

AGENDA

COMMITTEE ON FINANCE

Meeting: 2:00 p.m., Tuesday, September 16, 2003
Glenn S. Dumke Auditorium

William Hauck, Chair
Shailesh J. Mehta, Vice Chair
Roberta Achtenberg
Kathleen E. Kaiser
Ricardo F. Icaza
M. Alexander Lopez
Frederick W. Pierce IV

Consent Item

Approval of Minutes of Meeting of July 16, 2003

Items

1. Report on the 2003/2004 Support Budget, *Information*
2. Report on the 2004/2005 Support Budget Planning Assumptions, *Information*
3. Recommended Lottery Revenue Budget, *Information*
4. Approval to Issue Trustees of the California State University, Systemwide Revenue Bonds and Related Debt Instruments for a Project at California State University, Northridge, *Action*
5. California State University, Stanislaus, Stockton Off-Campus Center and California State University, Channel Islands University Development Status, *Information*
6. California State University Annual Investment Report, *Information*

**MINUTES OF THE MEETING OF
COMMITTEE ON FINANCE
Office of the Chancellor
Glenn S. Dumke Conference Center
401 Golden Shore
Long Beach, California**

July 16, 2003

Members Present

William Hauck, Chair
Shailesh J. Mehta, Vice Chair
Debra S. Farar, Chair of the Board
Roberta Achtenberg
Harold Goldwhite
Ricardo F. Icaza
M. Alexander Lopez
Frederick W. Pierce, IV
Charles B. Reed, Chancellor

Other Trustees Present

Robert G. Foster
Murray L. Galinson
Alice A. Huffman
Ralph R. Pesqueira
Anthony M. Vitti

Chancellor's Office Staff

David S. Spence, Executive Vice Chancellor and Chief Academic Officer
Richard P. West, Executive Vice Chancellor and Chief Financial Officer
Christine Helwick, General Counsel
Jackie R. McClain, Vice Chancellor, Human Resources

Chair Hauck called the meeting to order at 9:03 a.m.

Approval of Minutes

The minutes of May 14, 2003 were approved.

Status Report on the 2003/2004 Support Budget

Chair Hauck announced Mr. Patrick Lenz, assistant vice chancellor, budget development, would present the item. With the aid of a PowerPoint presentation, Mr. Lenz updated the committee on

current events in Sacramento related to the budget situation and how those events would affect the CSU. He indicated this was essentially a recap of information that had been presented at prior meetings. Mr. Lenz noted there was still much speculation as to when the state budget would be passed, however, he felt it could happen within the next 7 to 10 days.

Mr. Lenz noted during budget discussions there was serious concern about how CSU was going to manage with the magnitude of reductions proposed in the governor's January budget, the May Revise, and possible subsequent reductions that might be proposed by either house or party. He presented a number of possible scenarios regarding what may happen. However, without a final budget, it was impossible to correctly determine a set course of action.

In an effort to deal with concerns, CSU and the CFA have collaborated on supplemental report language that would protect to the extent possible, undergraduate and graduate instruction. It also recognizes priority for academic support, as well as maintenance and operations, and the role it provides in the quality of CSU education. Exploration of alternative funding sources (to the extent possible by law) will also be considered to mitigate the budget reductions.

Other areas targeted for reductions include administrative costs, and where feasible, deferment of the expansion of CMS start-up projects. CSU will also be subject to extensive reporting requirements on student enrollment, average class size, number of course selections, impact on CSU employees, and actual expenditure data for CSU.

Mr. Lenz observed the campuses and the presidents have done a commendable job in planning to address the reductions. He noted a recent survey indicated approximately 2300 vacant or frozen positions as the core of the reductions we are looking at. The campuses have indicated they would look at eliminating those vacant or frozen positions before implementing any layoffs of existing positions.

Trustee Icaza inquired about the status of the CMS program and if it was still going forward. Trustee Hauck explained CSU intends to postpone CMS projects that have been planned for 2003-2004 if possible. However, there are a number of instances where this cannot be done since the projects are already well underway at a number of the campuses.

Trustee Goldwhite said the scale of administrative reductions at the Chancellor's Office impressed him. He asked if there was comparable information about administrative reductions at the campuses. Mr. West referred to the slide presented earlier indicating 2300 vacant or frozen positions, noting that 1700 of them were administrative.

State University Fee Increase

Mr. Lenz stated the proposal before the committee will increase both undergraduate and graduate fees by 30 percent.

Utilizing a PowerPoint slide presentation, Mr. Lenz reviewed the history of student fees from the mid 1990's to the present. He outlined the events leading to the current fiscal crisis resulting in the need to substantially increase student fees.

Dr. James M. Rosser, president, California State University, Los Angeles, read a statement in support of the fee increase endorsed by the 23 campus presidents. Dr. Ruben Arminana reinforced the support of the presidents and urged the trustees to support the resolution.

Trustee Huffman said that as a new trustee she had a few questions. She asked what percentage of students currently receive financial aid; how many students may not attend CSU because they do not qualify for aid; and how will the university manage the growth and enrollment reduction?

Dr. Allison Jones, assistant vice chancellor, academic affairs, student academic support, responded to the trustee's questions. He indicated a little more than 60 percent of CSU students receive some form of financial aid based on financial need. CSU determines financial need as mandated by the U.S. Congress. With regard to how many students would not be able to attend because they do not qualify for aid, Dr. Jones said he could not answer the trustee's question due to the complexities in determining individual financial need. Chancellor Reed added that he has provided written guidelines to the campus presidents on enrollment management, as well as revised enrollment targets for 2003/2004.

Trustee Lopez stated the students do understand we are in difficult financial times and the need to face that reality. However, what students are most concerned about is the magnitude of the fee increase and the lack of sufficient notification. Recognizing that access, quality, and affordability are the cornerstones of the university's mission, the trustee wondered where the line would be drawn. He concluded stating that approval of the increase may be the best solution for the state, but it merely increases the obstacles for students in achieving the American Dream.

Trustee Icaza said he did not support the fee increase and reinforced his belief that other alternatives exist.

Trustee Galinson asked about the process of applying for student loans and if students who already receive aid would need to re-apply if the fee increase is approved. Dr. Jones responded that those students would not be required to initiate any action. Each campus will generate a new financial aid award letter that will reflect the adjustment.

Trustee Pierce said it was clear to him there is no reasonable alternative to a fee increase at this time and that he supported the fee increase. In the future, to avoid a similar crisis of this magnitude, the trustee suggested revisiting the student fee policy and exploring a budgetary policy. He also suggested the possibility of creating a reserve policy within the budget to set aside a percentage of funds to stabilize situations similar to the one we are now experiencing.

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Trustee Hauck announced the next portion of the meeting would be devoted to public comment.

The following attendees addressed the board on the fee increase issue:

Patrick Hallahan – State Employees Trade Council United
Jessica (unable to determine last name) Student, CSU, Los Angeles
Brent Hansen – Student, Fresno State
David Abella – Student, San Francisco State University
John Travis – California Faculty Association, President
Kim Geron – California Faculty Association, Treasurer
Linda Current – California Faculty Association, Lecturer
Adam Mednick – California Faculty Association, Student
Miguel Paredes – California State University, Student
Lil Taiz – California Faculty Association, Vice President
An-Hoa-Tran, Asian Pacific Islander Students of Social Work

With the exception of Patrick Hallahan of the State Employees Trade Council who spoke in support of the fee increase, the other speakers expressed opposition to the fee increase.

Trustee Hauck thanked the speakers.

The committee recommended approval of the proposed resolution (RFIN 07-03-10).

Before going to the next item, Trustee Hauck announced Trustee Achtenberg would like to speak.

Trustee Achtenberg acknowledged it was the general sense of the board to concur with many of the statements made about the unfairness of the fee increase. The trustee explained the purpose of her remarks was to initiate a plan to assist the board in preparing for situations in the future requiring difficult decisions on fee issues. She pointed out that the board of trustees could not control the kind of situation it has been put in by the legislature; however, the board could control its own conduct.

Trustee Achtenberg introduced a motion to put the board on record as urging the chancellor to convene a representative group of all stakeholders in the university, to develop a recommendation on how to create a regular, predictable, and gradual augmentation of the fee structure over time. The group would then come back to the board for formal approval.

Trustee Vitti said it was a great idea and suggested making the group a permanent committee of the board. Trustee Galinson agreed and said one of the goals of the committee should be to look at adjusting state laws regarding our reserves.

Trustee Pierce asked if it was correct for the motion to be taken at this meeting. Christine Helwick, general counsel, said the committee could take a motion related to the fee increase matter. She clarified this is a motion to consider the matter in detail at a later date and time.

The motion was carried.

Approval to Issue Trustees of the California State University, Systemwide Revenue Bonds and Related Debt Instruments for a Project at San Francisco State University

Mr. Dennis Hordyk, assistant vice chancellor, financial services introduced the action item. The item requested the Board of Trustees' authorization for issuance of systemwide revenue bonds and interim financing under the CSU's commercial paper program in an amount not-to-exceed \$3,865,000 to provide needed funds for upgrading a campus apartment building currently undergoing renovation. He added the property had been vacated due to mold contamination, during which time the campus pursued and received a legal settlement in 2002 with the contractor.

Trustee Pierce questioned one of the revenue calculations in the agenda item that reflected net revenue of 0.89 percent and asked what that percentage meant.

Mr. Hordyk explained the 0.89 percent figure was for the housing program. He noted the housing program continued to pay debt service during the time the property was vacant, therefore revenues are down, but costs have stayed the same.

The committee recommended approval of the proposed resolution (RFIN 07-03-11).

Public/Private Venture to Develop Student Housing on Private Property Adjacent to California State University, San Bernardino

The Board of Trustees approved a resolution at the May 13-14, 2003 meeting to approve the concept of a public/private partnership that would provide land and facilities to support the University's educational mission and academic programs, and bring additional student housing closer to the campus.

The item requests the board to grant authority to the Chancellor to enter into an "Affiliation Agreement" and an "Option to Purchase Agreement" with American Campus Titan (ACT) to facilitate the operation and potential purchase by the CSU of a student housing project to be constructed by a private developer on private land located across the street from the campus.

Mr. Hordyk explained the project terms and details.

Trustee Pierce asked for clarification of the agreement termination policy. Mr. Hordyk said either party has the ability to terminate the agreement. Mr. Richard K. Leffingwell, senior

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director, financing and treasury, added this would be a 30-year agreement and that CSU will accrue equity in the project. If ACT sells the project to some other party at any point in time, the CSU will receive a gift of funds from ACT equal to the calculated equity. Similarly, if the CSU and ACT maintain the relationship under the Affiliation Agreement for 30 years without CSU's purchase of the project, ACT will donate the project and the property to CSU upon the 30 year anniversary.

Trustee Hauck assessed this was a complicated project and it appears that related issues are linked to the fact that it is an entirely private project, (with the exception of the Affiliation Agreement) until such time as the university decides to purchase or not purchase the project. Mr. Hordyk acknowledged that was correct.

The committee recommended approval of the proposed resolution (RFIN 07-03-12).

Student Housing and Land Acquisition at California Polytechnic State University, San Luis Obispo

Chancellor Reed said he would ask the board to defer action on the item. He explained it is very clear the San Luis Obispo campus needs additional housing. The campus is under tremendous pressure from the city and its residents to provide a much greater amount of student housing on the campus.

The chancellor also reminded the committee at the last board meeting he requested that a third party be engaged to advise us about this project. An outside consultant was engaged, and an evaluation was prepared suggesting several improvements on the project. An analysis of the developer fees revealed they are reasonable given the size of the project; and the developer will be required to bid all of the subcontracts on the project. As part of the project, the developer has proposed to bring to the university, approximately 1,250 acres of revenue producing agricultural land.

The chancellor explained the next steps will be to perform additional due diligence on the acquisition of the agricultural land to ensure its value and to assess that the academic uses of the land will be appropriate. He reiterated this is a very large project, and once these actions are completed, the project proposal would be brought back to the Trustees for review and final approval.

Trustee Hauck asked if there were any objections to deferring the item until the September board meeting.

There were no objections.

The meeting adjourned at 11:05 a.m.

COMMITTEE ON FINANCE

Report on the 2003/2004 Support Budget

Presentation By

Richard P. West
Executive Vice Chancellor and
Chief Financial Officer

Patrick J. Lenz
Assistant Vice Chancellor for Budget Development

Summary

On August 2, 2003, the Governor signed Assembly Bill 1765 (Chpt. 157) after achieving the two-thirds vote in the Senate and Assembly necessary to enact the 2003-04 State Budget. The \$98.9 billion budget represents the collective effort to enact a fiscal spending plan that attempts to close a \$38 billion "budget gap" through a combination of spending cuts, tax shifts, and borrowing. The Board will be given an overview of the 2003-04 state budget, the fiscal impact to the CSU, and implication for the 2004-05 fiscal year.

2003/04 Support Budget

The recently enacted state budget assumes three major changes to the CSU budget that are different than the Governor's proposed January budget. The first is the overall fiscal impact to the CSU that resulted in an additional \$83.3 million reduction over the Governor's January budget, second is the reduction for enrollment growth from 7 percent to 4.3 percent that is equivalent to a reduction of 9,000 full-time equivalent students (FTES), finally, the budget recognizes an additional 5 percent increase in student fees for undergraduates, 10 percent for graduate student, over the student fee assumptions in January.

The CSU budget from state General Fund and student fees is \$3.468 billion, \$2.492 billion from the state General Fund and \$976 million from student fees. As a result of the proposed budget and subsequent legislative reductions the CSU will incur a net fiscal impact of \$304 million for the 2003-04 fiscal year. A \$304 million net reduction will result in an overall funding per FTES decrease from \$10,942 in the 2001-02 fiscal year to 10,355 per FTES in 2003-04, while the state General Fund support per FTES will decrease from \$8,798 to \$7,441 for the same fiscal years.

The state General Fund does provide \$90.9 million to fund an enrollment growth increase of 4.3 percent to serve an additional 13,782 FTES in 2003-04. In addition, the budget includes

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Supplemental Report language, which will be reviewed with the board at the meeting. Finally, the legislature adopted a budget trailer bill (AB 1756) indicating the intent of the legislature that the California State University and the University of California not seek funding for compensation, price increases, or enrollment growth for the 2004-05 fiscal year.

COMMITTEE ON FINANCE

Report on the 2004/2005 Support Budget Planning Assumptions

Presentation By

Richard P. West
Executive Vice Chancellor and
Chief Financial Officer

Patrick J. Lenz
Assistant Vice Chancellor for Budget Development

Summary

As indicated in the report on the 2003-04 Support Budget, the legislature enacted budget trailer bill (AB 1756) language expressing their intent the CSU and UC would not seek state General Fund resources for compensation, price increases, or enrollment growth for the 2004-05 fiscal year. In addition, the Department of Finance has sent CSU and UC their budget instructions for the 2004-05 fiscal year that are consistent with the budget trailer bill language. In both of these instances, the legislature and the Administration recognize that the state will likely start the 2004-05 fiscal year with a budget deficit between \$8 and \$12 billion.

Despite the state's fiscal condition and given so many uncertainties with the fiscal and political situation in the next few months, the Board will be presented with budget options that recognize the mandatory costs for the CSU, what the CSU would request under the Partnership Agreement, additional CSU budget priorities, and backfilling budget reductions that occurred this year. These are merely budget options for discussion of the strategic approach by the CSU as we begin discussing with the Department of Finance the issues that CSU will face despite the state's overall fiscal condition.

COMMITTEE ON FINANCE

Recommended Lottery Revenue Budget

Presentation By

Richard P. West
Executive Vice Chancellor and
Chief Financial Officer

Patrick J. Lenz
Assistant Vice Chancellor for Budget Development

Summary

This item is being presented to the Board of Trustees at this meeting as an information item and is scheduled for adoption at the special October budget meeting. A draft budget outline has been prepared for discussion with the Executive Council, the System Budget Advisory Committee and other CSU constituencies, which will be used to help establish system budget priorities and form the detailed plan to be discussed at the September board meeting.

The Board will be provided with handout material for discussion.

2004/05 Lottery Revenue Budget

The recommended 2004/05 Lottery Revenue Budget is also being presented to the Board of Trustees at this meeting as an information item and is scheduled for adoption at the special October budget meeting. The proposed budget includes an increase in projected lottery receipts and a slight decrease in projected interest earned. The net result is an increase of anticipated revenue of \$3.5 million or 8.9% over the 2003/04 budget.

Systemwide program budgets continue to be designated for the Forgivable Loan/Doctoral Incentive Program, California Pre-Doctoral Program and CSU Summer Arts. The only change from the previous budget is an increase in the Pre-Doctoral Program is recommended bringing the budget from \$633,000 to \$714,000, which is a 13% increase. This increase will allow the program to expand the number of summer internships being offered, meet the increased costs associated with the internships, and provide enough funding for a fulltime program director. The campus-based budget remains at the same level as the current year.

In summary, a total of \$42.6 million is proposed for the 2004/05 lottery budget. After deducting \$5 million for the systemwide reserve that is used for cash flow and as a safeguard against potential downward fluctuations in revenue, \$37.6 million, which includes projected interest earnings, is recommended for programmatic use. Three system-designated programs remain (Forgivable Loan/Doctoral Incentive Program, Pre-Doctoral Program, and Summer Arts) and the rest of the dollars are recommended for campus-based programs.

2004/05 Recommended Lottery Revenue Budget

	2003/04 Adopted Budget	2004/05 Recommended Budget
Sources of Funds		
Beginning Balance	\$ 5,000,000	\$ 5,000,000
Receipts	32,300,000	36,081,000
Projected Interest Earnings	1,800,000	1,500,000
Total Revenues	\$ 39,100,000	\$ 42,581,000
<i>Less Systemwide Reserve</i>	<i>(1,300,000)</i>	<i>(5,000,000)</i>
Total Available for Allocation	\$ 37,800,000	\$ 37,581,000
Uses of Funds		
<i>System Programs</i>		
Forgivable Loan/Doctoral Incentive Program	\$ 3,000,000	\$ 3,000,000
California Pre-Doctoral Program	633,000	714,000
CSU Summer Arts Program	1,200,000	1,200,000
Systemwide Implementation Costs	341,000	341,000
	\$ 5,174,000	\$ 5,255,000
<i>Campus Based Programs</i>	\$ 32,626,000	\$ 32,326,000
Total Uses of Funds	\$ 37,800,000	\$ 37,581,000

COMMITTEE ON FINANCE

Approval to Issue Trustees of the California State University, Systemwide Revenue Bonds and Related Debt Instruments for a Project at California State University, Northridge

Presentation By

Dennis Hordyk
Assistant Vice Chancellor
Financial Services

Summary

This item requests the Board of Trustees to authorize the issuance of Systemwide Revenue Bonds and the issuance of interim financing under the CSU's commercial paper program in an aggregate amount not-to-exceed \$7,025,000 to provide needed funds for the renovation of the Northridge student union facility. The long-term bonds for the project will be part of a future Systemwide Revenue Bond sale and are expected to bear the same ratings from Moody's Investor Services and Standard and Poor's Corporation as the existing Systemwide program.

The project is as follows:

California State University, Northridge University Student Union Renovation, Phase I

Previously, the Board of Trustees approved the amendment of the Nonstate Funded Capital Outlay program and schematics for the student union renovation project. The project was delayed by over a year due to the receipt of construction bids that were higher than anticipated, and was redesigned into two phases. The two renovation phases will allow for a more efficient use of space and will better meet the needs of the expanding student body. The board is currently being requested to approve the financing of the Phase I project which includes the renovation of an existing pub, the construction of a pedestrian walkway, two retail/food venues, a new entrance and restrooms for the performance art center, and the demolition of building A which has meeting rooms, offices, retail space, and a lounge. The demolition is needed for preparation of the Phase II project which is anticipated to be presented to the board for financing approval in September 2004. (Phase II project will include new retail/food venues, lobby/lounges, clubs and organization spaces, a computer lab, coffee house, and convenience store.) The proposed project scope was overwhelmingly approved in a May 2000 student union referendum. The not-to-exceed par value of the proposed bonds is based on total project costs for the Phase I project of \$7,288,733, of which \$874,523 will be paid from campus student union reserves, and the remaining balance will be paid from financing proceeds. The campus received good project bids and expects to open the Phase I project in November 2004.

The following table provides information about the financing transaction.

Not-to-exceed amount:	\$7,025,000
Amortization:	Approximately level over 30 years
Pro-forma maximum annual expected debt service	\$ 479,076
Projected debt service coverage including the new project: 1	
Gross revenue – all Northridge pledged revenue programs:	5.25
Net revenue – all Northridge pledged revenue programs:	1.97
Net revenue – projected for the campus Student Union Program:	1.70

1. Projected information – Combines the 2001/02 information for the campus-operated pledged revenue programs, the first year of operation of the new project with expected full debt service.

The not-to-exceed amount, the maximum annual debt service and the ratios above are based on the construction project bid amount, expected debt service and capitalized interest at the current interest rate environment plus 50 basis points (computed average coupon rate – 5.4%; August 20, 2003), which provides a modest safeguard to be used if needed for changing financial market conditions that could occur before the permanent financing bonds are sold. The campus has developed a financial plan that demonstrates its ability to meet its student union program and debt service obligations and meet required CSU net income coverage rates of 1.35 for the campus and 1.10 for the program with the projected campus rate coverages noted above. The financial plan also includes level amortization of debt service, which is our CSU program standard. In addition, the campus is managing its overall use of debt so that the Phase I project, the campus debt payments will total approximately 3.38% of its net unrestricted expenditures, which is within the maximum CSU internal benchmark allocation of 4.0% for campuses. It is anticipated that with Phase II, the campus will continue to stay within the CSU benchmark.

Trustee Resolutions and Recommended Action

Orrick, Herrington & Sutcliffe LLP, as bond counsel, is preparing a set of resolutions to be presented at this meeting for the project described in agenda item 4 of the September 16-17, 2003 Board of Trustees agenda that authorize interim and permanent financing for the Phase I project. The proposed set of resolutions will be distributed at the meeting and will achieve the following:

- (1) Authorize the sale and issuance of Systemwide Revenue Bond Anticipation Notes and the related sale and issuance of the Trustees of the California State University, Systemwide Revenue Bonds in an amount not-to-exceed \$7,025,000 and certain actions relating thereto.

- (2) Provide a delegation to the Chancellor, the Executive Vice Chancellor And Chief Financial Officer, and their designees to take any and all necessary actions to execute documents for the sale and issuance of the bond anticipation notes and the revenue bonds.

Approval of the financing resolutions for the project as described in this agenda item is recommended for:

Northridge Student Union Renovation, Phase I

COMMITTEE ON FINANCE

California State University, Stanislaus, Stockton Off-Campus Center and California State University, Channel Islands University Development Status

Presentation By

Richard P. West
Executive Vice Chancellor and
Chief Financial Officer

Summary

The item is a visual presentation providing a status update of progress on these two Trustee initiatives related to new and off-campus development. The presentation will document physical, financial, and organizational progress to date of these important CSU development projects, with a brief history and visual statement of the current accomplishments for each.

COMMITTEE ON FINANCE

California State University Annual Investment Report

Presentation By

Dennis Hordyk
Assistant Vice Chancellor
Financial Services

Summary

In 1997 the Board of Trustees established an investment policy for the investment of funds held in California State University trust accounts. This item provides the annual investment report for fiscal year 2002-03 (Attachment A) for the funds managed under this policy.

The California State University
Office of the Chancellor



Annual Investment Report

July 1, 2002 – June 30, 2003
Prepared by
The Office of Financing and Treasury

Summary

At the January 1997 meeting, the Board of Trustees approved the creation of a centralized investment program to manage the investment of funds held in California State University trust accounts. In addition, the Board approved an investment policy consistent with the authority provided in existing statutes to guide the university in administering the investment program. A copy of the investment policy is provided in Attachment A.1. The Board also agreed that an external fund manager should be hired to invest the funds consistent with the investment policy of the Board of Trustees. The firm of Metropolitan West Securities, Inc. was hired through a competitive process to manage an investment program for the California State University.

This agenda item reports the results of the CSU investment program administered by Metropolitan West for the twelve months ending June 30, 2003. In addition, results are provided for the Surplus Money Investment Fund (SMIF) and Local Agency Investment Fund (LAIF). The State Treasurer administers SMIF and LAIF, which are available to the campuses as investment options.

Market Recap

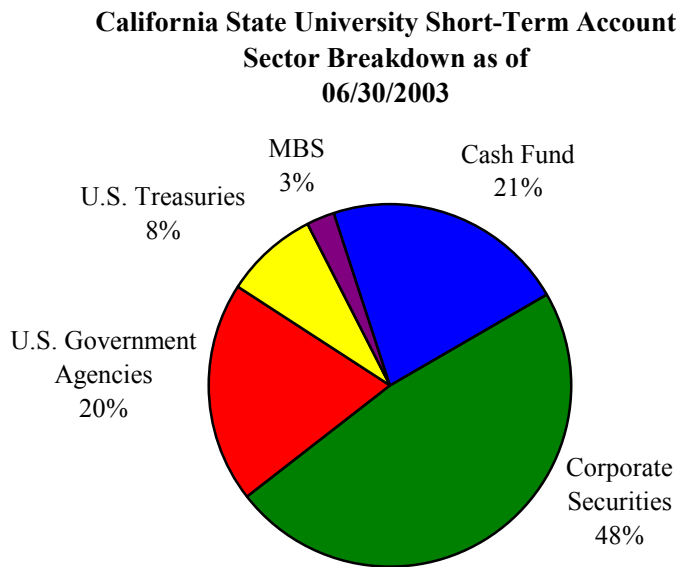
The past year has been marked by sharply falling interest rates. The Federal Funds overnight target rate has fallen from 1.75% to 1.00%. This happened in two stages. The FOMC (the policy making committee at the Federal Reserve) cut interest rates from 1.75% to 1.25% on November 6, 2002. On June 25, 2003, the Federal Reserve again cut the rate to 1.00%. The U.S. Treasury 2-year Note rate fell from 2.819% at the end of June 2002 to 1.308% at June 30, 2003 and the 10-year Note rate fell from 4.797% to 3.513% in that same time period.

Investor confidence improved considerably in the last 6-months, which was reflected in higher stock prices and tighter credit spreads. Current expectations are for GDP to exceed 3% in the second half of 2003. Furthermore, the fear of deflation should abate considerably if, in fact, we see the stronger GDP growth that is expected.

This environment has been generally favorable to participants in the three fixed income accounts, most notable on the Total Return and Long-Term accounts. A jobless recovery along with geopolitical unrest provided the backdrop for strong returns for fixed income securities. In keeping with the CSU investment policy (Attachment A.1) when investing the campus funds, the primary objective is to safeguard the principal, meet the liquidity needs of the campus and to return an acceptable yield.

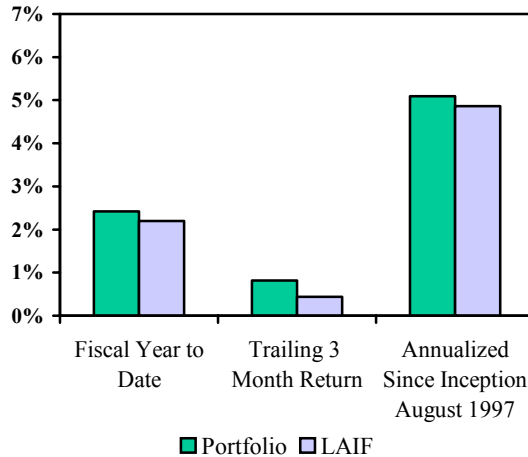
CSU Short-Term Investment Account Performance

As of June 30, 2003, the asset balance in the Short-Term account totaled \$209 million. The objective of the Short-Term account is to maximize current income along with preservation of capital. Consistent with the CSU investment policy, the portfolio is restricted to U.S. Treasury securities, mortgage backed securities, government agency securities, and highly rated corporate securities. State law prohibits the investment of these funds in equity securities. The portfolio's holdings by sector for the Short-Term account are as follows:



The Short-Term account has provided a return of 2.42 percent during the 12 months ended June 30, 2003. This return outperformed the 12-month return for the Local Agency Investment Fund by .22 percent.

**California State University System
CSU Short-Term Account
06/30/2003**

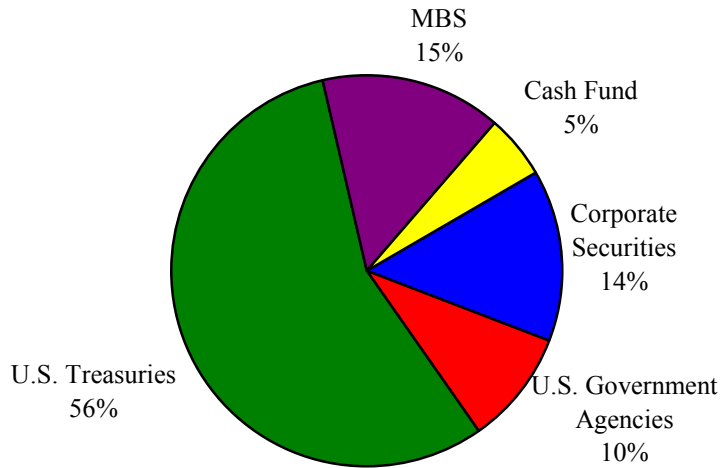


CSU Total Return Investment Account Performance

The objective of the Total Return account is to maximize medium term total return. The account is invested in a diversified portfolio of fixed income securities of varying maturities with approximate portfolio duration of 3.75 to 5.75 years. The account is benchmarked versus the Merrill Lynch 5-7 year Treasury Index, and is structured to outperform both the Short-Term account and LAIF over a 5-7 year investment horizon. As of June 30, 2003, the net asset value of the account was \$178 million.

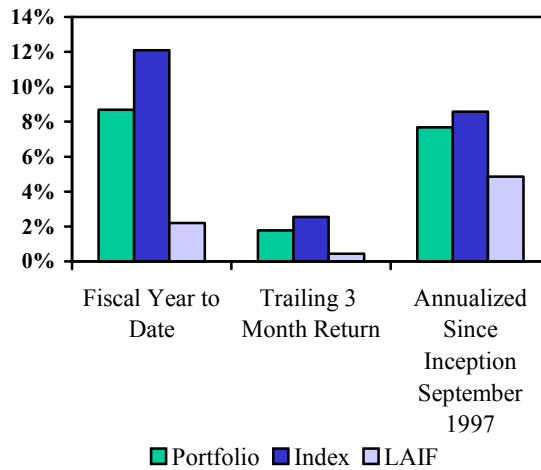
Consistent with the CSU investment policy, the Total Return account portfolio is restricted to U.S. Treasury securities, mortgage backed securities, government agency securities, and highly rated corporate securities. State law prohibits the investment of these funds in equity securities. The portfolio's holdings by sector for the Total Return account are as follows:

**California State University Total Return Account
 Sector Breakdown as of
 06/30/2003**



The Total Return account has provided a return of 8.69 percent during the 12 months ended June 30, 2003. This return exceeded the 12-month return for the Local Agency Investment Fund by 6.49 percent. Because of the funds defensive strategy, which emphasizes preservation of principal, the portfolio has a shorter duration, which led it to under perform the Merrill Lynch 5-7 Year Treasury Index by 3.41 percent.

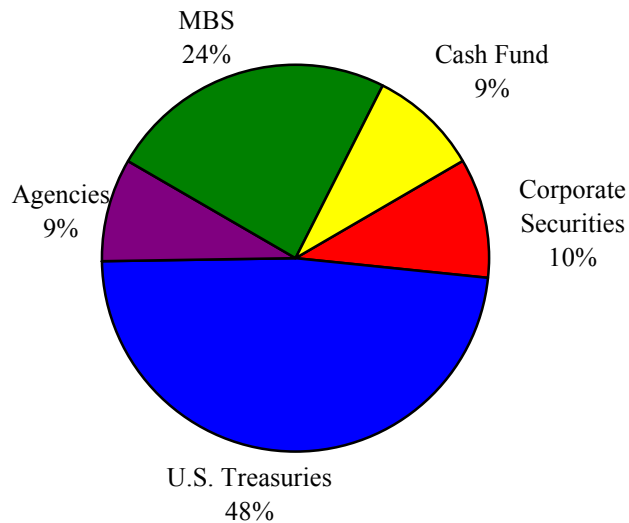
**California State University System
 CSU Total Return Account
 06/30/2003**



CSU Long-Term Account Investment Performance

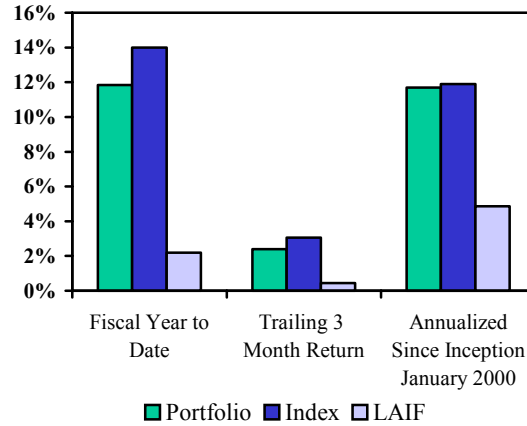
The investment objective of the Long-Term account is to maximize returns for funds that can be invested for a longer term. This account invests in a diversified portfolio of fixed income securities of varying maturities with approximate portfolio duration of 5 to 7 years. As of June 30, 2003, the net asset value of the account was \$74 million. Consistent with the CSU investment policy, the portfolio is restricted to U.S. Treasury securities, mortgage backed securities, government agency securities, and highly rated corporate securities. State law prohibits the investment of these funds in equity securities. The portfolio's holdings by sector for the Long-Term account are as follows:

**California State University Long-Term Account
Sector Breakdown as of
06/30/2003**



The Long-Term account has provided a return of 11.84 percent during the 12 months ended June 30, 2003. This return exceeded the 12-month return for the Local Agency Investment Fund by 9.64 percent. Because of the defensive strategy to shorten duration in the CSU Long-Term account, the portfolio under performed the Merrill Lynch 7-10 Year Treasury Index by 2.16 percent.

**California State University System
 CSU Long Term Return Account
 06/30/2003**



Surplus Money Investment Fund (SMIF)

The Surplus Money Investment Fund (SMIF) is a vehicle used by the State Treasurer to invest state funds in a short-term pool at virtually no risk. Cash on this account is available on a daily basis. SMIF is managed by the State Treasurer’s Office. The portfolio’s composition includes CD’s and Time Deposits, U.S. Treasuries, Commercial Paper, Corporate Securities, and U.S. Government Agencies. As of June 30, 2003, the balance was \$35.4 million.

**SMIF Performance Report
 Apportionment Yield Rate**

06/30/2003: 1.859%
 12/31/2002: 2.468%

**SMIF Past Performance
 1997-2003**

Average: 4.798%
 High: 6.493%
 Low: 1.859%

Local Agency Investment Fund (LAIF)

The Local Agency Investment Fund (LAIF) is a vehicle used by the State Treasurer to invest local agency funds. LAIF is administered by the State Treasurer’s Office. All investments are purchased at market, and market valuation is conducted quarterly.

**LAIF Performance Report
 Quarter ending 06/30/2003**

Apportionment Rate: 1.77%

The California State University Investment Policy

The following investment guidelines have been developed for CSU campuses to use when investing funds.

Investment Policy Statement

The objective of the investment policy of the California State University is to obtain the best possible return commensurate with the degree of risk that the CSU is willing to assume in obtaining such return. The Board of Trustees desires to provide to each campus president the greatest possible flexibility to maximize investment opportunities. However, as agents of the trustees, campus presidents must recognize the fiduciary responsibility of the trustees to conserve and protect the assets of the portfolios, and by prudent management prevent exposure to undue and unnecessary risk.

When investing campus funds, the primary objective of the campus shall be to safeguard the principal. The secondary objective shall be to meet the liquidity needs of the campus. The third objective shall be to return an acceptable yield.

Investment Authority

The California State University may invest monies held in local trust accounts under Education Code Sections 89721 and 89724 in any of the securities authorized by Government Code Section 16430 and Education Code Section 89724, listed in Section A subject to limitations described in Section B.

- A. State Treasury investment options include:
- Surplus Money Investment Fund (SMIF)
 - Local Agency Investment Fund (LAIF)
- B. Eligible securities for investment outside the State Treasury, as authorized by Government Code Section 16430 and Education Code Section 89724, include:
- Bonds, notes or obligations with principal and interest secured by the full faith and credit of the United States;
 - Bonds, notes or obligations with principal and interest guaranteed by a federal agency of the United States;

- Bonds or warrants of any county, city, water district, utility district or school district;
 - California State bonds or bonds with principal and interest guaranteed by the full faith and credit of the State of California;
 - Various debt instruments issued by: (1) federal land banks, (2) Central Bank for Cooperatives, (3) Federal Home Loan Bank Bd., (4) National Mortgage Association, (5) Federal Home Loan Mortgage Corporation, and (6) Tennessee Valley Authority;
 - Commercial paper exhibiting the following qualities: (1) “prime” rated, (2) less than 180 days maturity, (3) issued by a U.S. corporation with assets exceeding \$500,000,000, (4) approved by the PMIB. Investments must not exceed 10 percent of corporation’s outstanding paper, and total investments in commercial paper cannot exceed 30 percent of an investment pool;
 - Bankers’ acceptances eligible for purchase by the Federal Reserve System;
 - Certificates of deposit (insured by FDIC, FSLIC or appropriately collateralized);
 - Investment certificates or withdrawal shares in federal or state credit unions that are doing business in California and that have their accounts insured by the National Credit Union Administration;
 - Loans and obligations guaranteed by the United States Small Business Administration or the United States Farmers Home Administration;
 - Student loan notes insured by the Guaranteed Student Loan Program;
 - Debt issued, assumed, or guaranteed by the Inter-American Development Bank, Asian Development Bank or Puerto Rican Development Bank;
 - Bonds, notes or debentures issued by U.S. corporations rated within the top three ratings of a nationally recognized rating service;
- C. In addition to the restrictions established in Government Code Section 16430, the CSU restricts the use of leverage in campus investment portfolios by limiting reverse repurchase agreements used to buy securities to no more than 20 percent of a portfolio. Furthermore, the CSU:
- Prohibits securities purchased with the proceeds of a reverse repurchase from being used as collateral for another reverse repurchase while the original reverse repurchase is outstanding;

- Limits the maturity of each repurchase agreement to the maturity of any securities purchased with the proceeds of the repurchase (but in any event not more than one year) and;
- Limits reverse repurchase agreements to unencumbered securities already held in the portfolio.

Investment Reporting Requirements

- A. Annually, the Chancellor will provide to the Board of Trustees a written statement of investment policy in addition to a report containing a detailed description of the investment securities held by all CSU campuses and the Chancellor's Office, including market values.
- B. Each campus will provide no less than quarterly to the Chancellor a report containing a detailed description of the campus's investment securities, including market values. A written statement of investment policy will also be provided if it was modified since the prior submission. These quarterly reports are required:
 - to be submitted to the Chancellor within 30 days of the quarter's end
 - to contain a statement with respect to compliance with the written statement of investment policy; and
 - to be made available to taxpayers upon request for a nominal charge.