

**Office of the President**

**TO MEMBERS OF THE COMMITTEES ON GROUNDS AND BUILDINGS  
AND FINANCE:**

**DISCUSSION ITEM**

*For Meeting of November 18, 2008*

**STATUS OF THE DEVELOPMENT OF A NEW CAPITAL FUNDING STRATEGY**

At its September 2008 board meeting, the Regents endorsed a recommendation, among others, of the President to immediately commence a comprehensive evaluation of capital planning of the University including the following elements:

- a. the need for seismic upgrades/repairs and prioritization of seismic work in accordance with the University Seismic Safety Policy;
- b. infrastructure renewal and deferred maintenance needs; and
- c. the need to develop additional facilities/incremental space to meet anticipated enrollment and programmatic requirements as well as expansion of the University's research activities.

It was further agreed that the President would begin the process of developing various funding strategies to support capital outlay expenditures for projects that do not have an otherwise identified fund source, but which represent critical high priorities for the campuses and the University as a whole. This is a status report on the development of those funding strategies.

***Capital Needs***

Over the last two months, extensive analysis has been undertaken to begin to identify the long-term funding needs of the University to sustain its core mission.

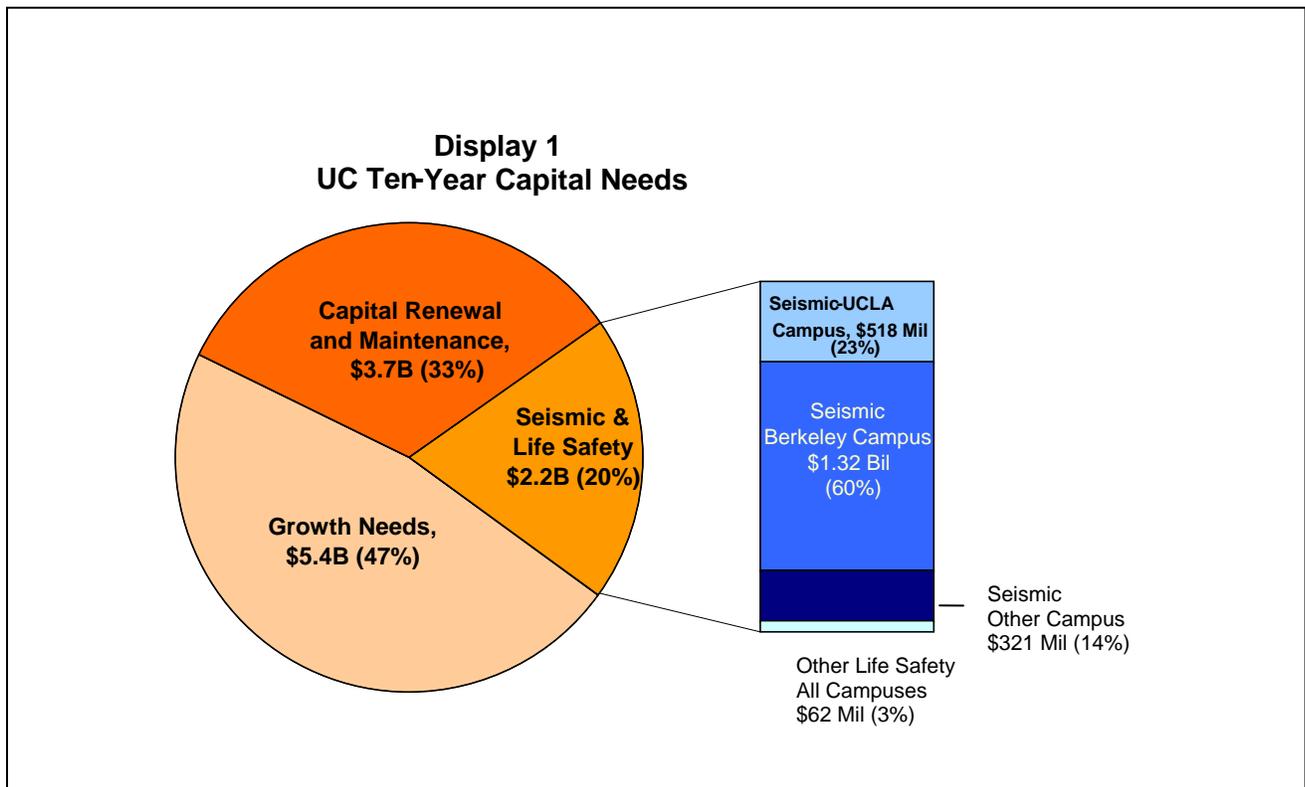
The key capital drivers are:

- **Seismic and Life Safety** – The University has many older buildings, particularly on the Berkeley and Los Angeles campuses, which were constructed prior to modern earthquake safety codes being developed. In addition, building codes have been updated over time as new information has been gathered on how ground motion affects the built environment. The University Seismic Safety Policy calls for a program for abatement of seismic hazards. A systematic process of evaluating the seismic risk of existing facilities

and upgrading facilities has been in place since 1979 with substantial corrections having been completed on the existing building inventory having the highest life safety risk. As of June 2008, corrective work has been completed in more than 230 structures comprising more than 16 million gsf. There remains, however, considerable work to complete the program. In addition to seismic safety, the University must also address fire/life-safety requirements, including upgrading fire alarm systems and hazardous materials abatement, and other building modifications.

- **Capital Renewal and Deferred Maintenance Needs** –As buildings and infrastructure age, the underlying systems must be replaced to sustain their continued operation. This ongoing investment in capital renewal is critical to maintaining facilities that can support the University’s vast array of instruction, research and public service programs. Yet, this funding is currently not included in either the operating or capital budgets (though it is included in the University’s five-year plan). With a large percentage of building systems in facilities constructed between 1955 and 1975 reaching the end of their useful life, the University’s annual capital renewal need is expected to increase dramatically over the next decade. In addition, campuses have a significant backlog of deferred maintenance, the result of both the lack of ongoing capital renewal funding and the chronic under-funding of basic maintenance.
- **Program Growth** – The University has experienced a sustained period of unprecedented enrollment growth over the last 10 years, requiring significant capital investments to develop classrooms, class laboratories, faculty offices, and research space. It is expected this dramatic rate of growth will moderate after 2010-11. Without sufficient space, it is difficult to attract the faculty needed to accommodate the students. Along with more buildings to house expanded programs comes the need for expanding the underpinning infrastructure of the campus including roads, sidewalks and the many utilities systems that serve the campus buildings.

Display 1 shows the University’s projected capital needs for the next 10 years based on (1) the remaining upgrades pursuant to the University’s Seismic Safety Policy requirements, (2) the existing condition of campus facilities—deferred maintenance backlog and capital renewal requirements, and (3) planned enrollment growth. The total ten-year need is estimated to be \$11.3 billion.



**Methodology:**

The following describes how the amount required for each of these capital funding needs was determined.

- Seismic & Life Safety Corrections (\$2.2 Billion)** – These funds, representing 20 percent of all capital funding needs, would provide for upgrading or replacing existing facilities (1) to improve seismic performance, or (2) that require life safety upgrades. Life safety requirements total \$62 million over the ten-year period. With regard to seismic improvements, most campuses have completed or will soon complete upgrading of facilities that were identified in the extensive engineering studies previously undertaken in response to the Seismic Safety Policy for all University buildings. Display 2 provides a summary of the status of the seismic work to be performed. Funding needed for seismic correction of space devoted to core instruction and research programs, referred to as State-supportable space, totals about \$2.1 billion. Funding needed to improve facilities for auxiliary and self-supporting programs (e.g. student housing, parking, athletics, etc.) amounts to an additional \$926 924 million and is expected to be supported from funds derived from program operations or from other non-State sources.

**Display 2**  
**UC Campuses**  
**Completed and Remaining Seismic Correction Work**

Campus	Gross Square Feet (GSF)		Cost to Complete (dollars in millions)	
	GSF Vacated, Completed, or Underway	Remaining GSF	Core Program	Auxiliary & Self- Supporting
Berkeley	4,319,272	2,237,941	\$1,320	\$737
Davis	2,096,120	145,160	1	under study
Irvine	1,880,621	44,772	0	<del>2</del> under study
Los Angeles	4,790,245	1,751,276	553	13
Riverside	1,734,178	57,201	0	under study
San Diego	1,545,340	7,282	0	under study
San Francisco	1,127,797	319,016	140	155
Santa Barbara	1,694,063	127,679	100	13
Santa Cruz	<u>1,043,995</u>	<u>0</u>	<u>0</u>	<u>6</u>
Total, All Campuses	20,231,631	4,690,327	\$2,114	<del>\$926</del> <u>924</u>

Assuming funding is available, campus plans are to ensure that the seismic work is completed within the next ten to twelve years. In some instances, space limitations and the lack of available rental space options place restrictions on each campus' ability to complete all of the work. Additionally, sheer physical limitations restrict the ability of some of the campuses to accelerate the work any sooner than currently scheduled. Office of the President staff will be reviewing the schedules and priorities developed by the campuses and working with outside experts and campus representatives to complete the outstanding seismic work .

**(2) Capital Renewal and Deferred Maintenance (\$3.7 Billion)** –In each of the next ten years, the University estimates that it needs to invest an average of \$370 million. This includes an estimated \$285 million for capital renewal and an additional \$85 million to reduce the significant backlog of deferred maintenance. These projections are based on a budget model that breaks down campus infrastructure and State-maintained buildings into systems that need to be renewed on a predictable basis and have life cycles between 15 and 50 years. These systems include components such as roofs, heating and ventilation systems, central plant chillers, fire alarm systems, and underground utility cabling. With 60 percent of the University's buildings over 30 years old, and a majority of those facilities constructed between 1955 and 1975, the University's ongoing capital renewal needs are expected to increase dramatically over the next decade. This dramatic increase in capital renewal need comes at a time when the State has eliminated all deferred maintenance funding to the University and the University lacks any regular systemwide funding program for capital renewal.

**(3) Growth (\$5.4 Billion)** – The majority of future needs is associated with mitigating space deficiencies on the campuses. In determining growth needs, the campuses prepare detailed

inventories of all space by use and by program. In addition, the California Postsecondary Education Commission and others have developed space guidelines that provide uniform comparisons of how much space is needed to support particular academic or support endeavors. Each year, the number of students and faculty are updated and space allowances for the core academic programs are determined for each campus. The analysis of growth needs considers the planned growth in enrollment based on the campus' academic program plans and the space allowances established for each program under the approved guidelines.

An investment representing nearly half of all capital funding over the next 10 years would alleviate the deficiencies that have resulted from dramatic enrollment growth over this decade by providing new instructional, research and support space, so that programs will have sufficient space to accommodate existing students and faculty as well as meet projected future modest enrollment growth needs.

### *Sources of Capital Funding*

By way of background, the University's capital program is funded through two sources: State funds and non-State funds. Over the last five years, State funds have averaged about \$350 million annually for the general campuses. In addition, in 2000-01 the University received \$600 million in State bond funding for seismic corrections at the five University teaching hospitals, and nearly \$300 million has been received over several years related to the construction of the Merced campus. The non-State portion of the University's capital program has averaged \$1.15 billion annually over the last five years, reflecting the University's need to augment State funding in order to meet its highest priorities for state-supportable capital facilities as well as provide facilities such as housing and parking that the State will not fund.

**State Funds – General Obligation Bonds and Lease-Revenue Bonds.** Capital funding to address State-supportable space has typically been provided by voter-approved general obligation bond acts as part of an overall State program to support the capital needs of K-12 schools and the three higher education segments in California. The State has also issued lease-revenue bonds as an alternative to general obligation funds. Under the lease-revenue bond program, specific projects are undertaken with the State retaining a financial interest in the facility while providing annual appropriations to the University to pay debt service related to the bonds. While State funding for the University's capital needs has increased over the last two decades, it has been insufficient to meet all of the University's identified needs. In addition, State funding for operations and maintenance of the University's facilities has not been adequately funded, leading to a substantial deferred maintenance backlog.

**Non-State Funds.** Most of the non-State capital funding supports auxiliary and self-supporting programs including housing, parking and medical centers. The University has also used non-State funds to augment State funding. These funds include:

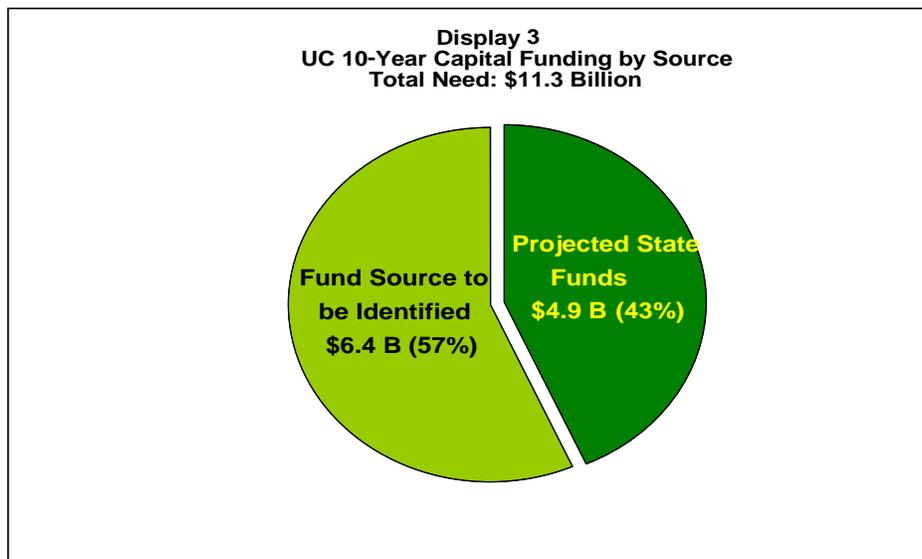
- Gift Funds – While donors are often supportive of new capital programs to assist the University, less than 20 percent of all donations to the University are for instructional and research program capital needs. The vast majority of these donations are for other than

State-supportable space needs, such as student athletics and hospital programs. In some cases, donor funds are used to augment State capital funding to provide specific upgrades that cannot be funded with State funds. While gift funds are not considered a typical revenue source for State-supportable space, these funds play a key role in the campuses' ability to meet capital outlay requirements, particularly when State funding falls short of the identified needs.

- University Opportunity Funds – When faculty undertake research that is sponsored by the federal government or by other organizations external to the University, the campus retains a portion of the grant to cover costs associated with conducting the research. These funds, known as University Opportunity Funds, support a wide variety of programs including student financial aid, faculty recruitment costs, as well as facilities upgrades.
- University-Secured Debt Funds – The University has the authority to issue its own debt. Campuses often finance all or portions of a capital project when funds from other sources are not available. The ability of a campus to undertake debt financing is dependent upon its ability to identify funds necessary to pay the debt service.

### **STRATEGY FOR FUTURE CAPITAL NEEDS**

Display 3, below, shows the amount of State funds projected over the next 10 years for capital outlay purposes compared to the amount from non-State sources that will be required in order to meet the \$11.3 billion in total capital outlay needs identified above.



### **State Funding Assumptions**

Despite the current budget challenges facing California, it is the University's intention to seek new general obligation bond funds beginning in 2010-11 through the next decade. Such funds will be sought for both the continuing needs of the general campuses, but also for capital investment in health science programs in recognition of the current shortage of physicians and other health care providers in California. It is clear, however, that even if the University is



The funding strategy being developed anticipates that the shortfall will be addressed through a variety of sources;

- A central bond initiative of up to \$2 billion which would be supported by operating revenues from the campuses;
- University funds from non-State sources generated by campuses from gifts, campus funds, and campus-based debt. Over the next ten years, approximately \$3 - \$5 billion might be generated from these sources.

***Process for Determining Allocation of Proceeds from \$2 Billion Bond***

Understanding that the debt service for a central bond package would need to be borne by all of the campuses according to an appropriate allocation method, it will be important to ensure that the proceeds are used to meet the highest priorities of the University and for the benefit of the University at-large. Moreover, the Regents have placed a high priority on completing remaining seismic corrections.

As indicated above, the Office of the President has surveyed the campuses and identified the outstanding seismic work yet to be addressed. While the outstanding work totals an estimated \$3 billion, about \$~~926~~ 924 million of the total is related to auxiliary and self-supporting activities which will need to be addressed by the campuses within the resources supporting those programs. Of the remaining \$2.1 billion of seismic work identified across the system, the majority is at the Berkeley and Los Angeles campuses. The Berkeley campus share is \$1.3 billion, of which \$62 million is expected to be provided from State funding in 2009-10 and another \$121 million will be requested for funding by the State over the next four years. Similarly, of the \$553 million in outstanding work at UCLA, a total of \$123 million is proposed for State funding in 2009-10 with an additional \$40 million in future years. It should be noted that the health sciences bond to be proposed for the next 10 years from State funds would also help to address seismic needs at the Los Angeles and San Francisco campuses. Funding for new facilities will allow the campuses to vacate seismically deficient buildings .

Based on these assumptions of State funds, the net cost of completing seismic work on the Berkeley and Los Angeles campuses would be \$~~1.36~~ 1.41 billion, as shown in Display 6.

**Display 6**  
**Seismic Correction Funding Plan**

<b>Capital Requirements</b>	<b>Funds (Millions)</b>
Total Capital Needed to Complete Seismic Corrections	\$ <del>2,983</del> <u>3,038</u>
Less: Funding from Auxiliaries & Self Supporting	<u>926</u> <u>924</u>
Remaining Seismic Corrections, Core Programs	<del>2,057</del> <u>2,114</u>
Less: Projected State Funding	<u>-700</u>
Remaining Corrections, Other-than-State Funds	\$ <del>1,357</del> <u>1,414</u>

The next step in the development of the President's funding strategy will be to analyze each of the outstanding seismic items to determine the appropriate level of funding for individual projects from the proposed \$2 billion bond package. This analysis should reflect the extent to which other non-State funds (e.g. campus funds) may be available for each project. Factors such as the following will need to be considered in making each allocation:

- the relative priority of the project among all remaining seismic safety correction projects considering current occupancy levels;
- the cost/benefit of the proposed renovation work weighed against the cost of building an entirely new facility;
- interim measures available to mitigate the hazard;
- the logistical issues related to the project. This would include an analysis of whether or not adequate temporary space (e.g. surge space) is available to house the programs that would be displaced because of the need to vacate the building;
- the feasibility of utilizing other non-State (e.g. campus funds) funds to pay for some costs, particularly if a portion of the project is aimed at improving the programmatic capability or functionality of the building.

It is expected that the process for reviewing projects based on these factors will be completed for the January Regents meeting.

The balance of the \$2 billion bond package will then be available for allocation to the remaining campuses for life safety, capital renewal and deferred maintenance, and growth projects. As with the seismic projects, certain assumptions will need to be made about the expected availability of State funding for all or some of these projects. Each campus' share of the University bond funds will be determined after factoring in the availability of campus funds for each project as well. It is anticipated that this process will be completed in time for the March Regent's meeting.

#### ***Issues Associated with Identified Funding Strategies***

The current economic condition of the State is constrained. Thus, it is uncertain if the State will continue to support the University's capital needs at the levels achieved in the past.

Expectations regarding the availability of campus-based funds to provide non-State support require further analysis. Federal funding for research is undergoing a slowdown – double digit rates of growth in the earlier part of this decade have evaporated. It is uncertain if growth in these fund sources will keep up with inflation, making these funds less reliable for capital purposes. Also, recent declines in the stock and credit markets may have impacts on expectations of philanthropic support.

And finally, the University will need further extensive analysis on the concept of a central University bond of \$2 billion in light of the recent activity in the credit markets nationally. Notably, funding required from campuses to support the debt service on this bond will

undoubtedly compete with other critical campus needs, in light of the reductions in State operating support.