

March 18, 2013

To: CARPA

Fr: Alexis T. Bell and Evan Williams, CAPRA Subcommittee on IA

Re: IA Finances and Academic Performance of Student Athletes

This report discusses the current status of IA's finances, including its revised model for servicing the debt taken on by the University to construct the Student Athletics High Performance Center (SAHPC) and to renovate the California Memorial Stadium (CMS), and IA's recently developed plan for addressing issues with the academic performance of student athletes.

IA Finances

IA is responsible for financing its annual operations as well as servicing the debt taken on by the University for construction of the SAHPC and renovation of the CMS. Both of these items have been issues of ongoing concern for CAPRA, as well as members of the Senate as whole. These concerns have focused on the annual level of support provided IA by the Chancellor and the prospect that IA might not be able to cover its annual debt service and would, therefore, require additional support from central campus. In what follows we analyze each of these issues separately, but it must be recognized that for tax purposes and reporting to the NCAA the debt service is treated as a part of IA's annual budget.

Financial Model for Servicing the SAHPC and CMS Debt

Some background is necessary in order to understand the origins of the decision to build the SAHPC and to renovate the CMS. CMS was built in 1923 and has long been recognized to have a number of significant structural and programmatic deficiencies. The Hayward fault runs through the middle of the stadium along its north/south axis, and the stadium has a seismic rating of poor. While the stadium is utilized only six or seven times a year for a few hours for sporting events, it is occupied by tens of thousands of spectators on these occasions. On the other hand, several hundred UC employees and student athletes have daily activities under the western grandstands. The programmatic deficiencies of CMS include inadequate locker rooms, facilities for sports medicine, meeting rooms for the 13 sports teams based at CMS, and game day facilities.

In 2004, newly arrived Chancellor Birgenau appointed a joint Senate/Administration/Alumni task force to develop recommendations for improving life safety in the stadium and upgrading the athletic facilities. This group recommended construction of the SAHPC immediately to the west of CMS to house facilities used by student athletes on a daily basis, and in the subsequent seismic upgrade of CMS. The SAHPC was expected to be financed by donations to supplement the IA operating budget. This plan was subsequently amended to include bond financing with Funds Functioning as Endowment (FFE) built up through donations. The seismic retrofit of CMS was envisioned to include a completely rebuilt western grandstand containing about 3000 premium seats and associated club facilities. The cost of the retrofitting CMS was to be covered by sales of these seats at a premium price over a long period of time, philanthropy, and naming opportunities. Funds generated in excess of those needed to cover annual debt service would be invested in an FFE to supplement the IA budget.

While it had been anticipated that fund raising for the construction of SAHPC and the renovation of CMS would be carried out in two phases, the plans to do so were thwarted by two events. The first was the lengthy delay caused by the tree sitters and the associated litigation, and the second was the 2008

instruction of the Regents to do the renovation of CMS immediately or abandon the stadium. As a result it was decided to combine the two projects into one with regard to fundraising.

Endowment Seating Program (ESP) sales began in July 2009 and the Director of Development for Intercollegiate Athletics reported very positive ESP sales figures to the Athletic Director (AD) and to campus leadership. These figures were in turn relayed by (then) VC Brostrom to the Academic Senate at its November 2009 meeting and by VC Yeary to the Senate Task Force on Intercollegiate Athletics (TFIA) in the spring of 2010. The Director of Development in IA reported in a press release on June 30, 2010 that 1854 seats with an up-front value of \$157M had been sold in the first year alone. These numbers gave a false sense of confidence in the campus leadership and in the Senate and TFIA that the ESP program was very likely to meet its goals. It was not until several months later, after the IA Development Director had left UC employment, that it was discovered that these sales figures were vastly inflated. In fact the number of sales reported on June 30, 2010 is still more than 100 less than the number of seats sold by December 31, 2012 using a proper accounting of sales.

In the late spring of 2012, VCFA John Wilton requested Professors Richard Stanton, Nancy Wallace, and Willie Fuchs, faculty members in the Haas School of Business, to undertake a review of the then current model developed by IA for financing the debt undertaken by the University for construction of CMS and SAHPC. The financing plan and its detailed financial model stipulate that the revenue stream pledged to debt holders is the operating revenues of IA with the understanding that the existing operating revenues of IA would be supplemented by additional revenue streams. The findings of this group revealed that the original forecast of seat sales under the ESP program, which was expected to provide the principal additional revenue stream, was far short of the original projections, and that the rate of new seat sales was progressing too slowly to enable attainment of the targeted number of sales by the fall of 2012. Stimulated by these findings, IA decided in early fall of 2012 to charge Solly Fulp, COO of IA, to develop a new ESP sales plan as well as broadening the set of revenue streams that could be used to service the debt associated with construction of CMS and SAHPC.

A description of IA's model for servicing the debt taken on to cover the construction of SAHPC and the renovation of CMS is given in Appendix I and a detailed analysis of the plan written by Professors Stanton, Wallace, and Fuchs is given in Appendix II. Below we provide an abbreviated summary of the model and note our concerns with it.

The cost of construction for SAHPC was \$153M. Of this amount \$29M was covered by philanthropy and the balance financed by bonds. By contrast, the \$321M cost of renovating CMS was covered totally by the sale of bonds. Table 1 lists the bonds sold, the interest rate for each bond and its date of maturation. The debt service payments due on the bonds sold are shown in Fig. 1. While the \$75M balance of the century bond is modeled as being paid off in 2053, the University is not obligated to pay the \$75M on the Century bond until 60 years later. There is also approximately \$45M in debt that remains to be issued. For modeling purposes, it is assumed this will be issued as 40 year debt, with a 20 year delayed amortization at 4%.

Table 1. Bond details. This table gives details of the bonds issued (and to be issued) between 2009 and 2013 to finance the SAHPC and CMS construction and retrofit. Taken form Appendix II.

Debt Issue	Principal (\$ million)	Date Issued	Mat. ^a	Bond type	Coup. (gross)	Coup. (net) ^b
SAHPC						
1. GRB 2009 Series Q ^{c,d}	5.645	8/2009	2040	Tax-exempt	5.00%	5.00%
2. GRB 2009 Series R ^e	118.375	8/2009	2043	Build America ^f	5.77%	3.75%
Total SAHPC debt	124.020					
CMS						
1. GRB 2009 Series R ^g	22.945	8/2009	2043	Build America	5.77%	3.75%
2. GRB 2009 Series Q ^h	0.090	8/2009	2040	Tax-exempt	5.00%	5.00%
3. LPR 2010 Series F ^{i,j}	178.410	9/2010	2050	Build America	6.14%	3.99%
4. GRB 2012 Series AD ^k	75.000	2/2012	2112	Taxable	4.86%	4.86%
5. To Be Issued ^l	44.555	2013	2053	TBA	4.00%	4.00%
Total CMS debt	321.000					
Total debt	445.020					

^a The maturity date listed in each case is the date of the last scheduled principal payment, but in most cases some principal will be paid back earlier. For example, most of the principal on the GRB 2009 Series Q bonds is due to be paid back in May 2032, the principal on the GRB 2009 Series R bonds is due to be paid back in increasing installments between 2032 and 2043, and the principal on the LPR 2010 Series F bonds is due to be paid back in increasing installments between 2039 and 2050. Principal on the 2112 “century bond” does not have to be repaid until 2112, but the university has the right to pay this off earlier.

^b Build America bonds are taxable, but the university receives a rebate from the Federal government (see <http://www.treasury.gov/initiatives/recovery/Pages/babs.aspx>).

^c GRB = General Revenue Bond.

^d See <http://emma.msrb.org/IssueView/IssueDetails.aspx?id=EP328212>.

^e See <http://emma.msrb.org/IssueView/IssueDetails.aspx?id=EP328199>.

^f See <http://www.treasury.gov/initiatives/recovery/Pages/babs.aspx> for information on the Obama Administration’s Build America Bonds program.

^g See <http://emma.msrb.org/IssueView/IssueDetails.aspx?id=EP328199>.

^h See <http://emma.msrb.org/IssueView/IssueDetails.aspx?id=EP328212>.

ⁱ LPR = Limited Project Revenue Bonds.

^j See <http://emma.msrb.org/IssueView/IssueDetails.aspx?id=EA338536>.

^k See <http://emma.msrb.org/IssueView/IssueDetails.aspx?id=ER348960>.

^l This debt has yet to be issued, so coupon rates are estimated.

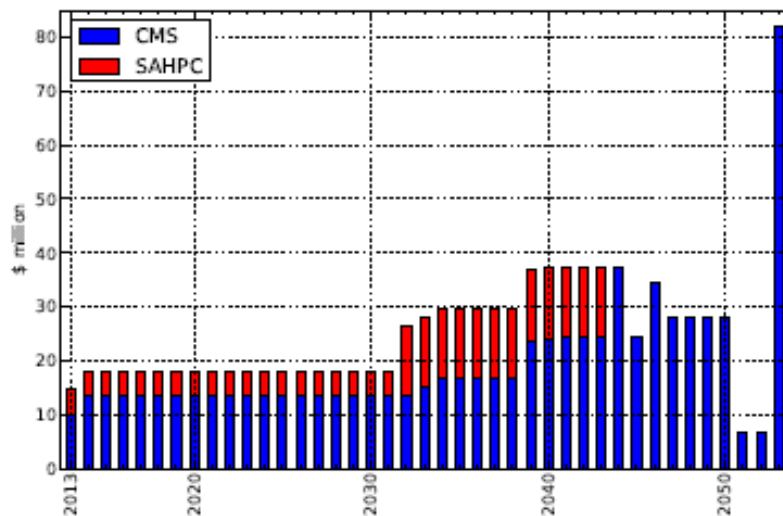


Figure 1. Bond payment Schedule. Taken form Appendix II.

Seven sources of revenue will be used to supplement the IA’s operating budget. These are ESP sales, sales of non-ESP seats, philanthropy, income from media rights, rental of space in SAHPC and CMS, earnings on the FEE, and cannibalization of the FEE. Figure 2 shows the expected cash flows associated with each of these revenue streams. The new financial model recognizes that the original model, which depended heavily on ESP sales as primary source of funding, was overly optimistic. The sales of ESP seats is now envisioned to provide a significant source of revenue but this will be supplemented by the sales of bundles of seats in the premium sections of the stands on the western side of the stadium, increased income from media rights, and rental of space in SAHPC and CMS. Funds from annual revenues received from all sources in excess of annual expenses for debt servicing will be placed into an FFE and the revenues from that fund will be used as an additional source of revenue.

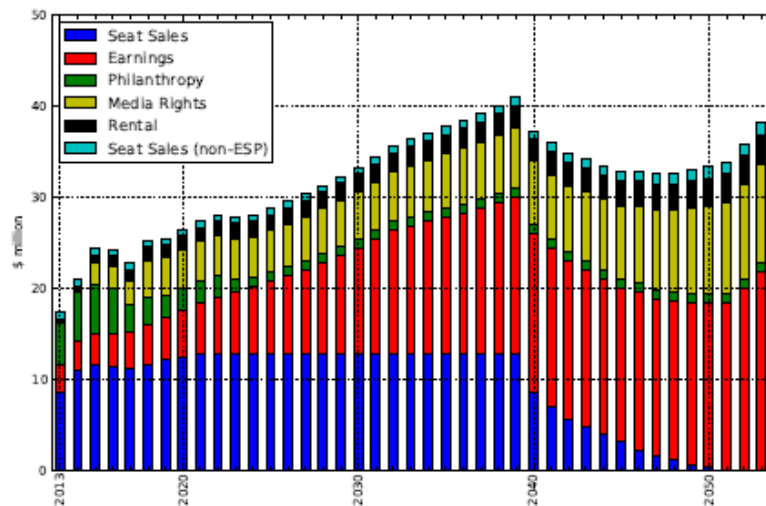


Figure 2. Sources of funds to repay stadium debt. This figure shows the projected sources of funds from 2013–2053 used to repay debt issued to finance SAHPC and the stadium renovations. Seat sales are shown net of estimated cannibalization of existing sales. Taken from Appendix II.

Figure 3 displays the total projected annual supplemental revenue to IA, the annual debt service that IA must pay from its operating budget, and differences between the two which generally would be added to the FFE each year, including in years when the difference is negative. For an assumed rate of income on the FEE of 6%, the net cash flow stays positive from 2013 till 2040, becomes slightly negative between 2040 and 2044, and then returns to positive from 2045 till 2052. The FFE increases from \$50.7M as of July 1, 2012 to \$319M in 2052. The sharp drop in revenue and net cash flow occurring at the end of 2052 is a consequence of paying off the remaining principal on the debt in 2053, \$42.8M. It is noted that repayment of this debt in 2053 is optional and IA may consider it wiser to refinance its remaining debt.

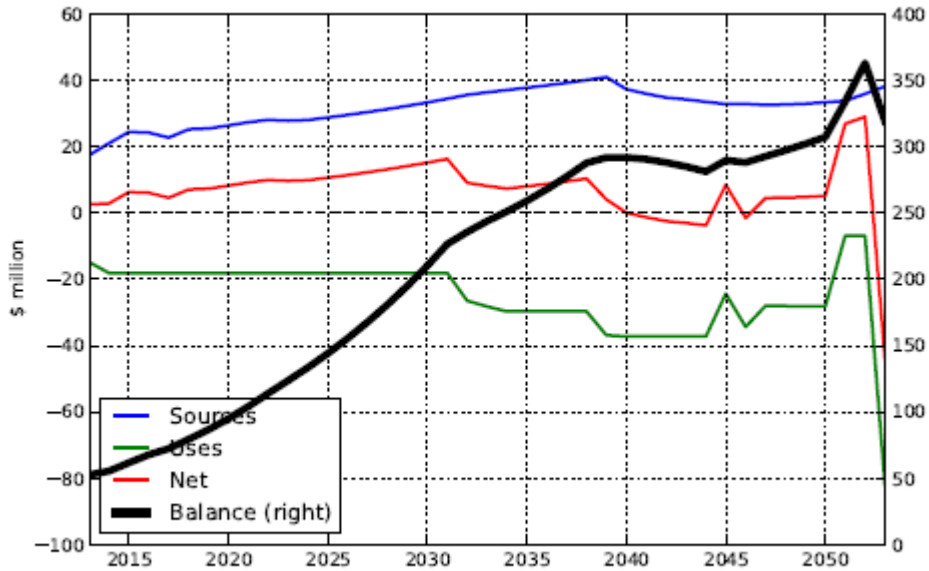


Figure 3. Sources and uses of funds and FFE balances, 2013–2053. The total projected annual supplemental revenue to IA, the annual debt service that IA must pay from its operating budget, the differences between the two, and FEE balance, assuming 6% return on investments in FFE. Taken from Appendix II.

Figures identical to Figure 3 but assuming rates of return on FEEs of 4%, 5%, 7%, and 8% are shown in Appendix 1. These figures indicate that the net cash flow will become negative at some time between 2032 and 2042 for 4% and 5% rates of return but never becomes negative for 7% and 8% rates of return.

Appendix II provides a detailed analysis of each of the revenue streams contained in the model and assesses the risks associated with failing to meet the projections. Below we summarize the main points of this analysis.

ESP sales: The sale of ESP seats remains the largest source of revenue in the revised model. The projected sales of new ESP seats remains above that projected to be viable by experts, such as Robert Nolls, and those based on market research. However, a sensitivity analysis shows that the final FFE balance in 2053 remains positive as long as ESP sales remain above 54% of their currently forecast levels.

FFE income: The second most important source of revenue is income from the FFE. Some of these funds are invested with the UC Regents and some with the UC Berkeley Foundation. Appendix II gives a thorough analysis of the interplay between the fraction of ESP seats that need to be sold and the return on investment that must be achieved in order for the FFE balance to remain positive in 2053. For example, if only 50% of the seat sales projected for 2013-2021 are achieved, the return on investment will need to be 6.16%; the needed return on investment decreases with increasing the percentage of projected seats sold. It should be noted though that even in the most pessimistic scenario that no further ESP seats are sold beyond 2012 and a 0% yield on investment for 40 years, the FFE does not go negative until 2033, providing 20 years to take corrective action.

Philanthropy: The \$10M Lisa and Douglas Goldman gift for the plaza outside CMS is a very significant component of the anticipated philanthropy. This gift is predicated, though, on developing the plaza area so that it is a vibrant community space, useable year round, for students, faculty, and visitors. Attainment of this goal requires a successful tenanting strategy for the leasable areas of SAHPC and CMS. It is

envisioned that this will require expansion of classroom facilities, development of a high quality student and faculty fitness facility, and creation of retail and food services. There is concern that the tenanting strategy for the leasable space (see below) threatens the success of this and other philanthropic efforts as well as the security of the needed revenue income.

Rental Revenue: Rental income is projected to provide 6% of the revenue needed to service the SAHPC/CMS debt. This projection is based on year-to-date rentals and anticipated future rentals and is contingent on the construction of a two-story parking structure at Maxwell Field for 500 vehicles by the end of 2014. There are several reasons for concern with the projected level of revenue for space rental. The space in CMS is quite diverse and presents a challenge to the development of a coherent rental strategy. Space with large windows located close to the plaza would be ideal for rental but are currently occupied by IA offices. The location of the kitchen and its distance from the University Club presents significant challenges to providing a high quality dining experience in the Club area. There is also concern about the ability of IA to develop a competitive rental strategy for leasing space in CMS. Also troubling is the current involvement of numerous personnel reporting to different Vice Chancellors without a single point of contact for the proposed leasing of a very large amount of space. It is notable that the Real Estate Advisory Committee of the Berkeley Foundation has recommended significant realignment of real estate rental functions within UCB, placing this activity under direct control of the VCAF. It is also notable that this committee suggests that considerably more income could be generated from the space in CMS than is projected in the current financial model.

Media Rights: Media rights are projected to provide 19% of the revenue for servicing the SAHPC/CMS debt. It is not possible to assess the accuracy of the projections. It should be noted that 20% of the total projected media rights will be dedicated to the model and the other 80% to the annual operating budget of IA. If the projected income from this source is not realized, IA may need to reassess the proportion of this revenue stream directed towards its annual operations.

Non-ESP Seat Sales: To offset the lower than expected sales of premium seats through the ESP program, IA has plans to sell these seats to corporations as corporate bundles (a minimum of 6 Field Club seats on a 1 year commitment or a minimum of 6 University Club seats on a 2 year commitment), and as bundles for individual games (a minimum of 20 University and Stadium Club seats for one game). While an analysis of non-ESP sales is not given in Appendix II, it is noted that IA COO Solly Fulp has established that there is a demand for corporate bundles of premium seats.

The strength of the revised financial model is in its diversification of revenue streams and in its reduced dependence on ESP sales as a primary source of revenue. Nevertheless, ESP sales still continue to be a significant part of the overall revenue required, and IA will need to devote a large effort to the sales of these seats, as well as the sale of corporate bundles of non-ESP seats. Rental of space in CMS represents another area of vulnerability and requires IA to work with the VCAF to develop a comprehensive plan for developing and leasing this space. Likewise, it will be imperative that IA makes every effort to maximize its revenues from media rights. On the positive side the revised model appears to be tolerant to significant variations in the fraction of projected ESP seats sold between 2013 and 2021 and the rate of return on funds invested in the FFE. To achieve its goal of servicing its debt solely from its own revenues, IA will need to monitor its revenue flows very carefully and make adjustments to its model as dictated by circumstances.

Operating Budget

IA's operating budget for 2012 is shown as Appendix III. The operating revenues total \$68M of which \$7M came from central campus and \$2.4M from student fees. Total operating expenses for the year were \$67.6. Separate from these figures was a non-operating revenue of \$3M from Cal Dining, which

constitutes the repayment of a loan made earlier by IA for construction of the kitchen in CMS that will be used by Cal Dining. This additional income, and the balance between operating revenues and expenses, was used to cover a \$25K non-operating expense, a payment of \$556K to the Chancellor for a loan, and a payment of \$2.83M for construction of the SAHPC. Thus, IA ended with a positive balance of \$137K.

It is important to note that the support of IA by central campus is declining. IA has agreed to payoff its loan of \$5.56M from the Chancellor made in 2009, and is doing so over a ten-year period. IA has also agreed to a glide path that will reduce its support by central campus from \$10.5M in FY2011 to \$5M by FY2014. All indications are that IA is honoring these commitments.

Academic Performance of Student Athletes

The academic performance of students participating in intercollegiate athletics is monitored by IA and reported annually to the NCAA. The University Athletics Board also monitors academic performance of student athletes. In 2002, the NCAA passed legislation requiring all member institutions to report annually the academic progress rate (APR) and the graduation success rate (GSR) of all students participating in intercollegiate athletics. According to these rules, teams not meeting national benchmarks are subject to penalties. These penalties come into play if a team has an APR of 930 or less out of a possible perfect score of 1000. A detailed discussion of the NCAA rules is presented in Appendix IV.

An issue of considerable concern for the UAB during the last few years has been the declining APR of the football team. Over the past three years the football APR scores have all been under the newly established minimum of 930. Urged by the UAB, IA organized an Academic Performance Working Group in the spring of 2012, comprised of senior athletics administrators, academic support staff, the Faculty Athletics Representative, and the football team's entire coaching staff. This group met monthly until the termination of the head football coach in November 2012. The Working Group and the UAB have required that IA establish an Academic Improvement Plan for the Cal football team, similar to one previously established for men's basketball in 2004-2005. The Plan designates areas for improvement of academic progress and approaches for achieving these improvements, sets measurable goals, and outlines specific steps and timetables for Cal to achieve its commitments to improvement of the academic performance of student athletes. A laudable feature of the Plan is its identification of individuals responsible for implementation of each segment of the Plan. Further details of the Plan may be found in Appendix IV.

The Plan for improving the academic performance of members of the football team is well thought through and should provide the basis for stemming the decline in the APR of this team. The Plan should also serve as a model for addressing the performance of students in other intercollegiate teams.