ANNUAL REPORT ON DEBT CAPITAL AND EXTERNAL FINANCE APPROVALS

OFFICE OF THE CHIEF FINANCIAL OFFICER

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Preface

The *Annual Report on Debt Capital and External Finance Approvals* is intended to provide The Regents with an overview of the University's debt capital program. This document serves as a background piece that addresses questions related to the University's overall debt capital structure, the University's financial strength as viewed by the capital markets, and the outlook for future financing flexibility.

At the July 16, 2009 Meeting of the Committee on Governance, *The Schedule of Reports to The Regents* was amended to incorporate *The Report on External Finance Approvals* into this report. As such, this report also includes a summary of external finance approvals for capital projects for the fiscal year ending June 30, 2012.

The *Annual Report on Debt Capital and External Finance Approvals* contains the following information:

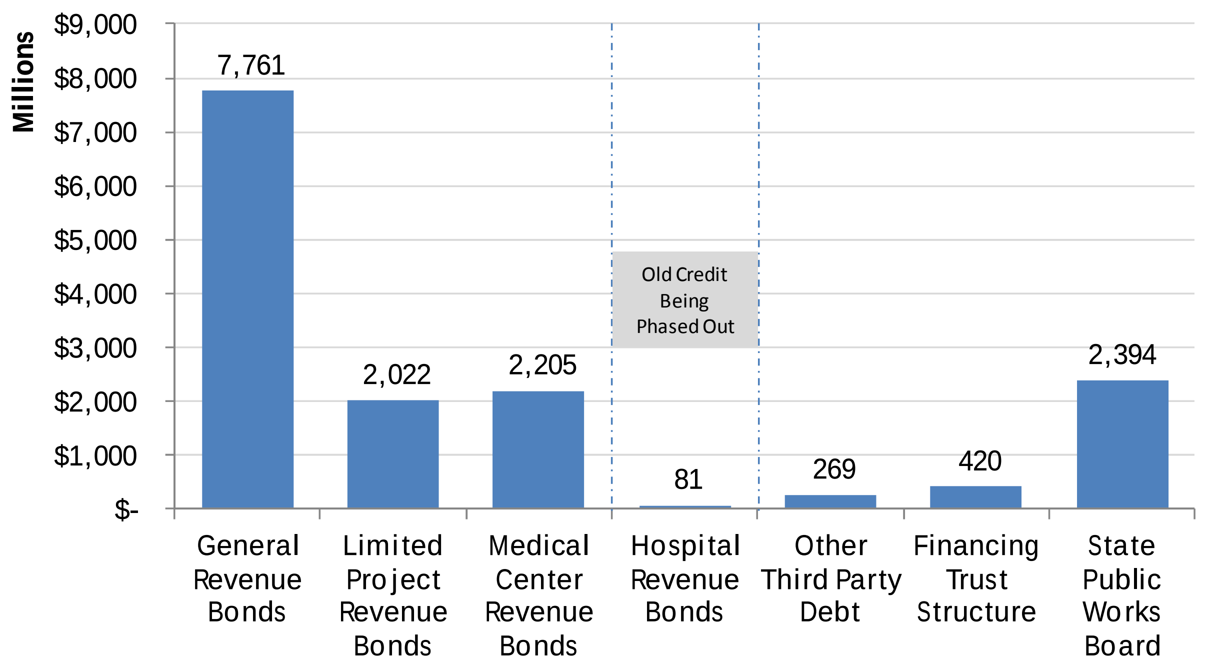
- Overview of the University's outstanding indebtedness;
- Summary of debt issuance over the past fiscal year;
- Review of projected debt issuance for the current fiscal year;
- Update of the University's debt capacity;
- Identification of financial ratios, including *Total Resources to Debt, Expendable Resources to Debt* and *Debt Service to Operations*;
- Analysis of the likely impact of the University's projected debt issuances on the University's overall financial strength and future financing flexibility; and
- Summary of external finance approvals for capital projects.

This report is not intended to be all-encompassing. Rather, it provides a snapshot of the University's current position and the likely impact authorized but unissued debt will have on that position. A number of factors, some of which are beyond the control of the University and its management team (such as general economic trends and the fiscal health of the State, for instance), can impact the University's perceived and actual credit strength and therefore the institution's debt capacity and its ability to service current and/or incremental debt.

Review of Outstanding Debt

As of December 31, 2012, the University had approximately $14.7 billion in debt outstanding, including authorized commercial paper (excluding SPWB). The weighted average cost of capital was 4.14% with an average life of 17.8 years[1] (not including Financing Trust Structure, commercial paper, SWPB and other third party debt). This debt consists of General Revenue Bonds, Limited Project Revenue Bonds, Medical Center Pooled Revenue Bonds, Financing Trust Structure Bonds, Other Third Party Debt, Hospital Revenue Bonds, and Commercial Paper. These different borrowing vehicles, or types of credit, are secured by varying revenue streams. This credit differentiation allows the University to maximize debt capacity while managing its cost of borrowing, degree of control and financial flexibility. In addition, the State Public Works Board obligations constitute indirect (contingent) debt of the University which is secured by the State's annual appropriation of debt service and a University commitment to make up any shortfalls. The chart below provides a breakdown of the University's outstanding debt by credit:

Debt Outstanding by Type of Credit



General Revenue Bonds. The General Revenue Bond (GRB) credit serves as the University's primary borrowing vehicle and is utilized to finance projects that are integral to the University's core mission of education and research. The GRB credit is secured by the University's broadest revenue pledge. The University has approximately $7.76 billion of outstanding GRB debt .The GRB credit was introduced in 2003 to replace the Multiple Purpose Projects (MPP) bond program and consolidated series from several purpose-specific credits, including MPP Revenue Bonds, Research Facilities Revenue

[1] Assumes General Revenue Bond Series AD amortizes as 30-year bullet

Bonds, Housing System Revenue Bonds and UCLA Central Chiller/Cogeneration Facility COPs. This credit consolidation serves to increase the University's overall debt capacity by pledging a broad revenue base (totaling $9.7 billion in FY 2011-12), facilitate the capital markets' understanding of the University's credit, and improve our overall ratings by recognizing the financial strength of the UC system.

Limited Project Revenue Bonds. The Limited Project Revenue Bond (LPRB) credit, established in 2004, is used to finance primarily auxiliary services such as student housing or parking. Pledged revenues for FY 11-12 was $509.0 million. The University has approximately $2.0 billion of outstanding LPRB debt. The LPRB credit provides the University's bondholders with a subordinated pledge of gross revenues derived only from facilities financed under the structure. This credit was created to conserve debt capacity in the GRB credit for mission-based projects.

Medical Center Pooled Revenue Bonds. The Medical Center Pooled Revenue bond credit serves as the primary financing vehicle for hospital debt; its initial issuance occurred in January 2007. The Bonds are secured by gross revenues of the five medical centers. The University has approximately $2.2 billion of outstanding pooled medical center debt. Previously, the medical centers issued debt on a stand-alone basis, secured by their individual revenue streams (see "Hospital Revenue Bonds" below). The pooled credit lowers borrowing costs, facilitates access to the financial markets, and increases debt capacity for the medical centers. Going forward, it has replaced the individual hospital credits. The medical center pooled revenue bonds are subordinate in payment priority to the prior pledges given to $81 million of University of California-Los Angeles Medical Center Bonds. It is currently management's intent to refinance these senior lien bonds under the new credit when economically feasible, which will ultimately eliminate this senior lien.

Other Third Party Debt. Currently, the University has $207.67 million outstanding through the California Infrastructure and Economic Development Bank (CIEDB) that financed the costs of a Neurosciences Building at the San Francisco campus. The transaction was facilitated through a lease-leaseback structure. In addition, the University provided credit support on $61 million that financed the costs of a stem cell research facility for a consortium of institutions conducting stem cell research including the San Diego campus. Both bonds were issued in calendar year 2010.

Financing Trust Structure. The University has approximately $420 million of outstanding third-party housing debt (i.e. debt issued by a party other than the University but for a project in which the University has an economic interest) under its Financing Trust Structure (FTS) credit. Currently the projects in the FTS are all housing projects at the Irvine campus. The FTS credit was created to reduce the financing cost of non-core projects, but with a lesser impact on the University's debt capacity (debt issued under the FTS credit is not counted against the University's debt capacity on a 1:1 basis). The bonds are secured solely by gross revenues of the projects financed.

Commercial Paper. The University's commercial paper program has an authorized amount of $2.00 billion. In calendar year 2012, the average amount of CP outstanding was approximately $1.26 billion. The program, which is a combination of both taxable and tax-exempt commercial paper, is used for a variety of purposes, including the funding of working capital, an investment with the State of California, and to provide interim funding for approved projects that are eventually to be funded using permanent financing.

State Public Works Board Debt. Lease obligations issued by the State Public Works Board (SPWB) on behalf of the University total approximately $2.4 billion. Classified as capital lease obligations on the University's balance sheet, these obligations are secured by an annual appropriation from the State of California to the University. Any shortfall in the State's appropriation of the annual debt service amount on these obligations requires the University to pay debt service from lawfully available funds; historically, the State has always appropriated the full amount.

The following credit will be phased out; no new debt is expected to be issued under this credit.

Hospital Revenue Bonds. The University has approximately $81 million of outstanding Hospital Revenue Bonds remaining (also see "Medical Center Pooled Revenue Bonds" above). These bonds are secured by individual medical center revenues. No new debt is expected to be issued under these credits. This structure has been replaced by the University's Medical Center Pooled Revenue credit and existing debt is expected to be gradually refinanced under the pooled revenue credit.

Summary of 2012 Debt Issuance and Market Conditions

Financial Markets in 2012. The financial markets in 2012 continued the theme of volatility with mixed economic news from sluggish job growth to continued euro zone worries and finally ending the year on fiscal cliff optimism/worries. While the 30-year Treasury yield started 2012 at 2.98% and ended the year at 2.95% the maximum rate during the year was 3.48% and the minimum was 2.46% - a difference of 102 bps intra year - demonstrating the volatility observed over the year.

Municipal Markets in 2012. The municipal markets saw an uptick from calendar year 2011. While total volume for 2011 was $295 billion, total issuance for 2012 as of December 1st was approximately $340 billion. Volume in big part was due to a large number of refundings driven by historically low rates. The municipal 30-year high grade index on January 3, 2012 was 3.57%. On December 31, 2012 that rate had dropped to 2.83%.

2012 Debt Issuance. Since December 31, 2011 (date of last report), the University issued approximately $1.86 billion of debt that included a refunding of $770.7 million of already outstanding debt related to existing debt for student housing and parking facilities and a restructuring of $83.5 million of existing Berkley student housing debt in order to minimize room and board rate increases. In addition the University issued $860 million with a 100-year final maturity. The horizon and taxable mode will allow the University to recycle proceeds several times over the tenor and give the University payment flexibility for a number of projects.

Summary of Debt Issuance from January 1, 2012 – December 31, 2012

Dated Date	Series Name	Par Amount ($ in 000s)	Use of Proceeds
March 1, 2012	General Revenue Bonds Series AD (100-yr maturity)	$860,000,000	New Money
April 26, 2012	State Public Works Board Series 2012B	$42,050,000	New Money
August, 9, 2012	Limited Project Revenue Bonds Series G and H	$999,695,000	New Money, Refunding and Restructuring
September 2, 2012	State Public Works Board Series 2012F	$91,715,000	Refunding
October 12, 2012	General Revenue Bonds Series AE	$2,385,000	New Money
	Total	**$1,995,845,000**	

The Regents has approved but not yet issued long-term debt for other projects totaling approximately $2.6 billion, which are anticipated to be financed over the next five fiscal years.

Debt Capacity

Overview. Debt capacity is a measure of the amount of debt an institution can incur at a particular credit rating level; it serves as a measure of the capital markets' assessment of an institution's financial strength. The credit ratings of the University's bonds are relevant in that they directly impact the cost of funding: the higher the credit rating, the lower the cost of borrowing (i.e., the yield the University has to pay investors of its bonds) and vice versa. The University holds strong underlying credit ratings, as assigned by Moody's Investors Service, Standard & Poor's and Fitch (GRB, LPRB, SPWB and CP ratings). The University's debt management program is designed to maintain this credit strength in order to minimize the cost of funding for core projects supporting the education and research mission, and to maximize future financial flexibility.

The following chart provides an illustration of the University's debt capacity. As shown, the University can continue to expand its debt capacity without sacrificing the "AA" rating category on its core credit.

Amount of Additional Debt Capacity over the Next Five Years

All at "AA"	GRB at "AA" LPRB at "A"	All at "A"
$2.0 - $4.0 Bn	$3.5 - $7.0 Bn	$6.5 - $10.0 Bn

- **Quotations denote rating categories**

Key Observations and Conclusions. The University has some additional debt capacity from a capital markets perspective and can still issue an additional $2 to 4 billion of debt over the next five years without we believe without affecting the strength of the credit rating on its core General Revenue Bond credit and other University credit vehicles. This estimate is contingent on a number of factors, including growth assumptions relating to the University's financial resource base, the liquidity thereof and operating budget. As previously stated, there are a number of other factors, many of which are outside of the University's control, that directly impact the institution's credit profile. In the course of 2012 the University explored the notion of shifting SPWB to the University's existing credit structure(s) for cashflow efficiencies. While this has not yet taken place, the University will confirm that *this* shift would not have a material impact on the University's ratings or future borrowing capacity.

The University had a slight decrease in relative debt capacity since the last report (December 31, 2011) – excluding the shift of SPWB to the University's credits. The University's (including Foundations) total and expendable financial resources decreased slightly from the last report. In addition, debt service to operations remained at a strong 3.6% of operations. This estimate is based on current conditions. To the extent market or other factors change, the projected debt capacity will change accordingly.

Debt Affordability Model and Prioritization. While from an external capital markets perspective the University is viewed as a single entity that finances on a consolidated, systemwide basis, internally each project's financial feasibility is assessed on an individual basis using an individual campus debt model. Each campus demonstrates affordability based on three metrics that mirror key rating agency ratios. The three metrics are debt service to operations, expendable resources to debt and/or debt service coverage based on available campus resources. In addition, the campus also must state its intended revenue source for each financing, demonstrating cash flow for debt service. The campuses prioritize projects in line with their respective long-term capital plans.

Credit Ratings. Generally, the credit ratings of major public research universities are a function of several factors. These factors include the following: student quality and demand issues; State support; the amount of debt outstanding, the amortization of the debt and the security features of the debt; operating performance, including nature and diversity of revenue base; the asset base including endowment and the liquidity of the asset base; and non-financial issues such as the quality of leadership and management.

It is important to note that the rating agencies do not consider ratings or debt capacity to be based solely upon income statement or balance sheet ratios. That is to say that debt capacity is not determined by formulas and ratios alone, but has much to do with the strategic reasons for issuing debt.

The following table illustrates the current underlying ratings of the University's various credits. Please see Appendix B for an overview of credit rating definitions.

Underlying Ratings of the University's Various Credits

	Moody's	Standard & Poor's	Fitch
General Revenue Bonds	"Aa1"	"AA"	"AA+"
Limited Project Revenue Bonds	"Aa2"	"AA-"	"AA"
Medical Center Pooled Rev Bonds	"Aa2"	"AA-"	NR
Financing Trust Structure Bonds	"Baa2"	NR	NR
State Public Works Board Debt	"Aa2"	"AA-"	AA

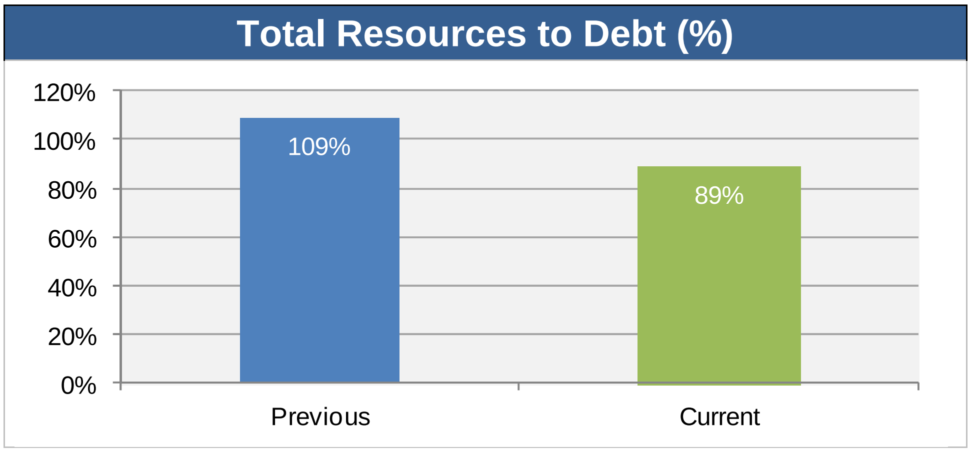
Ratings as of December 2012. NR = Not Rated.
All ratings have a stable outlook,
Does not include the University's Commercial Paper program, which carries the highest short-term ratings from Moody's, S&P and Fitch.

University's Credit Ratings Affirmed in the "AA" category for its primary borrowing vehicles. The University continues to maintain its ratings from Moody's, Standard & Poor's and Fitch (GRB, LPRB, SPWB and CP) on all of its credits despite declining State support. It should be noted however that the UC continues to evaluate the benefits of 3 ratings and may choose to use 2 ratings for certain credits in the future. In its July 13, 2012 report, Moody's continues to cite that "solid governance and management [that] has demonstrated willingness and ability to plan and implement financial and operational modifications to adjust to an evolving funding paradigm. The University's diverse revenue base, strong liquidity position, and its position as a premier research institution continue to be important credit strengths. These credit strengths continue to be mitigated by certain continuing challenges for the University that includes tightening available revenue from all sources including state and federal governments, regulatory changes in the healthcare sector (revenues that comprise 29% of the University's revenue base), and the cost of its obligations under the University's pension and retiree health plans."

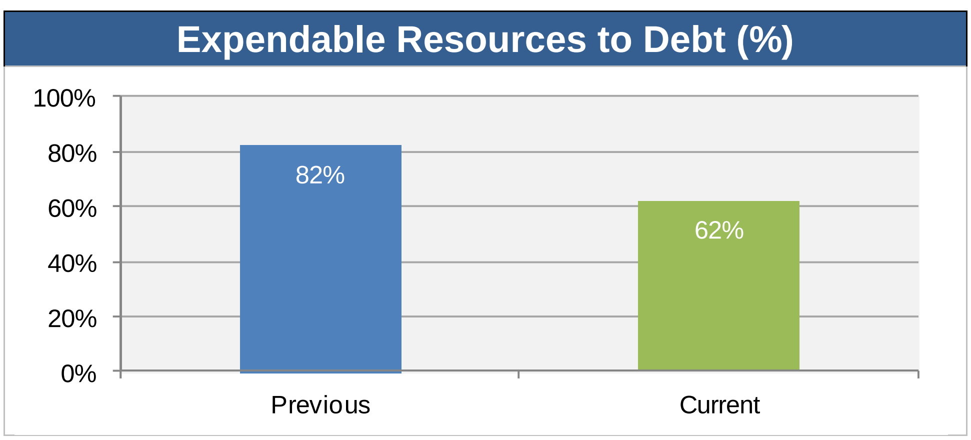
Financial Ratios. The credit rating agencies and capital markets review a number of key ratios in assessing an institution's financial strength. These ratios can include *Total Resources to Debt*; *Expendable Resources to Debt*; and *Debt Service to Operations*. Each of these measures for the University is examined in detail by the rating agencies and Capital Markets Finance. An analysis of these ratios can be useful in assessing an institution's current financial position. In addition, the rating agencies have also shifted in the last several years to weigh an institution's available working capital liquidity as another significant credit factor in its evaluation of an institution's financial flexibility. With the financial crisis of 2008 still weighing heavily on the financial markets, available liquidity for operations has become an even stronger determinant of an institution's credit rating. Of course, these credit ratio indications do not prescribe a particular rating level, nor a particular level of debt capacity. Instead, a number of qualitative and quantitative factors play a role in determining both the rating and debt capacity of an institution. The graphs on the following page show ratios based on the University's current financial position (based on FY 2011-12 audited financials and current debt outstanding).

As shown in the graphs, the University's *Total Resources to Debt* and *Expendable Resources to Debt* ratios have decreased vis-à-vis the last update and the University's *Debt Service to Operations* ratio increased slightly with the increase in total debt service. The pro-forma financial ratios shown on the next page are based on FY 2011-12 audited financial data and therefore do not account for future changes in the size of the University's financial resource base or operating budget. Therefore, to the extent the size of the University's financial resource base or its operating budget are likely to grow, the pro-forma ratios shown on the following page would be stronger.

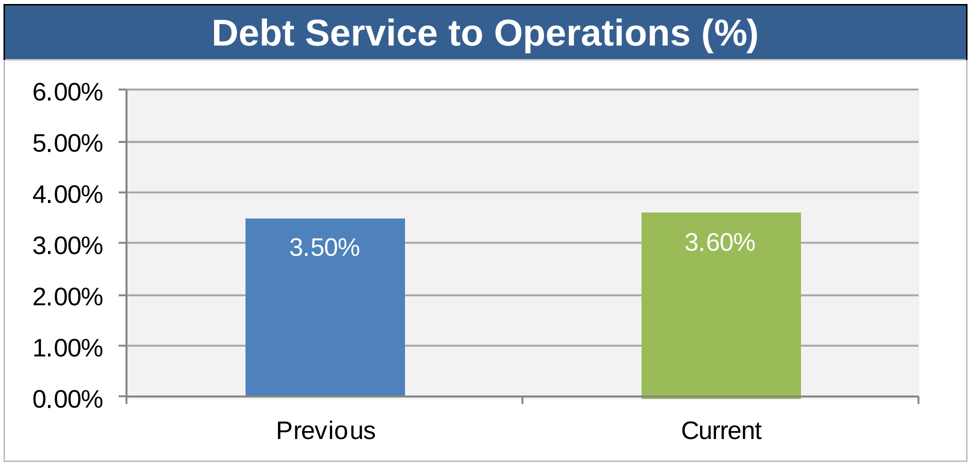
Total Resources to Debt is a broad measure of resources to debt that includes the corpus of endowed contributions. The higher the percentage, the greater the institution's perceived financial strength.



Expendable Resources to Debt measures the resources available to investors from expendable resources. The higher the percentage, the greater the institution's perceived financial strength.



Debt Service to Operations measures an institution's total debt burden on annual operating expenses. The lower the percentage, the greater the institution's financial strength (including the Build America Bond subsidies, debt service to operations is 3.4%).



Appendix A: Definitions of Financial Ratios

Total Resources to Debt (%) *A broad measure of resources to debt that includes the corpus of endowed contributions.* **(Desired Trend ↑)**	The sum of: Unrestricted net assets Plus restricted expendable net assets Plus restricted nonexpendable net assets Plus foundation total net assets Less net investment in plant Divided by debt outstanding.
Expendable Resources to Debt (%) *Measures the resources available to investors from expendable resources.* **(Desired Trend ↑)**	The sum of: Unrestricted net assets Plus restricted expendable net assets Plus foundation unrestricted/temporarily restricted net assets Less net investment in plant Divided by debt outstanding.
Debt Service to Budget (%) *Measures an institution's total debt burden on annual operating expenses.* **(Desired Trend ↓)**	Actual annual debt service Divided by total current fund expenses.

Source: Moody's Investors Service.

Appendix B: Investment Grade Rating Definitions

Moody's	S&P	Fitch	Description
"Aaa"	"AAA"	"AAA"	Bonds rated in this category are judged to be the highest quality.
"Aa1"	"AA+"	"AA+"	Bonds in the Aa/AA rating category are judged to be of high quality and standards. Together with the AAA category are generally known as high grade bonds.
"Aa2"	"AA"	"AA"	
"Aa3"	"AA-"	"AA-"	
"A1"	"A+"	"A+"	Bonds rated in the A/A category are considered as upper medium grade obligations.
"A2"	"A"	"A"	
"A3"	"A-"	"A-"	
"Baa1"	"BBB+"	"BBB+"	Bonds rated in the Baa/BBB category are considered medium grade obligations. They are neither highly protected nor poorly secured.
"Baa2"	"BBB"	"BBB"	
"Baa3"	"BBB-"	"BBB-"	

Source: Moody's Investors Service, Standard and Poor's, and Fitch

Appendix C: Summary of External Finance Approvals for Capital Projects

The summary of External Finance Approvals for Capital Projects describes the approval actions taken for the Fiscal Year 2011-12. It incorporates the following information:

- Delegated actions from the Regents to the President for projects that have been presented in campus' 10-year Capital and Financial Plans
- Regental actions (total project cost above $20 million).
- Actions by Concurrence (approval by the Chair of the Board, the Chair of the Committee on Grounds and Buildings, and the President) (total project cost between $10 million to $20 million).
- Presidential approvals (total project cost between $5 million to $10 million).

A total of approximately $456 million was approved by the Regents in external financing for capital projects in the fiscal year 2011-12. The following two tables summarize the debt and associated capital projects by campus in the fiscal year.

Summary of 2011-12 External Finance Approvals for Capital Projects		
Campus	**Debt Approved ($000s)**	**Total Project Cost ($000s)**
Berkeley	$ 229,595	$ 322,595
Davis	$ 43,808	$ 139,251
Irvine	$ 12,284	$ 56,996
Los Angeles	$ 95,000	$ 1,006,711
Merced	$ 1,600	$ 52,796
Riverside	$ -	$ -
San Diego	$ 5,188	$ 8,162
San Francisco	$ 3,000	$ 3,000
Santa Barbara	$ 33,390	$ 35,890
Santa Cruz	$ 25,117	$ 27,657
OP/LBNL	$ 7,000	$ 119,944
Total	**$ 455,982**	**$ 1,773,002**

SUMMARY OF 2011-12 EXTERNAL FINANCE APPROVALS FOR CAPITAL PROJECTS							
Campus	**Project Name**	**Approval Date**	**Approval Type**	**Debt Approved ($000s)**		**Total Project Cost ($000s)**	
Berkeley							
	Greek Theater Seismic Retrofit	8/2011	Delegated	$	4,350	$	9,350
	Lower Sproul Projects	11/2011	Regental	$	180,000	$	193,000
	Berkeley Art Museum and Pacific Film Archive	1/2012	Regental	$	20,000	$	95,000
	Computational Research and Theory [(1)]	1/2012	Regental	$	5,000	$	5,000
	Anna Head Building Seismic and Life Safety Code Upgrades	3/2012	Chancellor/Presidential	$	2,000	$	2,000
	Information Infrastructure Improvements	5/2012	Delegated	$	18,245	$	18,245
	Berkeley Sub-total			$	229,595	$	322,595
Davis							
	BGI @ UC Davis Joint Genomics Center	2/2012	Presidential	$	6,103	$	6,103
	Tercero Student Housing Phase 3	1/2012	Regental		8,198		88,441
	Steam Distribution Repairs	1/2012	Chancellor/Presidential		1,600		1,600
	Calif Ave and Old Davis Road Roundabout	7/2011	Chancellor/Presidential		1,537		1,666
	Chilled Water System Improvements Phase 7A	7/2011	Chancellor/Presidential		4,532		4,532
	Domestic Well #4 Replacement	7/2011	Chancellor/Presidential		2,630		2,630
	Campus Wastewater System Improvements Phase 1	7/2011	Chancellor/Presidential		4,516		4,516
	Roadway Maintenance Project Phase 1	7/2011	Chancellor/Presidential		1,000		1,250
	Electrical Improvements Phase 5	8/2011	Delegated		7,234		7,234
	Old Davis Road Extension	5/2012	Chancellor/Presidential		2,373		2,966
	CNPRC Respiratory Disease Center (augmenation)	5/2012	Chancellor/Presidential		4,085		18,313
	Davis Sub-total			$	43,808	$	139,251
Irvine							
	2010-12 Statewide Energy Partnership Program	5/1/2012	Action By Concurrence	$	12,284	$	56,996
	Irvine Sub-total			$	12,284	$	56,996
Los Angeles							
	Engineering VI Phase 1	11/2011	Delegated	$	47,000	$	53,000
	Westwood Replacement Hospital	3/2012	Presidential		48,000		953,711
	Los Angeles Sub-total			$	95,000	$	1,006,711
Merced							
	Housing Phase 4: The Summits	6/2012	Chancellor/Presidential	$	1,600	$	52,796
	Merced Sub-total			$	1,600	$	52,796
Riverside							
	None						
	Riverside Sub-total			$	-	$	-
San Diego							
	Solar Energy Projects for On-Campus Sites	6/2012	Chancellor/Presidential	$	2,344	$	3,076
	Tioga and Tenaya Hall Fire Life Safety and Data Upgrades	4/2012	Chancellor/Presidential	$	2,844	$	5,086
	San Diego Sub-total			$	5,188	$	8,162
San Francisco							
	Millberry Union and Ambulatory Care Center Parking Structures	3/2012	Chancellor/Presidential	$	1,200	$	1,200
	Next Generation Metropolitan Area Network, Phase II (NGMAN)	5/2012	Chancellor/Presidential	$	1,800	$	1,800
	San Francisco Sub-total			$	3,000	$	3,000
Santa Barbara							
	Santa Rosa Fire Safety and Renewal	3/2012	Delegated	$	5,000	$	7,500
	North Campus Faculty Housing Phase II	10/2011	Delegated	$	28,390	$	28,390
	Santa Barbara Sub-total			$	33,390	$	35,890
Santa Cruz							
	Cogeneration Plant Replacement Phase 1	12/2011	Delegated	$	23,806	$	26,046
	Marine Science Campus Parking Phase 1	10/2011	Delegated	$	1,311	$	1,611
	Santa Cruz Sub-total			$	25,117	$	27,657
LBNL							
	Computational Research and Theory [(1)]	1/2012	Regental	$	7,000	$	119,944
	LBNL Sub-total			$	7,000	$	119,944
Total				$	455,982	$	1,773,002

[(1)] Computational Research and Theory is a split funded project, financed with LBNL and Berkeley Campus funds