AGENDA

COMMITTEE ON FINANCE

Meeting: **9:00 a.m., Wednesday, September 21, 2005**
Glenn S. Dumke Auditorium

William Hauck, Chair
Raymond W. Holdsworth, Vice Chair
Roberta Achtenberg
Herbert L. Carter
Carol R. Chandler
Moctesuma Esparza
Robert G. Foster
Ricardo F. Icaza
Corey Jackson

Consent Item

Approval of Minutes of Meeting of July 19, 2005

Discussion Items

1. Status Report on Support Budget and 2006/2007 Lottery Revenue Budget Proposal, *Information*
2. Approval to Issue Trustees of the California State University, Systemwide Revenue Bonds and Related Debt Instruments for Various Projects, *Action*
3. California State University Annual Investment Report, *Information*

MINUTES OF THE MEETING OF
COMMITTEE ON FINANCE
Office of the Chancellor
Glenn S. Dumke Conference Center
401 Golden Shore
Long Beach, California

July 19, 2005

Members Present

William Hauck, Chair
Raymond W. Holdsworth, Vice Chair
Roberta Achtenberg
Herbert L. Carter
Carol R. Chandler
Robert G. Foster
Murray L. Galinson, Chair of the Board
Corey Jackson
Charles B. Reed, Chancellor
Craig Smith

Approval of Minutes

The minutes of May 10, 2005 were approved.

Status Report on the 2005/2006 Support Budget

Trustee Hauck asked Mr. Patrick J. Lenz, assistant vice chancellor, budget development, to present the report.

Mr. Lenz said he was pleased to confirm adoption of the 2005/2006 budget. He explained it had been a good year for CSU with a total funding augmentation of $222.9 million, which represents a 6.5 percent increase over the current year budget. In addition, the legislature and the administration fully supported the compact agreement by the chancellor and the CSU that was entered into over a year ago. This will allow for the enrollment of an additional 10,000 students beginning this fall and represents a 2.5 percent increase in our overall student enrollment.

CSU will be able to provide $23.3 million in state university grants for students, and $40.7 million to cover mandatory costs. There will also be $88.1 million for a compensation pool approved by the board last fall, and $7.9 million for long-term needs. Mr. Lenz observed this is the first time in three years CSU has been able to address mandatory costs.

Mr. Lenz said he was happy to report that the $7 million reduction in the January budget associated with outreach and academic preparation programs was restored in the final budget deliberations.

Other positive aspects of the budget for CSU include funds to expand nursing programs, and $26 million from bond funds for the capital renewal program. He concluded his remarks noting the legislature approved Supplemental Report Language for a review of CSU's state General Fund dollars per student known as the "marginal cost" methodology, which could allow the CSU greater funding per student beginning in the 2006/2007 fiscal year.

Chair Hauck thanked Mr. Lenz for the report and commended everyone involved in the budget process on a job well done.

Approval to Issue Trustees of the California State University, Systemwide Revenue Bonds and Related Debt Instruments for a Project at Sonoma State University

Mr. Dennis Hordyk, assistant vice chancellor, financial services, presented the item. He explained the item was a request by Sonoma State University for the Board of Trustees' to authorize issuance of Systemwide Revenue Bonds and interim financing under the CSU's commercial paper program to provide for the construction of a hospitality center as part of the Green Music Center at the Sonoma State campus.

Mr. Hordyk reviewed the details and components of the Green Music Center project. The hospitality center portion of the project will provide banquet, meeting, restaurant facilities, and limited retail space. The net par value for the proposed bond for the center is $4,750,000. Construction for the project is scheduled to begin this fall with completion anticipated by the fall of 2007.

The committee recommended approval of the proposed resolution (RFIN 07-05-09).

Auxiliary Organization Taxable Financing at California State University, Fullerton

Mr. Hordyk explained the item was a request by CSU, Fullerton, for an auxiliary financing for construction of a faculty and staff housing project located approximately three miles from the CSU, Fullerton campus.

The project called 'University Heights' will be the second off-campus faculty and staff homeownership program operated by the CSU, Fullerton Housing Authority that was established to develop and operate housing for faculty and staff in support of the university's mission.

Mr. Hordyk reviewed the terms and details of the project as set forth in the written agenda item. In response to an earlier question from Trustee Hauck, Mr. Hordyk estimated a combined income of between $100,000 and $140,000 per year would be needed to qualify for this housing based on a 5% down payment amount.

The committee recommended approval of the proposed resolution (RFIN 07-05-10).

Trustee Hauck adjourned the meeting.

COMMITTEE ON FINANCE

Status Report on Support Budget and 2006/2007 Lottery Revenue Budget Proposal

Presentation By

Richard P. West
Executive Vice Chancellor and
Chief Financial Officer

Patrick J. Lenz
Assistant Vice Chancellor
Budget Development

2005-06 Support Budget

On July 12 Governor Schwarzenegger signed the 2005-06 budget, fully funding the Compact for Higher Education, and allocating $235.2 million to the California State University (CSU) representing an increase of 6.5 percent for fiscal year 2005-06. The budget funds student access by enrolling an additional 10,000 students (8,103 FTES) at the 23-campus California State University. The 2005-06 budget increases the CSU General Fund support by 5.4 percent, and provides $134 million in new revenue, which is the first increase after three consecutive years of budget reductions. According to the agreement, the CSU's general fund budget for the 2005-06 academic year is $2.6 billion.

The Governor's budget is consistent with the revenue and expenditure assumptions requested and approved by the Board of Trustees last October that includes:

- enrollment growth of 2.5 percent to serve an additional 8,103 full-time equivalent students (FTES);
- $23.3 million set-aside for student financial aid for CSU's neediest students;
- $40.7 million to cover mandatory costs for the first time in three years;
- a total compensation pool of $88.1 million (some of which must be bargained); and
- $7.9 million for long-term needs including technology, libraries, and instructional equipment.

In addition, the Governor restored $7 million in funding for Outreach and Academic Preparation programs that had been deleted in his January budget, augmented funding of $560,000 to expand graduate level nursing programs, and provided an additional $250,000 to expand CSU's blended programs to increase the number of K-12 math and science teachers.

The budget also provides the CSU with the flexibility of using $26 million in current General Obligation bonds for a Capital Renewal program that will extend the useful life of facilities to provide additional classroom space for students. Finally, the budget includes Supplemental Report Language for a review of CSU's state General Fund dollars per student, know as our "marginal cost" methodology, which could allow the CSU greater funding per student beginning in the 2006-07 fiscal year.

Overview on the 2006-07 Budget

At this point there remain a number of uncertainties relative to the economic outlook for California in the 2006-07 fiscal year. At the time the budget was enacted, the Legislative Analyst Office (LAO) indicated if revenue estimates are achieved and the savings assumed in the 2005-06 budget are realized, the state would still face a $6.1 billion structural budget deficit. This $6.1 billion deficit could be reduced if there isn't a need for all or a portion on the $1.3 billion reserve. The LAO will be revising its' economic outlook for California in the November fiscal report.

The CSU, like the University of California, will be in the second year of a 5-year Compact for Higher Education that is designed to address student access, fund mandatory costs, meet minimum compensation needs and provide some fiscal predictability to the CSU. While discussions with the Governor's Office and Department of Finance on the exact funding that will be assumed in the Compact are continuing, the preliminary estimate of the revenue assumptions is as follows:

2006-07 Compact Revenue Projections

State General Fund		**$128,463,000**
• General Operations	$75,803,000	
• Enrollment Growth (2.5%)	$52,660,000	
Fee Revenue		**$107,463,000**
• State University Revenue	$79,467,000	
o Undergraduate Fee (8%; $2,520 to $2,724)		
o Credential Fee (8%; $2,922 to $3,414)		
o Graduate Fee (10%; $3,102 to $3,414)		
• Enrollment Growth Fee Revenue	$27,996,000	
2006-07 CSU Compact Revenue		**$235,926,000**

The 2006-07 CSU budget will resemble the current year budget with anticipated expenditures for mandatory costs ($30-40 million), enrollment growth ($65.1 million, 2.5 percent or 8,306 FTES), financial aid ($25-32.7 million assuming a range of 25-33% set-aside for State University Grants), compensation ($78.1 million, assuming 3% increase), and long-term needs for technology, libraries, and deferred maintenance ($10 million). These are preliminary estimates pending completion of the 2005-06 budget reporting process and recognizing that current discussions regarding changes to the "marginal cost" formula may result in higher state General Fund allocations per FTES.

The Board will be briefed on funding appropriated in the 2005-06 fiscal year and an overview on the 2006-07 CSU revenue and expenditure assumptions.

2006-07 Lottery Revenue Budget

Over the past several years CSU lottery revenue receipts have been strong. Due to this recent trend and the introduction of a new multi-state lottery game, a modest increase in the estimate of revenue is appropriate as the CSU plans for fiscal year 2006-07. The lottery revenue that will be allocated to the California State University in 2006-07 is estimated to be $51 million. After providing for a $5.0 million systemwide reserve, the amount available for allocation is $46 million. The $5.0 million reserve is used to assist with cash-flow variations due to fluctuations in quarterly lottery receipts and other economic uncertainties. The increased estimate of lottery revenue will be used to increase allocations for campus-based programs.

The lottery budget proposed for fiscal year 2006-07 is as follows:

2006/07 Proposed Lottery Revenue Budget

	2005/06 Approved Budget	2006/07 Proposed Budget
Sources of Funds		
Beginning Reserve	$ 5,000,000	$ 5,000,000
Additional Carryforward		7,600,000
Receipts	36,000,000	38,000,000
Projected Interest Earnings	500,000	400,000
Total Revenues	$ 41,500,000	$ 51,000,000
Less Systemwide Reserve	*(5,000,000)*	*(5,000,000)*
Total Available for Allocation	**$ 36,500,000**	**$ 46,000,000**
Uses of Funds		
System Programs		
Forgivable Loan/Doctoral Incentive Program	$ 3,000,000	$ 3,000,000
California Pre-Doctoral Program	714,000	714,000
CSU Summer Arts Program	1,200,000	1,200,000
Systemwide Implementation Costs	491,000	491,000
	$ 5,405,000	$ 5,405,000
Campus Based Programs		
Campus/CO Programs	$ 30,595,000	$ 34,595,000
Campus/CO Interest	$ 500,000	$ 400,000
	$ 31,095,000	$ 34,995,000
Planned Carryforward Expenditures		$ 5,600,000
Total Uses of Funds	**$ 36,500,000**	**$ 46,000,000**

COMMITTEE ON FINANCE

Approval to Issue Trustees of the California State University, Systemwide Revenue Bonds and Related Debt Instruments for Various Projects

Presentation By

Dennis Hordyk
Assistant Vice Chancellor
Financial Services

Summary

This item requests the Board of Trustees to authorize the issuance of Systemwide Revenue Bonds and the issuance of interim financing under the CSU's commercial paper program in an aggregate amount not-to-exceed $101,625,000 to provide funds for one project, three acquisitions and refundings of bonds, and one refunding of bonds. To facilitate maximum flexibility, the Board is being asked to approve separate resolutions relating to each of these actions. The long-term bonds will be part of a future Systemwide Revenue Bond sale and are expected to bear the same ratings from Moody's Investors Service and Standard and Poor's corporation as the existing systemwide program bonds.

The project, acquisitions, and refundings are as follows:

1. **San Diego State University – Swimming Pool Complex**

The Board of Trustees approved the amendment of the Nonstate Funded Capital Outlay program in September 2004 and the schematics in May 2005 for the San Diego State University – Swimming Pool Complex. The project will construct a new pool complex to replace the former Terry Pool, which was taken out of service in June 2000. The proposed project will provide high quality swimming pool facilities for educational and recreational use by students, faculty, and staff, as well as provide facilities for the university's intercollegiate swimming team. The project will include three pools: a 50-meter by 25-yard Olympic-style pool, a 7,000 square foot recreational pool, and a 250 square foot hydrotherapy spa. A building (approximately 4,985 square feet) will be constructed to accommodate showers, locker rooms, restrooms, and administrative offices, with attached exterior storage space. In April 2004, the San Diego State University students voted to support an increase in student body center fees to construct and operate the Swimming Pool Complex.

The not-to-exceed par value of the proposed bonds is $13,125,000 and is based on an estimated project cost of $12,100,000. The project will be fully funded from financing proceeds. At the time the agenda item was written, the campus was expecting the receipt of construction bids. The campus expects to award a contract to construct the project in November 2005, and expects the project to be completed in January 2007.

The following table provides information about this financing transaction.

Not-to-exceed amount:	$13,125,000
Amortization:	Approximately level over 30 years.
Pro-forma maximum annual expected debt service:	$848,619
Projected debt service coverage including the new project: [1] Net revenue – all San Diego pledged revenue programs: Net revenue – projected for the campus Student Union program:	 1.34 1.30

1. Projected information – Combines unaudited 2003/04 information for the campus-operated pledged revenue programs and the first full year of operation of the new project.

The not-to-exceed amount for the project totaling $13,125,000, the maximum annual debt service, and the ratios above are based on the expected construction project bid amount, expected debt service and capitalized interest at the current interest rate environment plus 50 basis points (computed average coupon rate – 5.03%; August 12, 2005), which provides a modest safeguard to be used if needed for changing financial market conditions that could occur before the permanent financing bonds are sold. The financial plan includes level amortization of debt service, which is our CSU program standard. The campus has submitted a financial plan that has a 1.30 program net revenue debt service coverage and a campus combined net revenue debt service coverage from all pledged revenue programs of 1.34 which meet or are very close to the CSU benchmarks of 1.10 and 1.35 times respectively.

2. **Acquisition of the California State University Headquarters Building and Refunding of Related Lease-Revenue Bonds**

The Headquarters Building of the California State University was built as a project of the California State University Headquarters Building Authority (HBA), a joint powers agency of the California State University and the City of Long Beach (City). A special statute authorized the City to transfer the Headquarters Building site to the CSU (Chapter 854, 1971 Cal. Stats.), and a 1973 grant deed from the City to the CSU Trustees accomplished that transfer. In 1974 the HBA issued $5,470,000 of Lease Revenue Bonds to build the original Headquarters Building; in 1997 the HBA refinanced the remaining debt from the original Headquarters Building and issued new money, for a total of $30,680,000, to build a new Headquarters Building.

The HBA continues to meet annually, with two representatives from the City, two appointees from the CSU Trustees, and a fifth member jointly appointed by the other members. The CSU leases the land to the HBA, who then subleases the land and building back to the Trustees; the rent collected by the HBA from the Trustees is used to pay the debt service on the outstanding HBA bonds.

At this time, the Board is being asked to approve the acquisition of the Headquarters project with the Systemwide Revenue Bonds and refinance the HBA bonds; $25,570,000 remains outstanding on the 1997 bonds, and current market rates indicate that a significant net present value savings (approximately $1.3 million) would be possible from a refinancing. The portion of the remaining debt that was refinanced in 1997 is a current refunding, so that the entire refinancing of the 1997 bonds is eligible for advance refunding. This refinancing would be accomplished by using the following process:

1. CSU and the HBA would enter into a Facility Purchase Contract in which CSU agrees to purchase all interests of the HBA in the Headquarters Building, the site, and related improvements (the "Facilities"), and the HBA would apply the purchase price to refund and defease the 1997 bonds.
2. CSU would issue Systemwide Revenue Bonds to pay the purchase price for the Facilities.
3. The CSU Trustees would lease the Facilities to the HBA, and the HBA would sublease the facilities back to the CSU Trustees. The HBA would pay nominal rent under the lease and the CSU would pay a Base Rent under the sublease equal to the debt service on the Systemwide Revenue Bonds issued for this purpose.
4. The HBA would pledge and assign the Base Rent to the State Treasurer for payment of the Systemwide Revenue Bonds.

The Headquarters Building Authority met on September 6, 2005 and approved the above financing structure. The City of Long Beach must also approve the actions of the HBA, and, at the time this item was written, it was anticipated that approval would be provided. The not-to-exceed par value of the proposed refunding bonds is $26,000,000.

3. San Jose State University, Campus Village Housing Phase 1 Restructuring

At its November 2002 meeting, the Board of Trustees approved the financing in a not-to-exceed amount of $243,940,000 for the Campus Village Housing Phase 1 at the San Jose campus. The project was permanently financed with Systemwide Revenue Bond proceeds as part of the Series 2003A bonds that were sold in January 2003.

At present, the campus is on time with its construction completion of this project and is in the process of leasing-up the buildings. Because of the significant negative impacts on the San Jose housing market resulting from the recent economic downturns in the Silicon Valley area, surrounding rental market rates have dropped by as much as 27% and rental housing vacancy rates have risen by as much as 15% since 2001. These changes have created unforeseen difficulties for the overall housing program and the campus; occupancy rates for the housing program are currently at 70% for the Fall 2005 semester, compared to the assumed 90% occupancy rate assumed in the campus's financial pro forma. Although the Campus Village Housing project has a healthy 83% occupancy by students, the campus has been challenged to maintain acceptable occupancy levels in its older student housing stocks.

At this time, the Chancellor's Office is recommending that the debt service for this project be restructured to allow the campus additional flexibility during the early years of this project. It is recommended that a portion of the principal due during the first seven years of principal repayment be re-scheduled to be amortized over the final 23 years of the bonds. The principal that is rescheduled (approximately $30 million) and the additional interest associated with the rescheduling, when combined with the remaining outstanding bond amount, will not exceed the $243,940,000 originally authorized by the Board; additionally, full repayment of the bonds will still be accomplished within the original 30 years. While the refinancing is estimated to have a negative net present value of $1.35 million over the term of the bonds (based on current market rates), the housing program will benefit from a decrease of debt service payments of more than $17 million over the first seven years of the bonds. This will provide the campus housing program the opportunity to develop a balanced budget as it seeks ways to increase occupancy rates and readjust its rental rates. It is anticipated that this restructuring, in a not-to-exceed par amount of $30,000,000, will occur in a Systemwide Revenue Bond sale that is currently scheduled for late-September 2005.

4. Monterey Bay Foundation – Housing Facilities Refinancing

Previously, three separate auxiliary projects were approved for the Foundation at California State University, Monterey Bay (Foundation), a recognized auxiliary organization in good standing, to finance the renovation of student residence halls and office space. The Foundation originally sold bonds in three separate issues (1998, 1999, 2001) for a total par amount of $34,530,000.

A refinancing of these Foundation bonds through issuance of Systemwide Revenue Bonds is now being recommended to the Trustees. To accomplish this refinancing, state law requires the Board to acquire the facilities and lease them back to the Foundation. It is estimated that the refinancing will generate net present value savings of approximately $1.0 million. The lease will require a general obligation pledge of the Foundation.

Not-to-exceed amount	$32,500,000

Net present value savings	3.34% of the refunded principal amount

The not-to-exceed amount for both the refinancing and the net present value savings are based on the existing bonds, at the current interest rate of 4.29% (September 2, 2005), which may fluctuate before the bonds are sold. This refunding will have minimal impact on systemwide debt capacity since auxiliary debt is already included in the financial statements and debt capacity calculations.

Trustee Resolutions and Recommended Action

Orrick, Herrington & Sutcliffe LLP, as bond counsel, is preparing a set of resolutions to be presented at this meeting for the project and bond refundings described in this agenda item that authorize interim and permanent financing. The proposed set of resolutions will be distributed at the meeting and will achieve the following:

1. Authorize the sale and issuance of Systemwide Revenue Bond Anticipation Notes and the related sale and issuance of the Trustees of the California State University Systemwide Revenue Bonds in an amount not-to-exceed $101,625,000 and certain actions relating thereto.
2. Provide a delegation to the Chancellor; the Executive Vice Chancellor and Chief Financial Officer; the Assistant Vice Chancellor, Financial Services; and the Senior Director, Financing and Treasury; and their designees to take any and all necessary actions to execute documents for the sale and issuance of the bond anticipation notes and the revenue bonds.

Approval of the financing resolutions for the project and bond refundings as described in this Agenda Item 2 of the Finance Committee of the September 20-21, 2005 meeting of the CSU Board of Trustees is recommended for:

1. **San Diego State University – Swimming Pool Complex**

2. **Acquisition of the California State University Headquarters Building and Refunding of Related Lease-Revenue Bonds**

3. **San Jose State University, Campus Village Housing Phase 1 Restructuring**

4. **Monterey Bay Foundation – Housing Facilities Refinancing**

COMMITTEE ON FINANCE

California State University Annual Investment Report

Presentation By

Dennis Hordyk
Assistant Vice Chancellor
Financial Services

Summary

This item provides the annual investment report for fiscal year 2004-05 for funds managed under the California State University (CSU) Investment policy.

At the January 1997 meeting, the Board of Trustees approved the creation of a centralized investment program to manage the investment of funds held in CSU trust accounts. In addition, the Board of Trustees approved an investment policy consistent with the authority provided in existing statutes to guide the CSU in administering the investment program. The Board of Trustees also agreed that an external fund manager should be hired to invest the funds consistent with the investment policy of the Board of Trustees. In May 1997 the firm of Metropolitan West was hired to manage the investment program for the CSU based upon the firm's understanding of the CSU's particular needs and its overall lower cost. In September 2001, based upon the same strengths, Metropolitan West was again retained to manage the CSU's investment program following another competitive bid process. The current contract with Metropolitan West expires in September 2006.

As of June 30, 2005, the CSU had $334 million invested in the Metropolitan West Short-Term Account and $170 million invested in the Metropolitan West Medium Term Account. Although the Short-Term Account has underperformed in recent years compared to the Local Agency Investment Fund (LAIF), it has outperformed LAIF over the long term. Furthermore, the Medium Term Account has consistently outperformed LAIF, averaging about 2% per year greater return than would otherwise be the case had the funds been invested in LAIF.

The attached Year End Investment Report, Attachment A, has been prepared by Metropolitan West for the Board of Trustees and provides additional information on the results of the investment program for the fiscal year ended June 30, 2005.

The State Treasurer also provides investment vehicles that may be used for CSU funds. The Surplus Money Investment Fund (SMIF) is used by the State Treasurer to invest state funds in a short-term pool at virtually no risk. LAIF is used by the State Treasurer to invest local agency funds. The year-end results for these two funds are reported in Attachment B, which has been prepared by the Office of Financing and Treasury.

The Board of Trustees' Investment Policy is included as Attachment C.

YEAR END INVESTMENT REPORT
FOR THE FYE 6/30/05

PREPARED BY METROPOLITAN WEST FOR THE CALIFORNIA STATE UNIVERSITY

MARKET SUMMARY

The past year has been marked by a flatter yield curve. The Federal Funds overnight target rate rose from 1.25% to 3.25%. These increases happened in 25 basis point intervals. The U.S. Treasury 2-year Note rate rose from 2.677% at the end of June 2004 to 3.633% at June 30, 2005; and the 10-year Note rate declined from 4.581% to 3.913% in that same time period.

Jobs growth averaged a gain of 175,000 per month in the past 12-months with the unemployment rate dropping from 5.5% to 5.0% in the same period. The improved jobs market helped give the FOMC added comfort in raising the Fed Funds by 200 basis points in the one-year period. Current expectations are for GDP growth to be strong in the second half of 2005. Oil may become a greater concern in the coming year as prices increased by almost $20 per barrel in the past year and may stay above $60 in the year to come.

The last year proved to be fair for the fixed income accounts, with the longer portfolios performing the best in spite of the increase in the Fed Funds rate.

PROGRAM PERFORMANCE SINCE INCEPTION

Since the CSU Investment Program was launched in September 1997, it has provided an effective vehicle for the investment of campus operating reserves and other short-term holdings. The following chart illustrates how the accounts have provided long-term benefit to participants relative to the Local Agency Investment Fund (LAIF).

	Fiscal Year 2004-05	Trailing Three Years[1]	Trailing Five-Years[1]	Since Inception[1]
Short-Term Account	**2.17%**	**1.86%**	**3.23%**	**4.19%**
LAIF	2.25%	2.00%	3.15%	4.10%
Medium-Term Account	**3.20%**	**3.90%**	**6.21%**	**6.08%**
Merrill Lynch Index[2]	3.25%	4.58%	6.89%	6.59%

[1] Annualized.
[2] The Medium Term index from inception of the program through November 2004 was the Merrill Lynch 5-7 year Treasury index. On November 30, 2004 the investment committee changed the index from the Merrill 5-7 year Treasury index to the Merrill 1-5 Treasury and Agency index. The Merrill 5-7 year Treasury index and the Merrill 1-5 year Treasury and Agency index are unmanaged indices consisting of the cumulative daily returns of US Treasuries with maturities between 5 and 7 years, and 1 and 5 years, respectively.

SHORT-TERM ACCOUNT PERFORMANCE
Fiscal Year 2004-05

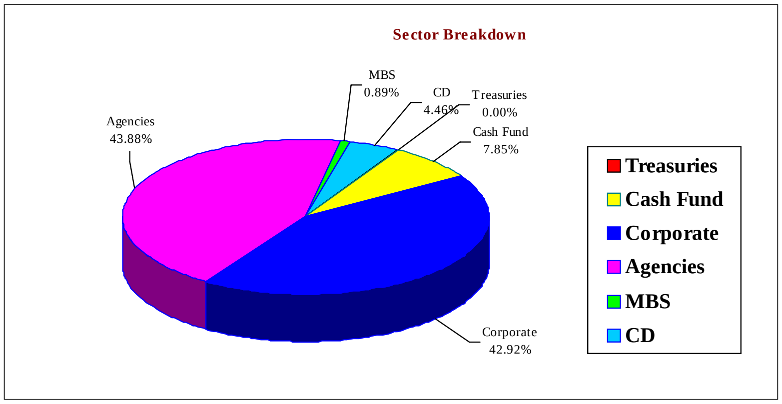
As of June 30, 2005, the net asset value in the Short-Term Account totaled $334 million. The objective of the Short-Term Account is to maximize current income along with preservation of capital. Consistent with the CSU investment policy, the portfolio is restricted to US Treasury securities, mortgage-backed securities, government agency securities, and highly rated corporate securities. State law prohibits the investment of these funds in equity securities. The portfolio's holdings by sector for the Short-Term account are as follows:

**California State University Short-Term Account
Sector Breakdown as of
June 30, 2005**

Corporate Securities	42.92%
US Government Agencies	43.88%
US Treasuries	0.00%
MBS	0.89%
CD	4.46%
Cash Fund	7.85%

The Short-Term Account provided a return of 2.17% during the 12-months ended June 30, 2005. This return slightly underperformed the 12-month return for Local Agency Investment Fund (LAIF). Because of the relatively short duration in the CSU Short-Term Account, the portfolio outperformed somewhat longer fixed income benchmarks, like the Merrill Lynch 1-3 Year Treasury Index.

California State University System
CSU Short-Term Account
6/30/2005



MEDIUM-TERM ACCOUNT PERFORMANCE

Fiscal Year 2004-05

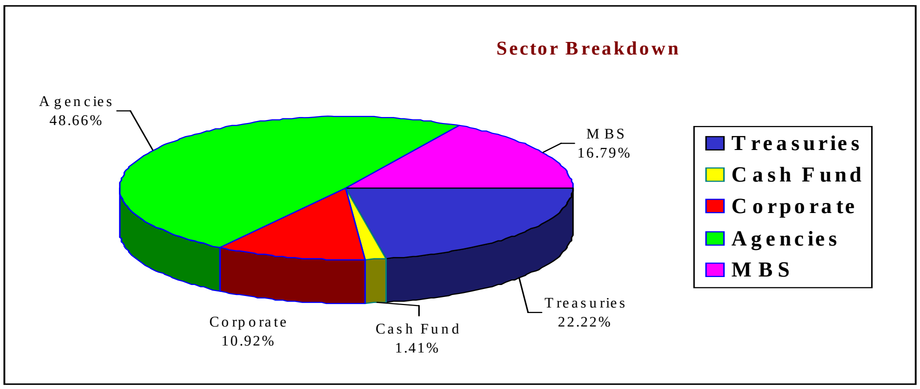
The objective of the Medium-Term Account is to maximize medium term total return. The Account is invested in a diversified portfolio of fixed income securities of varying maturities with an approximate portfolio duration of 1.75 to 2.75 years. The account is benchmarked versus the Merrill Lynch 1-5 year Treasury and Agency Index, and is structured to outperform both the Short-Term Account and LAIF over a 5-7 year investment horizon. As of June 30, 2005, the net asset value of the account was $170 million.

Consistent with the CSU investment policy, the Medium-Term Account portfolio is restricted to US Treasury securities, mortgage-backed securities, government agency securities, and highly rated corporate securities. State law prohibits the investment of these funds in equity securities. The portfolio's holdings by sector for the Medium-Term account are as follows:

California State University Medium-Term Account
Sector Breakdown as of
June 30, 2005

US Treasuries	22.22%
Corporate Securities	10.92%
US Government Agencies	48.66%
MBS	16.79%
Cash Fund	1.41%

California State University System
CSU Medium-Term Account
6/30/2005



The Medium-Term Account provided a return of 3.20% during the 12-months ended June 30, 2005. This return was greater than the 12-month return for the Local Agency Investment Fund. The portfolio slightly underperformed relative to its benchmark index, the Merrill Lynch 1-5 Year Treasury and Agency Index.

Surplus Money Investment Fund (SMIF)

The Surplus Money Investment Fund (SMIF) is a vehicle used by the State Treasurer to invest state funds in a short-term pool at virtually no risk. Cash on this account is available on a daily basis. SMIF is managed by the State Treasurer's Office. The portfolio's composition includes CD's and Time Deposits, U.S. Treasuries, Commercial Paper, Corporate Securities, and U.S. Government Agencies. As of June 30, 2005, the amount of CSU funds invested in SMIF was $58.3 million.

SMIF Performance Report Apportionment Yield Rate		**SMIF Past Performance 1997-2005**	
06/30/2005:	2.851%	Average:	3.901%
06/30/2004:	1.441%	High:	6.493%
		Low:	1.441%

Local Agency Investment Fund (LAIF)

The Local Agency Investment Fund (LAIF) is a vehicle used by the State Treasurer to invest local agency funds. LAIF is administered by the State Treasurer's Office. All investments are purchased at market, and market valuation is conducted quarterly. As of June 30, 2005, the amount of CSU funds invested in LAIF was $80.5 million.

LAIF Performance Report Apportionment Yield Rate		**LAIF Past Performance 1997-2005**	
06/30/2005:	2.855%	Average:	3.763%
06/30/2004:	1.446%	High:	6.530%
		Low:	1.446%

The California State University Investment Policy

The following investment guidelines have been developed for CSU campuses to use when investing funds.

Investment Policy Statement

The objective of the investment policy of the California State University (CSU) is to obtain the best possible return commensurate with the degree of risk that the CSU is willing to assume in obtaining such return. The Board of Trustees desires to provide to each campus president the greatest possible flexibility to maximize investment opportunities. However, as agents of the trustees, campus presidents must recognize the fiduciary responsibility of the trustees to conserve and protect the assets of the portfolios, and by prudent management prevent exposure to undue and unnecessary risk.

When investing campus funds, the primary objective of the campus shall be to safeguard the principal. The secondary objective shall be to meet the liquidity needs of the campus. The third objective shall be to return an acceptable yield.

Investment Authority

The California State University may invest monies held in local trust accounts under Education Code Sections 89721 and 89724 in any of the securities authorized by Government Code Section 16430 and Education Code Section 89724, listed in Section A subject to limitations described in Section B.

A. State Treasury investment options include:

- Surplus Money Investment Fund (SMIF)

- Local Agency Investment Fund (LAIF)

B. Eligible securities for investment outside the State Treasury, as authorized by Government Code Section 16430 and Education Code Section 89724, include:

- Bonds, notes or obligations with principal and interest secured by the full faith and credit of the United States;

- Bonds, notes or obligations with principal and interest guaranteed by a federal agency of the United States;

- Bonds or warrants of any county, city, water district, utility district or school district;

- California State bonds or bonds with principal and interest guaranteed by the full faith and credit of the State of California;

- Various debt instruments issued by: (1) federal land banks, (2) Central Bank for Cooperatives, (3) Federal Home Loan Bank Bd., (4) National Mortgage Association, (5) Federal Home Loan Mortgage Corporation, and (6) Tennessee Valley Authority;

- Commercial paper exhibiting the following qualities: (1) "prime" rated, (2) less than 180 days maturity, (3) issued by a U.S. corporation with assets exceeding $500,000,000, (4) approved by the PMIB. Investments must not exceed 10 percent of corporation's outstanding paper, and total investments in commercial paper cannot exceed 30 percent of an investment pool;

- Bankers' acceptances eligible for purchase by the Federal Reserve System;

- Certificates of deposit (insured by FDIC, FSLIC or appropriately collateralized);

- Investment certificates or withdrawal shares in federal or state credit unions that are doing business in California and that have their accounts insured by the National Credit Union Administration;

- Loans and obligations guaranteed by the United States Small Business Administration or the United States Farmers Home Administration;

- Student loan notes insured by the Guaranteed Student Loan Program;

- Debt issued, assumed, or guaranteed by the Inter-American Development Bank, Asian Development Bank or Puerto Rican Development Bank;

- Bonds, notes or debentures issued by U.S. corporations rated within the top three ratings of a nationally recognized rating service;

C. In addition to the restrictions established in Government Code Section 16430, the CSU restricts the use of leverage in campus investment portfolios by limiting reverse repurchase agreements used to buy securities to no more than 20 percent of a portfolio. Furthermore, the CSU:

- Prohibits securities purchased with the proceeds of a reverse repurchase from being used as collateral for another reverse repurchase while the original reverse repurchase is outstanding;

- Limits the maturity of each repurchase agreement to the maturity of any securities purchased with the proceeds of the repurchase (but in any event not more than one year) and;

- Limits reverse repurchase agreements to unencumbered securities already held in the portfolio.

Investment Reporting Requirements

A. Annually, the Chancellor will provide to the Board of Trustees a written statement of investment policy in addition to a report containing a detailed description of the investment securities held by all CSU campuses and the Chancellor's Office, including market values.

B. Each campus will provide no less than quarterly to the Chancellor a report containing a detailed description of the campus's investment securities, including market values. A written statement of investment policy will also be provided if it was modified since the prior submission. These quarterly reports are required:

- to be submitted to the Chancellor within 30 days of the quarter's end

- to contain a statement with respect to compliance with the written statement of investment policy; and

- to be made available to taxpayers upon request for a nominal charge.

(Approved by the CSU Board of Trustees in January, 1997)