The Regents of the University of California

**FINANCE AND CAPITAL STRATEGIES COMMITTEE**
November 18, 2020

The Finance and Capital Strategies Committee met on the above date by teleconference meeting conducted in accordance with Paragraph 3 of Governor Newsom's Executive Order N-29-20.

Members present: Regents Blum, Cohen, Estolano, Kounalakis, Leib, Makarechian, Muwwakkil, Park, Reilly, and Sherman; Ex officio members Drake and Pérez; Advisory member Lott; Chancellors Christ, Gillman, Hawgood, Khosla, Muñoz, and Wilcox; Staff Advisor Jeffrey

In attendance: Regent Zettel, Regent-designate Zaragoza, Faculty Representative Horwitz, Secretary and Chief of Staff Shaw, Chief of Staff and Special Counsel Drumm, Executive Vice President and Chief Financial Officer Brostrom, Executive Vice President Byington, Executive Vice President and Chief Operating Officer Nava, Interim Vice President Lloyd, Chancellor May, and Recording Secretary Johns

The meeting convened at 2:30 p.m. with Committee Chair Makarechian presiding.

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

Upon motion duly made and seconded, the minutes the meeting of September 16-17, 2020 were approved, Regents Estolano, Leib, Makarechian, Muwwakkil, Park, Pérez, Reilly, and Sherman voting "aye."[1]

2. **CONSENT AGENDA: PRELIMINARY PLANS FUNDING, DATA HUB NEW ACADEMIC BUILDING, BERKELEY CAMPUS**

The President of the University recommended that the 2020-21 Budget for Capital Improvements and the Capital Improvement Program be amended to include the following project:

Berkeley: Data Hub New Academic Building – preliminary plans – $30 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.]

Committee Chair Makarechian briefly introduced this consent agenda item.

[1] Roll call vote required by the Bagley-Keene Open Meeting Act [Government Code §11123(b)(1)(D)] for all meetings held by teleconference.

Upon motion duly made and seconded, the Committee approved the President's recommendation and voted to present it to the Board, Regents Drake, Estolano, Leib, Makarechian, Muwwakkil, Park, Pérez, Reilly, and Sherman voting "aye."

3. **UC DAVIS 2020 LONG RANGE DEVELOPMENT PLAN FOLLOWING ACTION PURSUANT TO THE CALIFORNIA ENVIRONMENTAL QUALITY ACT AND 2020 PHYSICAL DESIGN FRAMEWORK, UC DAVIS SACRAMENTO CAMPUS**

The President of the University recommended that, following review and consideration of the environmental consequences of the proposed Long Range Development Plan update (2020 LRDP), as required by the California Environmental Quality Act (CEQA), including any written information addressing this item received by the Office of the Secretary and Chief of Staff no less than 24 hours in advance of the beginning of this Regents meeting, testimony or written materials presented to the Regents during the scheduled public comment period, and the item presentation, the Regents:

A. Certify the Environmental Impact Report for the UC Davis 2020 LRDP, UC Davis Sacramento campus.

B. Adopt the Mitigation Monitoring and Reporting Program, and make a condition of approval the implementation of mitigation measures within the responsibility and jurisdiction of UC Davis.

C. Adopt the CEQA Findings and Statement of Overriding Considerations.

D. Approve the UC Davis 2020 LRDP for the UC Davis Sacramento Campus.

E. Receive and accept the 2020 Physical Design Framework.

[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 reported that the Committee had amended the item *Delegations to Ground Lease a Portion of the UC Davis Sacramento Campus and Enter into Space Leases for the Potential Aggie Square Phase 1A Project, UC Davis Sacramento Campus,* which the Committee had discussed and approved in the preceding closed session meeting, in order to address comments made during the public comment period earlier that day. The Committee was recommending that the Board approve this item, with the following conditions: the University shall ensure that the development is in compliance with Regents Policy 5402 and Article 5 of the American Federation of State, County and Municipal Employees (AFSCME) Collective Bargaining Agreement; the Davis campus shall work with the City of Sacramento to identify appropriate community benefits, which may include consideration of additional affordable housing; and the development of Phase 1A shall include no less than 200 beds of affordable student housing at Aggie Square. These amendments would not change the California Environmental Quality Act analysis for the project.

Chancellor May noted that UC Davis had made good progress on its plans for its Sacramento campus and the Aggie Square project since April 2018, when UC Davis had announced the project launch with Sacramento Mayor Darrell Steinberg, members of the State Assembly, and local business and community leaders. Since then, UC Davis had announced collaborations with corporate and nonprofit partners, engaged its developer partner, Wexford Science and Technology, and had undertaken a community engagement process to position UC Davis to better meet the needs of the local community.

Associate Vice Chancellor Robert Segar stated that the Aggie Square design would complement a vision of innovation, partnership, and inclusion. From the beginning, UC Davis had four goals for Aggie Square: to advance innovation in teaching, research, and public engagement; to propel economic development in Sacramento; to contribute to resilience in local neighborhoods; and to create shared public spaces that would connect the Sacramento campus with the surrounding communities. The design of Aggie Square gave form to these goals and reinforced the principles in the Physical Design Framework for the UC Davis Sacramento campus. Phase 1 of Aggie Square occupied a strategic location on the Sacramento campus. From a planning and design perspective, Aggie Square would tie the campus together in terms of public space, architecture, and transportation and would better connect the campus with its surrounding communities. Mr. Segar briefly described the site plan. All four buildings would have major entrances on a tree-lined public event space, which would bring this innovation district to life. This Aggie Square event space would open up onto a second major public space, the Market Plaza, located along Stockton Boulevard on the border of the campus. The Market Plaza would create a new front door to the surrounding community. It would host a farmers' market pavilion and provide community access to UC Davis health and food initiatives.

Mr. Steinberg described this project as a signature economic development and opportunity for the City of Sacramento and the greater Sacramento region. For many years, the city and the region have had an idea and vision of a much closer relationship—economic, entrepreneurial, research, and education—with UC Davis. It was only when Chancellor May was appointed that this aspiration became reality. The vision of Aggie Square was important for the University, for the City of Sacramento, and for the millions of people living in the northern part of the Central Valley. This was an opportunity to show the rest of the state that the combined power of the University of California and the entrepreneurial spirit of a changing and growing city like Sacramento can achieve something remarkable. This project must not only be good for the University, for the city, and for the region as a whole, but also for the affected communities, especially low-income communities residing near Aggie Square. The City and UC Davis had been working a community benefits agreement, which would include affordable housing, so that this project would not lead to gentrification. Mr. Steinberg expressed confidence in the project. He commended Chancellor May and thanked the Regents for their willingness to take the right kind of risk on behalf of the University and to integrate UC Davis into the economic future of the region. For Mr. Steinberg, this project was the number one economic development priority for Sacramento. The City was proud to engage as a financial partner in this project through an Enhanced Infrastructure Financing District. He was grateful for the Regents' vision of the University as engaging in a very positive way with the communities in which the University resides.

Regent Pérez thanked Mr. Steinberg for his leadership and partnership with UC Davis, which had made the project possible. He expressed appreciation for the investment that the City had made. Mr. Steinberg noted that Sacramento had been waiting for this kind of partnership and catalyst for a long time, in order to become another California center of innovation, life science, technology, and green and clean energy.

Regent Leib anticipated that this project would be an outstanding addition to the Sacramento community.

Regent Kounalakis underscored the fact that the project was Mr. Steinberg’s number one economic development priority for the city and region. The project was even more important at a time of general concern about economic recovery from the impact of the COVID-19 pandemic. She observed that, when new projects are built, people in the surrounding community do not always feel that they are a part of the project. There would be further discussions to ensure that residents of the communities adjoining Aggie Square would also benefit. She thanked Mr. Steinberg for his engagement.

President Drake concurred with Regent Kounalakis’ observation that people living near new developments sometimes feel disenfranchised and pushed away. In this case, there was a tremendous opportunity to create jobs for the local community as the project was being built and coming to fruition.

Upon motion duly made and seconded, the Committee approved the President’s recommendation and voted to present it to the Board, Regents Drake, Estolano, Kounalakis, Leib, Makarechian, Muwwakkil, Park, Pérez, Reilly, and Sherman voting “aye.”

Student observer Andy Li noted that, in addition to embarking on the Aggie Square project, UC Davis had recently built a large housing project, The Green at West Village, specifically dedicated to transfer students. In spite of the current recession and budget limitations, the UC system should continue to keep a strong focus on providing affordable on-campus and off-campus student housing. Mr. Li expressed support for the Aggie Square project, which would provide not only economic opportunities, but also internship and networking opportunities for students. Aggie Square would broaden the University’s research base and propel UC Davis toward continued excellence.

4. **DESIGN FOLLOWING ACTION PURSUANT TO THE CALIFORNIA ENVIRONMENTAL QUALITY ACT, AGGIE SQUARE PHASE 1A, UC DAVIS SACRAMENTO CAMPUS**

The President of the University recommended that, following review and consideration of the environmental consequences of the Aggie Square Phase 1 project, as required by the California Environmental Quality Act (CEQA), including any written information addressing this item received by the Office of the Secretary and Chief of Staff no less than 24 hours in advance of the beginning of this Regents meeting, testimony, or written materials presented to the Regents during the scheduled public comment period and the item presentation, the Finance and Capital Strategies Committee recommend that the Regents:

A. Adopt the CEQA Findings for the Phase 1 Project, having considered the UC Davis Sacramento Campus 2020 Long Range Development Plan (LRDP) Supplemental Environmental Impact Report (EIR) for the UC Davis Sacramento campus.

B. Make a condition of approval the implementation of applicable mitigation measures within the responsibility and jurisdiction of UC Davis as identified in the Mitigation Monitoring and Reporting Program adopted in connection with the 2020 LRDP EIR.

C. Approve the project design for all project elements included in Phase 1A.

D. Direct the President of the University, or designee, in consultation with the Office of General Counsel, to execute all 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.]

In response to a question by Committee Chair Makarechian, Chief of Staff and Special Counsel Kelly Drumm explained that the California Environmental Quality Act (CEQA) Findings were drafted to address Phase 1A, which did not include housing. Later, when an item for approval of the housing project was presented to the Regents, the Findings would be augmented, based upon the existing CEQA document.

Regent Pérez recalled that the action taken during the preceding closed session meeting had moved the student housing element of the project into Phase 1A. He asked if this item needed to be amended so that this element would be included. Ms. Drumm opined that this item did not need to be amended.

Upon motion duly made and seconded, the Committee approved the President’s recommendation and voted to present it to the Board, Regents Drake, Estolano, Kounalakis, Leib, Makarechian, Muwwakkil, Park, Pérez, Reilly, and Sherman voting “aye.”

5. **UNIVERSITY OF CALIFORNIA FINANCIAL REPORTS, 2020**

The President of the University recommended that the Regents adopt the 2019-20 Annual Financial Reports for the University of California, the University of California Retirement System, and the five University of California Medical Centers.

[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.]

Associate Vice President Peggy Arrivas began her remarks with an assurance that the University's finances remained very stable. She noted that there had been an approximately $1.7 billion revenue increase over the past year. Part of the loss due to the impact of the COVID-19 pandemic was made up with Coronavirus Aid, Relief, and Economic Security (CARES) Act funds of almost $700 million received by UC. Medical center revenues continued to grow at a good pace prior to the impact of COVID-19 in the spring. Auxiliary enterprises showed a decline, primarily due to the closing of dormitories and refunds to students in the spring. At the same time, the University kept all employees on the payroll through the end of the fiscal year, even when there was not work for some of them to do. Expenses were increasing. The overall status of operations was affected by accounting for the pension and retiree health benefits, with lower-than-expected investment returns in the UC Retirement Plan (UCRP) and an extremely low discount rate for retiree health.

Committee Chair Makarechian observed that revenues had increased, and expenses had increased by about $4 billion over the prior year. For the first time, the Total Return Investment Pool (TRIP) had earned less than the Short Term Investment Pool (STIP). He asked how this was possible. Executive Vice President and Chief Financial Officer Brostrom responded that much of the growth in expenses over the last two years, about $5 billion, was due to accounting for pension benefits. This was the result of lower returns and changes in actuarial assumptions made two year earlier. Because of the decline in the equity markets, the TRIP had a lower return than the STIP for 2020. Since July 1, however, TRIP earnings had increased to double digits due to the return of the equity markets. This had also helped increase the market value status of the UCRP.

In response to another question by Committee Chair Makarechian, Mr. Brostrom recalled that UC had liquidated the Blue and Gold Pool portfolio when the COVID-19 pandemic began to ensure that the University had sufficient liquidity for this difficult period and to provide a cushion against losses. Campuses were now beginning to move funds from STIP back into TRIP.

Committee Chair Makarechian asked if the increase in the net pension liability from 2018 to 2020 was due to the discount rate or lack of returns. Mr. Brostrom responded that there were two relevant factors. First, the University had made changes in its actuarial assumptions, extending the life expectancy of plan members, which added about $4 billion to the liability. Second, the discount rate was lowered from 7.25 percent to 6.75 percent, which added another $4 billion to the liability. The UCRP had not met the 6.75 percent rate for the past two years.

Upon motion duly made and seconded, the Committee approved the President's recommendation and voted to present it to the Board, Regents Drake, Estolano, Kounalakis, Leib, Makarechian, Muwwakkil, Park, Pérez, Reilly, and Sherman voting "aye."

## 6. APPROVAL OF THE 2020-26 CAPITAL FINANCIAL PLAN

The President of the University recommended that the University of California 2020-26 Capital Financial Plan be approved.

[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.]

Associate Vice President Peggy Arrivas observed that the 2020-26 Capital Financial Plan was being presented at an unusual time. The campuses had shifted to remote instruction in the spring, when the University began working on the Plan. The Plan was prepared with the assumption that the campuses would continue as they were currently, with a hybrid model of some remote and some in-person instruction. The University's seismic and Integrated Capital Asset Management Program (ICAMP) facilities assessments had led to more seismic and ICAMP projects prioritized by the campuses. Ms. Arrivas described this as a positive step and noted that UC had been moving in this direction over the past two years. In addition, due to the limited occupancy in UC student housing, some housing projects were being deferred in this year's Plan. Executive Vice President and Chief Financial Officer Brostrom added that Ms. Arrivas' team had done an outstanding job in making seismic evaluations. At this time, between 4,000 and 6,000 UC buildings had been evaluated for seismic safety. Even if the University reduced the amount of administrative and office program space, deferred maintenance represented a large capital liability, and one for which there was not an identified funding source. UC would have to find creative ways to finance necessary seismic upgrades and deferred maintenance for aging facilities.

Committee Chair Makarechian asked about the time frame and cost of accomplishing these projects. Mr. Brostrom responded that the cost for this Plan was over $25 billion, with about $11 billion in seismic safety projects, $12.7 billion in deferred maintenance, and $2 billion in infrastructure. ICAMP also considered the life cycle of facilities. Not all funding would be needed immediately, and these resources would be allocated over a five- or six-year period. An update on UC plans for seismic safety and deferred maintenance projects would be presented at a future meeting. Committee Chair Makarechian suggested that this update include information on how the projects would be financed.

Regent Park referred to the current opportunity to change the model of educational delivery and the implications this had for capital planning. She asked about the timetable for this analysis and if there was a process so that campuses would carry out this same kind of analysis. Ms. Arrivas responded that there had been some discussion of this by the Academic and Student Affairs Committee, and the Office of the President would work with the campuses on these questions in the coming year. Certain types of projects, such as large auditoriums, were not part of projects this year. These changes might take a few years to bring about. Mr. Brostrom added that these questions concerned not only the educational delivery model. There might also be changes to UC administrative and office spaces; some spaces might be repurposed.

Regent Park requested a written report describing a timeline and plan for this process. She asked about the overlap of creation of new space, renovation, and demolition. Ms. Arrivas responded that just now, at the end of October, the University had completed the Tier One assessments. Tier Two would be a study in greater depth, looking at plans, taking soil samples, and conducting additional analysis of facilities to determine how to retrofit facilities or if it was not possible to retrofit them. As this information was gathered in the coming months, there would be a determination of future projects. The data now available made it clear that there was a significant overlap of seismic safety and deferred maintenance projects, but more information was needed to determine retrofitting needs. Mr. Brostrom remarked that campus plans might evolve and change, with new construction replacing older buildings. This was the case of the Data Hub New Academic Building at UC Berkeley, which would replace four older buildings. The campus would then determine plans for the older buildings.

In response to another question by Regent Park, Mr. Brostrom confirmed that auxiliary enterprise projects would generally be self-funded and that medical center projects for the most part had a funding plan.

Regent Park referred to the category of projects for which funding had not been identified and asked if this determination was related to certain fiscal years and the life cycle of these facilities. Mr. Brostrom responded in the affirmative. As mentioned by Ms. Arrivas, there was a great deal of overlap between seismic safety and deferred maintenance projects. Campuses had been successful in securing philanthropy and other funds for new buildings, but it was difficult to identify funding for deferred maintenance projects. Regent Park asked that UC report on its funding plans for these projects.

Regent Estolano referred to the question of how administrative spaces might change. During the COVID-19 pandemic, it had become clear that not everyone has to show up for work in an office five days a week. This might change, and she anticipated that, next year, the Capital Financial Plan report would look different. She asked the University to think about how to document how these changes in administrative work might save money and lead to more sustainable, climate-friendly solutions. The University would not have to build as much office space. UC should consider new models. Mr. Brostrom responded that every campus had some work under way to consider the future of administrative work. There were opportunities in terms of capital facilities and real estate, to reduce the University's carbon footprint, and to attract talent in different places. UC Merced had been able to hire employees for research contract and grant accounting who were not located in Merced, but who came to campus for meetings about once a month.

Regent Estolano stated that she would like to see the University take a leading role in developing new models for how work is done; this would have a positive impact on the environment and the planet.

Upon motion duly made and seconded, the Committee approved the President's recommendation and voted to present it to the Board, Regents Drake, Estolano, Kounalakis, Leib, Makarechian, Muwwakkil, Park, Pérez, Reilly, and Sherman voting "aye."

7. **BUDGET, SCOPE, AND EXTERNAL FINANCING FOLLOWING ACTION PURSUANT TO THE CALIFORNIA ENVIRONMENTAL QUALITY ACT, THEATRE DISTRICT LIVING AND LEARNING NEIGHBORHOOD, SAN DIEGO CAMPUS**

The President of the University recommended that:

A. The 2020-21 Budget for Capital Improvements and the Capital Improvement Program be amended as follows:

From: San Diego: Theatre District Living and Learning Neighborhood – preliminary plans and partial working drawings – $35 million to be funded from housing reserves ($34 million) and campus funds ($1 million).

To: San Diego: Theatre District Living and Learning Neighborhood – preliminary plans, working drawings, construction, and equipment – $565 million to be funded with external financing ($564 million) and housing auxiliary reserves ($1 million).

B. The scope of the Theatre District Living and Learning Neighborhood (TD LLN) project shall provide:1) residential space of approximately 574,000 assignable square feet (ASF) comprised of 2,000 undergraduate student beds, 50 beds for resident advisors and live-in staff, and residential support space; 2) non-residential space of approximately 71,000 ASF comprised of flexible classrooms (17,100 ASF), offices for residential life and administrative staff (10,900 ASF), campus meeting spaces (9,000 ASF), student dining hall (17,700 ASF), a restaurant for students and campus community, including Theatre District patrons (3,800 ASF), convenience retail (1,500 ASF), and building maintenance and operations space (11,000 ASF); 3) underground parking for approximately 1,165 cars (325 net new spaces); and 4) public realm and vehicular circulation improvements including an improved campus entry at Revelle College Drive, realignment of Scholars Drive South, an extension of Ridge Walk, a valet/drop-off zone for the adjacent performing arts venues; a transit hub for campus shuttles; and recreation and outdoor wellness areas throughout the site.

C. The President be authorized to obtain external financing in an amount not to exceed $564 million plus additional related financing costs. The President shall require that:

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

(2) As long as the debt is outstanding, general revenues from the San Diego

campus shall be maintained in amounts sufficient to pay the debt service and to meet the related requirements of the authorized financing.

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

D. Following review and consideration of the environmental consequences of the proposed TD LLN project, as required by California Environmental Quality Act (CEQA), including any written information addressing this item received by the Office of the Secretary and Chief of Staff no less than 24 hours in advance of the beginning of the Regents meeting, testimony or written materials presented to the Regents during the scheduled public comment period, and the item presentation, the Regents:

Adopt CEQA Findings, affirming that the proposed project is consistent with and covered by 2018 Long Range Development Plan Environmental Impact Report for the La Jolla Campus and Addendum No. 5 to the 2018 Long Range Development Plan Environmental Impact Report for the Theatre District Living and Learning Neighborhood, previously considered by the Regents on September 17, 2020.

E. The President be authorized, in consultation with the General Counsel, to execute all 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.]

Committee Chair Makarechian introduced this item and recalled that, at the September 2020 meeting, the San Diego campus presented this project for approval of budget, scope, external financing, and design following action pursuant to the California Environmental Quality Act (CEQA). The Regents had questions related to the project's financial feasibility as well as the project cost. Due to these questions, the Regents amended the action to (1) authorize an additional $5 million to fund partial project working drawings, (2) approve the project design, and (3) adopt Findings for the project, having considered Addendum No. 5 to the 2018 Long Range Development Plan Environmental Impact Report (LRDP EIR) pursuant to CEQA. The action, as amended, was approved. The Regents requested that the campus revisit and reduce the project budget before returning to a future Regents meeting to request full budget and financing approval. The campus was now requesting full budget and financing approval for the Theatre District Living and Learning Neighborhood (TD LLN) project.

Chancellor Khosla noted changes the campus had made to the project since the September meeting. He stressed that the campus took very seriously the feedback it received from the Regents. UC San Diego was able to reduce the project budget by more than 12 percent and the campus reassessed the scope of the project to reflect a post-pandemic reality. A proposed large lecture hall space would be reconfigured for smaller, flexible classrooms. Student demand for housing was high and significant. The campus had a goal of housing up to 65 percent of its students in campus housing at below-market rental rates. At this time, the campus was unable to offer even a two-year housing guarantee to students, a terrible situation for an institution of this size and caliber. This project would add about 2,000 undergraduate student beds. Chancellor Khosla stressed the importance of the on-campus living experience for undergraduates and especially for transfer students, who are at UC San Diego for only a few years.

Committee Chair Makarechian congratulated Chancellor Khosla on having reduced the project cost from $645 million to $565 million, a substantial amount of savings. He asked about the campus' commitment to maintaining rental rates at a certain percentage below market. Chancellor Khosla recalled that, many years earlier, UC San Diego had made a commitment to rental rates at least 20 percent below market. At this point, campus housing rates were closer to 31 percent below market rates. Committee Chair Makarechian emphasized the importance of such a commitment for all campuses.

Regent Leib expressed support for the project.

Upon motion duly made and seconded, the Committee approved the President's recommendation and voted to present it to the Board, Regents Cohen, Drake, Estolano, Kounalakis, Leib, Makarechian, Muwwakkil, Park, Pérez, Reilly, and Sherman voting "aye."

8. **REPORT OF BUDGET TO ACTUAL EXPENDITURES FOR FISCAL YEAR 2019-20 FOR THE OFFICE OF THE PRESIDENT AND FIRST QUARTER FISCAL YEAR 2020-21 RESULTS**

[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.]

Associate Vice President Zoanne Nelson reported that actual expenditures for the Office of the President (UCOP) in 2019-20 were $23.7 million under the budget of $941.7 million. Year-end fund balances fell from $149 million to $55 million from the prior year to this year, a decrease of 63 percent. For the first quarter of fiscal year 2020-21, total actual expenses were approximately 21 percent of the total budget.

In response to a question by Regent Park, Ms. Nelson explained that $9 million would be carried over from the previous year.

Regent Park referred to figures included in the background materials for budget to actual expenditures for the first quarter of fiscal year 2020-21, which indicated underspending of about $47 million, yet these expenditures were about 21 percent of the total budget. She asked about the fact that this appeared to be tracking historical spending but not the budgeted amount, and if the budget process divided the year into four parts. Executive Director David Baltaxe responded that UCOP had recently begun monthly budgeting. The budgeting was spread evenly across the year, and the figures as stated were correct. Regent Park drew attention again to the statements that there was underspending, yet the expenditure was tracking historical patterns. Something might need to be adjusted.

9. **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 recalled that, in November 2016, the Regents adopted Regents Policy 5307: University of California Debt Policy. This helped the University in structuring debt to finance capital projects. The Office of the President had a few proposed changes to the Policy. These changes were being presented for discussion. Mr. Brostrom anticipated that an action item with amendments to the Policy would be presented at the January 2021 meeting.

Director Meghan Gutekunst provided a brief update on the University's debt portfolio. The University had approximately $25 billion of total debt outstanding. For the three primary credits—general revenue bonds, limited project revenue bonds, and medical center pooled revenue bonds—the debt outstanding was about $23.6 billion. UC continued to maintain strong credit ratings, in particular with regard to its general revenue bond credit. UC continued to evaluate opportunities for financing. Only about $166 million of UC debt was currently callable. If tax law were to change, the University might have the opportunity to refund about $5 billion of debt, which would result in about $800 million in savings. Mr. Brostrom added that his office was working with Federal Governmental Relations on this issue. The ability to carry out advance refunding would help the University, and UC had been able to do this until the 2017 tax law went into effect. UC hoped that this would become possible again under a new U.S. presidential administration.

Committee Chair Makarechian asked about the amount of UC's third-party debt and debt associated with joint ventures. Ms. Gutekunst responded that this debt was considered separately. This smaller amount of debt, about $1.3 billion, was in a financing trust structure, and $200 million of this would be callable beginning the following year. The University would evaluate opportunities to refinance this as well. In response to another question by Committee Chair Makarechian, Associate Vice President Peggy Arrivas confirmed that this debt was on the University's balance sheet. Ms. Gutekunst added that this debt was not included in the UC Debt Policy. UC would have to work with the third parties to move forward with any refunding.

Committee Chair Makarechian asked why UC would not do this as part of its Debt Policy. These transactions were on the balance sheet and affected UC's credit rating. He suggested that this be considered in the future. He asked why UC was suggesting shortening the requirement for days' cash on hand. Ms. Gutekunst explained that one of the proposed changes was a requirement that campuses maintain liquidity in the Short Term Investment Pool greater than or equal to 60 days. Currently, the University did not have a requirement for days' cash on hand for the campuses.

Committee Chair Makarechian recalled that there was a days' cash on hand requirement for the medical centers. Ms. Gutekunst explained that the medical center debt was part of the Debt Policy. This item was focused on the general revenue bond and limited project revenue bond credit. The medical centers had a requirement for 60 days' cash on hand, and the proposed amendment to the Policy would not change this. Mr. Brostrom observed that about 40 to 50 percent of the Total Return Investment Pool (TRIP) was liquid assets. The University now had more liquidity than it had earlier, before the TRIP was established. The campuses would like to maintain as much in TRIP as possible, with better returns, while still meeting liquidity requirements.

Committee Chair Makarechian commented that TRIP had been earning less than the Short Term Investment Pool (STIP). Mr. Brostrom responded that this had been only a momentary phenomenon.

Committee Chair Makarechian asked if the proposed amendment would maintain UC's credit ratings. Ms. Gutekunst responded that the Debt Policy would continue the requirement that the University maintain credit ratings in the AA rating category for the general revenue bond credit.

Regent Cohen stated his understanding that the proposed amendment would move the requirement or criterion of debt service as a percentage of operating expenses from the campuses to the system. He asked about the rationale for this change, and why one would not wish to apply this criterion both at the campus and system level. Ms. Gutekunst responded that one motivation for making these changes was to keep the Debt Policy updated and in line with external and internal requirements and standards. She believed that the debt service to operations metric was a useful measure for the UC system; at the campus level, because campuses were of different sizes, and as campuses moved to make budget cuts, one found that comparing debt service to operations could be a disadvantage for smaller campuses. Instead, it might be more appropriate to measure the amount of cash flow a campus was generating to ensure that it had sufficient cash flow to service debt.

Regent Cohen observed that the real value of this measure was to make sure that one was not overcommitting on debt and that one was leaving sufficient resources for operations. In the case of UC Merced, the campus was being built up, and Merced had more debt than a typical campus. Once this campus matured, it would be desirable to measure it using a campus-based measure, to ensure that no single UC campus was overcommitted with respect to the annual budget. Innovative public-private partnerships made sense and gave the University flexibility. UC must keep track of these projects and not forget that, once UC is committed to them, they operate just like traditional debt. Ms. Gutekunst responded that UC included the financing trust structure debt in the overall debt policy. The University ensures internally that these projects meet certain benchmarks before proceeding with them. The proposed amendment had loosened up auxiliary enterprise metrics to allow campuses to issue some limited project revenue bond debt for student housing projects, providing flexibility while ensuring that UC lives within its means. Mr. Brostrom added that it would be appropriate to have further discussions of financing trust structures, which were almost always project-specific. In some ways, their coverage requirements were more rigorous than for limited project revenue bonds. In many cases, UC has had to use campus guarantees to reach coverage ratios. This could be discussed at a future meeting.

Regent Cohen recalled that the Committee had discussed the creation of a working group focused on the University's long-term obligations. This idea had been put aside due to the COVID-19 pandemic. Regent Cohen asked that the Regents convene this group to address longer-term issues facing the University in order to avoid being taken by surprise, and to have a comprehensive plan to address liabilities.

Regent Park referred to the replacement of the debt service to operations measure at the campus level. She asked if a situation could arise in which specific campuses used up all the debt capacity to the detriment of other campuses, and what would prevent this from happening. Ms. Gutekunst responded that the way to prevent this was to maintain two important criteria for the rating agencies: strong operations and the resource base. These were key drivers for UC's current benchmarks, ensuring that positive operating cash flow covers the debt service and that there is sufficient days' cash on hand to continue operations for a certain number of months. With the campuses meeting both these benchmarks, UC anticipated that, collectively, it would be able to maintain its strong credit rating. Mr. Brostrom added that, if campuses can maintain a debt service coverage ratio of 1.1x or greater, they would not be using up the debt service; they would create revenues to cover the debt service. The medical centers had a debt service coverage ratio requirement of 3x, and, if they could meet this requirement, they would be generating revenues covering much more than debt service.

Regent Park asked if all the chancellors were in support of this proposed change. Mr. Brostrom responded that this proposal was presented to the chancellors and to campus chief financial officers. There were some concerns about liquidity and a desire to move more funds from STIP into TRIP.

Regent Park asked if the requirement for auxiliary debt service coverage of 1.1x was prudent; it had moved from 1.25x to 1.1x. Mr. Brostrom responded that he believed this was prudent. At this time, there was ample coverage in UC's housing bonds. This was indicated by the fact that both housing and medical centers were rated AA-. This was a strong credit rating for auxiliary enterprises.

Regent Park asked why the rate had been lowered to this level. Associate Vice President Peggy Arrivas explained that, in general, these projects were quite expensive. The University wished to ensure that revenue from new projects covered the cost of the projects, to keep rental rates for student housing low, to keep rental rates consistent across different campus housing facilities, and address the high cost of construction now.

Regent Park asked about a change in the language of the Debt Policy. The Policy had stated that the University's debt service must not exceed six percent of its operating budget; this language was being removed. The updated Policy would state that maintaining debt service to operations at or below six percent was a systemwide target. Ms. Gutekunst responded that the systemwide targets were a new feature added to the Policy. The University believed that it was important to continue to monitor the credit profile of the system and to report on this to the Regents. The two targets being added, debt service to operations and spendable cash and investments to debt, would help keep the Regents apprised regarding UC's credit status.

Regent Park asked about the proposed change from a hard cap of six percent on debt service to operations for campuses in existing policy to a systemwide six percent cap. Ms. Arrivas clarified that UC was moving from a six percent cap on expenses to a covenant that required having sufficient revenue to cover expenses, which was more restrictive for the campuses.

Regent Sherman asked about borrowing capacity as it related to the underfunded pension. Given the historically low interest rates at this time, he asked if there was arbitrage to be made by borrowing, which would reduce the amount of underfunding and the amortization of that amount. He asked if this approach would be possible. Mr. Brostrom responded that UC had been considering this. There had been a successful program of borrowing from STIP, which had increased the UC Retirement Plan (UCRP) funding ratio by about seven points. The University had borrowed externally for the UCRP, but this would be a hardened liability. The advantage of borrowing from STIP was that the University could change terms, delay interest, or take other actions that were not possible with an outside liability.

Regent Sherman asked about the annual cost of the unfunded liability. Mr. Brostrom responded that this cost was essentially equal to the discount rate. While remaining mindful of its liquidity needs, he believed that UC should consider another such borrowing program.

Regent Sherman asked if UC would have the capacity for external borrowing, specifically to reduce the amount of underfunding in the UCRP. Ms. Gutekunst responded that the University had about $4 billion to $6 billion in capacity recorded at the beginning of the year. UC had used a portion of this capacity. She opined that any use of this capacity to borrow for the UCRP would not leave future capacity for capital projects.

Committee Chair Makarechian asked that, when the revised Policy was presented to the Regents for approval, it include off-balance-sheet financing and that any exceptions to the Policy be reported to the Regents regularly. Mr. Brostrom responded that this would be done. He remarked that most exceptions were for housing projects, where the University wishes to keep rental rates low for students and grants a coverage waiver. Ms. Arrivas added that, when these exceptions are granted for a project, this is reported in the project action item. Mr. Brostrom stated that this could be reported separately as well.

## 10. ANNUAL ACTUARIAL VALUATION OF THE UNIVERSITY OF CALIFORNIA RETIREE HEALTH BENEFIT PROGRAM

[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.]

Regent Park referred to background information provided about projected increases in cash costs and increases in the number of UC retirees receiving retiree health benefits. She asked if this was due to the aging of the workforce and that a large number of employees would be retiring in the coming years or to longer life expectancy for retirees. The average cost per member, not including the implicit subsidy, would increase from about $5,000 to $7,000 in the next ten years. She asked how the University would address this. Executive Vice President and Chief Financial Officer Brostrom responded that the annual cash cost of this program, $334 million, was a small part of the overall UC budget of $41 billion. Accounting standards required that the discount rate be based on the risk-free cost of capital, and this had decreased from 3.5 percent to 2.21 percent. This led to what in Mr. Brostrom’s view was a huge disjunction in accounting, with expenses of $334 million turning into a liability of about $23 billion. He acknowledged that expenses were increasing and that a large number of employees would become eligible for retirement in the coming years, but underscored again that this component of the University’s expenses was much smaller than other expenses with which UC was grappling.

Deloitte Consulting representative Michael de Leon commented on the projected doubling of benefit payments over the next ten years. About half of this increase was due to an increase in the number of individuals receiving benefits. More people would become eligible for retirement and life expectancy would increase, so that Deloitte expected the number of retirees receiving benefits to increase from about 67,000 at present to about 90,000 over time. The remaining half of the increase was due to medical costs. Currently, Deloitte was expecting medical cost increases of five to six percent on a per capita basis, which would represent a long-term increase of four percent. Medical costs were expected to increase faster than inflation.

Regent Park reiterated that these costs and liabilities were a matter of concern, even if they were only a small part of the total UC budget. Mr. Brostrom responded that the larger issue was to control UC’s overall health benefit costs, which was a $2 billion expense. Retiree health benefit costs were a small part of this and were also influenced by the decisions UC made on its overall health benefits portfolio for employees. A change in the Medicare eligibility age would have a significant effect on retiree health benefit costs for UC. The University would carefully monitor any changes to the Affordable Care Act. Executive Vice President and Chief Operating Officer Nava added that benefits management was an important factor. A major change in the past year was the replacement of a more expensive health plan with a more cost-effective Medicare advantage plan. This had significantly reduced the overall cost of retiree health benefits. The University would continue to seek such opportunities.

Regent Park noted that there had been discussions about UC increasing the ability of UC Health to serve UC employees. UC had making cost containment efforts for some time, and she wondered how much more cost containment would be possible. UC would try to advocate for favorable action by the federal government. Mr. Brostrom referred to a chart in the background materials which showed the pay-as-you-go cash costs of retiree health benefits, both recent and projected for the coming ten years. In the preceding ten years, the number of retirees increased, but the cash costs did not increase significantly. During this period, the University strove to control retiree health benefit costs and to keep them from growing by more than four percent per annum. He acknowledged that cost containment in this area was becoming more difficult, and that the University needed to continue focusing on this challenge.

Committee Chair Makarechian asked if the University still took the position that it did not have an obligation to cover retiree health benefits. Associate Vice President Peggy Arrivas responded that, because the University had a practice of paying retiree health benefits, it was obligated to record this liability in its financial statements.

Committee Chair Makarechian asked if this liability should be referred to as a contingent liability. Ms. Arrivas responded that, under accounting principles, this was not considered a contingent liability, but a real liability that must be included in UC financial statements. Interim Vice President Lloyd stated that it had been communicated to UC employees and retirees over the years that retiree health benefits are not an accrued or vested benefit entitlement, and can be changed by the University at any time. However, since retirees have been receiving this benefit for many years, this would be very controversial. Mr. Brostrom concurred with the statement of Ms. Arrivas that retiree health benefits were considered a liability even though they were not a vested right or benefit.

Regent Cohen stated that, in the long term, the University would be in a better position if it had a plan in place to address this liability. When accounting standards were changed, rating agencies allowed government agencies some leeway about such plans, but this would change. He anticipated that those government agencies with a plan would be financially better off than others which were still using a pay-as-you-go system.

Regent Pérez commented that it would be complicated to move away from an expectation of providing retiree health benefits, especially for staff covered by collective bargaining agreements. This would be a fundamental shift. He agreed with Regent Cohen that the University should explore the long-term benefits of pre-payment for retiree health benefits rather than the pay-as-you-go model. Mr. Brostrom responded that, if UC had excess funds, he would strongly suggest moving them into the UC Retirement Plan or a health care trust fund.

11. **ANNUAL ACTUARIAL VALUATIONS FOR THE UNIVERSITY OF CALIFORNIA RETIREMENT PLAN AND ITS SEGMENTS AND FOR THE 1991 UNIVERSITY OF CALIFORNIA-PUBLIC EMPLOYEES' RETIREMENT SYSTEM VOLUNTARY EARLY RETIREMENT INCENTIVE PROGRAM**

[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 Chair Makarechian asked if the Regents should plan to review the UC Retirement Plan (UCRP) discount rate at the January or March 2021 meeting, based on current trends. Executive Vice President and Chief Financial Officer Brostrom responded that the University generally carries out an experience study every four years, reviewing the discount rate and actuarial assumptions. It was now the second year following such a study, and Mr. Brostrom would recommend keeping to the four-year cycle.

Committee Chair Makarechian referred to the impacts of the COVID-19 pandemic. If UC waited two years, it might be too late to address this situation. Associate Vice President Peggy Arrivas responded that the University had informally reviewed the UCRP investment strategy in September with Segal, the University's consulting actuary, and validated that this strategy supported the use of the 6.75 percent discount rate. She underscored the need to consider long-term rates rather than short-term returns, which might be affected by the COVID-19 pandemic for only a year or two.

Committee Chair Makarechian stated that he was concerned about rates over the long term. Mr. Brostrom commented that one should focus on the actuarial value of assets, which showed that the UCRP was 79 percent funded. On a market value of assets basis, the UCRP was 76 percent funded. Since July 1, UCRP had added eight points, so that it was 84 percent funded, which was quite strong compared to other defined benefit programs. UC needed to continue increasing its employer contribution, and, to the extent possible, continue borrowing from the Short Term Investment Pool (STIP) up to the Annual Required Contribution, given the excess returns possible from STIP.

Committee Chair Makarechian expressed concern about the increase in the actuarial accrued liability. He asked that the UCRP status and liabilities be discussed in January or March 2021.

The meeting adjourned at 4:35 p.m.

Attest:

Secretary and Chief of Staff