

## **Office of the President**

### **TO MEMBERS OF THE INVESTMENTS COMMITTEE:**

#### **DISCUSSION ITEM**

*For the Meeting of November 16, 2022*

### **REAL ESTATE INVESTMENT STRATEGY UPDATE**

#### **EXECUTIVE SUMMARY**

In May 2022, the Investments Committee requested an overview of the opportunities and challenges associated with the Office of the Chief Investment Officer (CIO) investments in University-related capital projects. Over the past several years, this topic has been discussed from time to time with both the Investments and Finance and Capital Strategies Committees. A better understanding of the accounting requirements would help inform future decision making for the campuses and members of these Committees.

#### **BACKGROUND**

Several opportunities have arisen where campuses have explored whether the Office of the CIO could invest in real estate assets that would support the campus. The Office of the CIO is exploring new structures, including an independent real estate management company, to accomplish investing in direct real estate opportunities. The short answer is that this can be done, but there are several differences between investments and capital assets that need to be considered as these decisions are being made.

The Office of the CIO solely makes investments. The acquisitions of the Office of the CIO are made with the expectation of future income and profit and are both measured and recorded at fair market value. On the other hand, capital assets, buildings that are used to support the mission of the University for housing, research, instruction, and administration, are recorded at cost on the acquisition date and then depreciated over the useful life of the asset.

#### **ACCOUNTING RULES**

##### *Governmental Accounting Standards Board*

Established in 1984, the Governmental Accounting Standards Board (GASB) is the independent, private-sector organization that establishes accounting and financial reporting standards for State and local governments that follow Generally Accepted Accounting Principles (GAAP). GASB accounting rules and standards govern all public universities, including the University of California.

GASB 72 was enacted in 2016 and provided new definitions for investments and requirements

for disclosure. More specifically, an investment is defined as “a security or other asset that a government holds (1) primarily for the purpose of income or profit and (2) its present service capacity is based solely on its ability to generate cash or to be sold to generate cash.” The asset must meet both criteria to be classified as an investment. Under accounting rules articulated in GASB 72, the University makes this determination at the time of the acquisition of the property and maintains it through the life of the asset. If an acquisition of a building is deemed to be an investment, the building remains an investment regardless of whether a campus later rents the building for University purposes.

For the University, the criteria for whether an acquisition is an investment or a capital asset are fairly straightforward. In broad terms, for an investment, the terms of any campus participation—rental rates, lease terms, other operating provisions—must reflect market pricing and market conditions, and the campus must not have any involvement or influence in decisions over the property. Similarly, the Office of the CIO would not have day to day operational management involvement in the property. In a real estate investment, University planned occupancy should be 50 percent or less of the space, although it can fluctuate over time.

#### *Financial Accounting Standards Board*

The Financial Accounting Standards Board (FASB) is the independent nonprofit organization responsible for establishing accounting and financial reporting standards for companies and nonprofit organizations in the United States, following GAAP. FASB accounting rules and standards govern all private universities, such as Harvard, MIT, and Stanford.

The corollary to GASB 72 is FASB Accounting Standards Codification (ASC) 820. This standard is similar in many ways to the GASB standard, but there is one key difference. The FASB standard allows an institution to purchase real estate as an investment, convert to a capital asset at a later date, and realize investment gains on the real estate upon the date of that conversion. Thus a private university has no limitations on the use of the real estate once it converts to capital asset, and also gets the benefit of realizing investment gains on the property.

### **EXAMPLES OF OPPORTUNITIES**

The University has investment opportunities under the GASB structure, with certain guardrails in place. As an example, the Office of the CIO could purchase and operate housing near a campus, and rent out some units at market rates to University students. However, the Office of the CIO could not enter into a master lease agreement with the campus for a certain number of reserved beds. Similarly, the Office of the CIO can invest in or develop a research park near a campus and rent out portions of the facility to University tenants, however these leases must reflect market rates and commercial standards for the lease term and other operating conditions.

Research facilities tend to be strong opportunities for the Office of the CIO to invest and develop, because they often have a spectrum of tenants, ranging from University basic research to commercial tenants that are teamed with University personnel. Faculty and staff housing represent another good opportunity for Office of the CIO investment. Additionally, the housing should be available to other tenants in addition to University faculty and staff. In this instance,

any subsidy or discount available to University employees must come from the campus to the employee and not from the Office of the CIO.

In instances where a project is known to only support University related operations, one option to embark on such a project would be to provide equity in a general partner/limited partner (GP/LP) structure, where Office of the CIO does not have 100 percent ownership of the property, nor does it manage any day to day operations of the property.

There are many interesting opportunities for real estate investments on and around UC campuses and other locations; however, it is important for campuses to explore these early with the Offices of the CIO and the Chief Financial Officer to ensure the transactions are as seamless and beneficial as possible while meeting applicable regulations.