michael Lairmore underscored the outstanding influence and rankings enjoyed by the UC Davis School of Veterinary Medicine. It is the only veterinary school in the UC system. The School has about 700 students, most enrolled in the four-year veterinary degree program. There are also graduate programs in preventive veterinary medicine, epidemiology, immunology, and integrative pathobiology. In the current year, the School accepted 145 students, of whom 131 were from California. Forty-two percent of them were from underrepresented minority groups. The School of Veterinary Medicine provides significant scholarship support to its students, who have a low debt to income ratio.

Veterinary scientists have a critical role to play in combating emerging diseases such as the Ebola and Zika viruses. Seventy percent of emerging diseases have animal origins. The UC Davis School of Veterinary Medicine is a leader in clinical trials and has many programs that help protect the food supply, the public, and the environment, many in collaboration with the California Department of Food and Agriculture, or with groups such as cattlemen and crab fishermen.

The need for this Veterinary Medical Center was illustrated by its patient volume, over 50,000 annually, its exceptional faculty and staff, and specialties in 34 disciplines. The campus has exhausted its ability to meet the needs of the School of Veterinary Medicine. Due to funding constraints and other facility priorities, teaching and research have taken precedence over the development of new clinical space. UC Davis’ veterinary teaching hospital was built for 3,000 patients, while patient volume, as mentioned earlier, has grown to more than 50,000. The movement toward translational medicine is also significant for the School’s clinical research.

The vision for the Veterinary Medical Center is outlined in a ten-year master plan. One important goal of the planning is to create distinct and separate receiving points for large animals and increase biosecurity, and to reduce opportunities for cross-contamination. An incremental building program in the past has led to inefficient space and facilities arrangements. Low-intensity support functions would be moved to the perimeter, while imaging facilities would be in a central location, for large and small animals. There would be central space for integrated clinical research operations. The plan encompasses 17 projects. The master plan total budget of $500 million includes fixed equipment, operating and energy costs, projected utility connecting fees, and interest during the
construction period. The 17 projects were aligned with UC Davis’ Long Range Development Plan and Physical Design Framework. Some of these projects would need approval by the Regents as they were developed; one of these was the Small Animal Clinic East Wing Project.

The $500 million plan integrates new construction, renovation, and site improvements in a planned series of projects. The campus has engaged Marts & Lundy for a feasibility study of fundraising capacity for the Veterinary Medical Center. The School of Veterinary Medicine had raised over $70 million the previous year and was projecting a need to raise $60 million annually as work on the Veterinary Medical Center proceeds. The School had $7 million in cash on hand, $25 million in support from the University for site preparation and utilities, and a recent $50 million philanthropic grant from the Oakland-based Valley Foundation.

Mr. Lairmore concluded by outlining the project’s next steps. The School has been active, conducting weekly planning sessions with its hospital planning team, project manager, and planning consultants. It would continue its fundraising activities and issue a comprehensive Environmental Impact Report. The School had considered alternatives to this plan. Taking no action whatsoever would ultimately have a negative impact on the School’s mission and reputation, and incremental growth, the approach over the previous 20 years, had led to a less than optimal situation. Another approach would be to build an entirely new hospital on a new piece of land; this would be too costly and the hospital would lose the advantage of its current location.

Committee Chair Makarechian asked if there is insurance coverage for animal care and if the hospital, with its current client base, had reached a saturation point for the region. In response to the first question, Mr. Lairmore explained that fewer than 15 percent of the veterinary hospital’s clients have pet insurance. There is no third-party payer insurance. The hospital is essentially a cash operation. For clients who cannot afford to pay the costs, there are Compassionate Care Funds; there is a Faithful Partner Fund for police dogs. In response to the second question about saturation, Mr. Lairmore remarked that patients come to the veterinary hospital from around the world. The hospital has not reached a saturation point for patients from the Sacramento region.

Committee Chair Makarechian asked if there were plans for extending the hospital. Mr. Lairmore responded that the School has satellite locations, such as the Veterinary Medicine Teaching and Research Center in Tulare, in operation since 1986. In October, UC Davis would open the South Valley Animal Health Laboratory in Tulare, in collaboration with the California Department of Food and Agriculture. The School also has a specialty clinic in San Diego and the SeaDoc Society, a program on Orcas Island in Washington state, funded by donors, which looks after the health of marine mammals in that region.

Committee Chair Makarechian asked about efforts to raise awareness that health insurance is available for pets. Mr. Lairmore responded that this was a nationwide issue.
At the current time, the School of Veterinary Medicine did not have enough cash for self-insurance.

Chancellor Hawgood asked if the School’s clinical program on its own provided profits, just covered its expenses, or represented a deficit. Mr. Lairmore responded that profitability varied by specific clinical services. Oncology was a growing program, part of the UC Davis Comprehensive Cancer Center, and paid for itself. Other services, such as the large animal clinic, required supplementary support. In this case the small animal clinic paid for that balance. Providing services outside the School might increase efficiency.

Chancellor Hawgood stated his assumption that this would not be a source of sufficient funds to cover capital needs. Mr. Lairmore responded that because the School does not have a third-party payer base, this income supports the School’s structural budget.

In response to a question by Committee Chair Makarechian, Mr. Lairmore explained that the action item to be brought to the Regents at the November meeting would concern only the Small Animal Clinic East Wing Project.

Regent Zettel asked if the School was reaching out to alumni in its fundraising efforts and commented on the importance of conveying information about student financial aid. Mr. Lairmore responded in the affirmative. He estimated that 15 percent of development funding came from alumni. Regent Zettel asked if the School collaborates with the Scripps Institution of Oceanography. Mr. Lairmore responded that the School engages in collaboration with Hubbs-SeaWorld Research Institute.

6. **APPROVAL OF PRELIMINARY PLANS FUNDING, WARNER GRADUATE ART STUDIO RENOVATION AND ADDITION, LOS ANGELES CAMPUS**

The President of the University recommended that the 2016-17 Budget for Capital Improvements be amended to include the following project:

Los Angeles: **Warner Graduate Art Studio Renovation and Addition** – preliminary plans – $2 million to be funded from gift funds.

[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.]

UCLA Vice Chancellor Steven Olsen introduced the item, a request for preliminary plans funding approval, explaining that UCLA would present items at a future meeting for design and budget approval. The UCLA graduate art studio has been located at this site in Culver City since 1985, about four-and-a-half miles south of the UCLA campus, in a light industrial area known as the Hayden Tract. The graduate art program has about 40 students and is ranked second in the nation. The goal of this project is to provide modern, functional studio space for students, as well as workshops, laboratories, and gallery space that were lacking in the current facility. The project involves the addition of
18,500 square feet of new space, as well as 5,700 square feet of unenclosed covered space, an upgrading of the building infrastructure, and correction of life-safety deficiencies. A significant gift agreement had been executed with a UCLA alumnna and retired art dealer and gallery owner Margo Leavin, who would provide the majority of the funding necessary for this project.

Mr. Olsen recalled questions that had been raised at the July meeting about the possibility of providing housing at this site. UCLA had provided information to the Office of the President on this topic. The zoning category for the Hayden Tract is “industrial general,” and the area lacks housing and grocery or retail stores. Mr. Olsen described this as an area unsuited for the development of student housing.

Committee Chair Makarechian suggested that the project location could be re-zoned, emphasizing that Culver City was an active area for development. Mr. Olsen responded that the campus could provide more information on the housing situation for the graduate art program students. UCLA is not subject to local zoning, but has historically been respectful of zoning decisions by local municipalities. UCLA could consider housing in its initial planning, but this might limit the campus’ options for this project.

Regent Gould requested the campus’ estimate of the total project cost and fund sources. Mr. Olsen responded that the project cost would be in the range of $30 million. The gift agreement was for $20 million, and the campus has identified other prospects.

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

7. AUTHORITY TO INDEMNIFY THE CALIFORNIA COASTAL COMMISSION FOR DEVELOPMENT PERMIT FOR THE MAIN CAMPUS INFRASTRUCTURE RENEWAL PHASE 1C PROJECT, SANTA BARBARA CAMPUS

The President of the University recommended that:

A. The President or her designee be authorized to approve the terms and conditions of the California Coastal Commission’s (Commission) approval of the Permit for the Main Campus Infrastructure Renewal Phase 1C Project (Project), including the Regents’ assumption of the risk, and indemnification of and holding harmless the Commission from and against any liability arising from any damage due to hazards including bluff erosion, surf, storm waves, surges and flooding.

B. The President, or her designee, after consultation with the General Counsel, be authorized to approve and execute any 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 briefly introduced the item.

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

The meeting adjourned at 12:25 p.m.

Attest:

Secretary and Chief of Staff