

**Office of the President
May 8, 2002**

TO MEMBERS OF THE COMMITTEE ON FINANCE:

ITEM FOR ACTION

For Meeting of May 16, 2002

**AUTHORIZATION TO MORTGAGE PROPERTY, SAN FRANCISCO ART
INSTITUTE**

The President recommends that the Committee on Finance recommend to The Regents that:

- (1) The President, in consultation with the General Counsel, be authorized to provide for the subordination of The Regents' remainder interest in the 800 Chestnut Street property to the interests of a lending or conduit financing authority for the benefit of the San Francisco Art Institute.
- (2) No funds of The Regents shall be pledged in any financing contemplated by the San Francisco Art Institute.
- (3) Officers of The Regents be authorized to execute all documents necessary in connection with the above.

BACKGROUND

As designated by the 1893 trust agreement between The Regents and Edward F. Searles, The Regents serve as "remainder trustee" for property donated by Searles to the San Francisco Art Association, predecessor to the current San Francisco Art Institute (SFAI). As discussed further below, SFAI's principal facilities are now located at 800 Chestnut Street. In 1998, SFAI borrowed from the California Educational Facilities Authority (CEFA), a state conduit issuer for private nonprofit corporations, and pledged properties not subject to the trusteeship of The Regents. SFAI would like to secure additional financing through a lender or conduit financing authority and proposes to provide the lender with a security interest in the 800 Chestnut Street property, which is senior to that of The Regents in the property, provided that The Regents approve the actions contemplated by this Item

History of the Relationship

The San Francisco Art Institute is an internationally distinguished private degree granting college of fine arts with a current enrollment of approximately 550 undergraduate and 150 graduate students, plus 300 continuing education and non-degree students. SFAI has 32 full and part-time core faculty and approximately 70 adjunct and visiting faculty per academic term. The Institute is accredited by the Western Association of Schools and Colleges and by the National Association of Schools of Art and Design. SFAI offers the Bachelor and Master of Fine Arts degrees and post-baccalaureate programs in filmmaking, new genres, painting, photography,

printmaking, interdisciplinary, and sculpture/ceramic sculpture. SFAI is governed by an independent, 40-member board of trustees. The Institute celebrated its 125th year in 1996.

The San Francisco Art Institute is associated with the University of California by virtue of a trust agreement between The Regents and Edward F. Searles. Mr. Searles executed a trust agreement in 1893 under the terms of which The Regents were identified as the *de facto* remainder trustee of certain property to be used for "...an institute of art under the control and management of the San Francisco Art Association." Since its founding in 1871, the San Francisco Art Association has changed its name several times. It currently operates as the San Francisco Art Institute.

Mr. Searles, who was married to the widow of Mark Hopkins, inherited the bulk of his wife's estate when she died in 1891. The property donated to the San Francisco Art Association under the 1893 trust agreement was the Mark Hopkins mansion on the southeast corner of California and Mason Streets in San Francisco - now the site of the Mark Hopkins Hotel. That property was sold in 1926 and the proceeds were used to purchase the land at 800 Chestnut Street in San Francisco where the Art Association ultimately built its current buildings.

The 800 Chestnut Street site, which is located on approximately 65% of a city block on the northeast slope of Russian Hill, is comprised primarily of two interconnected buildings. The original building, constructed in 1926, is approximately 52,000 gross square feet and houses the administrative offices, library, an art supply store, classrooms, and galleries. The building bears City of San Francisco landmark designation. The adjoining building, opened in 1969, is comprised of approximately 48,000 gross square feet and houses classrooms, studios, galleries, a 250-seat lecture hall, and a public cafe.

The Searles trust agreement permits the mortgaging of the property on behalf of SFAI. Between 1966 and 1998 SFAI received approximately \$6.5 million of secured and unsecured commercial bank loans negotiated by The Regents. These loans, which were used for a variety of capital and operating needs of SFAI, were largely secured by a deed of trust on the 800 Chestnut Street property and repaid from the Institute's cash flow.

All loans were repaid in accordance with their terms and, in 1998, SFAI entered into an agreement with the California Educational Facilities Authority to participate in a private college and university bond pool, the proceeds of which repaid all remaining indebtedness to The Regents.

The Regents' Involvement

The Regents exercise no administrative, programmatic, or financial control over SFAI's operations, and the relationship is anomalous within the UC system. During the period of 1966 through 1998 when The Regents provided "conduit" financing for SFAI, a number of discussions took place concerning the future necessity and desirability of The Regents' continued role in SFAI's long-term financing arrangements. In fact, since the 1950s, correspondence and The Regents' records indicate an interest on the part of The Regents in the dissolution of its role as *de facto* "remainder trustee".

At the present time, SFAI is planning the financing of major additional capital and operating needs and it has been determined that the optimum borrowing conditions for its purposes would

include utilizing the 800 Chestnut Street property as collateral under a deed of trust. The estimated current appraised value of the property is between \$15 and \$25 million. SFAI's bond issuance in 1998 and 1999 and subsequent transactions have demonstrated the institution's ability to access the public and private debt markets without the need for Regental participation. The proposed actions would enable SFAI to further develop its financial strength and independence.

Further Discussions

SFAI has requested that the President, in consultation with the General Counsel, engage in discussions with SFAI which may lead to an eventual transfer of the trusteeship from The Regents to SFAI under conditions amenable to both parties. Any proposals resulting from these discussions would be brought to The Regents for approval.