
SENATE COMMITTEE ON EDUCATION

Senator Carol Liu, Chair
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SUMMARY

This bill expands the investment authority of the California State University (CSU) by authorizing CSU to invest specified funds in mutual funds and real estate investment trusts, as specified, and restricts the use of any increased earnings from these investments to capital outlay expenditures.

BACKGROUND

Existing law, in addition to any funding appropriated to the CSU by the Legislature, appropriates monies received from a variety of other sources for the support of the State University system. These sources include funds received from the sale of publications, fees for services, materials, or facilities, non-resident fees, special session fees, gifts, bequests and donations of real property and monies from agreements entered into by the Trustees with public or private agencies, persons, institutions, and others, for performance of acts or furnishing of services, facilities, materials, goods, supplies or equipment, and monies collected as higher education fees and income from students. Existing law specifically excludes fees for instructionally related activities as defined, and revenues derived from the conduct of the instructionally related activities from this appropriation.

Existing law authorizes, upon approval by the CSU Trustees, a chief fiscal officer of a campus or the Treasurer to invest these funds in the eligible securities authorized pursuant to Government Code § 16430. Existing law also requires that any funds received from the sale or disposition of real property acquired by, or on behalf of, a particular state university to be appropriated to the Trustees for expenditure for capital outlay for the acquisition or improvement of real property for that state university, subject to the approval of the Director of Finance. (Education Code § 89724)

Existing law authorizes that grants, revenues and other funds received by the Trustees for research, workshops, conferences institutes and special projects, as specified, be transmitted to the Treasurer and deposited in the California State University Special Projects Fund (Fund). Existing law grants the Trustees the authority to establish the rules and procedures under which the Fund will operate. Existing law authorizes the Treasurer, upon approval of the Trustees, to invest these funds in the eligible securities authorized pursuant to Government Code § 16430. (Education Code § 89725)

Existing law specifies the types of securities that are eligible for the investment of surplus state funds. These include U.S. government securities, securities of federally-sponsored agencies, domestic corporate bonds, interest-bearing time deposits in California banks, savings and loan associations and credit unions, prime-rated commercial paper, repurchase and reverse repurchase agreements, security loans, banker's acceptances, negotiable certificates of deposit and loans to various bond funds. (Government Code § 16430)

ANALYSIS

This bill expands the investment authority of the California State University (CSU) to invest in securities beyond those authorized for surplus state funds (pursuant to GC § 16430). Specifically, it:

- 1) Authorizes the CSU to invest specified funds received by a campus or by the Trustees in mutual funds subject to registration by, and under the regulatory authority of, the United States Securities and Exchange Commission or, in real estate investment trusts.
- 2) Expands the authority of the Department of Finance (DOF) to annually audit the CSU Special Projects Fund by authorizing an audit as frequently as the Audits Division of the DOF deems appropriate.
- 3) Establishes specified conditions to be met in order to exercise the expanded investment authority Specifically it:
 - a) Requires the Trustees to establish a committee to provide advice and expertise on investments. Further it:
 - i) Requires that a majority of the committee members be individuals with investment experience.
 - ii) Prohibits committee members from being employees of the CSU.
 - iii) Requires that the Treasurer be allowed to serve, or appoint a deputy treasurer to serve, as a member of the committee.
 - b) Caps the total amount to be invested in securities outside those listed in GC § 16430 at \$200 million, \$400 million, and \$600 million in the fiscal years ending June 30th 2017, 2018, and 2019, respectively.
 - c) Beginning in the fiscal year ending June 30, 2020, caps the total amount to be invested in mutual funds and real estate investment trusts at 30 percent of all monies received and invested by the campus or the Trustees, pursuant to specified law.

- d) Establishes related reporting requirements. Specifically it:
 - i) Requires that the Trustees receive a quarterly investment performance report describing investment returns, comparisons to benchmarks, holdings, market values, and fees.
 - ii) Requires the Trustees to distribute an annual investment performance report to the Legislature and Department of Finance (DOF).
- e) Establishes restrictions on the use of monies earned through investments in the expanded securities and investments authorized by the bill. Specifically it:
 - i) Requires that these investment returns be used only for deferred maintenance or capital outlay projects.
 - ii) Prohibits the use of these investment returns for ongoing operations.
- f) Establishes prohibitions relative to the expanded investment authority. Specifically it:
 - i) Prohibits the Trustees from requesting funding from the DOF or the Legislature to compensate for investment losses.
 - ii) Prohibits the Trustees from citing investment losses to justify approval of an increase in student tuition or fees.
- 4) Clarifies an obsolete cross reference to the Civil Code.
- 5) Makes a number of related technical changes.

STAFF COMMENTS

- 1) ***Need for the bill.*** According to the California State University (CSU), this bill is necessary to support new capital outlay and infrastructure investments to meet its overall capital needs of \$8.8 billion, as identified in the CSU Five-Year Capital Improvement Plan. According to the CSU, the 2014 shift of primary responsibility for funding its capital program and annual debt service obligations on existing buildings from the State to the CSU, requires the identification of new options for addressing its capital needs. This bill would expand the investment tools available to the CSU for this purpose by expanding the eligible investments for specified CSU funds to include mutual funds and real estate trust investments; greater risk, but higher yield investments.
- 2) ***Related budget activity.*** Prior to 2014-15, the state funded construction of projects for the CSU by issuing general obligation bonds and lease revenue bonds and appropriated funding annually to service the associated debt. This was changed by the enactment of SB 860 (Committee on Budget, statutes of

2014) which authorized the CSU to pledge up to 12% of the state funds provided in its General Fund support budget, less general obligation debt payments and lease payments, towards capital outlay, lease-revenue bond debt financed and “pay as you go” capital outlay projects. As a result, the state no longer issues bonds for university capital outlay projects. In addition, the California State University (CSU) capital expenditure process was streamlined by granting the CSU authority to pursue capital outlay projects subject to approval by the Department of Finance and review by the budget committees and subcommittee in each house.

A similar process and authority were also created for the University of California (UC).

- 3) ***Clarification of application of investment authority.*** This bill authorizes the expanded investment of revenues received by the CSU campuses from fees for services, materials and facilities, agreements, non-residents, special sessions, special fees, gifts, bequests and donations, the sale of unclaimed, lost or abandoned property, and monies collected as higher education fees and income from students of any campus of the CSU. Currently, investment of these funds is limited to those securities identified for investment of state surplus funds by Government Code § 16430. This bill would expand this list (for the CSU only) to include mutual funds and real estate trust investments.

According to the Treasurer’s Office Government Code § 16430 guides the investment of monies in the Pooled Money Investment Account (PMIA), which is funded from State general fund, special funds held by State agencies, and monies deposited by cities, counties and other entities into the Local Agency Investment Fund (LAIF). According to the Treasurer, PMIA policy sets as primary investment objectives safety, liquidity and yield. The Treasurer’s Office, characterizes the investments authorized by GC § 16430 as securities that are short term, liquid, maintain principal, and have a fairly low rate of return.

The provisions of this bill do not apply to CSU general fund appropriations or PMIA balances.

- 4) ***How would it work?*** According to the CSU, it has the option of placing the affected fee revenues in the appropriate “special” fund in the State Treasury or in a local trust account outside of the State Treasury. The CSU has chosen as a matter of systemwide policy to place all these revenues in local trusts and invests all funds from these sources under the CSU Investment Policy. According to the CSU, its current investment fund, the Systemwide Investment Fund Trust (SWIFT), is made up of reserves from the fee sources previously noted. The CSU reports that returns from investment of these funds are frequently less than 1 percent and are used to support one-time expenses of the University and its 23 campuses.

This bill would result in a new local trust account for purposes of the expanded investment authority. The CSU reports that about \$2.8 to \$3 billion in reserves are carried over year to year so, under the provisions of this bill, up to \$1 billion of these reserves could be invested in mutual funds and real estate investment

trusts in 2020. The remaining reserve funds would continue to be invested in the securities authorized under Government Code § 16430.

According to the California State University (CSU), current year operations are not dependent upon these reserves so neither they, nor student tuition, would be impacted by any investment losses. In addition, the CSU indicates that it intends to implement a fiscally prudent investment/payout strategy based upon its experience managing endowment accounts, and, because increased earnings are restricted to one time capital purposes, it has the ability to adjust its capital program to reflect earnings.

- 5) **Controls and accountability.** In anticipation of concerns regarding the potential for, and consequences of, investment losses from higher yield investments, the bill incorporates several elements to mitigate risks and ensure accountability. These include the following:
- a) Quarterly investment reports to the Trustees.
 - b) Annual investment reports to the Legislature and Department of Finance.
 - c) Annual caps on the amount which can be invested in the expanded securities for the first three years with an ongoing cap of no more than 30 percent of all monies invested.
 - d) Creation of a committee with investment expertise to provide advice and expertise on investments.
 - e) Prohibitions on the use of investment earnings for ongoing operational expenses.
 - f) Restrictions on the use of earnings to capital outlay or deferred maintenance costs.

In addition the bill prohibits the request of funds to compensate for investment losses or the use of such losses to justify student fee increases. While these provisions do not necessarily bind a future Legislature, they do codify the intent and expectation that the CSU exercise fiscal prudence in the implementation of its new investment authority.

In order to strengthen and further clarify the Legislature's expectations in this regard, **staff recommends** the bill be amended to insert on page 6 after line 37, "There shall be no increase in tuition or reduction in course sections offered due to investment losses sustained as a result of this section."

- 6) **In the absence of this bill?** The CSU reports that it has already allocated \$35 million of ongoing new state funding provided by the Legislature and Governor for debt service on new projects. Absent this bill, the CSU reports that it can use its operating funds for its facilities needs and campuses can and have reserved about \$175 million in funds on a case-by-case basis for specific projects. However, the CSU is concerned that the pressure to use operational funds for

infrastructure needs could ultimately come at the expense of support for students, faculty and staff.

While the state could also provide additional general obligation bond funding in the future, the last bond authorization to provide such funding to the CSU occurred in 2006.

- 7) **Technical amendments.** Consistent with the author's request, **staff recommends** the bill be amended on page 3, line 32 to insert "U.S. registered" before "real estate investment trusts."
- 8) **Prior legislation.** This bill is almost identical to AB 130 (Committee on Budget, 2015). While AB 130 was successfully passed out of the Assembly, Senate Budget Committee members requested that this measure be deferred until the next legislative year and be considered through the policy committee process.

SUPPORT

California State University

OPPOSITION

None received.

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