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MEMORANDUM

Date: June 9, 2006

TO: Ad Hoc Committee on Alternative Funding Sources
George G. Gowgani, Trustee
Melinda Guzman Moore, Trustee
Milton A. Gordon, President, CSU, Fullerton
Don W. Kassing, President, San Jose State University
Richard P. West, Executive Vice Chancellor/CFO

FROM: William Hauck, Chair

SUBJECT: Notice of Meeting – Wednesday, June 21, 2006

The Committee will meet in open session for the purpose of reviewing different types of revenue opportunities. The meeting will be held at 10:00 a.m. on Wednesday, June 21, 2006 in the Board Room of the Alumni Center located at CSU Sacramento, 6000 J Street, Sacramento, CA 95819. The committee will report back to the full board at its September 18-19, 2006 meeting.

c: Members, Board of Trustees
Agenda Mailing List

AD HOC COMMITTEE ON ALTERNATIVE FUNDING SOURCES

Review of Revenue Alternatives

Presentation By

Richard P. West
Executive Vice Chancellor and
Chief Financial Officer

Background

During the November 2005 meeting, the Board of Trustees discussed the difficulty of recovering from the $524 million in cuts made by the state during the 2002 - 2005 period. This combination of budget reductions and unfunded costs was seriously eroding the quality of education provided by the CSU and resulted in reduced student access and allowed for no compensation increases for faculty and staff. Due to the budget cuts imposed by the state, the Board of Trustees had little choice but to increase substantially student fees during the same period and at one point was directed by the Department of Finance to increase fees at mid-year. While discussing this state-of-affairs in November 2005, the Board shifted the discussion to exploring other revenue opportunities that might augment the state contribution to the CSU budget. This committee was appointed to look at various options.

Current Revenue

Approximately two-thirds of the total CSU operating budget is state General Fund and one-third comes from fees and other reimbursements. For 2004-05 the following represents the total funding provided for the operating budget.

General Fund Appropriation	2,475,792,000
Revenue	1,098,122,000
Reimbursements	175,624,000
Total CSU Appropriation	**$3,749,538,000**

Additionally, the auxiliary organizations at the campuses collected $219 million from federal sources in 2004-05, and $903 million from other sources, for a total operating budget of $1.112 billion.

State funding for the capital program was $313 million in 2004-05, and the Board-approved nonstate capital program was $88 million.

Review of Revenue Alternatives

The alternatives presented here fall into the two general categories of land use and philanthropic gifts.

Use CSU Land More Intensively

Objectives and Considerations

- Land lease arrangements have included faculty/staff housing projects and third party leases to generate revenue, with the understanding that the leases will encourage educational opportunities for students and collaboration opportunities for faculty, create new physical assets for the campus, and further the overall educational mission of CSU (Executive Order 747)
- Land leased to outsiders or used for faculty/staff housing projects typically ties up the land for 50-100 years, too long to assume the land can be returned to relevant campus use for educational purposes.
- Financial arrangements for land use by third parties should increase by some indexed amount – choice of index may or may not increase with market value of land.
- Limited equity appreciation, which is a key part of the structure of faculty/staff housing, may not appeal to faculty in meeting retention needs when outside housing markets are appreciating at a much faster pace than the index chosen for the equity appreciation.
- Despite the value of land being excluded from the faculty/staff housing calculus, projects that include high infrastructure costs must include those costs in the upfront price of the unit or be recovered through a monthly ground rent that can be steep and is not tax-deductible to the homeowner.
- Mortgage assistance programs, as an alternative to using campus land to create faculty/staff housing, can be helpful to first-time homebuyers, but recycling or resupplying those funds is key to ensuring future homebuyers are also included.

Examples

- Channel Islands Faculty/Staff Housing (For-Sale and Rental) and related commercial activities – Net revenues from the overall project will provide debt service for the financing of the Library ($64,655,000 project costs financed for Library).
- Fresno Campus Pointe (45-acre parcel rental to Kashian Enterprises, LP) – Developer has leased land for a 55-year term, with 35-year extension to self-fund construction on multi-family housing and commercial space ($880,000/year), hotel ($1,455,000 one-time), which is equivalent to a NPV for 90-year ground lease of $21,284,000, or NPV per acre of $473,000 for the 90-year term – unimproved property appraised value was $11,690,000.

- Dominguez Hills Home Depot Center – Anschutz Southern California Sports Complex, LLC has leased 85 acres (negotiated in 2 phases) to construct a $150 million sports complex, as well as a conference center, 200-room hotel, 50,000 sq ft athletic performance center, and 240-bed dormitory. The first phase negotiation guaranteed the campus $250,000/year for 4 years plus $200,000/year for the life of the agreement based on ticket sales and parking revenues. The second phase guarantees the campus $200,000/year, based on the hotel and conference activities plus $250,000/year for 4 years and 10% of naming rights revenues for new developments. Additionally Anschutz renovated existing athletic facilities and provides paid internship opportunities to students, and the new facilities will allow the campus to develop its corporate training programs and create a hotel management program.
- Pomona Innovation Village – Built on 65 acres, it has been conceived as a 960,000 sq ft project, built over multiple phases. The first phase was a 52,000 sq ft Center for Training, Technology and Incubation, funded from NASA and EDA grants. The second phase was the development of a 201,000 sq ft American Red Cross blood processing facility built on 15 acres (55-year lease, with 40-year extension for $360,000/year), and the third phase is a 120,000 sq ft commercial office building built on 7 acres by Trammell Crow Company (75-year lease with 15-year extension, $221,000/year).

The range of annual income depending on project size, length of rental term and location of land (campus) is $220,000 per year to $2 million per year.

<u>Philanthropic Gifts</u>

Objectives and Considerations

- The majority (95%) of annual revenue from gifts and the endowment levels are for restricted purposes, such as scholarships, buildings or specific programs. They do not replace the need for state appropriations, but provide a “margin of excellence” to campus programs. The annual amount of giving is approximately $300 million for the system.
- Investment of current endowments can be enhanced through the combination of endowed funds from smaller campuses being invested for higher returns and at lower costs. This will also assist smaller campuses in lowering their investing costs and improving their reporting. The current endowment corpus for the system is approximately $600 million, which would yield about $24-30 million each year.

Examples

- For 2004-05, campus foundations' year over year change (investment return plus new investments less spending rate) ranged from a high of 20% to a negative change.
- Currently, campus foundations pay fees to their investment managers anywhere from 25 to over 200 basis points, depending on the type of investment, the size of investment, and the services provided. If even 25 basis points could be saved on a consolidated investment portfolio of $150 million, that savings would be $375,000, which could be distributed to endowed programs at the campuses.

Sponsored Contracts and Grants

Objectives and Considerations

- Overhead on contracts and grants is intended to reimburse the CSU for the costs associated with those programs; there is no "profit" associated with their provision. The programs are intended to advance scholarship for the faculty and provide public service and advance knowledge in the respective discipline.
- The amount of research conducted by the CSU is modest, although growing. Current levels are at approximately $480 million/year, and most of the research is conducted through campus auxiliaries.

Examples

- CSU's contracts and grants activities are generally too limited to warrant some of the expedited reimbursement methods available to large research institutions. As a result, campuses may end up "loaning" funds to the contracts and grants activities as they await reimbursement from the sponsoring agency.

Exclusive Provider Arrangements

Objectives and Considerations

- Exclusive Provider Arrangements involve a contract with a single service provider to make their services available to a campus.
- The most common type of exclusive provider arrangement is for pouring rights contracts. Most campuses currently having pouring rights contracts in place – usually through auxiliary organizations.

Examples

- The Fresno campus has exclusive pouring rights as a part of a larger agreement with a vendor.
- Campus pouring rights agreements can yield $100-200,000/year, all the way up to over $1.5 million/year.

Lease Backs

Objectives and Considerations - (a) Tax credit "sale"

- The CSU has not participated in any of these opportunities to create cash from existing assets. Using them would likely involve higher accounting overhead costs, temporary loss of ownership of the asset, and increased federal scrutiny created by this tax "loophole." There may be some concern that would be raised by the trustees and the public from "selling" a public asset to a private party.

Objectives and Considerations - (b) Sale/lease back of asset

- Neither has the CSU engaged in any sale/lease back of assets to create cash. Proposals have been received regarding parking and student housing projects. Concerns include loss of direct control of an asset, the raising of rates to market pricing by a private company, and attendant labor issues. The tax advantage of lease backs, if determined to be feasible, have a value of $10-50 million in one-time funds.

Review of Cost Reductions

Objectives and Considerations

1. Greater use made of Energy Services Contracts, coupled with tax-exempt financing
   - Finance energy services contracts through either the Commercial Paper/Equipment financing program or through the issuance of Certificates of Participation. COP's may be needed when there are real estate-based enhancements required or if the amortization is greater than the stated period for the CP/Equipment program of 8 years or when the amounts to be financed exceed $5 million. Rates for fixed-rate debt will not be quite as low as SRB debt, but could be close, and the rating agencies and market would really like the consolidated approach of these contracts coupled with a consolidated approach for financing the improvements.

2. Creation of Systemwide Investment Fund-Trust
   - As a part of the overall changes that will be occurring with Fees in Trust, the CSU will be able to generate a short-term investment pool of available campus funds (combination of student fees and other trust fund monies) that can demonstrate the liquidity of the CSU and could eventually be used in some of the ways that University of California uses its STIP funds (Commercial Paper back-up in place of expensive letters of credit, faculty mortgages, working capital borrowings, etc.)

3. External Services Provision/Partnering with Private Sector
   - Work with the private sector to "outsource" or create partnerships that benefit both the CSU and the private party. These frequently revolve around information technology services, resulting in labor force reductions.
   - Third party student housing, a frequent third-party partnership opportunity that is presented to the CSU, can provide some off-balance sheet housing needs for campuses, but will frequently result in on-credit analysis, especially if campus land is leased to the provider and the campus seeks to limit or control the rental rates to students. Since the CSU has available credit capacity, and CSU financing (borrowing) costs are cheaper than developers' available borrowing, this approach doesn't have a current benefit to the CSU.
   - Campus land ground rents for third-party student housing are typically not as high as the net revenues that would eventually be achieved if campuses built and managed their own student housing.