

Date of Hearing: June 21, 2016

ASSEMBLY COMMITTEE ON HIGHER EDUCATION

Jose Medina, Chair

SB 1412 (Block) – As Amended April 12, 2016

**SENATE VOTE:** 39-0

**SUBJECT:** California State University: investments

**SUMMARY:** Authorizes the California State University to invest in mutual funds subject to regulation by the United States Securities and Exchange Commission (SEC) or in United States registered real estate investment trusts, as specified, and restricts earnings to capital outlay expenditures. Specifically, **this bill:**

- 1) Authorizes the CSU to invest money received from specified funds in mutual funds subject to SEC registration and regulation, or in United States registered real estate investment trusts.
- 2) Authorizes Department of Finance (DOF) to audit the CSU Special Projects Fund as frequently as the Audits Division of the DOF deems appropriate.
- 3) Requires the CSU Trustees to establish a committee to provide advice and expertise on investments, as outlined below:
  - a) Requires that a majority of the committee members be individuals with investment experience.
  - b) Prohibits committee members from being employees of the CSU.
  - c) Requires that the Treasurer be allowed to serve, or appoint a deputy treasurer to serve, as a member of the committee.
- 4) Caps the total amount to be invested in securities outside those currently authorized at \$200 million for Fiscal Year (FY) 2016-17, \$400 million for FY 2017-18, and \$600 million for FY 2018-2019. Beginning in FY 2019-20, 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.
- 5) Establishes related reporting requirements, including requires that the CSU Trustees receive a quarterly investment performance report describing investment returns, comparisons to benchmarks, holdings, market values, and fees; and, requires the CSU Trustees to distribute an annual investment performance report to the Legislature and DOF.
- 6) Establishes restrictions on the use of monies earned through investments in the expanded securities and investments to only deferred maintenance or capital outlay projects and prohibits the use of these investment returns for ongoing operations.
- 7) Establishes prohibitions relative to the expanded investment authority by prohibiting the CSU Trustees from requesting funding from the DOF or the Legislature to compensate for

investment losses and prohibiting the CSU Trustees from citing investment losses to justify approval of an increase in student tuition or fees.

**EXISTING LAW:**

- 1) 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 Section 16430)
- 2) Appropriates monies received from a variety of other sources for the support of the CSU 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. (Education Code Section 89720)
- 3) 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, as authorized. 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. (EC Section 89724)
- 4) 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 CSU 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, as authorized. (EC Section 89725)

**FISCAL EFFECT:** According to the Senate Appropriations Committee:

- 1) Investments: Unknown costs or savings related to expanded investment authority. The authority provided to the CSU to utilize alternative investment tools, could potentially lead to a significant increase in returns. To the extent higher returns materialize, the CSU would be restricted to using these funds to address one-time capital outlay projects which would relieve pressure on the CSU's operating budget, including state General Fund, to address the system's capital needs. The bill establishes certain protections to mitigate risk exposure to the CSU, including an incremental phase-in of funds that may be invested under this authority and the establishment of an advisory committee dedicated to providing advice and expertise on how these funds will be invested. The actual performance of the investments under the authority provided in this bill would depend on a number of factors, including the performance of the overall economy.

- 2) Administrative costs: The Investment Advisory Committee is expected to have between nine and 13 members that meet quarterly. The CSU indicates the potential need for additional staff. Together these activities could cost the CSU in the low hundreds of thousands. Additional, potentially significant costs could be incurred related to increasing contracted support for financial advisory and investment management services.

**COMMENTS:** *Purpose of this bill.* According to the author, "the capital needs of the CSU are substantial. Currently, it is estimated that the CSU has \$2.6 billion of deferred maintenance on existing infrastructure and this amount will grow by approximately \$150 million per year. There is also the additional need to renovate existing or construct new facilities totaling approximately \$6 billion to better serve teaching and learning for the 21<sup>st</sup> century. To put this into perspective, the annual CSU operating budget totals approximately \$5.2 billion."

The author further notes, "since 2014, CSU has allocated \$35 million of ongoing, new state funding provided to the university to support debt service on approximately \$300 million to \$525 million of capital projects. Additionally, the state provided \$25 million of one-time funding in the Budget Act of 2015 for these purposes, specifically for pay-go projects. This is certainly a step forward, but relatively small compared to the overall CSU capital needs of \$8.8 billion as detailed in the CSU Five-Year Capital Improvement Plan."

This bill proposes changes to the current statutory limits on investments to create another tool to help address capital outlay and infrastructure needs. Specifically, current law limits CSU's investment earnings potential to fixed-income securities, which has, according to CSU, resulted in annual returns of less than 1 percent. This bill proposes to expand investment options to mutual funds regulated by the SEC, including equity mutual funds, and real estate investment trusts. The CSU believes this could lead to greater returns within appropriate levels of risk.

*Oversight of investment activity.* CSU points to the following provisions in the bill that provide protection of the public interest and oversight of investments:

- 1) Measured and Phased-In. CSU notes the proposal will phase in over a multi-year period the amount of fund balances that can be invested by CSU in the new asset classes (See: Summary #4).
- 2) Uses. CSU notes that this bill would be limited to one-time capital outlay and maintenance only (See: Summary #6).
- 3) No Burden on the State or Students. CSU notes this proposal stipulates that CSU will not request funding from the Legislature or increase student fees as a result of negative investment returns (See: Summary #7).
- 4) Transparency and Oversight. CSU points to the requirements for quarterly investment performance reports to the Trustees, the annual investment performance report to the Legislature, increased auditing authority of the DOF, and the investment committee made up of investment experts as evidence of strong transparency and oversight requirements. (See: Summary #2, 3, and 5).

*Prior related 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.

**REGISTERED SUPPORT / OPPOSITION:**

**Support**

California State University (Sponsor)  
John Chiang, Treasurer, State of California

**Opposition**

None on File

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