Dear Friends and Colleagues,

Since my last message to faculty regarding the Upper Hearst project we have received a number of good, substantive questions. In the name of transparency and full disclosure I want to share the answers to these queries with all of you so that our discussion at this afternoon’s senate meeting is fully informed by the facts.

Before proceeding to the answers, I want to acknowledge the concern and frustration that has been expressed regarding the review and approval process for this project. While we have engaged and informed a wide range of academic stakeholders and committees over the course of nearly three years, I agree with CAPRA that our capital planning process---including site selection---needs substantial improvement. I am ready and eager to work with the Senate to design a new process. However, in this instance, I believe that any procedural deficiencies notwithstanding, the project is properly situated and rests on a strong financial foundation where most of the risk is being born by non-campus entities. The benefits in terms of faculty housing needs are significant. There are no hidden subsidies for a GSPP, which sorely needs space to accommodate its rapidly growing program. While 345 C/F permit parking spots will be lost during construction, we are now able to promise that those who use the Upper Hearst lot will have access to at least 345 C/F spots that are currently unavailable or unused, at lots and garages no more than 1/3 of a mile distant from the Upper Hearst site.

Nothing is more difficult than land-use decisions on a land-poor campus. With finite resources and a limited number of sites, there will always be trade-offs between competing claims, interests, and priorities. We cannot address the housing crisis without having an impact on our parking infrastructure. We cannot wait for the State of California to resume funding of academic facilities, and must embrace new financial strategies. In this context I see no feasible way to please everyone, all of the time, and so hard decisions must be made. However, I do believe that going forward we can and will provide ample opportunity for the broadest possible faculty input when, as is the case in this instance, there is tension between unit-specific interests and the greater good of the campus.

The answers to the latest round of questions we have received can be found below.

Sincerely,

Carol Christ
Chancellor
Policy implications

1. While not directly acknowledged until the Chancellor’s email of 2019-04-25:15:40, the P3 project cross-subsidizes the GSPP project by providing access to capital markets at rates that it would not have access to without the attached housing development. Can other units avail themselves of this the Upper Hearst Development bond issue in a similar manner to undertake their own academic development projects? Going forward, will other campus units be allowed to propose developments on UC Berkeley owned properties in order to access bond markets for the construction of academic facilities using this type of vehicle?

Some background might be helpful to answer your question fully. As you may know, UC Berkeley has very limited debt capacity as a result of our financial performance over the last decade. Though we have balanced our budget, debt capacity will grow much more slowly over time. The debt model, developed and maintained by the Office of the President, reflects debt capacity of $150 million to $200 million. That funding will be used very carefully and likely committed to a large academic building, critical deferred maintenance or seismic corrections. Current projections reflect $4 billion of capital need over the next decade.

The GSPP academic building represents approximately 30% of the larger Upper Hearst project, inclusive of housing, allowing the campus to use the Financing Trust Structure (FTS). This model allows the campus to finance this project with third-party debt (i.e. not State-funded), transferring some risk while preserving campus financing capacity for other high priority projects. At the end of the ground lease term (approximately 31 years), the improvements will revert to the Regents at no cost, free and clear of liens or encumbrances. Risk transference includes construction risk, financing risk, and occupancy risk. There is no subordination of UC’s land interest or its leasebacks. The project rents are the only assets out of which the borrower is legally obligated to use to repay the loan. A slightly higher bond interest rate is applied for this vehicle. As such, GSPP’s debt service is higher than campus constructed projects. **GSPP will not receive any compensation from the center for the increased financing costs.**

As the pro forma reflects the project does generate net cash flow. The net cash flow will be distributed at the Chancellor’s discretion after a parking “in-lieu” fee is paid to Parking and Transportation. **GSPP will not receive benefit from this distribution.** There is no other direct subsidy of a grant, gift of money, or a provision of fungible resources or funds that could be used for other academic purposes disadvantageous to another campus unit.

Are there financial benefits that accrue to GSPP and the campus as a result of the project’s financial model? Yes, and they are the very same benefits that would and will accrue to all campus units with capital needs who adopt a similar model. For projects to be eligible for FTS, there must be a portion of the project (our guidance is approximately 70%) that produces auxiliary recurring revenue.
**GSPP modeling issues**

1. The GSPP portion of the bond issue is based upon GSPP paying down the bonds with revenue from its self-supporting degree program, its executive education program, and philanthropic funds. In recent years, these, as reported to us, are currently healthy -- roughly $2 million/year over the last 3 years (actuals). As the bond term is apparently 31 years @ $1.6M/year for servicing, in what way has the campus accounted for the continued health of these programs or made contingency plans?

First, it is worth noting that the conservative pro forma assumption of a $1.6 million per year lease is based upon a $10 million philanthropic equity contribution. As has been previously noted, GSPP intends to make a $13.1 million equity contribution. Hence the lease payment will be less than $1.6 million per year--most likely something like $1.3 million (although the final amount depends upon the final cost estimate and the cost of capital which are not yet fully determined). Also, since the lease payment will be constant in nominal dollars, as time goes by it will be less and less in real terms which will make it less and less of a burden for GSPP.

The biggest protection for the campus is that GSPP has four relatively independent sources of funds for this project: MPA revenues, Executive Education revenues, philanthropic annual giving, and large philanthropic gifts. Their relative independence decreases the overall risk of meeting future obligations.

The most predictable of these revenue sources is the Masters of Public Affairs which has grown faster than predicted each year (see the target versus actual enrollment numbers). With its further growth there is every reason to believe that it could, on its own, cover the debt service in the next two years (see “GSPP Net Revenue Streams--Historical and Projected”).

In addition, the new building will provide more space for executive education which has performed very well and seems poised for additional expansion. While this stream of revenue can be more unpredictable than enrollment in a degree program, there is every indication that it will continue to do well given GSPP’s reputation, its success with its executive education so far, and the experience of other public policy schools.

Annual giving is typically a very predictable source of income because it is based upon repeatedly returning to the donor base with requests for annual contributions. GSPP has recently invested in a staff member to expand its alumni/annual giving and there is every reason to believe that this will yield dividends as it has for others across campus. Recent reports by advisors to the campus have noted the extraordinarily large untapped potential of UC Berkeley’s alumni.

Finally, GSPP continues to raise large philanthropic gifts completely separately from its annual giving and from its income from the “Recent new Endowment--Annual Payout” reported by GSPP on its “Overview of Finances for Academic Building”. At the moment, GSPP has a $2.5
million pledge that will be realized over the next five years, and with the continued health of its programs over the next two years it should save $2 million to 2.6 million before the building is built and lease payments begin. These amounts can be used to pay off the debt and reduce the lease payment by about $350,000. Large philanthropic gifts are not a fundamental part of the plan for financing the academic building as they are lumpy and unpredictable, but GSPP has done very well with such gifts over the past decade and there is every reason that it will continue to do so.

In terms of cost savings, GSPP could also end its lease at Memorial Stadium and realize about $180,000 per year. Finally, GSPP has $20 million in an additional endowment that could be drawn upon if necessary, although this would require cost-savings in other parts of its programs.

In summary, GSPP has a very strong plan for meeting its obligations. It has been one of the best revenue generating units on campus. GSPP has repeatedly met and exceeded its revenue targets for the past five years. The school has also demonstrated an admirable ability to run its programs efficiently. Finally, it has relatively independent sources of income and fundraising available to meet its obligations.

2. A GSPP funding stream for maintenance and upkeep of the new building is not apparent in the documents shared with us. Can you provide a pro-forma showing these details? In particular, how much in total will GSPP be transferring to the campus on an ongoing basis (above the already identified bond service payments).

The academic building is being built to house GSPP’s new revenue-producing programs, as well as its long-standing Masters of Public Policy and undergraduate minor programs. These programs currently produce approximately $500,000 per year in fees which is likely to increase to $1 million as they grow. The fees are returned to cover campus overhead costs including maintenance and upkeep for buildings. The general campus practice has been for building upkeep and maintenance to be covered by central campus funds generated through tuition and state funding, except in cases where building operators wanted higher levels of maintenance. Because GSPP has a very high level of student credit hours per ladder rank faculty member (with more undergraduate SCH than graduate SCH), GSPP contributes significantly to serving students who provide tuition income and who garner state funding. And as noted above, GSPP also provides through its revenue-producing programs substantial fees to cover overhead more directly. The Common Goods/Revenue Programs task force that is part of the campus’s overall financial reform effort is reviewing these practices.

3. Are the “Philanthropic Funds” listed as part of GSPP’s annual revenues separate from the philanthropic component of GSPP’s $13.1 downpayment?

Yes. The $13.1 million equity contribution (downpayment) consists of funds already raised and in the bank, or pledged. In the case of the final $3 million that GSPP is in the process of obtaining from a trusted campus donor, the pledge is based upon a promise that the funds will be available before GSPP has to make an equity contribution in July. The “Recent New
Endowment -- Annual Payment” listed on “GSPP Net Revenue Streams” is completely separate, and it is not included in the $13.1 million.

**Housing project modeling issues**

1. Can we see the Net Present Value analysis for the project? Including both buildings but separated out from each other. Please highlight how the current value of the structure presently sited at Upper Hearst appears in the analysis; note it is our understanding that the seismic rating of the current structure is Good.

The ground rent to be paid to the University are the residual net cash flows to the campus from the residential portion of the project after the ground lessee has paid all operating expenses, maintenance reserves, and debt service, and met all required bond covenants. The Net Present Value (NPV) of the cash flow/ground rent for the residential building is found in the pro forma at the bottom of the cash flow pages. The completed academic building will be leased back to the University as an absolute net lease wherein the campus will be responsible for all operation and maintenance costs. For the academic building, the annual rent payment will only be for the amount of debt service, so there will be no residual cash flow. Thus there is no net present value of cash flow/ground rent.

The current value of the present Upper Hearst parking structure is reflected in the parking in-lieu fee of $30,000 for every space that is not replaced in the new project.

2. How are control rights over the operations of the project (e.g., rent levels, maintenance levels) allocated between the university, CHF and ACC? What happens if the parties Disagree?

There are three components to the project: academic, residential, and parking. For the academic and parking components, the University will execute two separate leaseback agreements. In these agreements, the University will be responsible for the operations and maintenance of those leased back areas. Any revenues that accrue from the use of those spaces (e.g. additional student fees or parking revenue) will accrue to the University.

Through the ground lease, the ground lessee (CHF) will be obligated to operate and manage the residential component in accordance with the negotiated standards developed by the UC Berkeley campus and documented in the final ground lease. CHF will sign an operating or management agreement with ACC, to transfer the operating obligations to ACC as the initial operator. Failure to meet those standards would result in an event of default. If the default is not cured within the given cure periods the campus could seek various remedies including, but not limited to, fines or change of operators.

With respect to residential rents, the rents charged to the residential occupants (i) shall be evaluated annually and approved by the campus, and (ii) shall be sufficient to pay all of CHF’s expenses associated with the operation and financing of Upper Hearst Housing and Upper
Hearst Parking, including but not limited to operating expenses, replacement reserves, and debt service, and budgeting rents and operating expenses to achieve the required 1.20x debt service coverage ratio (DSCR).

If there is disagreement over fulfillment of the standards of operations, rents, or other obligations under the ground lease the document will include a process to address dispute resolution. The ground lease and management agreements will also provide for a management committee, which will be made up of equal members from the University and CHF (including the manager) that will review annual budgets, capital improvement plans, and general property operations and standards each year of operations.

3. How is CHF compensated for its participation in this project?

For their role as borrower and ground lessee, CHF will receive an upfront “acquisition” fee of 25 bps of the total bond par amount, not to exceed $100,000, which is paid upon ground lease execution/financial closing. CHF also receives an annual fee of 1.5% of total revenues, not to exceed $100,000 per year, which is paid as a project operating expense until the bonds mature or are retired. These fees are standard across the UC system as CHF is the preferred 501c3 foundation.

4. Can we see the overall cash flows to the campus for this project separated out by Building?

Please refer to the pro forma for a detailed overview of the residual cash flows from the housing component of the project. In summary, as long as the 1.2x debt service coverage ratio is met, surplus cash generated by the residential portion of the project flows back to the campus in the form of ground rent each year. As noted above, net cash flow will be distributed at the Chancellor’s discretion after a parking “in-lieu” fee is paid to Parking and Transportation. GSPP will not receive benefit from this distribution.

Note that, as with any other debt-financed academic building project on campus, the campus is not expecting residual cash flows from the academic portion of the project. The Goldman School of Public Policy (GSPP) will use a mix of fundraising and operating revenues to service the debt associated with the academic building.

5. Using the 35% affordability level, annual household incomes triggering subsidies will be salaries below $96K (studio), $115K (1 bd), and $143K (2 bd) -- for 2021 rental rates (and increasing 3% per year). For the stated target population, most residents will be receiving subsidies of varying magnitudes. Can we see the analysis of the annual estimated housing subsidies that the campus expects to supply to the project? How are these reflected in the pro-forma?

As shared at the review meeting, rent subsidies will ultimately be decided by the Vice Provost of the Faculty with advisement from faculty. For purposes of modeling for the project, three models
were developed to assess the amount of subsidy needed anticipating high, medium and low annual subsidy levels. All three models fell within the target range of the subsidy that would be available. In all situations, a single faculty member or a household without a working partner would require a subsidy.

The basic assumptions used to develop all three subsidy models included specific household size and income assumptions. For example, the models assume that single adults will rent the studio units, that a mix of singles and couples will rent the one bedroom units, and that a mix of couples and families will rent the two bedroom units. It was also assumed that some of the couples would have a dual income (a working partner). It is not expected that the two-bedroom units would be rented to singles. Current faculty salaries were used (2018/19 rates) for Assistant Professor starting at $72,800 through $90,500. Partner incomes were set at $60,000 per year.

The High Subsidy model assumed that only 30% of the faculty in the building had a working partner and that 70% of the households were either single adults or had a partner who was not working. Various stages of the faculty ladder were tested with some units rented to first step ladder faculty and some units rented to fifth step ladder faculty. This was the model that required the highest amount of subsidy in the range of $1.8 million to 2.2 million per year.

The Medium Subsidy model assumed a 50% split of dual-income households and resulted in a medium range of subsidy. This model required a range of $1 million to $1.5 million per year in annual subsidy.

The Low Subsidy model assumed that 80% of the faculty had a working partner and that only 20% were single or without a working partner. The same degree of variation regarding faculty ladders was tested. This was the model that assumed the least amount of annual subsidy in the range of $800,000 to $1.0 million per year.

6. How is the payment to ACC affected by any rent subsidies paid by the university? Is ACC’s 3.5% management fee based on the full listed rent, regardless of what tenants directly pay?

ACC’s operating management fee is based upon the actual gross revenues received by the project each year. The management fee will not be reduced if a household receives a rent subsidy.

7. UC Berkeley has aggressive plans to build upwards of 6000 beds for campus affiliates. How has the impact of this large delta to the local housing stock been accounted for in sustainable rent levels? The market study even shows decreasing Berkeley rents which they attribute to several new developments having come online.

As the nation’s most experienced developer and manager, ACC takes a market validated approach to every housing project they develop and plan to do the same on each phase of future new housing development at UC Berkeley. One of the earliest stages of pre-development
is market analysis – both internal by ACC as well as through an independent third-party consultant – to validate demand, product type, rents and track projected supply changes.

Additional housing proximate to campus will be developed and delivered in phases over the next decade. The result will be purpose-built student and faculty housing that will meet the campus’ housing master plan objectives.

With regard to off-campus, it is ACC’s experience that when a university market experiences significant new supply (on or off campus, or both), all things being equal the growth of rental rates in the market is likely to slow or reverse. However, if new supply is gradually introduced, the market will absorb the new supply as intended and housing previously occupied by students is likely to be occupied by other members of the community.

We acknowledge the noted decreasing rents in response to several new developments currently in the area and have accordingly priced the Upper Hearst project below market comparables in order to protect against any further reset of rent levels as supply is absorbed.

8. The furnishing arrangements are not mentioned. What furnishings and or appliances are provided in the rentals?

In-line with market comparable properties the project rentals include full typical kitchen appliances – refrigerator, oven, range, microwave, dishwasher, and garbage disposal. The units each also provide in-unit washers and dryers.

In terms of furnishings, the units are unfurnished based again on market comparables and the intended target market of faculty/staff. All common areas (offices, lounges and fitness center) are fully furnished from the project budget.

9. What is included in the listed rents? Unit? Utilities? Internet? For expected costs that are not included in the rent, who will bear the costs? If it is UC Berkeley, where is this reflected on the pro-forma?

The rental rates include expenses for water, sewer, and trash, while the residents are responsible for payment of electricity, cable and/or internet. The rents were structured to be in-line with market comparables.

The campus does not anticipate bearing any additional costs associated with the occupancy of the units beyond the above referenced included utilities. It is assumed that the tenants would bear any additional costs.

10. The project transaction structure has been underwritten by campus and ACC to an aggressive 1.2 debt service coverage ratio. It is also our understanding that if over the bond repayment period ACC should fall below the 1.2 debt service coverage ratio the “project lessee, borrower, and project owner” Collegiate Housing has contingency
powers to cease full distributions to ACC. These contingency positions are not laid out in the transaction structure nor is there any information on the ground lease and contracting structure to Collegiate Housing. Can you provide this information?

1.2x is the standard debt service coverage ratio used by the Office of the President when underwriting housing projects in the UC system, as well as being the standard by rating agencies and bond investors for these types of projects. Various UC housing projects done in the past few years were underwritten using a 1.2x coverage ratio with no adverse effect or impact from credit rating agencies and investors. Currently, note that the interest rate assumption in the pro forma provided is 50bps above current market to account for market condition changes between now and pricing the bonds in August, while also providing a cushion within the 1.2x coverage ratio while maintaining affordable project rents.

In any given year, if annual revenues are such that the debt coverage ratio is above 1x but under 1.2x, the residual cash flows will not be distributed to the campus but will remain with an independent trustee until such a time that the 1.2x coverage ratio is met again.

As standard with these types of debt transactions, contingencies and other covenants are typically laid out in the bond documents that will be executed at financial closing and described in the public Offering Statement.

11. The reported transaction structure does not give any information on the rights of the University of California, Berkeley on its ground lease in the case of default of either ACC or Collegiate Housing. Can you provide this information?

In the event of a default under the ground lease by CHF, or ACC as the agent of CHF, the Regents’ interest in the land will not be subordinated. Otherwise as is standard in agreements such as this, the ground lease will have a process for curing a default, dispute resolution, and dissolution of the agreement. These will be based on similar agreements that the system has entered into for other projects financed through the Financing Trust Structure.

12. Since the Upper Hearst redevelopment site runs alongside the Hayward fault, seismic and life safety considerations need to be carefully addressed both in terms of costs of mitigants in the structural engineering of the building and in terms of provisions for earthquake insurance or other risk mitigants over the 30 to 40 year life of the transaction. Which of the three participants in this transaction Collegiate Housing, ACC, or UC

13. Berkeley bears the residual risk of significant earthquake damages? Do the recognized insurance cost shown in the pro forma include earthquake risk insurance?

The campus will be responsible for insurance for the two elements of the project it will lease back, specifically the academic and the parking components. The residential component will be responsible for holding insurance as deemed appropriate by campus and OP risk management.
As the ground lessee, CHF holds responsibility for the bearing the cost of insurance but they may transfer this obligation to the operator.

**Parking issues**

1. According to statements in the Chancellor’s email of 2019-04-25:15.40 of the current 345 parking spaces P&T operates now, 80 will be available to the campus at the end of the project (as 90 will be reserved for residents), leaving 265 spaces to be mitigated by displacing public and student parking at the Lower Hearst lot (50 spaces), shuttle service to the Foothill and Clark-Kerr lots, and by entering into a lease arrangement with the privately run Maxwell garage for 150 to 200 spaces on an ongoing basis. Where are these costs reflected in the pro-forma?

As noted above, the $30,000 in-lieu fee, which is to be paid from residual, net revenue, would go towards creating new parking inventory in the future. UC Berkeley Parking and Transportation will also be reimbursed for the costs of the mitigation during construction from net cash flow: $270,000 for a new shuttle, and between $240,000 and $300,000 to lease spaces at the garage at the Maxwell Family Field. Negotiations to enter into a long term use agreement with Maxwell Garage are underway. Long term mitigation will be part of the campus’s Long Range Development Plan and Campus Master Plan.

**Why not build housing on the Foothill Lot?**

The State of California has established a variety of regulations and requirements related to seismic safety and structural integrity, including the California Building Code, the Alquist-Priolo Earthquake Fault Zoning Act, and the Seismic Hazards Mapping Act. The Alquist-Priolo Earthquake Fault Zoning Act was passed in 1972 to mitigate the hazard of surface faulting to structures for human occupancy. The main purpose of the Act is to prevent the construction of buildings used for human occupancy on the surface trace of active faults. (California Geological Survey, Alquist-Priolo Earthquake Fault Zones, [http://www.consrv.ca.gov/CGS/rghm/ap](http://www.consrv.ca.gov/CGS/rghm/ap))

The law requires the State Geologist to establish regulatory zones (known as Earthquake Fault Zones or Alquist-Priolo Zones) around the surface traces of active faults and to issue appropriate maps. The maps are distributed to all affected cities, counties, and state agencies for their use in planning and controlling new or renewed construction. Local agencies must regulate most development projects within the zones and there can generally be no construction within 50 feet of an active fault zone. The zones vary in width but average about one-quarter mile wide. (California Geological Survey, Alquist-Priolo Earthquake Fault Zones, [http://www.consrv.ca.gov/CGS/rghm/ap](http://www.consrv.ca.gov/CGS/rghm/ap))

Under the provisions of the Alquist-Priolo Earthquake Fault Zoning Act, sites within 50 feet of an active fault trace are assumed to be underlain by a fault, unless proven otherwise. (California Code of Regulations, Title 14, Division 2, Chapter 8, Subchapter 1, Article 3, Section 3603(a), http://ccr.oal.ca.gov/default.htm).

The Hayward Fault has been identified as an active fault, per geological reports prepared for the campus for the 2020 Long Range Development Plan and for Foothill Housing project, the Memorial Stadium project and the 2015 update to the Site-Specific Seismic Hazard Analysis and Development of Seismic Design Ground Motions study.

There are active parts of the Hayward Fault that run through the Foothill parking lot. Because no structures for human occupancy may be built across an identified active fault trace (California Public Resources Code, Division 2, Chapter 7.5, Section 2621.5(a), Alquist-Priolo Earthquake Fault Zoning Act, http://www.leginfo.ca.gov), housing development would require a 50 ft. setback from these active faults, which makes most of the lot unsuitable for development, based on compliance with regulation and policy (the Alquist-Priolo Earthquake Fault Zoning Act and the University Policy on Seismic Safety).

On the south end, there is a small, irregular shaped portion that could potentially accommodate some building development while maintaining the required 50 ft. from the fault. However, any development footprint would be very irregular because of the odd shape and a huge retaining wall on the east side. As a result, the buildable portion is inefficient and would not provide significant unit count and was, therefore, not included in the Housing Task Force list of recommended housing sites. The small portion may be considered for potential future development.
Seismic Standards of Project

At the financial model charette on April 26, 2019, a question was asked regarding the planned seismic rating of the new project (both the academic and residential/parking buildings).

The project is under review by the Seismic Review Committee for the campus, which will include an independent peer review. Under UC’s Seismic Safety Policy, the academic building will be built to a rating of III and the residential/parking building will be built to a rating of II. The rating levels are such that, the lower the number the lower the implied risk to life and implied seismic damageability. A rating of III corresponds to UC’s prior standard of “good” with respect to seismic performance, such that the rating of II represents an insignificant implied risk to human life.