

Office of the President

TO MEMBERS OF THE FINANCE AND CAPITAL STRATEGIES COMMITTEE:

ACTION ITEM

For Meeting of July 19, 2023

**AUTHORIZATION OF TERMS FOR URBAN SERVICES AGREEMENT AND
POTENTIAL ANNEXATION, MERCED CAMPUS**

EXECUTIVE SUMMARY

In support of the Governor's May 2022 Compact with the University of California and the University's mission to educate more California students, UC Merced continues to grow. The campus is located outside of the jurisdictional limits of the City of Merced (City) and therefore, following approval of UC Merced's first Long Range Development Plan (LRDP) in 2002, the Board of Regents authorized the President to execute an agreement with the City in January 2003, consenting to the City's future annexation of the first phase of the Merced campus (102 acres) in exchange for provision to the campus of City water and sewer services outside of its jurisdictional boundary (Services Agreement). Through the 2003 Permanent Financing Capital Facilities Fee Agreement, the City financed the construction of water and sewer lines to the Merced campus and the campus has been paying the debt service, with the understanding that, should other development connect to these lines, those connection fees would be reimbursed to the campus through 2033. In 2016, during the approval process for the UC Merced Revised 2020 Project, the Services Agreement was amended to expand the provision of water and sewer services (and the area subject to future annexation) to the approximately 117-acre Revised 2020 Project area, for a cumulative total of 219 acres. The current Services Agreement provides for City water and sewer services for an enrollment of up to 10,000 students, which the campus anticipates surpassing in the coming years. Also in 2016, the campus entered into a transportation improvement funding agreement with the City (2016 Transportation Agreement), which sets forth the obligations of the parties with respect to the transportation improvements required to mitigate the impacts of the Revised 2020 Project and buildout of full LRDP development to specific roadways.

The City now wishes to annex the entirety of the 1,026-acre main campus as identified in UC Merced's recently updated 2020 Long Range Development Plan (2020 LRDP), and has requested UC Merced's partnership to submit an annexation application to the Merced Local Agency Formation Commission (Merced LAFCO), the agency charged with reviewing and approving changes in boundaries for cities and special districts. If approved by the Merced LAFCO, the City would be obligated to provide water and sewer services to the entire campus on the same terms as any other City ratepayer, and a Services Agreement requiring the City to provide water and sewer services to 219 acres of the campus would no longer be necessary.

Partnering with the City to pursue the Merced LAFCO's authorization to annex the entire campus area provides an opportunity for the campus to renegotiate the 2003 Permanent Financing Capital Facilities Fee Agreement and the 2016 Transportation Agreement to ensure that public services are available and fairly priced to support campus growth well into the future, and require the campus to only pay its proportional share of the cost for transportation improvements that serve the growing City environs. In addition, partnering with the City to request annexation of the entire Merced campus as opposed to only the currently developed portions will enable the City to authorize development of adjacent properties with nearby housing, dining, and retail options that better serve the campus community.

The Board has not expressly reserved the authority to approve the Services Agreement, the 2003 Permanent Financing Capital Facilities Fee Agreement, and the 2016 Transportation Agreement, or to authorize annexation of the campus, and the general authority to enter into such agreements has been delegated to the Chancellors pursuant to Bylaw 31. However, UC Merced is bringing this item to the Board given that it constitutes a significant development affecting the University and campus. If approved, UC Merced will seek delegated authority from the President to the Chancellor to approve and execute the agreements described in the Recommendation section below.

RECOMMENDATION

The President of the University recommends that the Finance and Capital Strategies Committee recommends that the Regents:

- A. Authorize the President, on behalf of the Merced campus, to approve and execute, after consultation with the General Counsel, an agreement with the City memorializing the terms pursuant to which the University will support the City's application to annex the entire acreage of the Merced campus (1,026 acres) as follows:
 - (1) Permit the Merced campus to support annexation of the entire acreage of the Merced campus into the City for the purpose of providing City services, provided that any conditions proposed by the Merced Local Agency Formation Commission (Merced LAFCO) in its draft resolution are not inconsistent with the following provisions:
 - (a) The entirety of the UC Merced campus as identified in the 2020 Long Range Development Plan (LRDP), a total area of 1,026 acres, will be annexed into the City of Merced.
 - (b) The City will provide water and sewer services to the entire 1,026-acre campus. The City's service obligation will be tied to the campus population and development as described in the UC Merced LRDP, as amended or updated by the Regents over time (i.e., upon annexation, the City's service obligation shall increase to 15,000 students, the enrollment projection in the 2020 LRDP,

- and shall further increase if and when this enrollment projection is updated).
- (c) There shall be no cap or limitation on campus enrollment, or the amount and type of campus development and uses (i.e., total building space, student housing, parking, retail/restaurant space, and incubator space).
 - (d) The University retains its full powers of organization and government set forth in Article IX, Section 9, of the California Constitution.
- (2) Monthly water and sewer service use charges shall accurately reflect the City's cost to provide service to the UC Merced campus, through rates based on the applicable user category as defined in the City of Merced Municipal Code (MMC), consistent with rates paid by other users of the same category.
 - (3) The new agreement will maintain the current "per student" charge structure for water and sewer facilities charges set forth in the Services Agreement, both up to and beyond enrollment of 10,000 students. Any future capacity/connection charges for additional campus development will be negotiated by the parties, subject to the limitations on charges for capital improvements set forth in Government Code Section 54999.3.
 - (4) The City will extend by 10 years, through 2043, the reimbursement period for campus-provided water and sewer infrastructure (from developers who connect to the campus-funded water and sewer lines in the future) in the 2003 Permanent Financing Capital Facilities Fee Agreement.
 - (5) The City will modify the 2016 Transportation Agreement to clarify that the campus shall only contribute its proportionate share of the cost to widen Bellevue Road.
- B. The President, after consultation with the General Counsel, shall be authorized to approve and execute any additional documents necessary to implement the terms of the new agreement.

BACKGROUND

Campus Development and Urban Services

In January 2002, the Regents approved the first Long Range Development Plan (LRDP) for the UC Merced campus. Following approval of the LRDP, the Regents authorized the campus to enter into an urban services agreement (Services Agreement) with the City for the provision of water and

sewer services to Phase 1 of the campus, covering approximately 102 acres.¹ As a condition of the Services Agreement, UC Merced and the City entered into an “agreement to annex” Phase 1 of the campus into the City. Concurrently, through a separate 2003 Permanent Financing Capital Facilities Fee Agreement, the campus agreed to pay to extend the City’s water and sewer lines to the campus at a cost of approximately \$8.5 million, subject to future reimbursement as development in the area surrounding the campus occurs and other users connect to the extensions.

The next campus LRDP, approved by the Regents in 2009, contemplated overall development of the campus to support an eventual enrollment of 25,000 students, and specifically contemplated development of the UC Merced 2020 Project (2020 Project) to accommodate up to 10,000 students. The 2009 LRDP was amended in 2013 to better accommodate the development proposed by the 2020 Project. In 2016, the Regents approved the 2020 Project, subject to additional design changes, and with development sufficient to accommodate approximately 9,793 students (the Revised 2020 Project).

During the approval process for the Revised 2020 Project, the Services Agreement was amended to expand the provision of City water and sewer services to the approximately 117-acre Revised 2020 Project area, for a cumulative total of 219 acres and an enrollment of 10,000 students. The amended Services Agreement did not involve a change to the existing water and sewer lines constructed between the campus and the City limits or an amendment to the 2003 Permanent Financing Capital Facilities Fee Agreement, as the existing facilities had adequate capacity to serve the additional development.

The 2020 LRDP plans for the next increment of growth across the entire 1,026-acre campus, building upon the recent completion of the Revised 2020 Project. It projects an enrollment of 15,000 students. To serve this growth, the campus needs City water and sewer services for the additional 807 acres and 5,000 students, through either an updated Services Agreement or via annexation into the City. The campus believes the best course of action is to agree to annexation of the full campus acreage, in exchange for an agreement that will include the terms set forth herein. To this end, the campus has engaged in discussions with the City for the past six months, and the parties have agreed in principle to the recommendations set forth herein, which were endorsed by the Merced City Council on June 19, 2023.

The Board has not expressly reserved the authority to approve the Services Agreement, 2003 Permanent Financing Capital Facilities Fee Agreement, and the 2016 Transportation Agreement, or to authorize annexation of the campus, and the general authority to enter into such agreements has been delegated to the Chancellors pursuant to Bylaw 31. However, UC Merced is bringing this item to the Board given that it constitutes a significant development affecting the University and campus.

¹ The urban services agreement covers only water and sewer services. All other services are provided by the County or by the campus itself.

Annexation Process

Under the Cortese-Knox-Hertzberg Local Government Reorganization Act of 2000, each county has a Local Agency Formation Commission (LAFCO), which reviews and approves changes in boundaries for cities and special districts, including annexation. In general, the role of LAFCO is to ensure that government services are provided efficiently and economically while preserving open space and prime agricultural lands and discouraging urban sprawl.

Normally, new territory cannot be annexed into the City unless it is contiguous to the City at the time the annexation proposal is initiated. Because the UC Merced campus is located approximately two miles northeast of the City's limits, annexation of the campus would have been prohibited under the LAFCO statute. Instead, the City may provide new or extended services by contract or agreement outside its jurisdiction only upon LAFCO approval. Merced LAFCO reviewed and approved the 2003 and 2016 Services Agreements. Such approval generally requires an agreement to annex the out-of-boundary site, though actual annexation can occur only after the City has satisfied all legal requirements for annexation, the annexation of any intervening property has been completed, and LAFCO has approved the annexation proceeding, including the City's plan for providing services.

In 2020, the Governor signed AB 3312 (Gray), which specifically permits the City to submit a LAFCO application to annex the 1,026-acre UC Merced campus, along with a road strip that connects UC Merced to the City, *before* the intervening properties are annexed. Upon the City's annexation of UC Merced, the private property adjacent to the campus would be eligible for annexation by the City under AB 3312. (See Attachment 2 – A.B. 3312-Eligible Properties.) This will enable development to occur around the campus. Annexation into the City would not affect the University's exemption from local land use regulation as a constitutionally created State entity.

Of note, AB 3312 identifies significantly more acreage than the current Services Agreement between the City and UC Merced, which covers only 219 acres. (See Attachment 1 – Annexation Map.) If the City were to annex only 219 acres of the campus, as currently contemplated in the Services Agreement, the remaining campus acreage would not be eligible for City services (and would require a new out-of-boundary service agreement), and many of the properties adjacent to the campus would not be eligible for annexation.

SCENARIOS FOR CAMPUS GROWTH

In order to grow beyond 219 acres and 10,000 students, the campus needs additional water and sewer services. The campus could pursue development of its own water and sewer services, but this option, in particular the provision of potable water for drinking, would require entering into an extensive and uncertain regulatory procedure, in addition to significant time and expense. While the campus has several functioning wells, they are currently used for irrigation only and are non-potable. The Services Agreement also prohibits the campus from disconnecting from the City water and sewer system until 2026 and payment in full of the water/sewer lines.

Barring development of its own water and sewer capability, two options are feasible for the campus to serve its future population. Option 1 is to pursue approval through Merced LAFCO of an expanded urban services agreement with the City, but the City is opposed to that approach because it wants to annex the adjacent properties under AB 3312, and to do that, the entire 1,026-acre campus must be annexed first. The City is not obligated to agree to an expanded agreement to provide out-of-boundary services. This leaves Option 2, which is to agree to annexation of the entire campus into the City. This approach is preferred by the campus for a number of reasons.

The campus has negotiated a favorable term sheet with the City in exchange for an agreement to annex the entire campus, including:

- A commitment by the City, subject to LAFCO approval, to provide water and sewer service for the entire campus acreage and future campus growth as envisioned in the 2020 LRDP and any subsequent LRDPs approved by the Regents;
- Renegotiated terms in the existing 2003 Permanent Financing Capital Facilities Fee Agreement, which would entitle the Merced campus to seek reimbursement from future developers for an additional 10 years (through 2043) for debt service it has been paying the City for the construction of water and sewer lines to the Merced campus;
- Renegotiated terms in the existing 2016 Transportation Agreement to limit the campus's financial contribution to the cost to widen Bellevue Road;
- Clarity around future rates and charges for water and sewer services,

Each of these terms is described below in more detail.

In addition, annexation would allow for sorely needed private development of housing, retail and dining in the areas surrounding the rural campus.

While authorization to enter into this agreement does not guarantee that annexation will be successful, it will allow the campus to actively support the City's application for annexation. The agreement will also protect the campus in the event that LAFCO proposes conditions that are inconsistent with key terms. For the 219 acres of the campus that are already subject to an annexation agreement with the City, there are narrow exceptions pursuant to which the campus may effectuate termination of the annexation proceedings: (1) if any LAFCO condition is contrary to law, (2) would impose significant and unreasonable costs on either party (annual cost greater than \$2 million), or (3) materially infringe on either party's lawful powers of governance or organization. For the remaining 807 acres of the campus, the agreement with the City will require termination of the proceedings, i.e., the City's withdrawal of its annexation application, if LAFCO imposes a condition that is inconsistent with the terms set forth herein.

KEY TERMS

Area Subject to Agreement

The current Services Agreement only authorizes water and sewer service and annexation for 219 acres. The City is seeking to have the full acreage of the main campus (1,026 acres) annexed.

Once annexed, the entire campus could access City water and sewer services without having to negotiate with the City and return to LAFCO for approval of a revised Services Agreement.

Development, Land Use, and Enrollment Limitations

Development and enrollment limitations are included in the current Services Agreement covering 219 acres of the Merced campus, which were based on the Revised 2020 Project. These include maximums for total square footage of building space (3,145,900 gsf), housing (5,000 beds), parking (5,050 spaces), retail and restaurant building space (25,000 gsf), incubator building space (20,000 gsf), and a maximum enrollment of 10,000 students. The campus is nearing many of these limits. If annexed, these limitations would be removed.

Monthly Water and Sewer Service Charges

Water service charges are currently based on the applicable user category under the existing Merced Municipal Code (MMC) Section 15.36.050: *Residential, Industrial, Commercial – Metered Service Schedule*, which is the base rate generally paid by all users receiving metered services. In Fiscal Year 2021-22 the average net rate was \$0.86 per one hundred cubic feet (HCF) of water, and UC Merced used 178,975 HCF for an annual charge of \$153,539.15. Sewer service charges are also based on the applicable user category under the existing MMC Section 15.12.070: *Commercial and Industrial – Rate Determination Schedule Based on Metered Water Schedule – “Government Buildings”* and determined by metered water usage. In Fiscal Year 2021-22 the average net rate was \$3.28 per HCF for an annual charge of \$587,038. The estimated total annual water usage needed to serve a campus enrollment level of 25,000 students is approximately 492,000 HCF.

Pursuant to MMC 15.12.025 and 15.36.045, base monthly sewer and water service charges are adjusted annually by an amount equal to the percent change in the All Urban Consumers Index, U.S. City Average (USCA), as supplied by the Bureau of Labor Statistics. The campus shall be charged in the same manner as any other user in the same category. UC Merced will reserve the right to contest new or increased charges to which it has not previously agreed. The term sheet negotiated with the City would ensure that the same rate structure for monthly sewer and water service is maintained and applicable to the entire campus area.

Water and Sewer Facilities Charges

Water and sewer facilities charges are one-time charges to recover the City’s costs of existing facilities and that are necessary to establish new or expand existing facilities to provide capacity to serve the usage on the property.

As part of the original (2003) and amended (2016) Services Agreements, the City and UC Merced agreed on water and sewer facilities charges for Phase 1 and the Revised 2020 Project, which were assessed pursuant to the MMC Chapters 15.36 and 15.16 for water and sewer, respectively. These charges were based on the acreage of area proposed for development (excluding open space and natural lands), the specific sewer district in which campus

development would occur, and the size of the water and sewer mains installed under the 2003 Permanent Financing Capital Facilities Fee Agreement (see section below).

Due to the uncertainty of campus development over a long-range planning horizon, the Services Agreement included additional “*Future Sewer Facilities Charges*” to account for increased enrollment necessitating additional sewer capacity to be calculated on a per-student full-time-equivalent (FTE) basis for any annual increase in enrollment up to 10,000 students. This has the effect of spreading out the payment of sewer facilities charges in tune with the campus’s growth, rather than requiring full payment in advance. In 2020, the charge was \$613.73 per-student increase in enrollment; this per-student charge was determined by a third-party consultant and is based on representative UC Merced sewer strength and flow data and unit costs from which the City’s connection fees are derived. As with the monthly water and sewer service charges, the per-student fee is subject to annual increases computed by the U.S. City Average (UCSA) as defined in MMC Section 15.16.030. For 2019 and 2020, the charges have amounted to \$102,645.64 in 2019 and \$212,253.44 in 2020, based on year over year enrollment increases of 445 and 338, respectively.

Under the proposed term sheet, the structure for sewer facilities charges will maintain the current “per student” charge structure as set forth in the Services Agreement, both up to and beyond enrollment of 10,000 students. Any future water capacity/connection charges for additional campus development will be negotiated by the parties, subject to the limitations on charges for capital improvements set forth in Government Code Section 54999.3. As described above, during the negotiations, the City will need to detail its plans for identified facilities and the parties will agree on an amount or rate schedule that is non-discriminatory.

Reimbursement for Infrastructure Investments

As part of the construction of UC Merced, the University funded the installation of necessary sewer and water infrastructure to serve the campus at a cost of approximately \$8.5 million. To fund this initial investment, the City secured permanent financing from the California Infrastructure and Economic Development Bank, to which UC Merced contributes annual debt service payments that will end in 2034. UC Merced has approximately \$6.3 million in payments outstanding, ranging from approximately \$500,000 to \$550,000 per year.

The 2003 Permanent Financing Capital Facilities Fee Agreement contains a provision allowing for reimbursement of capital facilities fees when third-party users connect to the system for a 30-year reimbursement period to 2033. Reimbursements include connection fees (separate from all facilities charges) paid by third-party users that connect to the water and sewer infrastructure developed and funded under this agreement. The City deposits any collected fees into a special account and then modifies UC Merced’s remaining debt service payment schedule to reflect the inclusion of the collected amount. If the City extends any discounts or fee waivers, the City must repay that amount into the special account. The reimbursement provisions are also provided in MMC Sections 15.08.150(B) [sewer] and 15.40.080(B) [water].

The proposed term sheet with the City will extend the reimbursement provision an additional ten years, to 2043, and be revised to address the reimbursement procedure after the fulfillment of the debt service. This is based on the fact that an increase in connections to the system is not likely to occur until after annexation and 20 years have already elapsed from the original agreement.

Other Public Services

At this time, no other services such as Police, Fire, Animal Control, and/or Trash/Recycling are being requested from the City. Should the University be interested in obtaining these services in the future, separate negotiations and agreement can occur.

Transportation

In 2016, the City and the campus entered into the 2016 Transportation Agreement setting forth the obligations of the parties with respect to roadway improvements required to mitigate impacts of campus development associated with the Revised 2020 Project. The 2016 Transportation Agreement includes the campus's funding for several major road improvements, including the widening of Bellevue Road from two to four lanes. For the Bellevue project, the campus agreed to advance 83 percent of costs for its share and the University Community Properties.² The 2016 Transportation Agreement provides two mechanisms for partial reimbursement.

Since the 2016 Transportation Agreement was executed, there are new circumstances that require clarification, including the transportation assumptions for fee structure and timing, restructuring of the anticipated development pattern through AB 3312 that could affect the University's proportional share, the availability of a new travel demand model, and the amount of reimbursements that the campus may be eligible to receive for its contributions to future road improvements.

The dramatic slowdown in the state economy as a result of the 2008 financial crisis, which strongly affected the San Joaquin Valley, made it impractical to move forward with the University Community Properties development. Under the 2016 Transportation Agreement, the proportionate reimbursement provision currently only applies to the University Community Properties (now VST and the Hunt property). Through AB 3312, VST, but not the Hunt property, can be annexed and developed; additionally, the University Vista, UC Villages, and Branford Point developments adjacent to the campus are also eligible for annexation. See Attachment 2 for a map of properties that would be eligible for development following annexation.

² The 2009 LRDP EIS/EIR evaluated campus development up to 25,000 students and the development of University Community North and University Community South (collectively, University Community Properties). Today, University Community North is VST and University Community South is the Hunt property (south of VST). See Attachment 2.

The term sheet with the City will amend the transportation agreement with the following terms:

- Parties agree that AB 3312-eligible properties and other future development benefiting from the widening of Bellevue Road from two lanes to four lanes between G Street and Lake Road (“Bellevue Widening Project”) should contribute their proportionate share of the Project’s costs.
- Campus shall contribute its proportionate share of the cost of the Bellevue Road Widening Project. Prior to City’s commencement of the design phase for widening of Bellevue Road, City and Campus shall agree on the appropriate assumptions and methodology to determine proportionate share allocation. City shall prepare a study at Campus’s expense, similar to the process laid out in Section 6(b) of the 2016 Transportation Agreement. Alternatively, parties can agree to utilize an already-completed study.
- If the City constructs the Bellevue Road Widening Project:
 - Shift trigger for Campus payment from 9,000 ADT (average daily trips) to 11,600 ADT.
 - Campus to pay City for its proportionate share of the design phase for the Bellevue Road Widening Project within 60 days of commencement of the engineering and environmental analysis.
 - Campus to pay City for its proportionate share of construction costs (including right of way acquisition, environmental, engineering) for the Bellevue Road Widening Project in accordance with the payment schedule set forth in Section 4 of the 2016 Transportation Agreement.
- If a private party constructs the Bellevue Road Widening Project:
 - Campus to reimburse private party for Campus’s proportionate share of construction costs as defined by Merced Municipal Code Section 17.58.090 within 180 days of City’s acceptance of the Bellevue Road Widening Project.

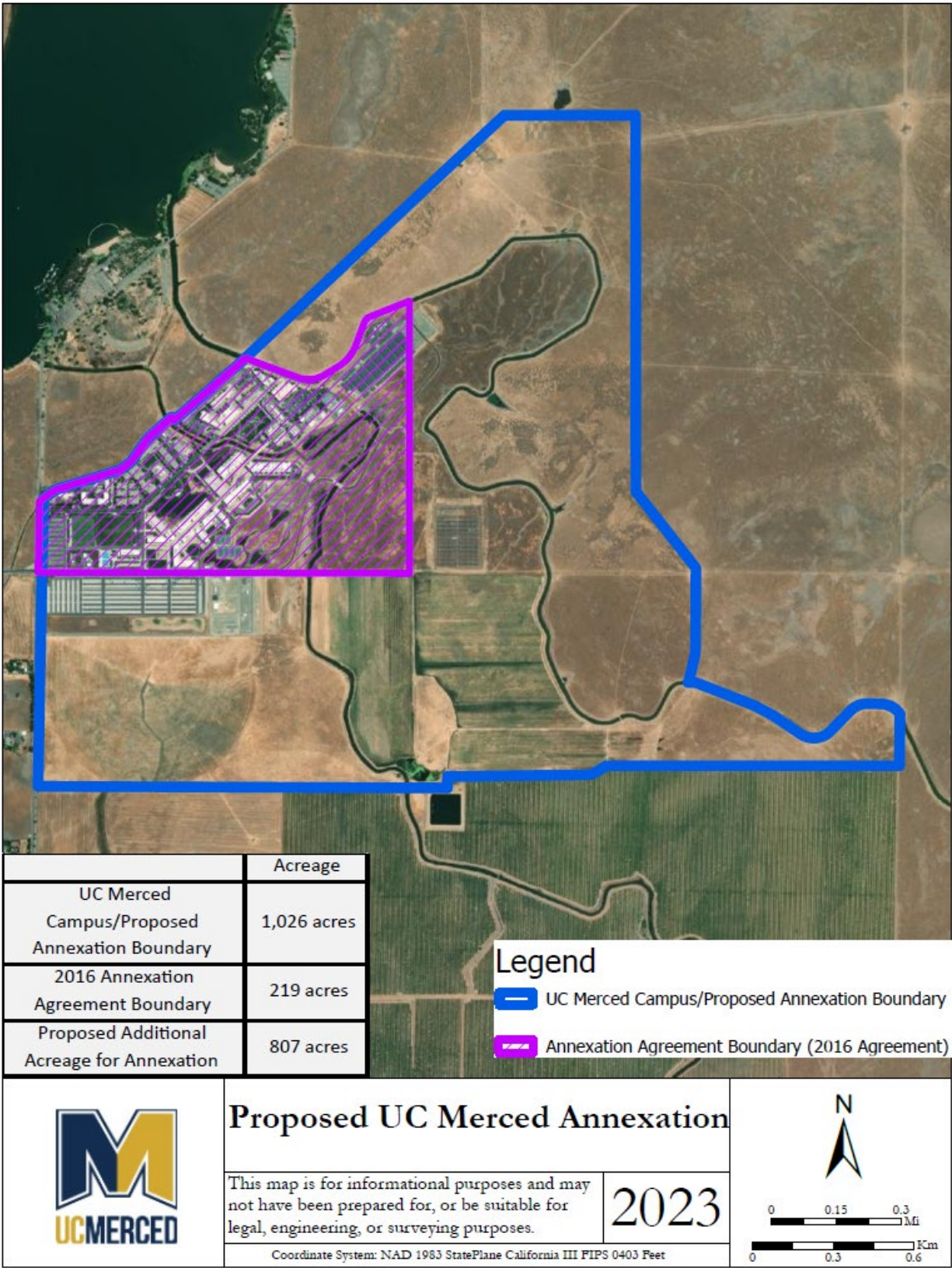
KEY TO ACRONYMS

2002 LRDP	UC Merced 2002 Long Range Development Plan
2009 LRDP	UC Merced 2009 Long Range Development Plan
2020 LRDP	UC Merced 2020 Long Range Development Plan
LAFCO	Local Agency Formation Commission
UCM	University of California, Merced

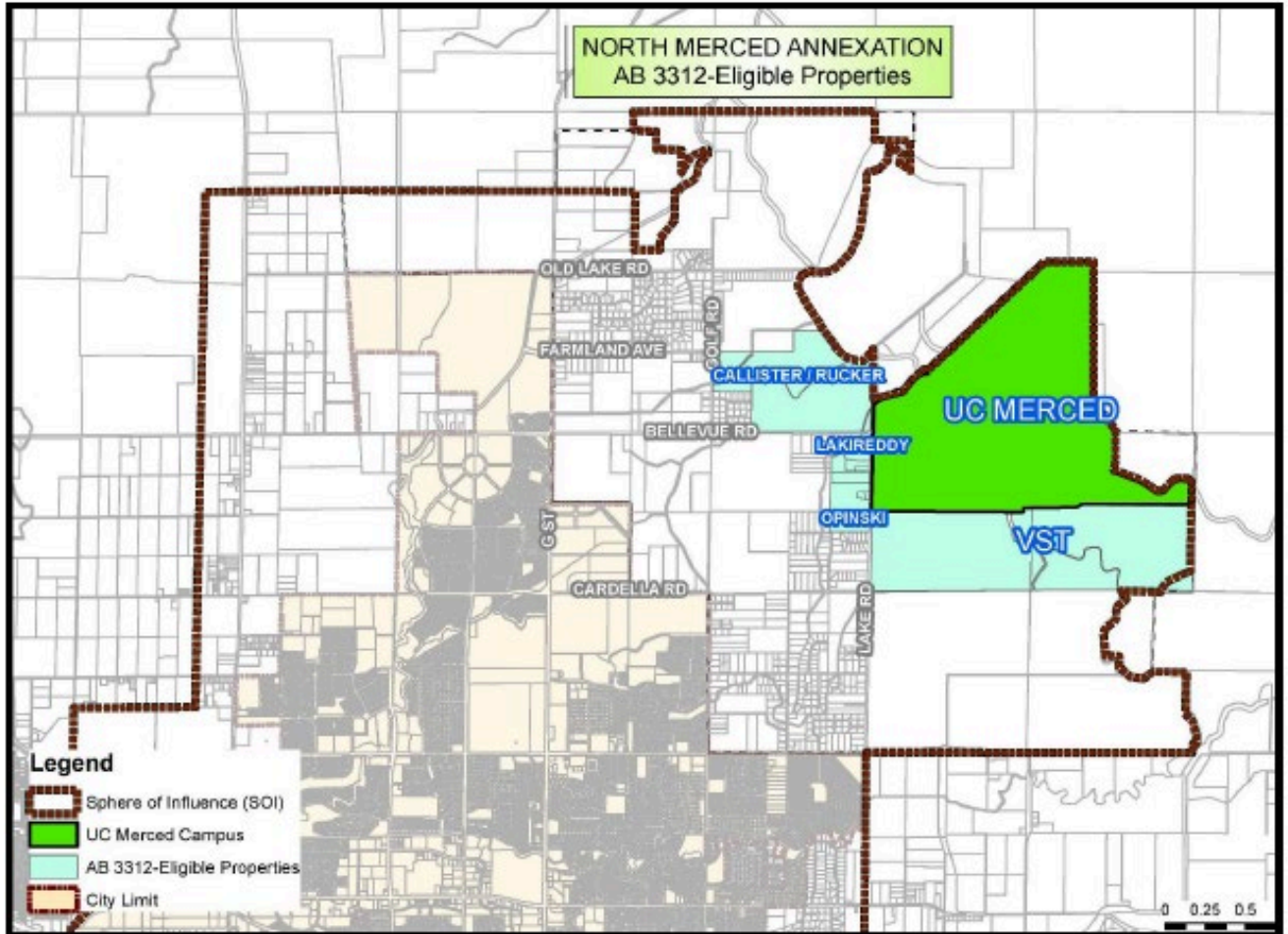
ATTACHMENTS

Attachment 1:	UC Merced Annexation Map
Attachment 2:	A.B. 3312-Eligible Properties
Attachment 3:	Roadway Network Map

ATTACHMENT 1: UC MERCED ANNEXATION MAP



ATTACHMENT 2: A.B. 3312-Eligible Properties



VST – Virginia Smith Trust

Callister/Rucker – University Vista (Playa Equities)

Lakireddy – UC Villages

Opinski – Branford Point

[illegible]UC Merced 2020 Long Range Development Plan Project
Roadway Network