Capital Markets Finance Newsletter

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University of California
Office of the President
Capital Markets Finance
1111 Franklin Street
Oakland, CA 94607

Sandra Kim
Executive Director
(510) 987-9660
sandra.kim@ucop.edu

Yoon Lee
Senior Finance Officer
(510) 987-9662
yoon.lee@ucop.edu

Pikka Sodhi
Finance Officer
(510) 987-9779
pikka.sodhi@ucop.edu

Allen Yin
Finance Officer
(510) 987-9852
allen.yin@ucop.edu

Timothy Loving
Finance Assistant
(510) 987-9664
timothy.loving@ucop.edu

CMF Departure!

Yoon Lee joined CMF in March 2009 as a Senior Finance Officer. He will be leaving the University at the end of July, where he will be the CFO of The Medical Center Company in Cleveland, Ohio.

NEW AND NOTEWORTHY

CapEquip – For FY 2011-12, the rate will be 1.99 %

Coming soon - Web based interactive interface for campus' funding needs

Market Update – 2nd Qtr

Interest Rates Rally to within Reach of Historic Lows

Long-term tax-exempt interest rates improved significantly over the course of the quarter, dropping by more than half of a percentage point to return to levels not seen since late 2010, prior to the run-up that occurred in the early months of the year. The 30-year MMD High Grade Index is currently hovering around 4.25%, only about 50 basis points above its all-time low and well below its 20-year average of 5.10%. The rally in tax-exempt rates has been driven in large part by strong Treasury market performance, continued low new issuance supply and slowing bond fund outflows. Meanwhile, short-term tax-exempt rates are at historical lows, with the SIFMA Index resetting at an astonishing 11 basis points in late June.

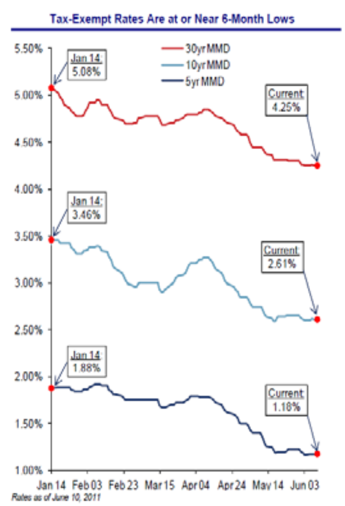
Declining Treasury yields were a key contributor to the improvement in tax-exempt rates, although tax-exempt bonds continue to trade at elevated ratios of taxables. The yield on the benchmark 10-year Treasury note once again breached the 3% threshold, down about 50 basis points from March and 120 basis points below its 10-year average. The 10- and 30-year MMD-to-Treasury ratios currently stand at about 90% and 102%, respectively, which has led to some crossover buyers tapping into the municipal market.

Treasuries, meanwhile, have rallied on mixed-to-weak domestic economic data that call into question the speed and viability of the economic recovery, the potential consequences of foreign sovereign debt crises, with Greece playing the most prominent role, as well as uncertainty surrounding the lingering effects of the Japan earthquake. With the Fed's QEII program coming to a close at month-end and no indications as of yet of further plans by the Fed to stimulate the economy, investors remain skeptical and skittish, contributing to a high degree of volatility and generally seeking the relative value of Treasuries.

New issuance supply remained low during the quarter, with both municipal and higher education year-to-date volume trailing 2010 levels by about half. However, issuance has picked up somewhat recently, with June seeing a couple of weeks of elevated volume as the negotiated calendar approached levels in line with historic measures. The market effectively digested this increase in supply, although it remains to be seen what the implications of a potentially more permanent increase in volume might be; early indications are that the increase in supply may put pressure on long-term rates in particular.

Following more than six months of outflows totaling more than $50 billion, long-term bond funds finally saw their first net inflows in June. The slowdown in redemptions translates into more demand for tax-exempt debt, contributing to lower rates.

Courtesy of Barclay's Capital



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Office of the President News

Approval of Fiscal Year 2011-2012 CapEquip Financing Authorization

Fiscal Year 2011-12 CapEquip Authorization:

At its May 18, 2011 meeting, The Regents authorized $240.12 million in external financing for the CapEquip Program for fiscal year 2011-2012. The revised rate for the new authorization was initially announced as 2.99%, (down from 4.00% in fiscal year 2010-11). However, after additional review of the current leasing market conditions, the Office of the President has decided to further reduce the equipment financing rate to **1.99%** for fiscal year 2011-2012.

The CapEquip program is part of a system-wide multi-year efficiency initiative called "Working Smarter" and enables the campuses, the medical centers and the Lawrence Berkeley National Laboratory to obtain capital equipment financing from The University Commercial Paper Program in lieu of third party capital leasing. Participants of this program will expend campus funds during the fiscal year, and seek reimbursement every quarter for all equipment purchases. The external financing will reimburse the participating campuses and medical centers for capital equipment purchases up to the maximum authorized amount. The first reimbursement cycle under the new fiscal year 2011-2012 authorizations will be in September 2011.

Participating campuses and medical centers may continue to use existing fiscal year 2010-2011 authorizations at 4.00% through the Q4 reimbursement in June. For the quarter ending June 30, 2011, the following campus services have utilized the CapEquip financing: Irvine Parking and Transportation Services to purchase campus buses and trucks, Merced Campus Police to acquire police vehicles, the Los Angeles campus to purchase medical equipment, and the Santa Barbara campus to finance cargo vans and trucks.

For information regarding the University capital equipment financing program, please visit the UCSIP (CapEquip/C3) website: http://www.ucop.edu/finance/ucsip.html

What Do We Pledge to Bondholders?

UC's Combined General Revenues and Limited Project Revenues Secure the Campuses' Debt

The University issues bonds pursuant to the powers and authority of The Regents contained in Article IX, Section 9 of the Constitution of the State of California. UC's General Revenue Bonds (GRBs) are limited obligations of The Regents, payable solely from General Revenues, the proceeds of the Bonds and other amounts held in funds or accounts established pursuant to the Indenture (excluding the Rebate Fund).

General Revenues consist of certain operating and non-operating revenues of the University, including (i) gross student tuition and fees; (ii) facilities and administrative cost recovery from contracts and grants; (iii) net sales and service revenues from educational and auxiliary enterprise activities; (iv) other net operating revenues; (v) certain other non-operating revenues, including unrestricted investment income; and (vi) any other revenues as may be designated as General Revenues by a Certificate of The Regents, *but excluding* (a) appropriations from the State of California (except as permitted under Section 28 of the State Budget Act or other legislative action); (b) moneys which are restricted as to expenditure by a granting agency or donor; (c) gross revenues of the University Medical Centers; (d) management fees for the DOE Laboratories; and (e) any revenues which may be excluded from General Revenues by a Certificate of The Regents.

The Regents have agreed with bondholders to set rates, charges, and fees in each Fiscal Year so as to cause General Revenues to be in an amount sufficient to pay the principal of and interest on GRBs for that Fiscal Year. General Revenues amounted to $7.66 billion in Fiscal Year 2009-10. Approximately $6.0 billion par amount of General Revenue Bonds is outstanding.

UC seeks to finance auxiliary projects with Limited Project Revenue Bonds, which are secured by a subset of General Revenues. Pledged Revenues consist of the sum of Gross Revenues of a Limited Project including (i) all income, rentals, fees, rates, charges, insurance proceeds, condemnation proceeds and other moneys derived by The Regents from the ownership or operation of the Project, but excluding any refundable deposits, fines or forfeitures, and (ii) any other revenues, receipts, income or other moneys from time to time designated by The Regents. The pledge of Limited Project Revenues is subordinate to the General Revenue Bond pledge. The Regents have agreed with bondholders to set rates, charges, and fees in each Fiscal Year so as to cause Pledged Revenues to be not less than 1.10 times the Aggregate Debt Service on LPRBs for that Fiscal Year.

"Whatever failures I have known, whatever errors I have committed, whatever follies I have witnessed in private and public life have been the consequence of action without thought."

Bernard M. Baruch

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"In attempts to improve your character, know what is in your power and what is beyond it."

Francis Thompson

UC and Solar

Adding Solar Generating Facilities to Bond-Financed Buildings

There can be many benefits to installing solar generating facilities. One common approach is for a campus to engage a private company to install and own solar generating facilities on top of existing buildings or structures. The private company then makes the energy generated available to the campus at a favorable price or provides some other financial incentive. The arrangement with the private company requires a long-term license (or some other type of use agreement) that allows the private company the legal right to locate the solar generating facilities on University buildings or structures.

If the building or structure was financed with tax-exempt (or Build America) bonds that are still outstanding, the license granted to the private company may have to be taken into account for purposes of determining the amount of private business use that is occurring at the building or structure. Private business use typically is limited to no more than 10% of the space of a bond-financed project. Private business use includes leases of (or licenses for the use of) space within a project, certain management or operating agreements, and certain sponsored research activities, but the federal tax law provides certain exceptions in which arrangements that otherwise would count as private business use can be ignored. One such exception, the exception for "incidental use," generally should apply to the licenses for solar facilities described above.

The incidental use exception applies to small, non-possessory uses of bond-financed assets, so long as (1) the private entity involved does not have the right to use the bond-financed asset in some other, non-incidental manner and (2) the aggregate incidental uses of that bond-financed asset do not aggregate to more than 2.5% of the space of that asset. Examples provided by the Internal Revenue Service for incidental uses include vending machines, kiosks, and advertising displays.

The typical configuration for solar generating facilities is to attach the solar facilities to the existing roof of a building with posts that suspend the solar facilities above the roof and allow for access to, and maintenance and repair of, the roof. In that case, the license allows the private company access to the roof, the legal right to physically use the part of the roof to which the posts are attached, and the right to use the air space above the roof. The license also will allow the private company to locate a limited amount of wiring and other electrical facilities in or near the building. These uses are considered non-possessory uses, and the private company is not likely to be a user of the building on any other basis. Therefore, the physical use of building space by the private company can be an excluded incidental use, so long as the total amount of incidental uses in the building are less than 2.5% of the space in the building. For purposes of measuring the amount of use attributable to the solar license, only the amount of square footage of the area to which the posts attach to the roof and the wiring or other electrical facilities attach to the building is counted.

Courtesy of Chas Cardall,
Orrick, Herrington & Sutcliffe