

## MINUTES

### UNIVERSITY OF WASHINGTON BOARD OF REGENTS

#### Finance and Asset Management Committee

Thursday, December 12, 2019  
Petersen Room, Allen Library

#### Call to Order and Attendance

Committee Chair Regent Riojas called the meeting to order at 8:30 a.m.

Present: Regents Riojas (Chair), Benoliel, Harrell, MacPhee, Rice, Suarez, Tamaki, Zeeck; President Cauce, Provost Richards, the Secretary.

Absent: Regents Ayer, Jaech.

#### Approval of Minutes

Regent Riojas announced that, hearing no objections, the minutes from the Committee meeting on November 14, 2019, were approved, as distributed.

Portage Bay Insurance Annual Report (Information only) (Item No. F-1)

Quarterly Investment Performance Report – Quarter Ended September 30, 2019 (Information only) (Item No. F-2)

Approve Internal Audit Charter and 2020 Internal Audit Plan (Action) (Item No. F-3)

UW Advancement Annual Return on Investment Report (Information only) (Item No. F-4)

Regent Riojas announced that, hearing no objections, Items F-1, F-2, F-3, and F-4 would appear on the full Board's agenda, as distributed.

See Attachments F-1, F-2, F-3, and F-4.

Finance, Budget, and Capital Report (Information only) (Item No. F-5)

Brian McCartan, Vice President, Finance, presented the attached semi-annual debt report. The \$102 million bond sale approved by the Board in July 2019 will be priced in mid-January. Current rates are low. If the University were to borrow presently, it would borrow at approximately 3.3 percent. Next week Finance staff will present to Standard & Poor's and Moody's. Moody's recently updated its sector outlook for higher education from negative to stable.

Asked about the impact of declining interest rates, Mr. McCartan replied that the University is exploring how expanding debt issuance might impact its credit rating.

Sarah N. Hall, Vice Provost, Planning & Budgeting, presented the monthly budget report. Revenues and expenses are tracking historical trends. The University is 33 percent through the fiscal year, and has spent 27 percent of budgeted core funds. In response to a request from the Board last month, she introduced Erin Guthrie, Assistant Vice Provost, Institutional Data & Analysis, Office of Planning & Budgeting, to describe ongoing changes to the University's activity-based budgeting (ABB) model. Ms. Guthrie explained that

ABB governs how three types of funds are distributed: tuition revenue, indirect cost recovery revenue, and the non-formulaic core operating funds distribution known as the supplement. The goal of the ongoing update, known as ABB Phase III, is to make incremental improvements that better enable academic leaders to align expenditures where costs are generated over a multi-year planning horizon and to create a flexible budget model that can adjust to uncontrolled factors such as shifting student demand.

President Cauce stated that the implementation of ABB in 2012 was driven by the deans of the College of Arts and Sciences, the College of Engineering, and the Foster School of Business. As Dean of Arts and Sciences, she found budgetary planning challenging because of the unpredictability of and the perverse incentives encouraged by then-existing practices. ABB is not quite responsibility-center management, or ‘every tub on its own bottom’ with units wholly self-sustaining budgetarily, but was designed to indemnify units against precipitous reductions in allocations, at the outset and over time. At implementation, she and others were shocked by the supplements initially required to align ABB principles with the University’s current budget allocation: for instance, the College of Arts and Sciences then had a considerable negative supplement. This was practicable when there was considerable enrollment in humanities and social-science fields in which the cost of instruction is low, but has since become less practicable on account of subsequent shifts in enrollment. ABB Phase III will enable the administration to revisit the model, and improve it incrementally.

Provost Richards stated that ABB Phase III will enable the University to adjust to changing student preferences. Three quarters of applicants now wish to major in economics or in one of nineteen science, technology, engineering, and mathematics (STEM) fields. Instruction is expensive in these fields, and the University has responded by seeking additional funding for computer science instruction, among other initiatives.

Asked how large an adjustment to the ABB model was planned, Ms. Hall replied that the supplement amounts to \$125 million in the context of a \$1.4 billion core operating budget. 2 percent of that supplement will be shifted, so as to mitigate unforeseen impacts. Provost Richards added that this is an exceedingly modest shift, amounting to a .2 percent shift in the core operating budget, which will nevertheless help instructional units. President Cauce noted that other Washington universities face similar situations, and plan to request supplemental funding from the state for instruction in the natural sciences.

Lou Cariello, Vice President, Facilities, reported that there are few major changes to the capital projects report. Of fourteen projects, nine are in the planning or design phases and five are under construction. On the report, a new, second column tracks when and how the Board approved each project. In addition, a new table on the second page provides a more detailed preview of upcoming projects. The Northwest Hospital (NWH) Childbirth Center indicates red on account of a two-month permitting delay with the City of Seattle. There is good progress on the Kincaid Hall and Parrington Hall projects, with no unpleasant discoveries during demolition. Seismic improvements are proceeding successfully. The Health Sciences Education building indicates yellow with respect to budget on account of the need to mitigate potential vibration from excavation. There is progress toward meeting or exceeding business equity goals.

Asked about the business equity consultant mentioned in note 5, Mr. Cariello replied that Aleanna Kondelis, Director of Procurement, Sourcing, and Business Diversity and Equity, is deploying considerable prior experience to help Facilities understand the market availability of diverse contractors for each project.

Mr. Cariello then explained the final attachment, detailing the planned shift to a one-stage approval process in preparation for discussing the UW’s long-term capital plans in March 2020. Shifting from a two-stage to a one-stage project approval process will still allow the Board to review and approve upcoming projects multiple times. It is really more of a timing change that shifts much of the present Stage 1 approval to the approval of the annual capital plan. The goal is thorough, comprehensive, early planning with project stakeholders, enforced by ‘gates’ for inclusion on the capital plan. There will be four categories used to

allocate resources in the long-term capital plan: growth, renewal, strategic, and clinical projects. Finance and Facilities have been engaging with deans and UW Medicine to understand their needs over the next four budget cycles.

Asked about the University's approach to deferred maintenance, Mr. Cariello observed that deferred maintenance is addressed through both operational and capital spending, and that all new capital projects must designate an appropriate, verified source of funds for operation and maintenance costs. Mr. Cariello was asked to report on steps to reduce the backlog of deferred maintenance.

Asked about shifting student demand, Mr. Cariello replied that long-term capital planning should drive a conversation about instructional priorities.

See Attachment F-5.

UWINCO Board Update (Information only) (Item No. F-6)

Garth Reistad, Deputy Chief Investment Officer, UWINCO, reported that the UWINCO Board met on December 6, including an executive session to discuss recommendations concerning the performance and compensation of UWINCO staff. During the regular meeting, Max Senter from Cambridge Associates discussed late-cycle investing, reviewing the goals of the endowment, appropriate risks, and the time horizon of the University's investments. The board reviewed asset allocation in preparation for making a recommendation to the Board of Regents in May 2020. Much discussion centered on how to bridge the gap between investment returns and the University's spending, with a focus on approaching emerging markets and private equity through risk budgeting and benchmarking. Year-to-date gains have outperformed peers in a lackluster environment. Growth is low, valuations are stretched, and the existence of \$17 trillion in global debt at negative rates amount to a long-term challenge to UWINCO.

Asked whether UWINCO has an environmental and social governance (ESG) strategy, Mr. Reistad replied that the University divested from coal a few years ago, and maintains proactive investments in advanced battery and metering technologies. Analysts focus on seeking returns from positive change.

Regents commended UWINCO's impressive reach across emerging markets, and some asked whether it might be more proactive about potential criticism of its investments by adopting an ESG guideline. When it was remarked that this is much on students' minds, President Cauce observed that endowment funds do not come from tuition dollars but from the donations of donors with a range of political and investment opinions, and with a primary concern to maximize investment returns so as to provide maximum support to students and researchers.

See Attachment F-6.

Finance Transformation: Stage 2 Approval (Action) (Item No. F-7)

Mr. McCartan introduced the item, noting that it reflects finalized scope, schedule, and budget, all directed at a go-live date of July 1, 2022. The approximately \$270 million project cost will be funded by up to \$180 million in bonds, \$50 million from the Internal Lending Program (ILP), and additional central and local funds. The item reflects a tremendous, multiyear effort from more than five hundred individuals. He thanked President Cauce and Provost Richards for their willingness to undertake this major initiative.

Aaron Powell explained that, as Vice President for UW Information Technology and Chief Information Officer, he has oversight of all information technology (IT) projects at the University. Finance Transformation is at a critical point: moving from design to implementation is as critical a shift as going

live. Major risks have been identified; mitigation is ongoing. Consultants and the state-mandated quality assurance consultant agree that the UW is ready. He endorses moving forward with the project.

Jacqueline Cabe, Chief Financial Officer, UW Medicine, and Vice President for Medical Affairs, states that UW Medicine can use every dollar saved from IT spending to provide patient care in pursuit of its mission of improving the health of the public. Finance Transformation is an opportunity to gain efficiency and to support better decision-making. The challenge is to realize the potential benefits of this opportunity fully. UW Medicine supports moving forward with the project, and looks forward to collaborating on it. Mr. McCartan interjected thanks to Ms. Cabe and to Joy Grosser, Chief Information Officer of UW Medicine.

Chris Malins, Associate Vice President, Treasury, described the planned \$50 million contribution from ILP reserves. The ILP was created in 2008 to provide a stable interest rate to internal borrowers. It initially issued debt at 5.5 percent, reduced to 4.75 percent in 2011, and currently issues funds at 4.5 percent. The reserve balance is used to buffer against potentially higher interest rates and to fund the bridge loan program. Any distribution of reserves requires the Board's approval. In April 2019, the Board approved a \$3 million distribution to fund a pilot, housing-assistance program for faculty and staff. As of June 2019 there was an audited reserve balance of \$120 million. Accounting for future inflows, this balance would be sufficient for thirteen to fifteen years of future lending. With the proposed \$50 million distribution, the remaining balance would be sufficient for eleven to thirteen years.

Asked whether the proposed withdrawal will jeopardize the ILP's mission, Mr. Malin replied that it will not, given current interest rates and expected future inflows.

Mr. Malins continued that the project is not being funded through the ILP, because it has a short amortization period of fifteen years, in comparison with the longer terms of building loans. The Provost's Office will pay the interest on commercial paper issued to fund the project of approximately \$7.4 million per year through 2022. Units will pay costs thereafter. The Treasury Office has reviewed a conservative base case and a series of stress tests. Realizing potential efficiencies will be crucial to the financial success of the project, because it will generate no new incremental revenue. There is risk if all efficiencies are not achieved, but this risk is lesser than that posed by failing to update the University's financial systems.

Regents appreciated the conservatism of the administration's projections. Mr. Malins noted that unneeded funds will not be borrowed. Some compared the project to renovating a century-old house, with respect to unknown issues. Asked why the projected project cost had increased from the \$200 million mentioned one year ago, Mr. McCartan stated that there are some increases of scope, but that much of the increase reflects a better awareness of potential mitigations and remediations. Mr. Powell and Edward J. Loftus, Associate Vice President, Finance Transformation, agreed that inserting a software-as-a-service into a legacy platform requires not just technical transformation but a transformation of the University's operating model. Provost Richards clarified that contingency funds are not intended for cost overruns, but for true unknowns. If budgeting is proven to have been truly conservative, some costs will come in over budget, and some costs under budget. Primary risks include schedule, with a one-year delay adding \$40 to \$50 million, mainly because of additional staffing costs, as well as the immense work of translation and renovation to existing systems that Mr. Powell and his team must perform.

Mr. McCartan concluded by proposing that he report to the Board at least quarterly on the progress of Finance Transformation, and by promising to return in February with the risk matrix requested by Regent Ayer at the last meeting.

Regent Rice moved, Regent Benoliel seconded, and the Finance and Asset Management Committee granted Stage 2 approval to Finance Transformation, as presented.

See Attachment F-7.

University District Station Building (UDSB): Stage 2 Approval (Action) (Item No. F–8)

Mr. Cariello introduced the item noting that the building will expand the University's office space and embrace the city, particularly the area west of 15<sup>th</sup> Avenue Northeast. Construction will be accomplished through a seventy-five year ground lease with the Lincoln Property Company. The UW will lease back office space. The University acquired air rights over the light rail station in 2013. The University District Upzone in 2016 increased maximum building height to 240 feet. The University must begin to develop the site by 2024, else it lose its air rights. The project will allow the University to consolidate leased space, saving the costs of many different leases over time.

Todd Timberlake, Chief Real Estate Officer, stated that the ground lease has a fixed payments for the first five years, after which the rent will be adjusted to current land values and reset every ten years thereafter. In addition, all rent will be annually adjusted to the Consumer Price Index, further protecting the University from rent erosion. The UW will make an initial fifteen-year commitment to lease the building, with five five-year extensions possible, and must decide next year whether to lease most or all of the building.

Mike McCormick, Associate Vice President, Asset Management, Facilities, reported that the developer is taking on the market risk of building the new building. With respect to space, the new office space should provide 140 to 145 square feet per person, which is more efficient than the current 170 to 340 square feet of leased space per person. He has managed this sort of transition before, and it will be challenging.

Asked about the developer's reputation, Mr. Timberlake replied that the bids came in a tight range, suggesting interest and accuracy. Lincoln Property Company is a privately held Texas company with offices in forty US cities. It is relatively new to Seattle, and is partnering with Perkins & Will, the architects of the new Life Sciences Building.

Asked about the connection between the station and the Burke Museum, Mr. McCormick stated that both Sound Transit and the City of Seattle are working to improve the path to the University.

Asked how much the building is expected to cost the developer, Mr. Timberlake replied that it may cost \$150 million, with no more than 75 percent to be debt-funded. Regent Benoliel observed that this is a great deal for the University, but not ideal. Self-development would be the ideal, so that the University could benefit from the property's long-term appreciation, but the required resources are lacking.

Regent Suarez moved, Regent Rice seconded, and the Finance and Asset Management Committee granted Stage 2 approval to the University District Station Building (UDSB), as presented.

See Attachment F–8.

West Campus Site W27 (including Center for Advanced Materials and Clean Energy Technologies): Stage 1 Approval (Action) (Item No. F–9)

Mr. Cariello requested permission to go to market for a development partner. This project is different than the UDSB, because it is on campus and is included within the provisions of the Campus Master Plan (CMP) agreed with the City of Seattle, and because the UW may choose not to occupy the majority of the building. Additional occupants will be partners who advance the University's teaching and research missions. The ground lease will specify a 340,000 square-foot building to be integrated with the CMP's vision for the West Campus area. Naming remains to be determined, but it will be appropriate and useful.

Mary Gresch, Chief Marketing and Communications Officer, stated that the CMP lays out a thirty-year vision for the campus, including the development of the West Campus. On the advice of an advisory committee, the West Campus will be a distinctive urban community where student and faculty experts

across many different fields partner with businesses, non-profit organizations, and governments to address major social issues. She clarified that any naming will be community-minded and values-driven.

Mr. McCormick noted that, here again, a partner is needed to take the risk of leasing and of attracting tenants. The project will entail the demolition of the Purchasing and Accounting Building, and the reconstruction of two blocks of the Burke-Gilman Trail. A range of potential occupants are being discussed, all of them compatible with the provisions of the City-University Agreement and the CMP.

Regent Zeeck moved, Regent Benoliel seconded, and the Finance and Asset Management Committee granted Stage 1 approval to West Campus Site W27 (including the Center for Advanced Materials and Clean Energy Technologies), as presented.

See Attachment F-9.

Health Sciences Education Building: Stage 2 Approval (Action) (Item No. F-10)

Mr. Cariello introduced the day's last capital project, the proposed \$100 million Health Sciences Education Building. The state will provide \$70 million, and an ILP loan provide up to \$30 million, depending on the progress of fundraising. The Board granted Stage 1 approval at \$90 million in July 2018. Additional costs reflect the increase of the project's scope to include an anatomy lab in the basement.

Mr. McCormick stated that this 96,000 square foot structure will take what is effectively the last open space in the South Campus area. Cost per square foot is high because of the addition of the anatomy lab.

Mr. Malins expects borrowing to be less than \$30 million. State funds will be spent first, and only then will debt be issued, likely beginning in the late fall of 2021. The debt will be amortized over twenty years, and payments will be shared between the six health sciences schools. Because the Provost has guaranteed the loan, the Treasury Office has performed no due diligence.

Ms. Hall stated that all health sciences schools have signed financing agreements to pay their shares of debt service on the full \$30 million, if required. If any fail, the agreements authorize the Provost to retain incremental funding. The Office of Planning & Budgeting is setting aside contingency funding to cover one year of debt service.

Hilary Godwin, Dean, School of Public Health, is excited. The new building will accommodate new types training required to address emerging health challenges. The Health Sciences Education Building will be the UW's answer to these global challenges, because the UW is uniquely well-placed for collaboration among all six health-sciences schools. The building will be focused on instruction, with no office or research space. Fundraising is underway.

Asked about the School of Dentistry's ability to pay its share of debt service, Ms. Hall stated that her office has documented contingency plans.

Regent Riojas praised the health-sciences schools for collaborating. ASUW President Kelty Pierce thanked the administration for taking student input into account. Provost Richards added that this is the only building that he has seen that was conceptualized by six deans together, and thanked all who contributed to the project.

Regent Rice moved, Regent Harrell seconded, and the Finance and Asset Management Committee granted Stage 2 approval to the Health Sciences Education Building, as presented.

See Attachment F-10.

Quarterly Advisory Committee on Real Estate (ACRE) Update (Information only) (Item No. F-11)

ACRE Chair Regent Benoliel noted that the last ACRE meeting was Regent Jaech's first, and that ACRE now has two Regent members.

Mr. Timberlake reported that ACRE met in the Husky Union Building (HUB) on December 4, welcoming new members Regent Jaech, Mike Hess, and Jane Blair. The committee discussed the UDSB, heard an update on the Gonzaga University-McKinstry partnership, and were briefed on developments concerning the site of the former Consolidated Laundry and renovations to the Fairmont Olympic Hotel.

Asked about the status of the Metropolitan Tract, Mr. Timberlake replied that the Rainier Square Tower is almost fully enclosed and that the Tract is 96 percent leased at this time.

Regent Benoliel noted of the Rainier Square Tower that Amazon.com took on all the leasing risk for itself, insulating the University from market risk, and that subleasing is moving ahead.

See Attachment F-11.

Adjourn

Hearing no other business to come before the Committee, Regent Riojas adjourned the Finance and Asset Management Committee meeting at 10:50 a.m.

*Approved at the meeting of the Committee on February 13, 2020.*