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Office of the President

TO MEMBERS OF THE COMMITTEE ON FINANCE:

ACTION ITEM

For Meeting of January 22, 2014

FORMATION OF A NONPROFIT CORPORATION AND TRANSFER OF THE RESIDENTIAL LENDING ACTIVITIES OF THE OFFICE OF LOAN PROGRAMS TO THE NONPROFIT CORPORATION

EXECUTIVE SUMMARY

This item recommends approval of the formation of a California nonprofit public benefit corporation to undertake the future residential lending activities currently performed by the Office of Loan Programs (OLP) at the Office of the President.

The purpose of transferring the residential lending activities of the University of California to a separate nonprofit corporation is to qualify the future residential lending activities for the Small Creditor Exemption to the Consumer Financial Protection Bureau's Ability-to-Repay rule.

RECOMMENDATION

The President recommends that the Committee on Finance recommend that the Regents:

1. Approve the University's formation of a California nonprofit public benefit corporation to be known as the University of California Home Loan Program Corporation (the Nonprofit) to undertake the future residential lending activities of the University of California (the Program), subject to the following conditions:

   A. The purpose of the Nonprofit shall be to operate the Program as it is currently operated or is modified in the future.

   B. The Nonprofit shall be governed by a five-person Board of Directors (Board) which will consist of five officers of the Regents or their designees: the President, Chief Operating Officer, Chief Financial Officer, Chief Investment Officer, and General Counsel, sitting ex-officio. Initially, the Chief Financial Officer, or designee, shall serve as the Chair of the Board; provided, however, that the President shall have the authority to remove the Chief Financial Officer as Chair of the Board at any time and appoint another member of the Board as Chair.

2. Approve the transfer of the future operation of the Program to the Nonprofit, excluding loans previously extended by the Office of Loan Programs and current cash reserves.

    A. The Nonprofit will be staffed entirely by employees of the University of California assigned to the Nonprofit pursuant to a services agreement to be executed between the Regents and the Nonprofit. As consideration for these services, the Nonprofit will transfer to the Regents the administrative fees collected under the Program.

    B. The Nonprofit will execute a master note agreement (Master Note) in favor of the Regents. Pursuant to the Master Note, the Regents will provide the Nonprofit with funding sufficient to enable the Nonprofit to extend future loans pursuant to the terms and policies of the Program. Loan payments received by the Nonprofit will be transferred to the Regents on a monthly basis, according to the terms set forth in the Master Note.

    C. The Nonprofit will apply for and expects to obtain tax-exempt status as an organization described in Section 501(c)(3) of the Internal Revenue Code of 1986 and the corresponding provisions under California law.

    D. Notwithstanding the transfer of the Program to the Nonprofit, the participation in the Program by any member of the Board shall be approved by the Regents.

3. Authorize the President, after consultation with the General Counsel, to approve and to execute (a) any documents reasonably required to accomplish the above; and (b) any modifications thereto, provided that such modifications do not materially increase the obligations of the Regents.

BACKGROUND

Program History

In July 1984, the Regents approved the establishment of the Mortgage Origination Program (MOP). MOP was approved to provide primary mortgage financing to support the Regents' recruitment and retention needs for faculty and senior managers. The Regents also administer the Supplemental Home Loan Program (SHLP), which was approved by the Regents in March 1993. SHLP provides flexibility to utilize campus funding sources to offer primary and secondary financing in support of a range of loan products.

MOP and SHLP are valuable resources in the recruitment and retention of faculty and senior managers. The underwriting guidelines for MOP and SHLP are designed to provide more flexible qualifying standards than products available in the conventional mortgage market.

Consumer Finance Protection Bureau Regulations

In November 2013, the Regents authorized the President to implement procedures to comply with new Federal Truth in Lending regulations promulgated by the Consumer Financial Protection Bureau (CFPB regulations). As part of the approval it was anticipated that the future operation of the Program would be transferred to the Nonprofit to qualify for the Small Creditor Exemption to the Ability-to-Repay rule available under the CFPB regulations.

Small Creditor Exemption

Under the CFPB regulations, which are effective January 10, 2014, a mortgage is considered a Qualified Mortgage if it meets the following requirements: (1) a loan term of 30 years or less; (2) no interest-only or balloon payment features; (3) a maximum 43 percent debt-to-income ratio; and (4) it is underwritten based on the highest possible rate in the first five years of the loan.

The Small Creditor Exemption to the Ability-to-Repay rule provides a separate exemption, effectively extending Qualified Mortgage status to loans with a debt-to-income ratio that exceeds the 43 percent requirement, as long as the loans are held in the small creditor's portfolio for at least three years. This exemption is not available to the University of California, as its assets exceed the small creditor limit of $2 billion. The Small Creditor Exemption will allow the Program to continue, through the Nonprofit, to make available more flexible underwriting criteria to assist in the recruitment and retention of faculty and senior managers.

Governance and Operation

The Nonprofit will be formed as a California nonprofit public benefit corporation, the sole purpose of which will be to operate the Program as it currently exists or is modified from time to time. As the source of capital for future loans under the Program, the Regents will be required to approve Program modifications. Upon dissolution, all assets of the Nonprofit shall be distributed to the Regents.

Under the overall supervision of the five-person Board, the Nonprofit will establish its own budgets, financial plans, underwriting policies and procedures, and the terms of future loans to be made under the Program, including administrative fees to be charged by the Nonprofit. Such matters will be reported to the Regents on a regular basis and ratified by the Regents as appropriate.

All necessary staffing and administrative support for the Program will be provided to the Nonprofit by the Regents pursuant to a services agreement (Services Agreement). Under the Services Agreement, Regents' employees will be assigned to the Nonprofit. The assigned employees will continue to be employees of the University of California. In addition, the Services Agreement will allow the Nonprofit the appropriate use of the Regents' name, trademarks and other necessary intellectual property. In exchange, the Nonprofit will transfer to the Regents the administrative fees collected by the Nonprofit under the Program. The Nonprofit will establish loan application procedures consistent with the Program and the CFPB regulations, and the Nonprofit will be the servicer of the loans which are originated and held by the

Nonprofit.

The Regents and the Nonprofit will enter into a master note agreement (Master Note). The Master Note will obligate the Regents to fund the loans made by the Nonprofit only to the extent the Nonprofit extends future loans which are consistent with the parameters of the Program which have been ratified by the Regents from time to time. Advances under the Master Note will be made at the STIP rate. In turn, the Master Note will obligate the Nonprofit to repay the Regents for all funds that are transferred under the Master Note pursuant to the current Program requirements. Loan payments received by the Nonprofit will be transferred to the Regents as necessary to repay the related obligations of the Nonprofit under the Master Note. It is anticipated that the Nonprofit will also retain any excess earnings to build up an appropriate reserve fund. Once a loan originated by the Nonprofit that is not a Qualified Mortgage has been held for the required holding period under the CFPB regulations (currently three years) the Nonprofit may transfer such loan to the Regents in exchange for relief of a like amount of liability under the Master Note. Loans that are Qualified Mortgages may be transferred to the Regents more quickly.

All cash balances and reserves of the Nonprofit will be invested by the Regents in the same manner as other funds of the Regents.