

**University of California,
Merced**

2015 - 2016

**Annual Financial Report
(unaudited)**



University of California, Merced

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Message from Vice Chancellor Michael Reese

Dear Readers,

I am pleased to present this Annual Financial Report for Fiscal Year 2015-16.

For much of its 11-year history, the University of California, Merced -- the University of California's tenth and youngest campus -- has been a well-kept secret.

No longer. In the last year, UC Merced has received national recognition that, in many critical ways, is cementing its distinction as the nation's first public research university of the 21st Century.

First, in a remarkable achievement for an institution as young as UC Merced, the campus was designated a "doctoral-granting university with higher research activity" — or R2, the second-highest classification for American research universities — in its first appearance on the highly cited Carnegie Classification of Institutions of Higher Education.

Only 107 universities in the United States have earned the R2 classification, which is a way of identifying institutions that are committed to similar levels of research.

A second national recognition came as UC Merced became by far the youngest university ever to appear in the *U.S News & World Report* ranking of national universities. The news magazine's 2017 Best Colleges rankings rate UC Merced No. 78 among public schools and No. 152 overall in the "National Universities" category, which evaluates major institutions with national reach, advanced degree programs and deep commitments to research.

UC Merced was also recognized No. 8 among all national universities in outperforming graduation rate expectations. And, despite the youth of its alumni, the vast majority of whom are in their 20s, the university ranked No. 47 among public institutions in alumni giving rates.

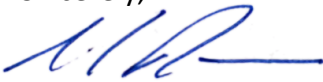
In other honors, *The Washington Monthly College Guide* ranked UC Merced fifth in the nation for social mobility, out of more than 300 universities. And the Association for the Advancement of Sustainability in Higher Education (AASHE) ranked UC Merced among the country's most sustainable campuses.

A further demonstration of UC Merced as a campus on the move was the fall 2016 groundbreaking for the "Merced 2020 Project" – the largest expansion in campus history through an innovative and unprecedented \$1.3 million public-private partnership with Plenary Properties Merced (PPM).

The project, which was approved in a historic vote by the UC Board of Regents in July, will create nearly one million square feet of new mixed-used space, including new housing, dining, classrooms, laboratories, recreation fields, open space and aquatics center. Delivery of the first phase of buildings is scheduled for mid-2018 with substantial completion in 2020.

It is an exciting moment for UC Merced that builds on its brief but distinctive history of innovation, energy, creativity and a commitment to the aspirations and needs of its unique student body. I hope that the following pages will give you a sense of all this, in addition to providing you with a picture of its financial status.

Sincerely,



Michael Reese
Vice Chancellor, Business and Administrative Services
University of California, Merced

University of California, Merced

Management's Discussion and Analysis (unaudited)

June 30, 2016 and 2015

The objective of Management's Discussion and Analysis (MD&A) is to give readers an overview of the financial position and operating activities of the University of California, Merced (UC Merced), for the fiscal year ended June 30, 2016 with selected comparative information for the fiscal year ended June 30, 2015. This discussion should be read in conjunction with the financial statements and accompanying notes.

UC Merced is the newest of ten campuses within the University of California System. The UC Merced Annual Financial Report, while not separately audited, is prepared from the official University of California records and accounts, which are maintained in accordance with the standards prescribed by the Governmental Accounting Standards Board (GASB). The three basic financial statements in this report, the statements of net position, the statements of revenues, expenses and changes in net position, and the statements of cash flows for UC Merced and the affiliated UC Merced Foundation. The financial statements for the UC Merced Foundation are presented discretely from UC Merced. The notes to the financial statements provide additional information that is essential to a full understanding of the financial statements.

The University of California

The University of California, one of the largest and most acclaimed institutions of higher learning in the world, is dedicated to excellence in teaching, research, health care and public service. The University has annual resources of nearly \$28.7 billion and encompasses ten campuses, five medical schools and medical centers, four law schools, and a statewide Division of Agricultural and Natural Resources. The University is also involved in the operation and management of three national laboratories for the U.S. Department of Energy (DOE).

The UC Merced Campus

UC Merced is the newest campus within the University of California, opening in the fall of 2005 with the primary mission of research, teaching and service. The financial statements included in this annual report encompass the following:

The Merced campus spans 7,045 acres in Merced and is devoted to undergraduate and graduate scholarship serving over 6,000 students in the following schools and graduate programs:

Academic Schools and Divisions

School of Engineering

School of Natural Sciences

School of Social Sciences, Humanities & Arts

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Graduate Studies

Applied Mathematics
Biological Engineering & Small-Scale Technologies*
Chemistry and Chemical Biology
Cognitive and Information Sciences
Electrical Engineering and Computer Science*
Environmental Systems
Interdisciplinary Humanities
Mechanical Engineering*
Physics
Political Science
Psychological Sciences
Quantitative and Systems Biology
Social Sciences*
Sociology

* Emphasis within the Individual Graduate Program

During the 2015-2016 academic year, receiving more than 21,400 first-time freshman and transfer applications for Fall 2015, UC Merced was able to enroll nearly 6,700 students. Enrollment stayed relatively flat from the previous year due primarily to capacity issues with existing facilities even though number of applications received was up nearly 14% from Fall 2014. During the year, the campus' graduating class increased by 10% awarding 1,236 degrees during the 2015-16 academic year compared to 1,120 in the prior year. Because the campus has reached capacity within its existing facilities, it has received approval from The Regents of the University of California for its proposal to double the physical capacity on the existing acreage of the campus by 2020. In June 2016, the Campus named Plenary Properties Merced the winning bidder for its next major phase of campus development, the 2020 Project, a move that would allow the campus to join other UC campuses in expanding enrollment for up to 10,000 students. The \$1.3 billion project will add 1.2 million gross square feet, including three new teaching and research lab buildings, 1700 beds of new on-campus housing, dedicated space for student life and organizations, new dining options, and more. The project will be completed in three phases between Fall 2018 and Fall 2020. While UC Merced consists of three schools, the School of Engineering, Natural Sciences, and Social Sciences, Humanities and Arts, there are plans to open two additional schools, a school of management and school of medicine in the future.

The campus' mission also includes a strong dedication to research and public service, embodied in its proud claim of being the first American research university of the 21st century. The amount of money spent at UC Merced on research, including graduate student salaries and benefits, along with supplies and equipment for research projects was \$39.9 million for fiscal year 2016 as compared to \$37.8 million for 2015. The UC Merced library provides access to approximately 116,000 online journals 626 databases, 123,000 books and almost 6.8 million e-books. The on-site collection is supplemented by access to the entire University of California collection of approximately 600 million web files, which includes 3.6 million books in digital full-text format.

In addition to its educational and research mission, UC Merced is an important strategic investment in California's future economy. The campus serves as an engine of economic growth throughout the San Joaquin Valley where unemployment and poverty rates substantially exceed California averages. Through August 2016 to date, the campus has contributed approximately \$1.44 billion to the valley economy in wages and benefits, construction contracts to local businesses and goods and services purchased from local businesses. Statewide, UC Merced's cumulative economic contribution has exceeded \$2.6 billion since the campus opened.

University of California, Merced

Management's Discussion and Analysis (unaudited)

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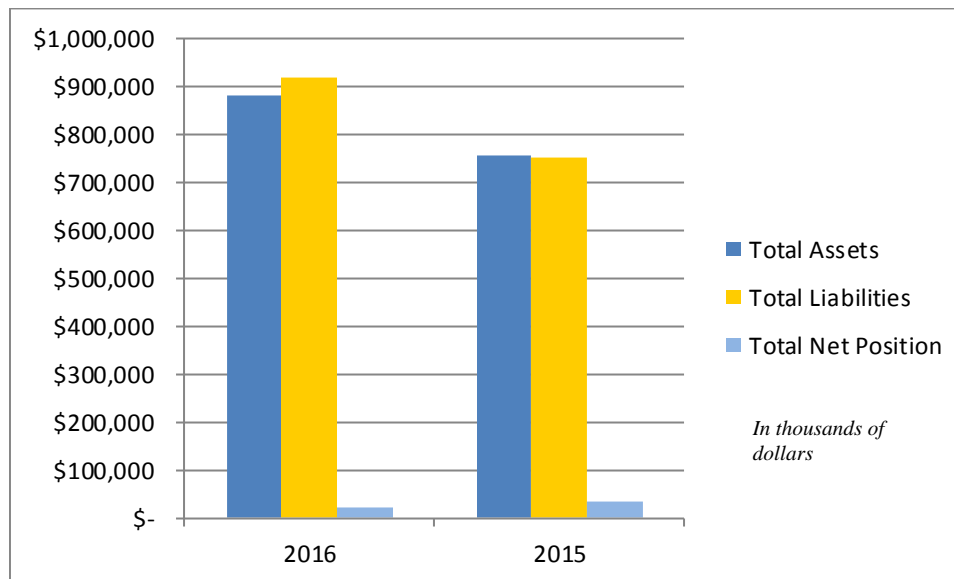
UC Merced is considered a leader in sustainability design and construction with a commitment to being zero waste and zero net emissions by 2020. All of UC Merced's buildings are certified by the 3rd party verification system, Leadership in Energy and Environmental Design (LEED) with the vision of LEED Gold being the campus minimum for all projects since 2009.

While UC Merced's financial information concerning assets, liabilities, revenues and core activity expenditures is discussed in further detail in the subsequent sections of the MD&A, the following table reflects the composition of the campus for 2016, listing enrollment figures, full-time equivalent employee figures and operating expenses by school.

(\$ amounts in thousands)

	Headcount		FTE	Salaries & Wages	Other Expenditures	Total Expenditures
	Under-graduates	Graduates	Employees			
School of Engineering	1,455		154	\$ 12,294	\$ 8,154	\$ 20,448
School of Natural Sciences	1,844		265	17,551	13,000	30,551
School of Social Sciences, Humanities & Arts	2,316		242	18,571	10,013	28,584
Graduate Studies		448	12	1,068	613	1,681
Undeclared	646					
All others, including auxiliaries, student services, etc.			887	69,068	128,266	197,334
Subtotal	6,261	448	1,560	\$ 118,552	\$ 160,046	\$ 278,598
Depreciation Expense						26,705
Total						\$ 305,303

The Campus' Financial Position



The statement of net position presents UC Merced's financial position at the end of the fiscal year. It displays all of UC Merced's assets and liabilities. The difference between assets and liabilities is net position.

University of California, Merced

Management's Discussion and Analysis (unaudited)

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The Campus' Assets

UC Merced's total assets have grown to \$880.7 million in 2016, compared to \$755.4 million in 2015.

Cash and cash equivalents decreased by \$52.0 million from the prior year due combination of \$45.6 million in investment purchases and increases in spending related to the preparation of Project 2020. Investments held by trustees relates to unspent bond proceeds for capital projects. The University allocated approximately \$100.0 million in unspent bond proceeds to UC Merced for Project 2020 of which, the Campus spent approximately \$4.2 million during fiscal year 2016. The remaining \$96.6 million in unspent bond proceeds will be spent over the next four years during the project's construction phase.

Capital assets, net of accumulated depreciation increased by \$35.1 million from 2015 to 2016. The increase is a result of \$62.1 million in capital additions offset by \$26.7 million in depreciation. Capital spending continues to increase in order to provide the facilities necessary to support UC Merced's teaching, research and public mission and is expected to increase even further over the next four years through Project 2020, which is anticipated to add an additional \$749.4 million in capital assets as the campus begins to significantly expand beginning in fiscal year 2017.

The Campus' Deferred Outflows of Resources

Losses on debt refundings and changes in the net pension liability are reported as deferred outflows of resources. The decrease of \$4.7 million in deferred outflows of resources in 2016 is due to a combination of amortization of deferred financing costs and recognition into pension expense, a portion of prior year pension related deferrals.

The increase of \$25.8 million in deferred outflows of resources in 2015 is primarily related to pension obligations.

The Campus' Liabilities

In 2016, campus liabilities increased by \$167.1 million when compared to the prior year due to an increase in long-term debt. Long-term debt increased by \$156.5 million, primarily from new debt issued for a four year capital project intended to add 1.2 million gross square feet, including three new teaching and research lab buildings, new on-campus housing, and additional space for student life. Because the Campus expects to spend approximately \$750 million in construction related costs over the next 5 years, the Campus expects the University will issue approximately \$550.0 million in additional debt over the next 4 years through a combination of general revenue bonds and limited project revenue bonds.

Campus liabilities increased by \$78.5 million in 2015 when compared to the prior year due to a combination of an increase of \$47.9 million in pension and other postretirement benefits and a \$31.0 million increase in outstanding commercial paper, of which the proceeds were used to finance capital projects.

The Campus' Deferred Inflows of Resources

Deferred inflows of resources are related to changes in the net pension liability. Deferred inflows of resources in 2016 decreased by \$32.7 million due to low investment returns compared to projected earnings.

Deferred inflows of resources in 2015 decreased by \$7.5 million due to an increase in precision between projected earnings on pension plan investments used in the actuarial valuation compared to actual earnings.

The Campus' Net Position

Net position represents the residual interest in UC Merced's assets after all liabilities are deducted. During the past two year, net position has decreased by \$13.0 million and \$27.5 million in 2016 and 2015, respectively due primarily to its continued investment in its physical facilities offset by increases in pension and other postretirement obligations.

University of California, Merced

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The Campus' Results of Operations

The statement of revenues, expenses and changes in net position is a presentation of the campus' operating results for the year. It indicates whether the financial condition has improved or deteriorated. In accordance with Governmental Accounting Standards Board (GASB) requirements, certain significant revenues relied upon and budgeted for fundamental operational support of the core instructional mission of the campus are required to be recorded as nonoperating revenues, including state educational appropriations, private gifts, and investment income.

A summarized comparison of the operating results from 2016 and 2015, arranged in a format that matches the revenue supporting the core activities of UC Merced with the expenses associated with core activities, is as follows:

(in thousands of dollars)

	2016			2015		
	Operating	Nonoperating	Total	Operating	Nonoperating	Total
REVENUES						
Student tuition and fees, net	\$ 62,898		\$ 62,898	\$ 62,228		\$ 62,228
State educational appropriations		\$ 128,758	128,758		\$ 119,065	119,065
Pell grants		18,108	18,108		16,526	16,526
Grants and contracts, net	21,532		21,532	20,979		20,979
Auxiliary enterprises, net	24,741		24,741	23,736		23,736
Private gifts, net		3,287	3,287		2,422	2,422
Investment income, net		2,765	2,765		2,842	2,842
Other revenues	6,592	2,097	8,689	7,153	1,739	8,892
Revenues supporting core activities	115,763	155,015	270,778	114,096	142,594	256,690
EXPENSES						
Salaries and benefits	187,077		187,077	168,472		168,472
Scholarships and fellowships	14,736		14,736	13,454		13,454
Utilities	4,945		4,945	4,534		4,534
Supplies and materials	20,370		20,370	21,025		21,025
Depreciation and amortization	26,705		26,705	25,843		25,843
Interest expense		22,257	22,257		20,233	20,233
Other expenses	51,470	506	51,976	42,150	220	42,370
Expenses associated with core activities	305,303	22,763	328,066	275,478	20,453	295,931
Income (loss) from core activities	\$(189,540)	\$ 132,252	\$(57,288)	\$(161,382)	\$ 122,141	\$(39,241)
OTHER CHANGES IN NET POSITION						
State capital appropriations			1,544			1,432
Capital gifts and grants, net			10,000			2,323
Contributions from the University for building programs			34,836			25,488
Other transfers			(2,924)			(17,473)
Increase in net position			(13,832)			(27,471)
NET POSITION						
Beginning of year			34,403			61,874
End of year			\$ 20,571			\$ 34,403

Revenues Supporting Core Activities

Revenues to support UC Merced's core activities, including those classified as nonoperating revenues, grew from \$256.5 million in 2015 to \$270.2 million in 2016, an increase of \$13.7 million as compared to an increase of \$27.3 million in 2015 compared to 2014.

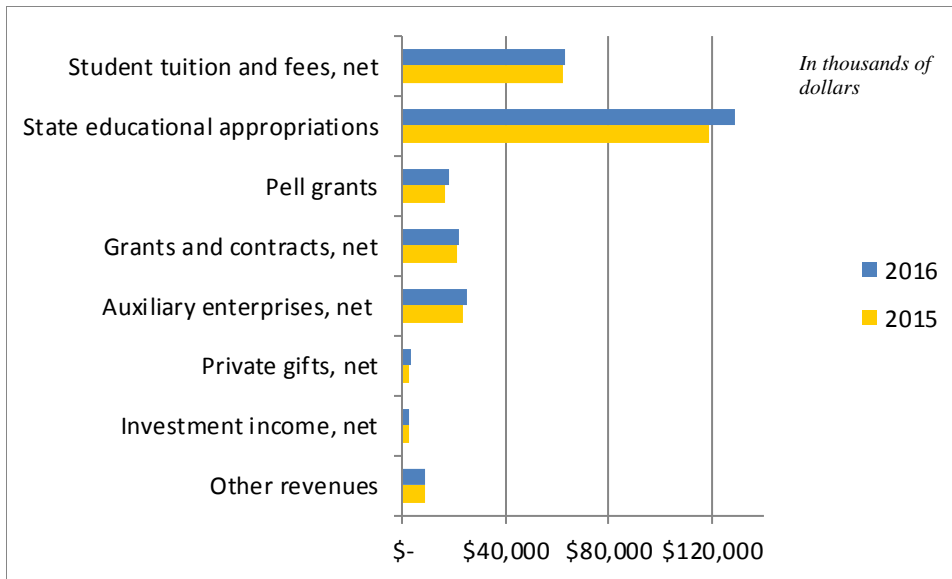
University of California, Merced

Management's Discussion and Analysis (unaudited)

June 30, 2016 and 2015

State of California educational appropriations, in conjunction with student tuition and fees, are the core components that support the instructional mission of the University. Grants and contracts provide opportunities for undergraduate and graduate students to participate in basic research alongside prominent researchers. Gifts to campus allow crucial flexibility to faculty for support of their fundamental activities or new academic initiatives. Other revenues are derived from educational activities and auxiliary enterprises, such as student housing, food service and parking.

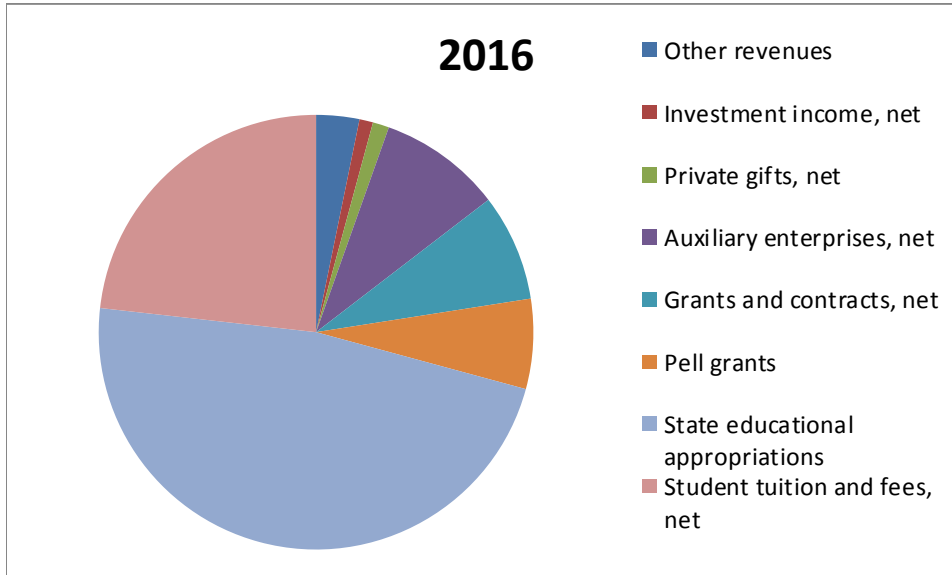
Revenues in various categories have increased or decreased over the last year as follows:



A major financial strength of UC Merced includes a diverse source of revenues, including those from student fees, federally sponsored grants and contracts, the state of California, private donors, self-supporting enterprises, and the commitment of the University of California ensuring UC Merced's success as a newer campus within the UC System.

University of California, Merced Management's Discussion and Analysis (unaudited) June 30, 2016 and 2015

Categories of both operating and nonoperating revenue that supported UC Merced's core activities in 2016 are as follows:



Student Tuition and Fees revenue, net of scholarship allowances, remained relatively unchanged from the prior year but is vital to the Campus as it accounts for 23% of UC Merced's revenue.

(in thousands of dollars)

	2016	2015	Change
Student tuition and fees	\$ 97,306	\$ 87,672	\$ 9,634
Summer sessions	4,873	10,130	(5,257)
Scholarship allowances	(39,281)	(35,574)	(3,707)
Total student tuition and fees	\$ 62,898	\$ 62,228	\$ 670

For 2016, student tuition and fees increased from the prior year as a result of increases in enrollment. Tuition, on a per student basis remained flat from the prior year and will continue to stay flat for the 2016-17 school year. In May 2015, the University agreed to freeze tuition for the 2015-16 and 2016-17 academic year in exchange for increased state funding over the next three years. Under the agreement, the UC will increase tuition, pegged to the rate of inflation beginning in 2017-18. Consistent with past practices, approximately one-third of the revenue generated from tuition and fees was used for financial aid for both 2016 and 2015.

In 2015, when compared to 2014, student tuition and fees increased primarily as a result of a \$1.5 million increase in out-of-state tuition. Resident enrollment rates remained relatively flat, and in connection with the passage of certain tax initiatives by the voters of California in November 2012 related to state educational appropriations, the University did not raise resident tuition in either 2014 or 2015. As a result, student tuition for resident students remained relatively flat in 2015 from 2014.

Summer session decreased as a result of changes in accounting policy in the prior year. Prior to 2015, the Campus recognized summer session revenue on a cash-basis of accounting. As a result of the change to accrual based accounting, 2015 includes cash received related to fiscal year 2014. Over the past three fiscal years, average summer session revenue has been approximately \$5.0 million per year.

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State educational appropriations from the state of California was \$128.8 million and \$119.1 million in 2016 and 2015, respectively, accounting for 48% of UC Merced's revenue in the current year. The increase is the result the budget framework agreed to with the governor calling for base budget adjustments of four percent annually over the next four years, through 2019. The framework also called for no tuition increases in 2016 and 2017, with tuition increases pegged to the rate of inflation thereafter.

In 2015, while the University of California received a 6% increase in state educational appropriations from the state of California due to tax initiatives approved by the voters of California in November 2012, UC Merced's share, an allocation determined by the University, increased by 9% as a result of the University's commitment to UC Merced's growth.

Grants and Contracts, net from federal, state, and private sources recognized as expenditures incur, including an overall facilities and administration cost recovery of \$4.3 million and \$3.9 million in 2016 and 2015, respectively are as follows:

(in thousands of dollars)

	2016	2015	Change
Federal government	\$ 16,772	\$ 16,556	\$ 216
State agencies	758	696	62
Private industries	4,002	3,727	275
Total grants and contracts, net	\$ 21,532	\$ 20,979	\$ 553

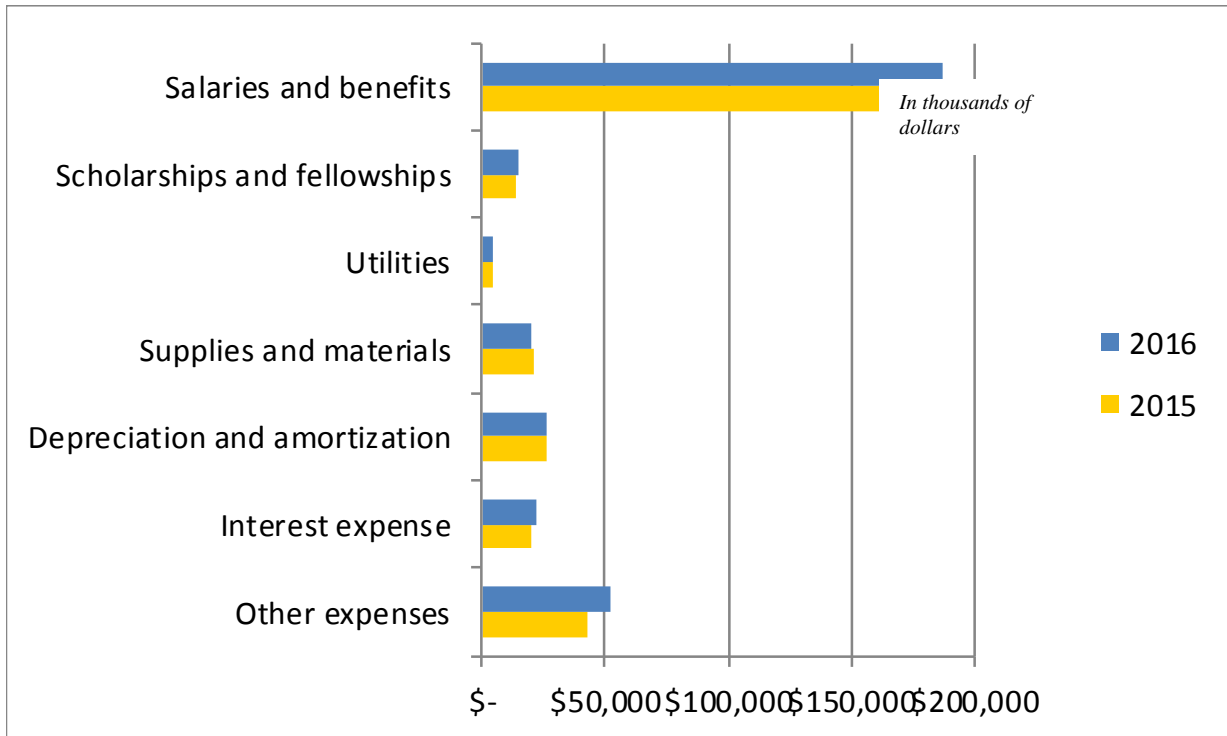
In 2016, revenues from the federal government remained relatively flat, unlike 2015 when compared to 2014, which increased by 16%, primarily as a result of projects with the National Institute of Allergy and Infection Diseases and National Science Foundation.

Expenses Associated with Core Activities

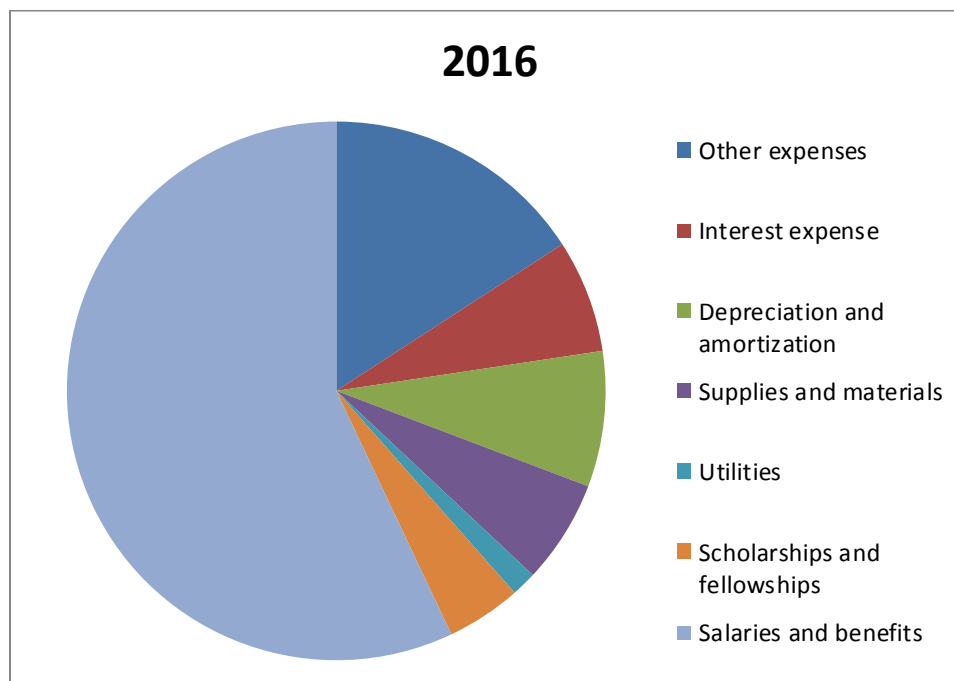
Expenses associated with UC Merced's core activities, including those classified as nonoperating expenses, were \$328.1 million and \$295.9 million in 2016 and 2015, respectively.

University of California, Merced Management's Discussion and Analysis (unaudited) June 30, 2016 and 2015

Expenses in the various categories have increased or decreased over the last year as follows:



Categories of both operating and nonoperating expenses that support core activities, as of June 30, 2015 are as follows:



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Salaries and benefits cover approximately 1,560 and 1,418 full-time equivalents (FTE), which represents an increase of 10.0% and 3.7% in 2016 and 2015, respectively. Over 57% and 61% of UC Merced's expenses are related to salaries and benefits in 2016 and 2015, respectively. In 2016, UC Merced's salaries and benefits increased by \$18.6 million due to a combination of an \$8.5 million increase in salaries and wages and \$10.1 million in employee benefits compared to 2015. In 2015, salaries and benefits increased by \$26.8 million from the prior year due to increases in salaries and wages (\$15.2 million) and increase in employee benefits expense (\$13.5 million).

In 2016, salaries increased by 7.7%, \$11.0 million due to an increase in the number of FTEs offset by a \$2.5 million decrease in the average salary per FTE. The decline in average salary is primarily the result of higher proportion of student employment and administrative staff as the Campus shifts its workforce to shared services for administrative processing. In 2015, salaries increased by 16%, \$3.5 million due to an increase in the number of FTEs and \$11.7 million due to an increase in the average salary per FTE. In the prior year, the campus initiated a compensation strategy designed to bring the campus closer to market wages, address salary inequities across the campus, invest in job functions critical to achieving the campus' growth initiatives, and implement the across the board increases initiated by The Regents of the University of California.

In 2016, employee benefits increased by \$10.1 million due to a combination of \$14.5 million increase in pension benefits, \$2.4 million increase in other employee benefits, offset by a \$6.9 million decrease in retiree health benefits expense. Pension expense, and the related net pension liability increased as a result of lower than expected investment returns on the pension investment portfolio and assumption changes. Other employer benefits increased, primarily as a result of employer related payroll cost increases from the increased workforce such as health insurance, Social Security, Medicare, and other employer costs. Retiree health benefits expense declined from the prior year because UC Merced's proportionate share of the liability remained relatively flat compared to the prior year, unlike 2015 where UC Merced's proportionate share increased from 2014.

In 2015, employee benefits increased by \$13.5 million due to a combination of \$9.7 million increase in retiree health benefits and \$3.8 million in other employee benefits. Retiree health benefits expense increased as a result of an increase in UC Merced's proportional share of the University of California's obligations and because of a decrease in the actuarially required contribution, which increases the obligation over the long-term. The increase in other employee benefits is a result of increases in employer related social security contributions and workers' compensation costs.

Scholarship and fellowships, represented as payments of financial aid made directly to students, UC Merced places a high priority on student financial aid as part of its commitment to affordability. Reported as operating expenses, UC Merced experienced an increase of \$1.3 million and \$4.5 million in 2016 and 2015, respectively.

Scholarship allowances, representing financial aid and fee waivers awarded by UC Merced, were \$47.5 million and \$44.0 million in 2016 and 2015, respectively. On a combined basis, as UC Merced continues its commitment to provide financial support for needy students, financial aid in all forms totaled \$62.3 million and \$57.5 million in 2016 and 2015, respectively, which represents an increase of \$4.7 million and \$5.8 million in 2016 and 2015, respectively. Consistent with past practices, approximately one-third of the revenue generated from tuition and fees was used for financial aid.

Other expenses associated with core activities, consist of a variety of expense categories, including materials and supplies, travel, rent, insurance, legal settlements, and repairs and maintenance, plus any gain or loss on disposals of capital assets and other nonoperating expenses. Other operating expenses increased in 2016 due primarily to an increase in outside purchased services over the past two fiscal years for environmental and planning studies and outside legal consulting related to projects associated with

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June 30, 2016 and 2015

increasing the size of the campus in terms of both physical infrastructure and campus operations in order to serve a larger student population.

Operating Losses

In accordance with the GASB's reporting standards, operating losses were \$189.5 million and \$161.4 million in 2016 and 2015, respectively. The operating loss in 2016 and 2015 was partially offset by \$131.7 million and \$122.0 million, respectively of net nonoperating revenue that clearly supports core operating activities of UC Merced. Expenses associated with core activities in 2016 and 2015 exceeded revenue available to support core activities by \$57.8 million and \$39.4 million, respectively.

Other Changes in Net Position

Similar to other nonoperating activities discussed above, other changes in net position are also not available to support the University's operating expenses in the current year. State capital appropriations and capital gifts and grants may only be used for the purchase or construction of the specified capital assets. Only income earned from gifts of permanent endowments is available in future years to support the specified program. UC Merced's enrollment growth requires new facilities; however, while other higher education institutions have a continuing need for renewal, modernization and seismic correction of existing facilities, because UC Merced is a newer campus fit to meet all safety regulations and meet most modern needs, we can put a higher level of our funds towards growing the campus with new facilities.

UC Merced Foundation

Under University policies approved by The Regents, each individual campus may establish a separate foundation to provide valuable assistance in fundraising, public outreach and other support for the missions of the campus and the University. Although an independent board governs the UC Merced Foundation (the Foundation), its assets are dedicated for the benefit of UC Merced.

During the years ended June 30, 2016 and 2015, gifts of \$1.7 million for each of the years were transferred to UC Merced from the UC Merced Foundation. In 2016 and 2015, the Foundation's net position remained flat at \$10.5 million.

The Foundation's Financial Position

The Foundation's statement of net position presents their financial position at the end of the year. It displays all of the assets, liabilities and net position. The difference between assets and liabilities are net position, representing a measure of their current financial condition.

University of California, Merced

Management's Discussion and Analysis (unaudited)

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The major components of the assets, liabilities and net position of the Foundation at 2016 and 2015 are as follows:

(in thousands of dollars)

	2016	2015
ASSETS		
Investments	\$ 8,959	\$ 9,250
Pledges receivable, net	711	695
Other assets	787	569
Total assets	10,457	10,514
LIABILITIES		
Accounts payable and other liabilities	-	-
Total liabilities	-	-
NET POSITION		
Restricted:		
Nonexpendable	7,592	7,120
Expendable	2,554	3,169
Unrestricted	311	225
Total net position	\$ 10,457	\$ 10,514

Investments decreased in 2016 due primarily to poor investment performance in the equity markets compared to 2015 where investment performance was strong, coupled with endowment contributions. The Foundation Board of Trustees is responsible for its specific investment policy, although the Foundation relies on the Investment Committee of The Regents. All of the Foundation's investments are managed by the University's Chief Investment Officer.

Pledge receivables have remained relatively unchanged the last two years.

The Foundation's Results of Operations

The Foundation's statement of revenues, expenses and changes in net position is a presentation of their operating results for the year. It indicates whether their financial condition has improved or deteriorated during the year.

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A summarized comparison of the operating results for 2016 and 2015 is as follows:

(in thousands of dollars)

	2016	2015
Operating revenues		
Private gifts and other revenues	\$ 1,469	\$ 1,370
Total operating revenues	1,469	1,370
Operating expenses		
Grants to campuses and other expenses	1,684	1,710
Total operating expenses	1,684	1,710
Operating income (loss)	(215)	(340)
NONOPERATING REVENUES (EXPENSES)		
Investment income	70	83
Net appreciation (depreciation) in fair value of investments	(398)	404
Income (loss) before other changes in net position	(543)	147
OTHER CHANGES IN NET POSITION		
Permanent endowments	486	1,047
Increase (decrease) in net position	(57)	1,194
NET POSITION		
Beginning of year	10,514	9,320
End of year	\$10,457	\$ 10,514

Operating revenues generally consist of current-use gifts, including pledges and income from other fundraising activities, although they do not include additions to permanent endowments and endowment income. Operating revenues fluctuate based upon fundraising campaigns conducted by the Foundation during the year; however, this year they remained relatively flat compared to the prior year.

Operating expenses generally consist of grants to UC Merced, comprised of current-use gifts and endowment income and other expenses, including gift fees. Grants to campus typically follow the pattern indicated by private gift revenue; however, the campus' programmatic needs are also taken into consideration, subject to abiding by the restricted purposes of gifts to the endowment and the amounts available for grants in any particular year.

Grants to campus can only be made when the cash is received and, in addition, also include endowment investment income, classified as nonoperating income. Therefore, operating losses can occur when grants distributed to the campus in any particular year exceed private gift revenue.

Financial Statements Transmittal Letter

The accompanying Financial Statements reflect the financial position and the results of operations of the University of California, Merced for the fiscal year ended June 30, 2016 and 2015.

The UC Merced Financial Statements are not individually audited, but rather are audited as part of the Consolidated Annual Financial Report of the University of California by the firm PricewaterhouseCoopers, whose report is transmitted to The Regents.

The accompanying Financial Statements and Management's Discussion and Analysis, detail only local campus activity. This separate UC Merced Annual Financial Report, while not separately audited, is prepared from the official University of California records and accounts, which are maintained in accordance with the standards prescribed by the Governmental Accounting Standards Board (GASB).

In compliance with GASB Statement No. 39, Determining Whether Certain Organizations Are Component Units, the financial activity of the legally separate, tax-exempt UC Merced Foundation can be found discretely recorded in the campus' financial statements under a separate column titled "UC Merced Foundation."

Respectfully submitted,



Michael R Riley, CPA
Controller and AVC – Business and Financial Services

University of California, Merced
STATEMENTS OF NET POSITION
At June 30, 2016 and 2015 (in thousands of dollars)

	Campus		Foundation	
	2016	2015	2016	2015
Assets				
Cash and cash equivalents	\$ 71,838	\$ 123,877	\$ 5	\$ 5
Accounts receivable, net	6,712	9,015		
Pledges receivable, net	150	-	433	283
Inventories	901	1,005		
Other current assets	-	-	782	564
Current assets	<u>79,601</u>	<u>133,897</u>	<u>1,220</u>	<u>852</u>
Investments	96,260	47,635	8,959	9,250
Investments held by trustees	96,577	1,734		
Pledges receivable, net	443	-	278	412
Notes receivable	40	-		
Capital assets, net	599,968	564,838		
Other noncurrent assets	7,789	7,256		
Noncurrent assets	<u>801,077</u>	<u>621,463</u>	<u>9,237</u>	<u>9,662</u>
Total assets	<u>880,678</u>	<u>755,360</u>	<u>10,457</u>	<u>10,514</u>
Deferred outflows of resources	72,096	76,803		
Liabilities				
Accounts payable	6,051	14,156		
Accrued salaries	10,114	9,857		
Employee benefits	2,221	3,325		
Unearned revenue	3,112	2,214		
Commercial paper	5,827	32,180		
Current portion of long-term debt	92,053	86,922		
Funds held for others	1,428	1,133		
Other current liabilities	4,487	5,363		
Current liabilities	<u>125,293</u>	<u>155,150</u>	<u>-</u>	<u>-</u>
Long-term debt	572,217	420,868		
Pension and other postretirement benefits	213,566	168,510		
Other noncurrent liabilities	5,374	4,808		
Total Noncurrent Liabilities	<u>791,157</u>	<u>594,186</u>	<u>-</u>	<u>-</u>
Total Liabilities	<u>916,450</u>	<u>749,336</u>	<u>-</u>	<u>-</u>
Deferred inflows of resources	15,753	48,424		
Net position				
Invested in capital assets net of related debt	55,058	54,255		
Restricted:				
Nonexpendable:				
Endowments and gifts	16,309	16,180	7,592	7,120
Expendable:				
Endowments and gifts	29,382	26,358	2,554	3,169
Other	6,455	2,559		
Unrestricted	(86,633)	(64,949)	311	225
Total net position	<u>\$ 20,571</u>	<u>\$ 34,403</u>	<u>\$ 10,457</u>	<u>\$ 10,514</u>

See Accompanying Notes to Financial Statements

University of California, Merced

STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION

As of for the year then ended June 30, 2016 and 2015 *(in thousands of dollars)*

	Campus		Foundation	
	2016	2015	2016	2015
OPERATING REVENUES				
Student tuition and fees, net	\$ 62,898	\$ 62,228		
Grants and contracts, net				
Federal	16,772	16,556		
State	758	696		
Private	4,002	3,727		
Auxiliary enterprises, net	24,741	23,736		
Campus foundation private gifts			\$ 1,398	\$ 1,319
Other operating revenues, net	6,592	7,153	71	51
Total operating revenues	115,763	114,096	1,469	1,370
OPERATING EXPENSES				
Salaries and wages	118,552	110,033		
UCRP benefits	24,524	9,981		
Retiree health benefits	11,924	18,824		
Other employee benefits	32,077	29,634		
Supplies and materials	20,370	21,025		
Depreciation and amortization	26,705	25,843		
Scholarships and fellowships	14,736	13,454		
Utilities	4,945	4,534		
Campus foundation grants			1,662	1,710
Other operating expenses	51,470	42,150	22	
Total operating expenses	305,303	275,478	1,684	1,710
Total operating loss	(189,540)	(161,382)	(215)	(340)
NONOPERATING REVENUES (EXPENSES)				
State educational appropriations	128,758	119,065		
State financing appropriations	-	30		
Federal financing appropriations	1,547	1,538		
Federal pell grants	18,108	16,526		
Private gifts, net	3,287	2,422		
Investment income:				
Short Term Investment Pool and other, net	2,010	2,272		
Endowment, net	755	570		
Campus foundations			70	83
Net appreciation (depreciation) in fair value of investments	550	171	(398)	404
Interest expense	(22,257)	(20,233)		
Loss on disposal of capital assets	(283)	(119)		
Other nonoperating (expenses) revenues, net	(223)	(101)		
Net nonoperating revenues	132,252	122,141	(328)	487
(Loss) income before other changes in net position	(57,288)	(39,241)	(543)	147
OTHER CHANGES IN NET POSITION				
Capital gifts and grants, net	1,544	1,432		
State capital appropriations	10,000	2,323		
Permanent endowments			486	1,047
Contributions from the University for the building program	34,836	25,488		
Other transfers	(2,924)	(17,473)		
(Decrease) increase in net position	(13,832)	(27,471)	(57)	1,194
NET POSITION				
Beginning of year, as previously reported	34,403	61,874	10,514	9,320
End of Year	\$ 20,571	\$ 34,403	\$ 10,457	\$ 10,514

See Accompanying Notes to Financial Statements

University of California, Merced
STATEMENTS OF CASH FLOWS

As of for the year then ended June 30, 2016 and 2015 (in thousands of dollars)

	Campus		Foundation	
	2016	2015	2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES				
Student tuition and fees	\$ 62,823	\$ 62,306		
Grants and contracts	24,650	19,779		
Auxiliary enterprises	24,632	23,632		
Campus foundation private gifts			\$ 1,383	\$ 1,343
Payments to employees	(117,909)	(107,173)		
Payments to suppliers and utilities	(79,026)	(64,100)		
Payments to UCRP	(13,528)	(12,563)		
Payments for retiree health benefits	(2,742)	(2,330)		
Payments for other employee benefits	(31,917)	(29,433)		
Payments for scholarships and fellowships	(14,736)	(13,454)		
Loans issued to students	(40)	-		
Payments to campuses and beneficiaries			(1,662)	(1,710)
Other receipts (payments), net	19,737	7,217	48	52
Net cash used by operating activities	(128,056)	(116,119)	(231)	(315)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES				
State educational appropriations	128,758	115,525		
Federal pell grants	18,150	16,502		
Gifts received for other than capital purposes:				
Private gifts for endowment purposes			486	1,047
Other private gifts	2,693	2,538		
Student direct lending receipts	25,012	25,560		
Student direct lending payments	(25,012)	(25,560)		
Scheduled principal paid on debt	(1,432)	(1,799)		
Interest paid on debt	(272)	(334)		
Other receipts (payments), net	(2,847)	558		
Net cash provided by noncapital financing activities	145,050	132,990	486	1,047
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES				
State capital appropriations	1,147	2,422		
State financing appropriations	-	30		
Federal financing appropriations	1,547	1,538		
Proceeds from debt issuance	168,660	-		
Purchases of capital assets	(52,536)	(49,618)		
Scheduled principal paid on debt & capital leases	(7,350)	(6,339)		
Interest paid on debt and capital leases	(21,344)	(17,577)		
Commercial paper financing:				
Proceeds from Issuance	27,243	31,425		
Payments of Principal	(53,596)	(409)		
Interest Paid	(20)	(23)		
Other receipts (payments), net	(89,999)	29,173		
Net cash used by capital and related financing activities	(26,248)	(9,378)	-	-
Cash Flows from Investing Activities				
Proceeds from sale & maturities of investments			2,162	1,368
Purchase of investments	(45,550)	(171)	(2,487)	(2,183)
Investment income, net of investment expenses	2,765	2,842	70	83
Net cash provided (used) by investing activities	(42,785)	2,671	(255)	(732)
Net (decrease) increase in cash and cash equivalents	(52,039)	10,164	-	-
Cash and cash equivalents, beginning of year	123,877	113,713	5	5
Cash and cash equivalents, end of year	\$ 71,838	\$ 123,877	\$ 5	\$ 5

See Accompanying Notes to Financial Statements

University of California, Merced

Notes to Financial Statements (unaudited)

June 30, 2016 and 2015

Organization

The University of California (“the University”) was founded in 1868 as a public, state-supported institution. The California State Constitution provides that the University shall be a public trust administered by the corporation, “The Regents of the University of California,” which is vested with full powers of organization and government, subject only to such legislative control necessary to ensure the security of its funds and compliance with certain statutory and administrative requirements. The majority of the 26-member independent governing board (The Regents) is appointed by the governor and approved by the state Senate. Various University programs and capital outlay projects are funded through appropriations from the state’s annual Budget Act. The University’s financial statements are discretely presented in the state’s general purpose financial statements as a component unit.

Financial Reporting Entity

The University of California, Merced (UC Merced) campus is the tenth and newest of the University of California’s campuses, established in 2005. The financial statements included in this annual report present the activities of the Merced campus. The University of California System is subject to an annual audit of the consolidated statements, of which UC Merced is a part. The financial statements for the Merced campus have not been individually audited.

The UC Merced Foundation (the Foundation) is a 501(c)(3) organization established for the purpose of encouraging voluntary private gifts, trusts, and bequests for the benefit of UC Merced. The economic resources received or held by the Foundation are entirely for the benefit of UC Merced. The financial activities of the separately incorporated Foundation are not reflected in the campus’ records until such time as gifts are transferred from the Foundation to the campus.

Because of the nature and significance of its relationship with UC Merced, including their ongoing financial support, the Foundation is reported under Governmental Accounting Standards Board (GASB) requirements as a discretely presented component unit of UC Merced. In accordance with the statements of GASB, Foundation activity is disclosed on UC Merced’s financial statements in a separate column.

Significant Accounting Policies

The financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America, using the economic resources measurement focus and the accrual basis of accounting. The University follows accounting principles issued by the GASB.

In February 2015, the GASB issued Statement No. 72, *Fair Value Measurement and Application*, effective for the University’s fiscal year beginning July 1, 2015. This Statement establishes standards for accounting and financial reporting for fair value measurements. The Statement requires investments to be measured at fair value and permits the use of net asset value as the fair value when an investment does not have a readily determinable fair value. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Statement No. 72 also requires certain disclosures related to all fair value measurements. Implementation of Statement No. 72 resulted in additional disclosures of investments and other assets reported at fair value within the fair value hierarchy.

In June 2015, the GASB issued Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68*, effective for the University’s fiscal year beginning July 1, 2015. This Statement establishes requirements for those pensions and pension plans that were not covered by Statements 67 and 68, specifically those not administered through a trust meeting specified criteria. Implementation of Statement No. 73 had no impact on the financial statements for the year ended June 30, 2016 and 2015.

University of California, Merced

Notes to Financial Statements (unaudited)

June 30, 2016 and 2015

In June 2015, the GASB issued Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*, effective for the University's fiscal year beginning July 1, 2015. This Statement reduces the GAAP hierarchy to two categories of authoritative GAAP from the four categories under GASB Statement No. 55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*. The first category of authoritative GAAP consists of GASB Statements of Governmental Accounting Standards. The second category comprises GASB Technical Bulletins and Implementation Guides, as well as guidance from the American Institute of Certified Public Accountants that is cleared by the GASB. Implementation of Statement No. 76 had no impact on the financial statements for the year ended June 30, 2016 and 2015.

In August 2015, the GASB issued Statement No. 77, *Tax Abatement Disclosures*, effective for the University's fiscal year beginning July 1, 2016. This Statement requires governments to disclose information about their own tax abatements separately from information about tax abatements that are entered into by other governments that reduce the reporting government's tax revenues. The purpose of this Statement is to increase transparency in regards to tax abatements governments enter into and make the impact of these agreements more apparent to users of the financial statements. Implementation of Statement No. 77 had no impact on the financial statements for the year ended June 30, 2016.

In December 2015, the GASB issued Statement No. 79, *Certain External Investment Pools and Pool Participants*, effective for the University's fiscal year beginning July 1, 2015. This Statement establishes criteria for an external investment pool to qualify for making the election to measure all of its investments at amortized cost for financial reporting purposes. Implementation of Statement No. 79 had no impact on the financial statements for the year ended June 30, 2016.

In April 2016, the GASB issued Statement No. 82, *Pension Issues — An Amendment of GASB Statements No. 67, No. 68, and No. 73*, effective for the University's fiscal year beginning July 1, 2016. This statement clarifies or amends Statements No. 67, 68 and 73 and specifically addresses the issues of presentation of payroll related measures in required supplementary information, the selection of assumptions and the treatment of deviations from guidance in Actuarial Standards of Practice for financial reporting purposes, and classification of payments made by employers to satisfy plan member contribution requirements. Implementation of Statement No. 82 had no impact on the financial statements.

The significant accounting policies of UC Merced are as follows:

Cash and cash equivalents. UC Merced considers all balances in demand deposit accounts to be cash.

Investments. Investments are measured and recorded at fair value. Investments consist of investments in the UC Regents Total Return Investment Pool (TRIP) and General Endowment Pool (GEP), University-managed investment pools which the Campus considers to be external investment pools. The Campus' investment in external investment pools are reported at net asset value and excluded from the fair value level hierarchy. The basis of determining the fair value of pooled funds or mutual funds is determined as the number of units held in the pool multiplied by the price per unit share.

The net change in the fair value of investments represents both realized and unrealized gains and losses on investments. Realized gains or losses are computed based on specific identification of investments sold or units held in pooled funds. Any gains or losses recognized on the sale of investments are included with investment income.

Endowment funds are invested in accordance with the Endowment Investment Spending Policies and Guidelines, adopted by the Board of Trustees (the Board) and the Uniform Prudent Management of Institutional Funds Act (UPMIFA). Investment decisions are based on a long-term investment strategy, with an objective of maximizing the endowment portfolio's long-term total return (yield plus appreciation).

University of California, Merced

Notes to Financial Statements (unaudited)

June 30, 2016 and 2015

The Campus and Foundation currently invests with the UC Regents and follows the UC Regents' asset allocation policy. The current allowable range for the portfolio is 32.5% to 52.5% equity securities, 7.5% to 17.5% fixed income securities, and 30% to 60% alternatives. It is the goal of the Foundation that the total return from endowment investments should be adequate to meet the following objectives:

- Preserve investment capital and its purchasing power.
- Generate sufficient resources to meet spending needs (payout).
- Attain reasonable capital appreciation through prudent acceptance of risk to enhance the future purchasing power of the investment capital.

Investments held by trustees. Investments held by trustees includes unspent debt proceeds held by the University on behalf of the Campus. Amounts held are primarily for capital related projects. As the Campus incurs related expenses for approved projects, the University reimburses the Campus.

Accounts receivable, net. Accounts receivable, net of allowance for uncollectible amounts, includes reimbursements due from state and federal sponsors of externally-funded research and other receivables. Other receivables include local government and private grants and contracts, educational activities and amounts due from students, employees and faculty for services.

Pledges receivable, net. Unconditional pledges, net of allowance for uncollectible amounts, of private gifts to UC Merced or to the UC Merced Foundation in the future are recorded as pledges receivable and revenue in the year promised at the present value of expected cash flows. Conditional pledges, including pledges of endowments to be received in future periods and intentions to pledge, are recognized as receivables and revenues when the specified conditions are met. Receivables and contribution revenue associated with externally-held investment trusts are not reflected in the accompanying financial statements. UC Merced recognizes contribution revenue when all eligibility requirements have been met.

Notes receivable, net. Loans to students, net of allowance for uncollectible amounts are provided from federal student loan programs and from other University sources.

Inventories. Inventories, consisting primarily of supplies and merchandise for resale, are valued at cost, typically determined using the weighted average method, which is not in excess of net realizable value.

Capital asset, net. Land, infrastructure, buildings and improvements, equipment, libraries and collections, and special collections are recorded at cost at the date of acquisition, or estimated fair value at the date of donation in the case of gifts. Estimates of fair value involve assumptions and estimation methods that are uncertain and, therefore, the estimates could differ from actual results. Capital leases are recorded at the present value of future minimum lease payments. Significant additions, replacements, major repairs, and renovations to infrastructure and buildings are generally capitalized if the cost exceeds \$35,000 and if they have a useful life of more than one year. Minor renovations are charged to operations. Equipment with cost in excess of \$5,000 and a useful life of more than one year is capitalized. All costs of land, library collections and special collections are capitalized.

Depreciation is calculated using the straight-line method over the estimated economic life of the asset. Equipment under capital leases is amortized over the estimated useful life of the equipment. Leasehold improvements are amortized using the straight-line method over the shorter of the life of the applicable lease, or the economic life of the asset.

University of California, Merced

Notes to Financial Statements (unaudited)

June 30, 2016 and 2015

Estimated economic lives are generally as follows:

	Years
Infrastructure	25
Buildings and improvements	15 - 33
Equipment	2 - 20
Computer software	3 - 7
Intangible assets	2 - indefinite
Library books and collections	15

Capital assets acquired through federal grants and contracts where the federal government retains a reversionary interest are also capitalized and depreciated.

Inexhaustible capital assets such as land or special collections that are protected, preserved and held for public exhibition, education or research, including art, museum, scientific and rare book collections are not depreciated.

Interest on borrowings to finance facilities is capitalized during construction, net of any investment income earned during the temporary investment of project-related borrowings.

Unearned revenue. Unearned revenue primarily includes amounts received from grant and contract sponsors that have not been earned under the terms of the agreement, and other revenue billed in advance of the event, such as student tuition and fees for housing and dining services .

Funds held for others. Funds held for others result from UC Merced acting as an agent or fiduciary on behalf of organizations that are not significant or financially accountable to UC Merced.

Federal refundable loans. Certain loans to students are administered by UC Merced with funding primarily supported by the federal government. UC Merced's statement of net position includes both the notes receivable and the related federal refundable loan liability representing federal capital contributions owed upon termination of the program.

Self-insurance programs. The University is self-insured or insured through a wholly-owned captive insurance company for medical malpractice, worker's compensation, employee health care and general liability claims. These risks are subject to various claims and aggregate limits, with excess liability coverage provided by an independent insurer. Liabilities are recorded on a systemwide basis when it is probable a loss has occurred and the amount of the loss can be reasonably estimated. These losses include an estimate for claims that have been incurred, but not reported. The estimated liabilities are based upon an independent actuarial determination of the present value of the anticipated future payments. Each campus funds the self-insurance liability through predetermined rates applied to payroll and other expenses. These amounts are reflected as operating expenses in UC Merced's statement of revenue, expenses, and changes in net position. UC Merced's financial statements do not reflect any liabilities for self-insurance claims, as these estimated liabilities are recorded on a systemwide basis.

Deferred outflows of resources and deferred inflows of resources. UC Merced classifies gains on retirement of debt as deferred inflows of resources and losses as deferred outflows of resources and amortizes such amounts as a component of interest expense over the remaining life of the old debt, or the new debt, whichever is shorter.

Changes in net pension liability not included in pension expenses are reported as deferred outflows of resources or deferred inflows of resources. Employer contributions subsequent to the measurement date of the net pension liability are reported as deferred outflows of resources.

University of California, Merced

Notes to Financial Statements (unaudited)

June 30, 2016 and 2015

Net position. Net position is required to be classified for accounting and reporting purposes into the following categories:

Invested in capital assets, net of related debt. This category includes all of UC Merced's capital assets, net of accumulated depreciation, reduced by outstanding debt attributable to the acquisition, construction or improvement of those assets.

Restricted. UC Merced and the Foundation classify the net position resulting from transactions with purpose restrictions as restricted net position until the specific resources are used for the required purpose, or for as long as the provider requires the resources to remain intact.

Nonexpendable. The net position subject to externally imposed restrictions that must be retained in perpetuity by UC Merced or the Foundation, is classified as nonexpendable net position. This includes UC Merced and the Foundation permanent endowment funds.

Expendable. The net position whose use by UC Merced or the Foundation is subject to externally-imposed restrictions that can be fulfilled by actions of UC Merced or the Foundation pursuant to those restrictions or that expire by the passage of time are classified as expendable net position.

Unrestricted. The net position that is neither reserved, restricted nor invested in capital assets, net of related debt, are classified as unrestricted net position. UC Merced's unrestricted net position may be designated for specific purposes by management or The Regents. The Foundation's unrestricted net position may be designated for specific purposes by their Board of Trustees. Substantially all of UC Merced's unrestricted net position is allocated for academic and research initiatives or programs, for capital programs or for other purposes.

Expenses are charged to either restricted or unrestricted net position based upon a variety of factors, including consideration of prior and future revenue sources, the type of expenses incurred, UC Merced's budgetary policies surrounding the various revenue sources or whether the expense is a recurring cost.

Revenues and expenses. Operating revenues of UC Merced include receipts from student tuition and fees, grants and contracts for specific operating activities, and sales and services from educational activities and auxiliary enterprises. Operating expenses incurred in conducting the programs and services of UC Merced are presented in the statement of revenues, expenses and changes in net position as operating activities.

Certain significant revenues relied upon and budgeted for fundamental operational support of the core instructional mission of UC Merced are mandated by the GASB to be recorded as nonoperating revenues, including state educational appropriations, certain federal grants for student financial aid, private gifts, and investment income, since the GASB does not consider them to be related to the principal operating activities of UC Merced.

The Foundation was established to financially support UC Merced. Private gifts to the Foundation are recognized as operating revenues since, in contrast to the University, such contributions are fundamental to the core mission of the Foundation. Foundation grants to UC Merced are recognized as operating expenses by the Foundation. Private gift or capital gift revenues associated with the Foundation grants to UC Merced are recorded by UC Merced as gifts when the Foundation transfers the gift to UC Merced.

Nonoperating revenues and expenses include state educational appropriations, state financing appropriations, federal Pell grants, private gifts for other than capital purposes, investment income, net unrealized appreciation or depreciation in the fair value of investments, interest expense, and gain or loss on the disposal of capital assets.

University of California, Merced

Notes to Financial Statements (unaudited)

June 30, 2016 and 2015

State capital appropriations, capital gifts and grants, and gifts for endowment purposes are classified as other changes in net position.

Student tuition and fees. Substantially all of the student tuition and fees provide for current operations of UC Merced. A small portion of student fees is required for debt service associated with the recreation center.

UC Merced recognizes scholarship allowances as the difference between the stated charge for tuition and fees, housing and dining charges, recreational center fees, and other fees, and the amount that is paid by the student and third parties on behalf of the student. Payments of financial aid made directly to students are classified as scholarship and fellowship expenses.

Scholarship allowances are netted in the statement of revenues, expenses and changes in net position for the years ended June 30, 2016 and 2015 as follows:

(in thousands of dollars)

	2016	2015
Student tuition and fees	\$ 39,281	\$ 35,574
Auxiliary enterprises	8,132	8,370
Other operating revenues	111	100
Scholarship allowances	\$ 47,524	\$ 44,044

State appropriations. The state of California provides appropriations to the University on an annual basis. State educational appropriations are recognized as nonoperating revenue; however, the related expenses for educational operations or other specific operating purposes are reported as operating expenses. State financing appropriations provide for principal and interest payments associated with lease-purchase agreements with the State Public Works Board and are also reported as nonoperating revenue. State appropriations for capital projects are recorded as revenue under other changes in net position when the related expenditures are incurred. A special state appropriation for breast cancer imaging research is reported as grant operating revenue.

Grant and Contract revenue, net. UC Merced receives grant and contract revenue from governmental and private sources. The campus recognizes revenue associated with the direct costs of sponsored programs as the related expenditures are incurred. Recovery of facilities and administrative costs of federally sponsored programs is at an estimated cost reimbursement rate negotiated with UC Merced's federal cognizant agency, the U.S. Department of Health and Human Services. For the year ended June 30, 2016 the facilities and administrative cost recovery totaled \$4,330, which consisted of \$3,487 from federally sponsored programs, \$71 from state sponsored programs and \$772 from private sponsors. For the year ended June 30, 2015 the facilities and administrative cost recovery totaled \$3,929, which consisted of \$3,215 from federally sponsored programs, \$89 from state sponsored programs and \$625 from other sponsors.

Retiree health benefits. The University established the University of California Retiree Health Benefit Trust ("UCRHBT") to allow certain University locations and affiliates, including UC Merced, to share the risks, rewards and costs of providing for retiree health benefits and to accumulate funds on a tax-exempt basis under an arrangement segregated from University assets.

The UCRHBT provides retiree health benefits to retired employees of UC Merced. Contributions from the UC Merced to the UCRHBT are effectively made to a single-employer health plan administered by the University as a cost-sharing plan. Campus contributions toward retiree health benefits, at rates determined by the University, are made to the UCRHBT and reduce the obligation for retiree health benefits in the statement of net position.

University of California, Merced

Notes to Financial Statements (unaudited)

June 30, 2016 and 2015

UC Merced's contributions toward retiree health costs made to UCRHBT are shown as operating activities in the statement of cash flows. Cash flows resulting from retiree health contributions from retirees are shown as noncapital financing activities in the statement of cash flows.

Pension Obligations. The University of California Retirement Plan ("UCRP") provides retirement benefits to retired employees of UC Merced. UC Merced is required to contribute to UCRP at a rate set by The Regents. Pension obligations include UC Merced's share of the University's net pension liability for UCRP. UC Merced's share of net pension liability, deferred inflows of resources, deferred outflows of resources and pension expense have been determined based upon their proportionate share of covered compensation for the fiscal year. The fiduciary net position and changes in fiduciary net position of UCRP have been measured consistent with the accounting policies used by the Plan. For purposes of measuring UCRP's fiduciary net position, investments are reported at fair value and benefit payments are recognized when due and payable in accordance with the benefit terms.

Pension expense is recognized for benefits earned during the period, interest on the unfunded liability and changes in benefit terms. The differences between expected and actual experience and changes in assumptions about future economic or demographic factors are reported as deferred inflows or outflows and are recognized over the average expected remaining service period for employees eligible for pension benefits. The differences between expected and actual returns are reported as deferred inflows or outflows and are recognized over five years.

Compensated absences. UC Merced accrues annual leave, including employer-related costs for employees at rates based upon length of service, job classification and compensatory time based upon job classification and hours worked.

Endowment spending. Under provisions of California law, the Uniform Prudent Management of Institutional Funds Act allows for investment income, as well as a portion of realized and unrealized gains, to be expended for the operational requirements of University programs.

Tax exemption. The University, which includes the UC Merced Foundation (the Foundation), is recognized as a tax-exempt organization under the provisions of Section 501(c)(3) of the Internal Revenue Code and is exempt from federal and state income taxes on related income. Because the University is a state institution, related income received by the Campus is also exempt from federal tax under IRC Section 115(a). In addition, the University is exempt from state income taxes imposed under the California Revenue and Taxation Code.

Use of estimates. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenditures during the reporting period. Although management believes the estimates and assumptions are reasonable, they are based upon information available at the time the estimates and judgment is made and actual amounts could differ from those estimates.

New Accounting Pronouncements. In June 2015, the GASB issued Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, effective for the University's fiscal year beginning July 1, 2017. This Statement revises existing standards for measuring and reporting retiree health benefits provided by the University to its employees. This Statement requires recognition of a liability equal to the net retiree health benefit liability, which is measured as the total retiree health benefit liability, less the amount of the UCRHBT's fiduciary net position. The total retiree health benefit liability is determined based upon discounting projected benefit payments based on claims costs, the benefit terms and

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legal agreements existing at the UCRHBT's fiscal year end. Projected benefit payments are required to be discounted using a single rate that reflects the expected rate of return on investments, to the extent that plan assets are available to pay benefits, and a tax-exempt, high-quality municipal bond rate when plan assets are not available. The Statement requires that most changes in the net retiree health benefit liability be included in retiree health benefit expense in the period of change. As of June 30, 2015, the University reported a retiree health benefit obligation of \$9.4 billion, of which, UC Merced's proportionate share is \$82,091. Under Statement No. 75, the University's OPEB obligation is expected to increase. The University is evaluating the effect that Statement 75 will have on its financial statements.

In December 2015, the GASB issued Statement No. 78, *Pensions Provided Through Certain Multiple-Employer Defined Benefit Pension Plans*, effective for the University's fiscal year beginning July 1, 2016. This Statement amends the scope and applicability of Statement No. 68, *Accounting and Financial Reporting for Pensions*, to exclude pensions provided to employees of state or local governmental employers through a cost-sharing multiple-employer defined benefit pension plan that (1) is not a state or local governmental pension plan, (2) is used to provide defined benefit pensions both to employees of state or local governmental employers and to employees of employers that are not state or local governmental employers, and (3) has no predominant state or local governmental employer (either individually or collectively with other state or local governmental employers that provide pensions through the pension plan). This Statement establishes requirements for recognition and measurement of pension expense, expenditures, and liabilities; note disclosures; and required supplementary information for pensions that have the characteristics described above. The University is evaluating the effect that Statement No. 78 will have on its financial statements.

In March 2016, the GASB issued Statement No. 81, *Irrevocable Split-Interest Agreements*, effective for the University's fiscal year beginning July 1, 2017. This statement addresses when Irrevocable Split-Interest Agreements constitute an asset for accounting and financial reporting purposes when the resources are administered by a third party. The Statement also provides expanded guidance for circumstances in which the government holds the assets. The University is evaluating the effect that Statement No. 81 will have on its financial statements.

1. Cash and Cash Equivalents

Cash and cash equivalents consist of balances in bank demand deposits and funds held with the University. UC Merced invests surplus cash balances in the University of California's Short Term Investment Pool (STIP) as managed by the Chief Investment Officer of the University. Substantially all of UC Merced's cash is deposited into the STIP. Deposits into STIP are considered demand deposits. Unrealized gains and losses associated with the fluctuation in the fair value of the investment included in STIP are not recorded by UC Merced, but are absorbed by the University as manager of the pool.

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Cash and cash equivalents at June 30, 2016, and 2015, consist of the following:

(in thousands of dollars)

	UC Merced		UC Merced Foundation	
	2016	2015	2016	2015
Checking accounts	\$ 235	\$ 259	\$ 5	\$ 5
University of California Managed Short Term Investment Pool (STIP)	71,603	123,618		-
Total cash and cash equivalents	\$ 71,838	\$ 123,877	\$ 5	\$ 5

The checking accounts at June 30, 2016 and 2015 were insured by federal depository insurance. UC Merced minimizes cash balances held in checking accounts by sweeping available balances into investment accounts on a regular basis. To mitigate the risk of custodial credit risk, UC Merced's cash and investments have been placed with high quality counter parties.

The University of California's STIP invests primarily in U.S. Treasury securities, prime-grade commercial paper, and short-term corporate notes with cost approximating market value. UC Merced earns income based on its average investment in the pool and such income is reported as investment income in the statement of revenue, expenses, and changes in net position.

2. Investments

The Regents, as the governing Board, is responsible for the oversight of the University's investments and establishes investment policy, which is carried out by the Chief Investment Officer. These investments are associated with the Short Term Investment Pool (STIP), Total Return Investment Pool (TRIP), and General Endowment Pool (GEP) managed by the Chief Investment Officer, or is separately invested. Pursuant to The Regents' policies on campus foundations, the UC Merced Board of Trustees has determined that all of its investments will be managed by the Chief Investment Officer. The composition of investments at June 30, is as follows:

(in thousands of dollars)

	UC Merced		UC Merced Foundation	
	2016	2015	2016	2015
Under management of The Regents of University of California (not subject to categorization)				
General endowment pool (GEP)	\$ 32,417	\$ 29,342	\$ 8,959	\$ 9,250
Total Return Investment Pool (TRIP)	63,843	18,293	-	-
Total investments	\$ 96,260	\$ 47,635	\$ 8,959	\$ 9,250

The University-managed commingled funds (UC pooled funds) serve as the core investment vehicle for the Campus. A description of the funds used is as follows:

TRIP. The Total Return Investment Pool (TRIP) allows participants the opportunity to maximize the return on their long-term working capital by taking advantage of the economies of scale of investing in a large pool across a broad range of asset classes. TRIP supplements STIP by investing in an intermediate-term, higher-risk portfolio allocated across equities, fixed-income and liquid alternative strategies, and allows participants to maximize the return on their long-term capital. The objective of TRIP is to generate a rate of return above the policy benchmark, after all costs and fees, consistent with liquidity, cash flow

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requirements and the risk. TRIP is considered to be an external investment pool from the perspective of the Campus.

GEP. The General Endowment Pool (GEP) an investment pool in which a large number of individual endowments participate in order to benefit from diversification and economies of scales. GEP is a balanced portfolio of equities, fixed-income securities and alternative investments. The primary goal is to maximize long-term total return, growth of principal and a growing payout stream to ensure that future funding for endowment-supported activities can be maintained. Where donor agreements place constraints on allowable investments, assets associated with endowments are invested in accordance with the terms of the agreements. GEP is considered to be an external investment pool from the perspective of the Campus and Foundation.

Investment risk factors

There are many factors that can affect the value of investments. Some, such as custodial credit risk, concentration of credit risk and foreign currency risk, may affect both equity and fixed-income securities. Equity securities respond to such factors as economic conditions, individual company earnings performance and market liquidity, while fixed-income securities are particularly sensitive to credit risks and changes in interest rates. The University and the Foundation have established investment policies to provide the basis for the management of a prudent investment program appropriate to the particular fund type.

Credit risk

Fixed-income securities are subject to credit risk, which is the chance that a bond issuer will fail to pay interest or principal in a timely manner, or that negative perceptions of the issuer's ability to make these payments will cause security prices to decline. These circumstances may arise due to a variety of factors such as financial weakness or bankruptcy.

A bond's credit quality is an assessment of the issuer's ability to pay interest on the bond and, ultimately, to pay the principal. Credit quality is evaluated by one of the independent bond rating agencies, for example Moody's Investors Service (Moody's) or Standard and Poor's (S&P). The lower the rating, the greater the chance, in the rating agency's opinion, that the bond issuer will default, or fail to meet its payment obligations. Generally, the lower a bond's credit rating, the higher its yield should be to compensate for the additional risk.

Certain fixed-income securities, primarily obligations of the U.S. government or those explicitly guaranteed by the U.S. government, are considered to have minimal credit risk.

The University recognizes that credit risk is appropriate in balanced investment pools such as TRIP and GEP by virtue of the benchmarks chosen for the fixed-income portion of those pools.

The Campus and Foundation's commingled funds (including GEP and TRIP) are not rated.

Custodial credit risk

Concentration of credit risk is the risk of loss associated with a lack of diversification of having too much invested in a few individual issuers, thereby exposing the organization to greater risks resulting from adverse economic, political, regulatory, geographic or credit developments. Securities issued or explicitly guaranteed by the U.S. government, mutual funds, external investment pools and other pooled investments are excluded from this review. Investments in the various investment pools managed by the Office of the Chief Investment Officer of the Regents are external investment pools and are not subject to concentration of credit risk.

Interest rate risk

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Interest rate risk is the risk that the fair value of fixed-income securities will decline because of changing interest rates. The prices of fixed-income securities with a longer time to maturity, measured by effective duration, tend to be more sensitive to changes in interest rates and, therefore, more volatile than those with shorter durations. Effective duration is the approximate change in price of a security resulting from a 100-basis-point (1-percentage-point) change in the level of interest rates. It is not a measure of time.

The University's portfolio guidelines for the fixed-income portion of TRIP limit weighted average effective duration to the effective duration of the benchmarks (Barclays Capital US Aggregate Index), plus or minus 10 percent. Similarly, portfolio guidelines for the fixed-income portion of GEP limit weighted average effective duration to the effective duration of their benchmarks (Barclay's Capital US Aggregate Index), plus or minus 20 percent. These portfolio guidelines constrain the potential price movement due to interest rate changes of the portfolio to be similar to that of the benchmark.

The Campus and Foundation considers the effective duration to be zero for money market funds because they are designed to have a constant \$1 share value due to the short-term, liquid nature of the underlying securities.

Foreign currency risk

The University's strategic asset allocation policy for TRIP and GEP includes allocations to non-U.S. equities and non-dollar-denominated bonds. Exposure from foreign currency risk results from investments in foreign currency-denominated equity, fixed-income and private equity securities. Foreign currency risk is managed by the Chief Investment Officer of the Regents for the University; however, the Foundation's endowment asset allocation policy includes an allocation to non-U.S. equities.

More detail about the University of California's investments can be found in the 2015–2016 annual report of the University.

3. Investments Held by Trustees

The University has entered into agreements with trustees to maintain trusts for the University's self-insurance programs, long-term debt requirements, capital projects, and certain other requirements. In addition, the state of California retains on deposit, certain proceeds from the sale of lease-revenue bonds to be used for capital projects. For both June 30, 2016 and 2015, the investments and deposits held by trustees were held by the University on behalf of the Campus for capital related projects.

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4. Accounts Receivable

Accounts receivable and the allowances for uncollectible amounts at June 30, 2016 and 2015 are as follows:

(in thousands of dollars)

	UC Merced			UC Merced Foundation
	State and Federal Government	Other	Total	
<i>At June 30, 2016</i>				
Accounts receivable	\$ 4,985	\$ 2,076	\$ 7,061	\$ -
Allowance for uncollectible amounts	(140)	(209)	(349)	
Accounts receivable, net	\$ 4,845	\$ 1,867	\$ 6,712	\$ -
<i>At June 30, 2015</i>				
Accounts receivable	\$ 7,320	\$ 2,052	\$ 9,372	\$ -
Allowance for uncollectible amounts	(162)	(195)	(357)	
Accounts receivable, net	\$ 7,158	\$ 1,857	\$ 9,015	\$ -

UC Merced's other accounts receivable are primarily related to private grants and contracts, tuition and fees, and auxiliary enterprises.

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5. Pledges Receivable

The composition of pledges receivable at June 30, 2016 and 2015 is summarized as follows:

(in thousands of dollars)

	UC Merced		UC Merced Foundation	
	2016	2015	2016	2015
Total pledges receivable outstanding	\$ 915	\$ 315	\$ 723	\$ 917
Less: Unamortized discount to present value	(7)	(2)	(12)	(26)
Allowance for uncollectible pledges	(315)	(313)	-	(196)
Total pledges receivable, net	593	-	711	695
Less: Current portion of pledges receivable	(150)	-	(433)	(283)
Noncurrent portion of pledges receivable	\$ 443	\$ -	\$ 278	\$ 412

Payments of pledges receivable for the fiscal years subsequent to June 30, 2016 and thereafter are as follows:

(in thousands of dollars)

	UC Merced	UC Merced Foundation
<i>Year Ending June 30</i>		
2017	350	433
2018	200	144
2019	200	112
2020	165	12
2021		11
2022-2026		11
Total payments on pledges receivable	\$ 915	\$ 723

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6. Capital Assets

The campus' capital asset activity for the years ended June 30, 2016 and 2015 is as follows:

(in thousands of dollars)

	2014	Additions	Disposals	2015	Additions	Disposals	2016
Original Cost							
Land	\$ 12,029	\$ 1,331		\$ 13,360	\$ 21,332		\$ 34,692
Infrastructure	36,449	\$ 128		36,577	102		36,679
Buildings and improvements	585,992	6,971		592,963	64,133		657,096
Equipment, software and intangibles	46,838	8,002	\$ (414)	54,426	7,073	\$ (3,119)	58,380
Libraries and collections	15,311	1,612		16,923	1,713		18,636
Special collections	132			132			132
Construction in progress	7,896	31,481		39,377	(32,235)		7,142
Capital assets, at original cost	\$ 704,647	\$ 49,525	\$ (414)	\$ 753,758	\$ 62,118	\$ (3,119)	\$ 812,757
Accumulated depreciation and amortization							
	2014	Depreciation and Amortization	Disposals	2015	Depreciation and Amortization	Disposals	2016
Infrastructure	\$ 11,258	\$ 1,422		\$ 12,680	\$ 1,451		\$ 14,131
Buildings and improvements	116,402	19,547		135,949	19,670		155,619
Equipment, software and intangibles	31,164	3,853	\$ (248)	34,769	4,455	\$ (2,836)	36,388
Libraries and collections	4,501	1,021		5,522	1,129		6,651
Accumulated depreciation and amortization	\$ 163,325	\$ 25,843	\$ (248)	\$ 188,920	\$ 26,705	\$ (2,836)	\$ 212,789
Capital assets, net	\$ 541,322			\$ 564,838			\$ 599,968

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7. Long-term Debt

The Regents of the University of California may finance the construction, renovation, and acquisition of certain facilities and equipment for UC Merced and other UC campuses through the issuance of debt obligations. Long-term financing includes revenue bonds, mortgages, capital lease obligations, and other borrowings that have been issued on behalf of UC Merced in the name of The Regents. UC Merced's outstanding debt at June 30, 2016 and 2015 is as follows:

(in thousands of dollars)

	2016	2015
Interim Financing:		
Commercial paper	\$ 5,827	\$ 32,180
Long-term Financing:		
University of California General Revenue Bonds	624,475	465,702
Note payables to UCOP	39,795	42,088
Total outstanding debt	670,097	539,970
Less: Commercial paper	(5,827)	(32,180)
Current portion of outstanding debt	(92,053)	(86,922)
Noncurrent portion of outstanding debt	\$ 572,217	\$ 420,868

The University of California's variable-rate demand bonds reset weekly, and, in the event of a failed remarketing, can be put back to The Regents for tender. Accordingly, UC Merced has recorded its portion, totaling \$81.4 million as current portion of long-term debt on the Statements of Net Position for both fiscal years ending June 30, 2016 and 2015. More detail about the University of California's debt can be found in the 2015-2016 annual report of the University.

8. Endowments and Foundation Gifts

Endowments and gifts are held and administered either by the University or by UC Merced's Foundation. The value of endowments and gifts held and administered by the University at June 30, 2016 and 2015 is as follows:

(in thousands of dollars)

	UC Merced		UC Merced Foundation	
	2016	2015	2016	2015
Restricted				
Endowments and gifts	\$ 16,309	\$ 16,180	\$ 7,592	\$ 7,120
Nonexpendable	16,309	16,180	7,592	7,120
Endowments	13,993	14,749	1,844	2,453
Funds functioning as endowments	7,239	4,053		
Gifts	8,150	7,556	710	716
Expendable	29,382	26,358	2,554	3,169
Unrestricted	1,390	-	311	225
University endowments and gifts	\$ 47,081	\$ 42,538	\$ 10,457	\$ 10,514

The endowments held by the University are administered on a system-wide basis. The University's endowment income distribution policies are designed to preserve the value of the endowment in real terms (after inflation), and to generate a predictable stream of spendable income. Endowment investments are

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managed to achieve the maximum long-term total return. As a result of this emphasis on total return, the proportion of the annual income distribution provided by dividend, interest income, and capital gains may vary significantly from year to year. The University's policy is to retain the realized and unrealized appreciation with the endowment, after the annual income distribution has been made to UC Merced.

The portion of investment returns earned on endowments held by the University and distributed at the end of each year to support current operations for the following year is based upon a rate that is approved by The Regents. The annual income distribution transferred to UC Merced from endowments held by the University was \$1,382 and \$1,357 for the years ended June 30, 2016 and 2015, respectively.

9. Operating Expenses by Function

Operating expenses, by functional classification, for fiscal years ended June 30, 2016 and 2015, are as follows:

<i>(in thousands of dollars)</i>	2016	2015
Instruction	\$ 61,610	\$ 55,596
Research	24,532	23,103
Public service	5,030	4,268
Academic support	25,330	23,062
Student services	24,755	24,097
Institutional support	76,398	63,004
Operation and maintenance of plant	19,844	17,187
Student financial aid	15,878	14,247
Auxiliary enterprises	22,265	20,546
Depreciation and amortization	26,705	25,843
Other	2,956	4,525
Total	\$ 305,303	\$ 275,478

10. Deferred Outflows and Inflows of Resources

The composition of deferred outflows of resources at June 30 is summarized as follows:

<i>(in thousands of dollars)</i>	2016	2015
Pension obligations	\$ 47,815	\$ 50,916
Loss on debt refunding	24,281	25,887
Total	\$ 72,096	\$ 76,803

Deferred inflows of resources for June 30, 2016 and 2015 are related to pension obligations.

11. Retiree Health Plans

The University administers single-employer health plans to provide health and welfare benefits, primarily medical, dental and vision benefits, to eligible retirees of the University of California and its affiliates. The Regents have the authority to establish and amend the benefit plans.

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The contribution requirements of the eligible retirees and the participating University locations, such as the Medical Centers, are established and may be amended by the University. Membership in the UCRP is required to become eligible for retiree health benefits. Contributions toward benefits are shared with the retiree. The University determines the employer's contribution. Retirees are required to pay the difference between the employer's contribution and the full cost of the health insurance. Retirees employed by the University prior to 1990 are eligible for the maximum employer contribution if they retire before age 55 and have at least 10 years of service, or if they retire at age 55 or later and have at least 5 years of service. Retirees employed by the University after 1989 and not rehired after that date are subject to graduated eligibility provisions that generally require 10 years of service before becoming eligible for 50 percent of the maximum employer contribution, increasing to 100 percent after 20 years of service.

Participating University locations, such as the Medical Centers, are required to contribute at a rate assessed each year by the University. The contribution requirements are based upon projected pay-as-you-go financing requirements. Contributions for fiscal years ended June 30, 2016 and 2015 were \$2,788 and \$2,311, respectively.

UC Merced's proportionate share of the net obligation for Retiree Health Benefits as of June 30, 2016 and 2015 is as follows:

<i>(in thousands of dollars)</i>	2016	2015
Proportion of the net obligation	0.9%	0.9%
Proportionate share of the net obligation	\$ 91,465	\$ 82,091

The actuarial value of UCRHBT assets and the actuarial accrued liability associated with the University's campuses and Medical Center's using the entry age normal cost method as of July 1, 2015, the date of the latest actuarial valuation, were \$50.6 million and \$17.3 billion, respectively. The net position held in trust for retiree health benefits on the UCRHBT's statement of plan fiduciary net position were \$72.5 million and \$50.6 million at June 30, 2016 and 2015, respectively. For the years ended June 30, 2016 and 2015, combined contributions from the University's campuses and Medical Centers were \$309.6 million and \$258.6 million, respectively, including an implicit subsidy of \$97.0 million and \$91.6 million, respectively. The University's annual retiree health benefit expense for its campuses and Medical Centers was \$1.4 billion and \$1.3 billion for the years ended June 30, 2016 and 2015, respectively. As a result of contributions that were less than the retiree health benefit expense, the University's obligation for retiree health benefits attributable to its campuses and Medical Centers totaling \$10.2 billion and \$9.1 billion at June 30, 2016 and 2015, respectively, increased by \$1.1 billion and \$907.7 million for the years ended June 30, 2016 and 2015, respectively.

Information related to plan assets and liabilities as they relate to individual campuses and Medical Centers is not readily available. Additional information on the retiree health plans can be obtained from the 2015-2016 annual reports of the University of California.

12. Retirement Plans

Substantially all full-time employees of UC Merced participate in the University of California Retirement System ("UCRS") that is administered by the University. The UCRS consists of The University of California Retirement Plan ("UCRP"), a single-employer defined benefit plan, and the University of California Retirement Savings Program ("UCRSP") that includes four defined contribution plans with several investment portfolios generally funded with employee non-elective and elective contributions. The Regents have the authority to establish and amend the benefit plans. Additional information on the retirement plans can be obtained from the 2015-2016 annual reports of the University of California Retirement System.

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The UCRP provides lifetime retirement income, disability protection, death benefits, and post-retirement and pre-retirement survivor benefits to eligible employees of the University. Membership is required in UCRP for all employees appointed to work at least 50 percent time for one year or more, or for an indefinite period or for a definite period of a year or more. An employee may also become eligible by completing 1,000 hours within a 12-month period. Generally, five years of service are required for entitlement to plan benefits. The amount of pension benefit is determined under the basic formula of covered compensation times age factor times years of service credit. The maximum monthly benefit cannot exceed 100 percent of the employee's highest average plan compensation over a 36-month period, subject to certain limits imposed under the Internal Revenue Code. Annual cost-of-living adjustments (COLAs) are made to monthly benefits according to a specified formula based on the Consumer Price Index. Ad hoc COLAs may be granted subject to funding availability.

Contributions. Contributions to the UCRP may be made by UC Merced and the employees. The rates for contributions as a percentage of payroll are determined annually pursuant to The Regents' funding policy, and based upon recommendations of the consulting actuary. The Regents determine the portion of the total contribution to be made by UC Merced and by the employees. Employee contributions by represented employees are subject to collective bargaining agreements. Effective July 1, 2014, employee member contributions were 8.0 percent. Effective July 1, 2015, employee member contributions range from 7.0 percent to 9.0 percent. The University pays a uniform contribution rate of 14.0 percent of covered payroll on behalf of all UCRP members.

Employee contributions to UCRP are accounted for separately and currently accrue interest at 6.0 percent annually. Upon termination, members may elect a refund of their contributions, plus accumulated interest; vested terminated members who are eligible to retire, may also elect monthly retirement income or a lump sum equal to the present value of their accrued benefits.

Contributions for fiscal years ended June 30, 2016 and 2015 are as follows:

<i>(in thousands of dollars)</i>	2016	2015
UC Merced	\$ 13,026	\$ 12,183
Employees	7,071	6,653
Total	\$ 20,097	\$ 18,836

Net Pension Liability. UC Merced's proportionate share of the net pension liability for UCRP as of June 30, 2016 and 2015 is as follows:

<i>(in thousands of dollars)</i>	2016	2015
Proportion of the net pension liability	0.9%	0.9%
Proportionate share of net pension liability	\$ 122,101	\$ 86,419

UC Merced's net pension liability was measured as of June 30, 2016 and 2015 and calculated using the plan net position valued as of the measurement date and total pension liability determined based upon rolling forward the total pension liability from the results of the actuarial valuations as of July 1, 2015 and 2014. Actuarial valuations represent a long-term perspective and involve estimates of the value of reported benefits and assumptions about the probability of occurrence of events far into the future. UC Merced's net pension liability was calculated using the following methods and assumptions:

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	2016	2015
Inflation	3.0%	3.0%
Investment rate of return	7.25%	7.25%
Projected salary increases	3.8 - 6.2%	3.8 - 6.2%
Cost-of-living-adjustments	2.0%	2.0%

Actuarial assumptions are subject to periodic revisions as actual results are compared with past expectations and new estimates are made about the future. The actuarial assumptions used in 2016 and 2015 were based upon the results of an experience study conducted for the period July 1, 2010 through June 30, 2014. For active members, inactive members and healthy retirees, the RP-2014 White Collar Mortality Tables (separate table for males and females), projected with the two-dimensional MP2014 projection scale to 2029, and with ages then set forward one year. For disabled members, rates are based on the RP-2014 Disabled Retiree Mortality Table, projected with the two-dimensional MP2014 projection scale to 2029, and with ages then set back one year for males and set forward five years for females.

The long-term expected investment rate of return assumption for UCRP was determined in 2015 based on a building-block method in which expected future real rates of return (expected returns, net of inflation) are developed for each major asset class. These returns are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage, adding expected inflation and subtracting expected expenses and a risk margin. The target allocation and projected arithmetic real rates of return for each major asset class, after deducting inflation, but before deducting investment expenses, used in the derivation of the long-term expected investment rate of return assumption are summarized in the following table:

<i>Asset Class</i>	Target Allocation	Long-Term Expected Real Rate of Return
U.S. Equity	28.5%	6.4%
Developed International Equity	18.5%	7.0%
Emerging Market Equity	8.0%	8.6%
Core Fixed Income	12.5%	0.8%
High Yield Bonds	2.5%	3.0%
Emerging Market Debt	2.5%	3.9%
TIPS	4.5%	0.4%
Real Estate	5.5%	4.8%
Private Equity	8.0%	11.2%
Absolute Return/Real Assets	9.5%	8.6%
Total	100.0%	5.6%

Discount Rate. The discount rate used to estimate the net pension liability as of June 30, 2016 and 2015 was 7.25 percent. To calculate the discount rate, cash flows into and out of UCRP were projected in order to determine whether UCRP has sufficient cash in future periods for projected benefit payments for current members. For this purpose, UC Merced's contributions that are intended to fund benefits of current plan members and their beneficiaries are included. Projected contributions that are intended to fund the service costs of future plan members and their beneficiaries, as well as projected contributions of future plan members, are not included. UCRP was projected to have assets sufficient to make projected benefit payments for current members for all future years as of June 30, 2016 and 2015.

Sensitivity of the Net Pension Liability to the Discount Rate Assumption. The following presents the current-period net pension liability of the University calculated using the current-period discount rate

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assumption of 7.25 percent, as well as what the net pension liability would be if it were calculated using a discount rate different than the current assumption:

(in thousands of dollars)

	1% Decrease (6.25%)	Current Discount (7.25%)	1% Increase (8.25%)
UC Merced	\$ 191,636	\$ 122,101	\$ 63,996

Deferred Outflows of Resources and Deferred Inflows of Resources. Deferred outflows of resources and deferred inflows of resources for pensions were related to the following sources for the year ended June 30:

(in thousands of dollars)

	2016	2015
Deferred Outflows of Resources		
Changes in proportion and differences between location's contributions and proportionate share of contributions	\$ 7,323	\$ 9,524
Changes of assumptions or other inputs	16,020	25,231
Net difference between projected and actual earnings on pension plan investments	23,279	16,161
Difference between expected and actual experience	1,193	-
Total	\$ 47,815	\$ 50,916
Deferred Inflows of Resources		
Changes in proportion and differences between location's contributions and proportionate share of contributions	\$ 5,481	\$ 6,459
Changes of assumptions or other inputs	7,851	12,329
Net difference between projected and actual earnings on pension plan investments	-	26,137
Difference between expected and actual experience	2,421	3,499
Total	\$ 15,753	\$ 48,424

University of California, Merced

Notes to Financial Statements (unaudited)

June 30, 2016 and 2015

Deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense during the year ending June 30, 2016 as follows:

(in thousands of dollars)

2017	\$	4,993
2018		2,877
2019		14,490
2020		9,656
2021		46
Total	\$	32,062

The UCRS plans (DC Plan, Supplemental DC Plan, 403(b) Plan and 457(b) Plan) provide savings incentives and additional retirement security for all eligible employees. The DC Plan accepts both pre-tax and after-tax employee contributions. The Supplemental DC Plan accepts employer contributions on behalf of certain qualifying employees. The 403(b) and 457(b) plans accept pre-tax employee contributions and the Medical Centers may also make contributions on behalf of certain members of management. Benefits from the plans are based on participants' mandatory and voluntary contributions, plus earnings, and are immediately vested.

13. Commitments and Contingencies

Contractual Commitments

Amounts committed but unexpended for construction projects totaled \$40,711 and \$29,650 at June 30, 2016 and 2015, respectively.

UC Merced leases buildings and equipment under agreements recorded as operating leases. The terms of operating leases extend through June 2020. Operating lease expenses for the years ended June 30, 2016 and 2015 were \$1,360 and \$1,323, respectively.

Future minimum payments on operating leases with initial or remaining non-cancelable terms in excess of one year are as follows:

(in thousands of dollars)

<i>Year Ending June 30</i>	Minimum Annual Lease Payments	
2017	\$	4,960
2018		4,833
2019		4,398
2020		3,718
Total	\$	17,909

Contingencies

Substantial amounts are received and expended by UC Merced under federal and states programs and are subject to audit by cognizant governmental agencies. This funding relates to research, student aid, and other programs. UC Merced management believes that any liabilities arising from such audits will not have a material effect on UC Merced's financial position.

University of California, Merced

Notes to Financial Statements (unaudited)

June 30, 2016 and 2015

UC Merced is contingently liable in connection with certain other claims and contracts, including those currently in litigation, arising in the normal course of its activities. Although there are inherent uncertainties in any litigation, UC Merced management and general counsel are of the opinion that the outcome of such matters will not have a material effect on UC Merced's financial position.

14. Subsequent Events

In August 2016, the University entered into an agreement with a developer, with minimum contractual payments of \$585.0 million to design, construct, finance, operate and maintain academic classroom and laboratory facilities, student housing and dining facilities, administrative offices, and athletic and recreational facilities, together with associated utilities and infrastructure for the UC Merced campus.

The Project is being undertaken in cooperation with Merced County, the City of Merced, Merced Irrigation District, and other local stakeholders and will be delivered in phases between Fall 2018 and Fall 2020. Under the agreement, the Campus plans to add 1.2 million gross square feet to the Campus, 1,700 new on-campus beds, and 1,500 additional parking spaces.

University of California, Merced

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June 30, 2016 and 2015

REQUIRED SUPPLEMENTARY INFORMATION

The schedule of UC Merced's proportionate share of UCRP's net pension liability is presented below:

(in thousands of dollars)

As of June 30	Proportion of the net pension liability	Proportionate share of net pension liability	Covered- employee payroll	Proportionate share of the net pension liability as a percentage of its covered- employee payroll	Plan fiduciary net position as a percentage of the total pension liability
2016	0.9%	\$ 122,101	\$ 93,049	131.2%	77.2%
2015	0.9%	86,419	87,460	98.8%	82.9%
2014	0.8%	55,302	71,228	77.6%	86.3%

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