

**University of California,
Merced**

2016 - 2017

**Annual Financial Report
(unaudited)**



University of California, Merced

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Message from *Interim* Vice Chancellor Veronica Mendez

It is my pleasure to present this Annual Financial Report for 2016-2017.

UC Merced is the 10th and newest campus in the UC System. We are also the [fastest growing public doctoral institution](#) in the nation. We enroll and serve a highly talented and [diverse set of students](#) 99% of which are California residents, 58% are underrepresented minorities, 72% are the first in their families to go to college, and 60% are Pell grant recipients. Since Merced opened its doors to the San Joaquin Valley in 2005, we have granted 7,650 degrees, with our 2017 graduates achieving the highest 4-year graduation rates (45%) to date. By the close of 2017, UC Merced was ranked [No. 3 in the Nation for Graduation Rate of Pell Grant Recipients](#), [No. 5 in the Nation for Social Mobility](#), and received the [Americas P3 Deal of the Year for the Merced 2020 Campus Expansion Project](#).

With each such success, expectations rise – pushing our institution to look for ways to fulfill our vision and commitments while remaining fiscally responsible. This year, we challenged our units to take broader responsibility outside of their immediate operations and work across the organization to share resources and make further advances. Most notable was the delivery of a Workforce Plan for strategic staff and faculty hiring and the launch of a sustainable budget planning process.

In 2017, we made marked progress on the [2020 Campus Expansion](#) project with the construction of three new buildings featuring classrooms, housing and dining, all set to open in Fall 2018. This project expands all the way to downtown Merced, where our new administrative building is nearly complete. Over 300 employees are scheduled to move into the new [Downtown Center](#) in February, 2018. An exciting year deserves an exciting finish, and so our HR, Finance and IT groups worked through the winter break to successfully launch [UC Path](#), a UC system-wide HR/payroll replacement project.

It goes without saying, that UC Merced's successes are a direct reflection of the brilliance and commitment of its students, faculty and staff. So it is with great pride and transparency that we manage the funds entrusted to us by the University as detailed in this financial report.

Sincerely,

Veronica Mendez
Interim Vice Chancellor, Planning and Budget
University of California, Merced

University of California, Merced

Management's Discussion and Analysis (unaudited)

June 30, 2017 and 2016

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, 2017 with selected comparative information for the fiscal year ended June 30, 2016. 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 \$33.4 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 8,195 acres in Merced and is devoted to undergraduate and graduate scholarship serving over 7,300 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
Management of Innovation, Sustainability and Technology*
Mechanical Engineering
Physics
Political Science
Psychological Sciences
Public Health
Quantitative and Systems Biology
Sociology

* Emphasis within the Individual Graduate Program

During the 2015-2016 academic year, receiving 24,000 first-time freshman and transfer applications for Fall 2016, UC Merced was able to enroll 2,200 freshman and transfer students. Enrollment grew by 10% compared to the prior Fall 2015 term as additional facilities were built and available to accommodate additional students. During the year, the campus' graduating class increased by 11% awarding 1,368 degrees during the 2016-17 academic year compared to 1,236 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 entered into an agreement with a developer to design, construct, finance, operate and maintain the 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, undertaken in cooperation with Merced County, the City of Merced, Merced Irrigation District, and other local stakeholders 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, 1,500 additional parking spaces 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 a school of management 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 \$45.5 million for fiscal year 2017 as compared to \$39.9 million for 2016. 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 which includes over 3.9 million books in digital full-text format and 118.8 terabytes

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 2017 to date, the campus has contributed approximately \$1.6 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 \$2.8 billion since the campus opened.

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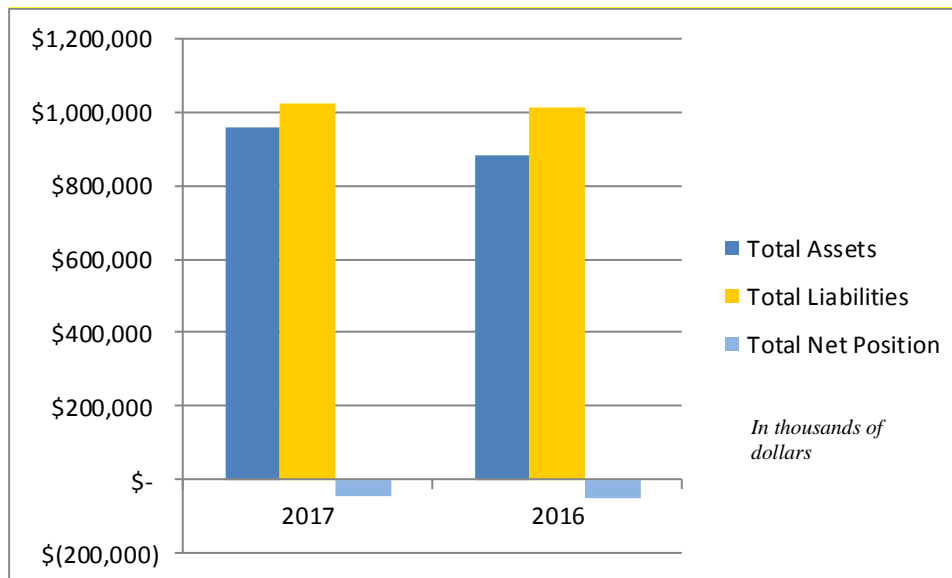
UC Merced is considered a leader in sustainability design and construction with a commitment to being zero waste and zero net emissions by 2020. All of UC Merced's buildings are certified by the 3rd party verification system, Leadership in Energy and Environmental Design (LEED) with the vision of LEED 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 2017, 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	1,698		172	\$ 13,353	\$ 9,975	\$ 23,328
School of Natural Sciences	1,981		296	18,601	14,894	33,495
School of Social Sciences, Humanities & Arts	2,550		264	20,195	11,896	32,091
Graduate Studies		521	12	1,137	824	1,961
Undeclared	586					
All others, including auxiliaries, student services, etc.			914	72,813	119,442	192,255
Subtotal	6,815	521	1,658	\$ 126,099	\$ 157,031	\$ 283,130
Depreciation Expense						29,906
Total						\$ 313,036

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.

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The Campus' Assets

UC Merced's total assets have grown to \$959.0 million in 2017, compared to \$880.7 million in 2016.

Cash and cash equivalents remained relatively unchanged from the prior year; however, cash and cash equivalents decreased by \$52.0 million from 2015 due to the combination of \$45.6 million in investment purchases and increases in spending related to the preparation of the 2020 Project. Investments held by trustees primarily relates to unspent bond proceeds for capital projects. The University allocated approximately \$100.0 million in unspent bond proceeds to UC Merced for the 2020 Project of which, the Campus spent approximately \$31.4 million to date. The remaining \$68.6 million in unspent bond proceeds will be spent over the next three years during the project's construction phase.

Capital assets, net of accumulated depreciation increased \$99.3 million and \$35.1 million in 2017 and 2016, respectively. In 2017, the increase is a result of \$129.3 million in capital additions offset by \$29.9 million in depreciation compared to 2016 capital additions of \$62.1 million offset by \$26.7 million in depreciation. The current year capital additions is a reflection of the significant expansion effort which began in 2017 related to Project 2020 in order to provide the facilities necessary to support UC Merced's teaching, research and public mission and grow the student population to 10,000 by 2020. In 2018, we anticipate, if the project continues on schedule, to incur capital expenditures totaling \$273.1 million with an additional \$429.1 million between 2019 and 2021.

The Campus' Deferred Outflows of Resources

Losses on debt refundings and certain changes in the net pension and net retiree health benefits liabilities are reported as deferred outflows of resources. In 2017, deferred outflows decreased due to higher than expected investment returns in the University of California Retirement Plan (UCRP) portfolio. In 2016, deferred outflows increased due to lower than expected investment returns in the UCRP portfolio.

The Campus' Liabilities

While total liabilities remained relatively unchanged in 2017 when compared to 2016, the campus saw an increase of \$34.8 million in long-term debt and \$19.4 million in accounts payable related to the capital expenditures associated with the 2020 Project. The increases were offset by a \$52.6 million decrease in pension and retiree health benefit 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.

The University has a financial responsibility for pension benefits associated with its defined benefit plans and for retiree health benefits which for UC Merced, is guaranteed by the University. In 2017, UC Merced's share of the net pension liability is \$90.9 million of the total \$10.7 billion for the University as a whole. In 2016, the balance was \$122.1 million of the total \$15.1 billion liability. The change in net pension liability for 2017 was primarily driven by higher than expected investment returns on the UCRP investment portfolio. The change in net pension liability for 2016 when compared to 2015 was primarily driven by lower than expected investment returns on the UCRP investment portfolio. UCRP's total investment rate of return was positive 14.5% in 2017, negative 2.0% in 2016 and positive 4.5% in 2015. The discount rate used estimate the net pension liability was 7.25% in 2017, 2016 and 2015.

UC Merced's 2016 financial statements have been restated as a result of adopting new accounting standards for retiree health benefits which are guaranteed by the University. In 2017, UC Merced's share of the net retiree health benefit liability is \$167.4 million of the total \$19.3 billion for the University as a whole. In 2016, the balance was \$188.8 million of the total \$21.8 billion liability. The University funds the retiree

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health benefits through UC Retiree Health Benefit Trust (UCRHBT) based on a project of benefits on a pay-as-you-go basis and the assets in the trust are not sufficient to fund retiree health benefits. Therefore, the Bond Buyer 20-year tax-exempt general obligations municipal bond index is used to discount the retiree health benefit liabilities. The changes in net retiree health benefits liability have been primarily driven by the changes in discount rates used to estimate the retiree health benefit liability. The discount rates as of June 30, 2017, 2016 and 2015 were 3.58%, 2.85%, and 3.8%, respectively.

The Campus' Deferred Inflows of Resources

Deferred inflows of resources are related to certain changes in the net pension and net retiree health benefits liabilities. In 2017, deferred inflows of resources increased due to the increase in the discount rate for estimating the net retiree health benefit liability. Deferred inflows of resources in 2016 decreased by \$32.7 million due to low investment returns compared to projected earnings.

The Campus' Net Position

Net position represents the residual interest in UC Merced's assets and deferred outflows after all liabilities and deferred inflows are deducted. Net position was restated for 2016 and 2015 as a result of adopting new accounting rules. UC Merced has a negative or net deficit balance of \$45.6 million in 2017 compared to a negative \$52.0 million in 2016 due to the University guaranteed pension and retiree health benefit liabilities. If the pension and retiree health benefit liabilities were removed, including the related deferred inflows and outflows from UC Merced's obligations, the net position balance as a result of operations would be a positive \$214.6 million and \$200.8 million for 2017 and 2016, respectively.

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.

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A summarized comparison of the operating results from 2017 and 2016, 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)

	2017			2016		
	Operating	Nonoperating	Total	Operating	Nonoperating	Total
REVENUES						
Student tuition and fees, net	\$ 69,115		\$ 69,115	\$ 62,898		\$ 62,898
State educational appropriations		\$ 159,149	159,149		\$ 128,758	128,758
Pell grants		19,522	19,522		18,108	18,108
Grants and contracts, net	25,451		25,451	21,532		21,532
Auxiliary enterprises, net	27,720		27,720	24,741		24,741
Private gifts, net		1,861	1,861		3,287	3,287
Investment income, net		3,838	3,838		2,765	2,765
Other revenues	9,192	5,245	14,437	6,592	2,097	8,689
Revenues supporting core activities	131,478	189,615	321,093	115,763	155,015	270,778
EXPENSES						
Salaries and benefits	192,149		192,149	191,919		191,919
Scholarships and fellowships	16,612		16,612	14,736		14,736
Utilities	5,781		5,781	4,945		4,945
Supplies and materials	19,896		19,896	20,370		20,370
Depreciation and amortization	29,906		29,906	26,705		26,705
Interest expense		28,111	28,111		22,257	22,257
Other expenses	48,692	(234)	48,458	51,470	506	51,976
Expenses associated with core activities	313,036	27,877	340,913	310,145	22,763	332,908
Income (loss) from core activities	\$ (181,558)	\$ 161,738	\$ (19,820)	\$ (194,382)	\$ 132,252	\$ (62,130)
OTHER CHANGES IN NET POSITION						
State capital appropriations			55			1,544
Capital gifts and grants, net			(388)			10,000
Contributions from the University for building programs			15,015			34,836
Other transfers			11,540			(2,924)
Increase in net position			6,402			(18,674)
NET POSITION						
Beginning of year, as previously reported			(52,026)			34,403
Cumulative effect of accounting change						(67,755)
Beginning of year, as restated			(52,026)			(33,352)
End of year			\$ (45,624)			\$ (52,026)

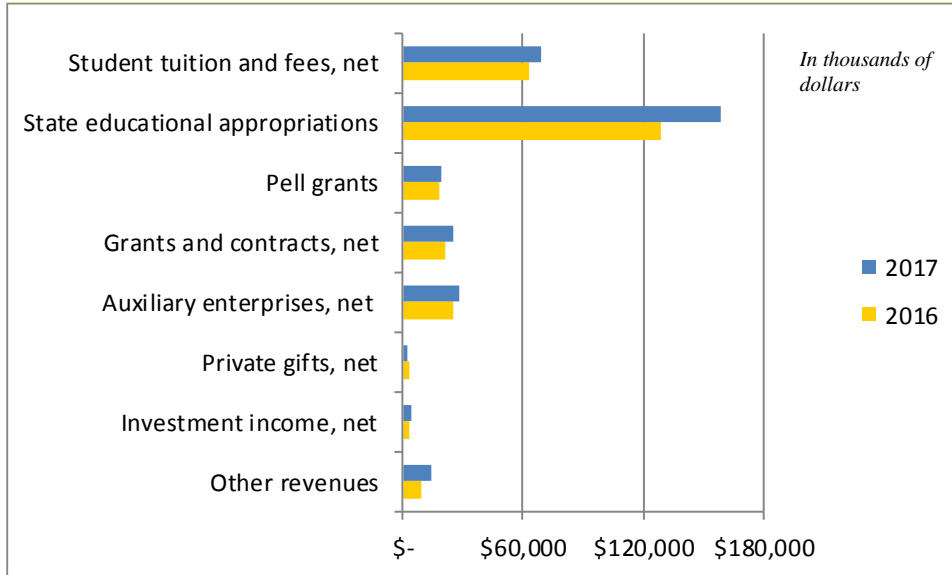
Revenues Supporting Core Activities

Revenues to support UC Merced's core activities, including those classified as nonoperating revenues, grew from \$270.8 million in 2016 to \$321.1 million in 2017, an increase of \$50.3 million as compared to an increase of \$14.1 million in 2016 compared to 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.

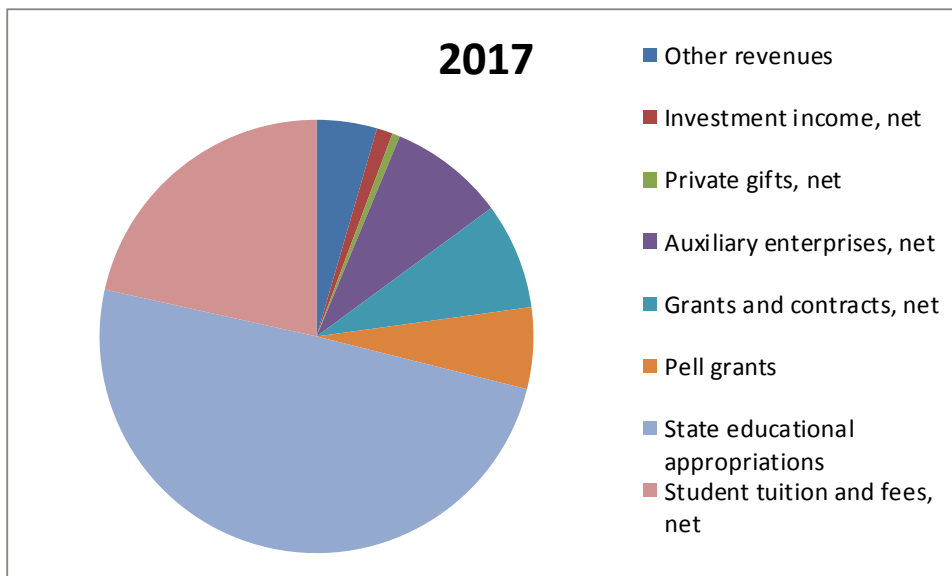
University of California, Merced Management's Discussion and Analysis (unaudited) June 30, 2017 and 2016

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.

Categories of both operating and nonoperating revenue that supported UC Merced's core activities in 2017 are as follows:



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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 21.5% and 23.2% of UC Merced's revenue for 2017 and 2016, respectively.

(in thousands of dollars)

	2017	2016	Change
Student tuition and fees	\$ 97,092	\$ 97,306	\$ (214)
Summer sessions	4,995	4,873	122
Scholarship allowances	(32,972)	(39,281)	6,309
Total student tuition and fees	\$ 69,115	\$ 62,898	\$ 6,217

For 2017, student tuition and fees has remained relatively flat; however, the student population grew by 10% offset by lower average tuition bills due to a shift in student populations, admitting more in-state residents compared to prior years where out-of-state students, which generate higher tuition bills has declined from past years. Scholarship allowances has declined from prior years as UC Merced comes into alignment with the rest of the University in which one-third of the revenue generated from tuition and fees was used for financial aid compared to previous years where 40% was set aside.

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, while the University has set a minimum threshold that one-third of the revenue generated from tuition and fees will be used for financial aid, UC Merced has historically set aside one-fifth of the revenue generated from tuition and fees for both 2016 and 2015.

State educational appropriations from the state of California was \$159.1 million and \$128.8 million in 2017 and 2016, respectively, accounting for 50% and 48% of UC Merced's revenue for 2017 and 2016, respectively. The increases are 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.

Grants and Contracts, net from federal, state, and private sources recognized as expenditures incur, including an overall facilities and administration cost recovery of \$4.5 million and \$4.3 million in 2017 and 2016, respectively are as follows:

(in thousands of dollars)

	2017	2016	Change
Federal government	\$ 19,117	\$ 16,772	\$ 2,345
State agencies	1,286	758	528
Private industries	5,048	4,002	1,046
Total grants and contracts, net	\$ 25,451	\$ 21,532	\$ 3,919

In 2017, revenues from federal grants increased as a result of projects with the National Science Foundation and the Department of Education. In 2016, revenues from the federal government remained relatively flat.

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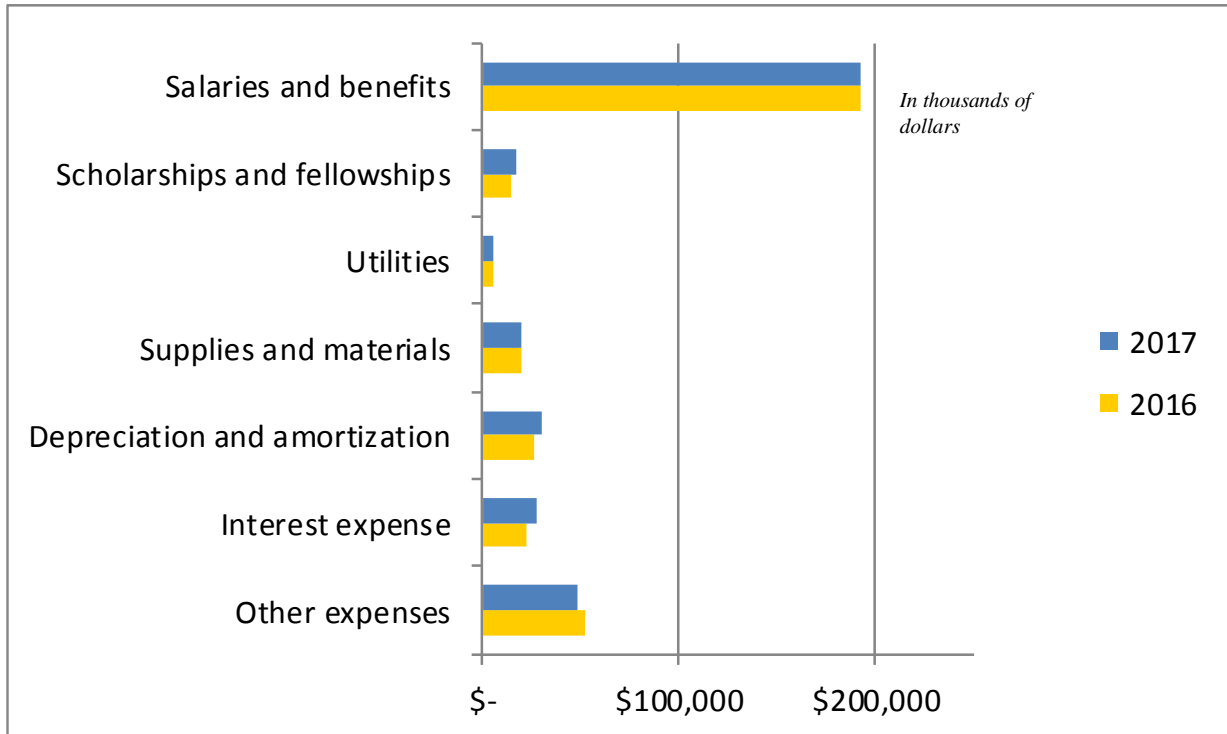
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Expenses Associated with Core Activities

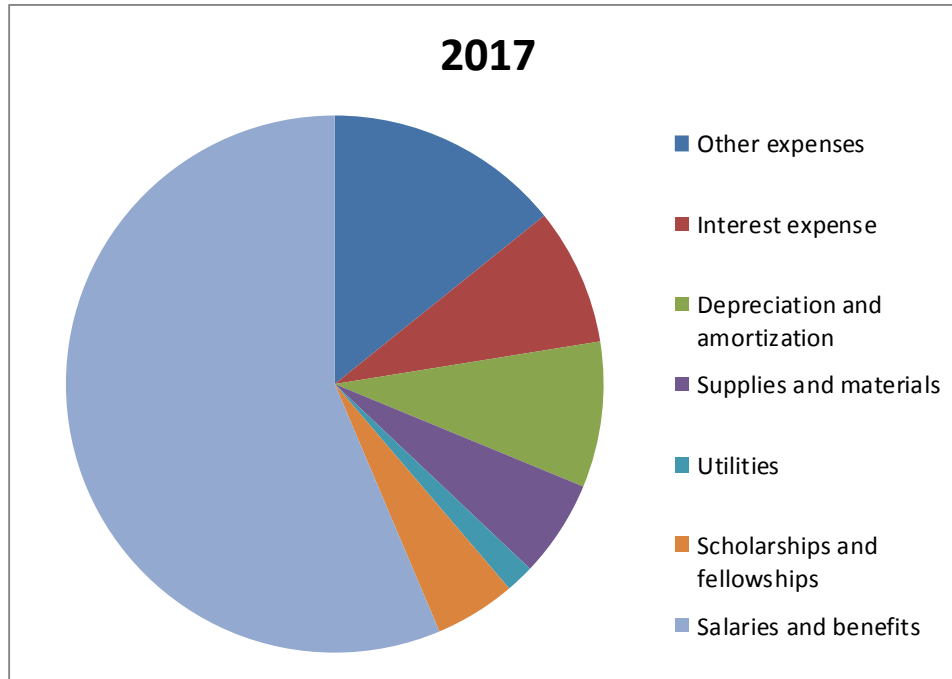
Expenses associated with UC Merced's core activities, including those classified as nonoperating expenses, were \$340.9 million and \$332.9 million in 2017 and 2016, respectively.

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



University of California, Merced Management’s Discussion and Analysis (unaudited) June 30, 2017 and 2016

Categories of both operating and nonoperating expenses that support core activities, as of June 30, 2017 are as follows:



Salaries and benefits cover approximately 1,658 and 1,560 full-time equivalents (FTE), which represents an increase of 6.3% and 10.0% in 2017 and 2016, respectively. Over 61% of UC Merced’s expenses are related to salaries and benefits for the past two fiscal years. In 2017, UC Merced’s salaries and benefits remained relatively flat when compared to 2016 due to a combination of a \$7.5 million increase in salaries offset by a \$7.3 million decrease in employee benefits. In 2016, salaries and benefits increased by \$23.4 million when compared to 2015 due to a combination of an \$8.5 million increase in salaries and wages and a \$14.9 million increase in employee benefits expenses.

In 2017, salaries increased by 6.4% primarily as a result of increases in the employee population. While the campus had moderate salary increases in 2017, when compared to 2016, for existing full-time employees, the campus experienced a 40% increase in student employees in the current year.

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 flattening of average salaries in 2017 and the decline in average salary in 2016 is primarily the result of higher proportions of student employment and administrative staff as the Campus shifts its workforce to shared services for administrative and personnel processing.

In 2017, employee benefits decreased by \$7.3 million due to a combination of a \$7.4 million decrease in pension benefits, \$2.6 million decrease in retiree health benefits expense, offset by a \$2.7 million increase in other benefits such as health insurance, Social Security, Medicare, and other employer costs. Pension expense, and the related net pension liability decreased as a result of higher than expected investment returns on the pension investment portfolio, which is in contract to 2016 when compared to 2015 where the portfolio experienced lower than expected investment returns. Retiree health benefits expense declined from the prior year due to the higher discount rate in 2017.

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In 2016, employee benefits increased by \$20.1 million due to a combination of \$14.5 million increase in pension benefits, \$3.1 million increase in retiree health benefits expense, and a \$2.4 million increase in other employee benefits. 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. Retiree health benefits expense increased due to the lower discount rate in 2016 when compared to 2015.

Other employer benefits increased over the past two years, 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.

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 \$1.9 million and \$1.3 million in 2017 and 2016, respectively.

Scholarship allowances, representing financial aid and fee waivers awarded by UC Merced, were \$44.6 million and \$47.5 million in 2017 and 2016, respectively. On a combined basis, as UC Merced continues its commitment to provide financial support for needy students, financial aid in all forms totaled \$61.2 million and \$62.3 million in 2017 and 2016. While total aid provided remained relatively flat in the current year, 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 remained relatively flat in 2017; however, the increase in 2016 when compared to 2015 was 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 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 \$181.6 million and \$194.4 million in 2017 and 2016, respectively. The operating loss in 2017 and 2016 was partially offset by \$161.7 million and \$132.3 million, respectively of net nonoperating revenue that clearly supports core operating activities of UC Merced. Expenses associated with core activities in 2017 and 2016 exceeded revenue available to support core activities by \$19.8 million and \$62.1million, 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

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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, 2017 and 2016, gifts of \$1.3 and \$1.7 million, respectively were transferred to UC Merced from the UC Merced Foundation. In 2017 and 2016, the Foundation's net position was \$12.4 million and \$10.5 million, respectively.

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.

The major components of the assets, liabilities and net position of the Foundation at 2017 and 2016 are as follows:

(in thousands of dollars)

	2017	2016
ASSETS		
Investments	\$ 10,462	\$ 8,959
Pledges receivable, net	592	711
Other assets	1,348	787
Total assets	12,402	10,457
LIABILITIES		
Accounts payable and other liabilities	-	-
Total liabilities	-	-
NET POSITION		
Restricted:		
Nonexpendable	8,327	7,592
Expendable	3,785	2,554
Unrestricted	290	311
Total net position	\$ 12,402	\$ 10,457

In 2017, the increase in assets is attributable to strong investment performance in the equity markets compared to a poor investment returns experienced in 2016 when compared to 2015 coupled with endowment contributions in both years. 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.

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 2017 and 2016 is as follows:

(in thousands of dollars)

	2017	2016
Operating revenues		
Private gifts and other revenues	\$ 1,207	\$ 1,469
Total operating revenues	1,207	1,469
Operating expenses		
Grants to campuses and other expenses	1,378	1,684
Total operating expenses	1,378	1,684
Operating income (loss)	(171)	(215)
NONOPERATING REVENUES (EXPENSES)		
Investment income	82	70
Net appreciation (depreciation) in fair value of investments	1,255	(398)
Income (loss) before other changes in net position	1,166	(543)
OTHER CHANGES IN NET POSITION		
Permanent endowments	779	486
Increase (decrease) in net position	1,945	(57)
NET POSITION		
Beginning of year	10,457	10,514
End of year	\$12,402	\$ 10,457

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 the Foundation saw declines in the average gift received by approximately 27% even though there was an overall increase in the number of gifts received when compared to 2016. In 2016, when compared to 2015, contributions remained relatively flat.

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

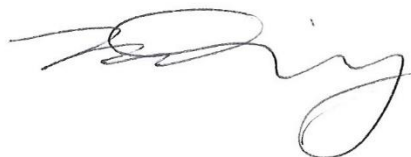
The accompanying Financial Statements reflect the financial position and the results of operations of the University of California, Merced for the fiscal year ended June 30, 2017 and 2016.

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,

A handwritten signature in black ink, appearing to read "Michael R. Riley". The signature is fluid and cursive, with a large loop at the end.

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

University of California, Merced
Statements of Net Position
June 30, 2017 and 2016

	UC Merced		Foundation	
	2017	2016	2017	2016
Assets				
Cash and cash equivalents	\$ 72,052	\$ 71,838	\$ 5	\$ 5
Accounts receivable, net	12,234	6,712		
Pledges receivable, net	150	150	380	433
Inventories	1,056	901		
Other current assets	2	-	1,343	782
Current assets	85,494	79,601	1,728	1,220
Investments	103,777	96,260	10,462	8,959
Investments held by trustees	69,380	96,577		
Pledges receivable, net	296	443	212	278
Notes receivable	415	40		
Capital assets, net	699,261	599,968		
Other noncurrent assets	403	7,789		
Noncurrent assets	873,532	801,077	10,674	9,237
Total assets	959,026	880,678	12,402	10,457
Deferred outflows of resources	71,378	111,972		
Liabilities				
Accounts payable	26,798	6,051		
Accrued salaries	11,974	10,114		
Employee benefits	2,503	2,221		
Unearned revenue	4,022	3,112		
Commercial paper	11,009	5,827		
Current portion of long-term debt	92,967	92,053		
Funds held for others	1,603	1,428		
Other current liabilities	3,526	4,487		
Current liabilities	154,402	125,293	-	-
Long-term debt	606,981	572,217		
Pension and other postretirement benefits	258,295	310,913		
Other noncurrent liabilities	3,206	5,374		
Total Noncurrent Liabilities	868,482	888,504	-	-
Total Liabilities	1,022,884	1,013,797	-	-
Deferred inflows of resources	53,144	30,879		
Net position				
Invested in capital assets net of related debt	79,976	55,058		
Restricted:				
Nonexpendable:				
Endowments and gifts	16,414	16,309	8,327	7,592
Expendable:				
Endowments and gifts	32,861	29,382	3,785	2,554
Other	835	6,455		
Unrestricted	(175,710)	(159,230)	290	311
Total net position	\$ (45,624)	\$ (52,026)	\$ 12,402	\$ 10,457

The accompanying notes are an integral part of these financial statements.

University of California, Merced
Statements of Revenues, Expenses and Changes in Net Position
Years Ended June 30, 2017 and 2016

	UC Merced		Foundation	
	2017	2016	2017	2016
OPERATING REVENUES				
Student tuition and fees, net	\$ 69,115	\$ 62,898		
Grants and contracts, net				
Federal	19,117	16,772		
State	1,286	758		
Private and local	5,048	4,002		
Auxiliary enterprises, net	27,720	24,741		
Campus foundation private gifts			\$ 1,084	\$ 1,398
Other operating revenues, net	9,192	6,592	123	71
Total operating revenues	<u>131,478</u>	<u>115,763</u>	<u>1,207</u>	<u>1,469</u>
OPERATING EXPENSES				
Salaries and wages	126,099	118,552		
UCRP benefits	17,114	24,524		
Retiree health benefits	14,127	16,766		
Other employee benefits	34,809	32,077		
Supplies and materials	19,896	20,370		
Depreciation and amortization	29,906	26,705		
Scholarships and fellowships	16,612	14,736		
Utilities	5,781	4,945		
Campus foundation grants			1,259	1,662
Other operating expenses	48,692	51,470	119	22
Total operating expenses	<u>313,036</u>	<u>310,145</u>	<u>1,378</u>	<u>1,684</u>
Total operating loss	<u>(181,558)</u>	<u>(194,382)</u>	<u>(171)</u>	<u>(215)</u>
NONOPERATING REVENUES (EXPENSES)				
State educational appropriations	159,149	128,758		
Federal financing appropriations	1,546	1,547		
Federal pell grants	19,522	18,108		
Private gifts, net	1,861	3,287		
Investment income:				
Short Term Investment Pool and other, net	2,257	2,010		
Endowment, net	1,581	755		
Campus foundations			82	70
Net appreciation (depreciation) in fair value of investments	3,699	550	1,255	(398)
Interest expense	(28,111)	(22,257)		
Loss on disposal of capital assets	(64)	(283)		
Other nonoperating (expenses) revenues, net	298	(223)		
Net nonoperating revenues	<u>161,738</u>	<u>132,252</u>	<u>1,337</u>	<u>(328)</u>
(Loss) income before other changes in net position	<u>(19,820)</u>	<u>(62,130)</u>	<u>1,166</u>	<u>(543)</u>
OTHER CHANGES IN NET POSITION				
State capital appropriations	55	1,544		
Capital gifts and grants, net	(388)	10,000		
Permanent endowments			779	486
Contributions from the University for the building program	15,015	34,836		
Other transfers	11,540	(2,924)		
Increase (decrease) in net position	<u>6,402</u>	<u>(18,674)</u>	<u>1,945</u>	<u>(57)</u>
NET POSITION				
Beginning of year, as previously reported	(52,026)	34,403	10,457	10,514
Cumulative effect of accounting change		(67,755)		
Beginning of year, as restated	(52,026)	(33,352)	10,457	10,514
End of Year	<u>\$ (45,624)</u>	<u>\$ (52,026)</u>	<u>\$ 12,402</u>	<u>\$ 10,457</u>

The accompanying notes are an integral part of these financial statements.

University of California, Merced
Statements of Cash Flows
June 30, 2017 and 2016

	UC Merced		Foundation	
	2017	2016	2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES				
Student tuition and fees	\$ 68,763	\$ 62,823		
Grants and contracts	21,798	24,650		
Auxiliary enterprises	27,520	24,632		
Campus foundation private gifts			\$ 1,203	\$ 1,383
Payments to employees	(126,267)	(117,909)		
Payments to suppliers and utilities	(72,795)	(79,026)		
Payments to UCRP	(15,140)	(13,528)		
Payments for retiree health benefits	(2,919)	(2,742)		
Payments for other employee benefits	(34,254)	(31,917)		
Payments for scholarships and fellowships	(16,612)	(14,736)		
Loans issued to students	(375)	(40)		
Payments to campuses and beneficiaries			(1,259)	(1,662)
Other receipts (payments), net	16,272	19,737	4	48
Net cash used by operating activities	(134,009)	(128,056)	(52)	(231)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES				
State educational appropriations	148,327	128,758		
Federal pell grants	19,524	18,150		
Gifts received for other than capital purposes:				
Private gifts for endowment purposes			779	486
Other private gifts	2,009	2,693		
Student direct lending receipts	27,085	25,012		
Student direct lending payments	(27,085)	(25,012)		
Scheduled principal paid on debt	(1,454)	(1,432)		
Interest paid on debt	(251)	(272)		
Other receipts (payments), net	773	(2,847)		
Net cash provided by noncapital financing activities	168,928	145,050	779	486
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES				
State capital appropriations	66	1,147		
Federal financing appropriations	1,546	1,547		
Proceeds from debt issuance	45,028	168,660		
Purchases of capital assets	(111,295)	(52,536)		
Scheduled principal paid on debt & capital leases	(7,537)	(7,350)		
Interest paid on debt and capital leases	(18,081)	(21,344)		
Commercial paper financing:				
Proceeds from Issuance	10,509	27,243		
Payments of Principal	(5,327)	(53,596)		
Interest Paid	(16)	(20)		
Other receipts (payments), net	46,564	(89,999)		
Net cash used by capital and related financing activities	(38,543)	(26,248)	-	-
Cash Flows from Investing Activities				
Proceeds from sale & maturities of investments			218	2,162
Purchase of investments		(45,550)	(1,027)	(2,487)
Investment income, net of investment expenses	3,838	2,765	82	70
Net cash provided (used) by investing activities	3,838	(42,785)	(727)	(255)
Net increase (decrease) in cash and cash equivalents	214	(52,039)	-	-
Cash and cash equivalents, beginning of year	71,838	123,877	5	5
Cash and cash equivalents, end of year	\$ 72,052	\$ 71,838	\$ 5	\$ 5

The accompanying notes are an integral part of these financial statements

University of California, Merced

Notes to Financial Statements (unaudited)

June 30, 2017 and 2016

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.

GASB issued Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, was implemented by the University as of July 1, 2016. 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 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.

University of California, Merced

Notes to Financial Statements (unaudited)

June 30, 2017 and 2016

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. The effects of reporting Statement No. 75 in UC Merced's financial statements for the year ended June 30, 2016, were as follows:

(in thousands of dollars)

	UC Merced		
	As of and for the Year Ended June 30, 2016		
	As Previously Reported	Effect of Adoption of Statement No. 75	As Restated
Statement of Net Position			
Deferred outflows of resources	\$ 72,096	\$ 39,876	\$ 111,972
Net retiree health benefit liability	91,465	97,347	188,812
Total liabilities	916,450	97,347	1,013,797
Deferred inflows of resources	15,753	15,126	30,879
Unrestricted net position	(86,633)	(72,597)	(159,230)
Total net position	20,571	(72,597)	(52,026)
Statement of Revenues, Expenses and Changes in Net Position			
Retiree health benefit expense	11,924	4,842	16,766
Total operating expenses	305,303	4,842	310,145
Loss from operations	(189,540)	(4,842)	(194,382)
Loss before other changes in net position	(57,288)	(4,842)	(62,130)
Change in net position	(13,832)	(4,842)	(18,674)

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. Implementation of Statement No. 78 had no impact on the financial statements.

The adoption of Statement No. 75 and 78 did not result in any adjustments to the financial statements of the Foundation.

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. UC Merced's

University of California, Merced

Notes to Financial Statements (unaudited)

June 30, 2017 and 2016

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). 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 20.0% to 52.5% equity securities, 28% to 82% alternatives, and 0% to 17.5% in liquidity (income) investments. 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.

The Foundation has been named the irrevocable beneficiary for charitable remainder trusts for which the Foundation is not the trustee. Upon maturity of each trust, the remainder of the trust corpus will be transferred to the Foundation. These funds cannot be sold, disbursed or consumed until a specified number of years have passed or a specific event has occurred. Consistent with the University's and Foundation's recognition policy for pledges of endowments, receivables and contribution revenue associated with these trusts are not reflected in the accompanying financial statements. UC Merced and the Foundation recognize contribution revenue when all eligibility requirements have been met.

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 of private gifts to UC Merced or to the Foundation, net of allowance for uncollectible amounts, are recorded as pledges receivable and revenue in the year promised at the net 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 and the related pledges receivable 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.

University of California, Merced

Notes to Financial Statements (unaudited)

June 30, 2017 and 2016

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.

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.

Bond premium. The premium received in the issuance of long-term debt is amortized as a reduction of interest expense over the terms of the related long-term debt.

University of California, Merced

Notes to Financial Statements (unaudited)

June 30, 2017 and 2016

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. Deferred outflows of resources and deferred inflows of resources represent a consumption and acquisition of net position that apply to a future period, respectively. 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 shorter of the remaining life of the old or new debt.

Changes in net pension liability and net retiree health benefit liability not included in pension expenses and retiree health benefits expense, respectively, are reported as deferred outflows of resources or deferred inflows of resources. Employer contributions subsequent to the measurement date of the net pension and retiree health liabilities are reported as deferred outflows of resources.

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.

Restricted or unrestricted resources are spent based upon a variety of factors, including funding restrictions, consideration of prior and future revenue sources, the type of expenses incurred, UC Merced's budgetary

University of California, Merced

Notes to Financial Statements (unaudited)

June 30, 2017 and 2016

policies surrounding the various revenue sources or whether the expense is a recurring cost. Unrestricted net position is negative due to UC Merced's proportionate share of University liabilities for pension and retiree health benefits exceeding UC Merced's assets available to pay such obligations.

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 UC Merced, 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.

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, 2017 and 2016 as follows:

(in thousands of dollars)

	2017	2016
Student tuition and fees	\$ 32,973	\$ 39,281
Auxiliary enterprises	11,514	8,132
Other operating revenues	145	111
Scholarship allowances	\$ 44,632	\$ 47,524

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

University of California, Merced

Notes to Financial Statements (unaudited)

June 30, 2017 and 2016

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, 2017 the facilities and administrative cost recovery totaled \$4,461, which consisted of \$3,511 from federally sponsored programs, \$135 from state sponsored programs and \$815 from private sponsors. For the year ended June 30, 2016 the facilities and administrative cost recovery totaled \$4,343, which consisted of \$3,487 from federally sponsored programs, \$84 from state sponsored programs and \$772 from private sponsors.

Retiree health benefits. The University provides retiree health benefits to UC Merced's retired employees. The University established the University of California Retiree Health Benefit Trust ("UCRHBT") to allow certain University locations and affiliates, including the Medical Centers, 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. Contributions from UC Merced to the UCRHBT are effectively made to a single-employer health plan administered by the University as a cost-sharing plan. UC Merced is required to contribute at a rate assessed each year by the University.

Net retiree health benefits liability includes UC Merced's share of the University's net retiree health benefits liability for UCRHBT. UC Merced's share of net retiree health benefits liability, deferred inflows of resources, deferred outflows of resources and retiree health benefits expense have been determined based upon their proportionate share of the University of California Retirement Plan's ("UCRP") covered compensation for the fiscal year. The fiduciary net position and changes in net position of UCRHBT have been measured consistent with the accounting policies used by the trust. For purposes of measuring UCRHBT'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.

Net pension liability. UCRP provides retirement benefits to UC Merced retired employees. UC Merced is required to contribute to UCRP at a rate set by The Regents. Net pension liability includes 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 the 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.

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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 UC Merced and 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 March 2016, the GASB issued Statement No. 81, *Irrevocable Split-Interest Agreements*, effective for UC Merced'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. UC Merced is evaluating the effect that Statement No. 81 will have on its financial statements.

In December 2016, the GASB issued Statement No. 83, *Certain Asset Retirement Obligations*, effective for UC Merced's fiscal year beginning July 1, 2018. This Statement establishes guidance for determining the timing and pattern of recognition for liabilities and corresponding deferred outflow of resources related to asset retirement obligations. The Statement requires the measurement of an asset retirement obligation to be based on the best estimate of the current value of outlays expected to be incurred. The deferred outflow of resources associated with an asset retirement obligation will be measured at the amount of the corresponding liability upon initial measurement and generally recognized as an expense during the reporting periods that the asset provides service. Disclosure requirements include a general description of the asset retirement obligation and associated tangible capital assets, the source of the obligation to retire the assets, the methods and assumptions used to measure the liability, and other relevant information. UC Merced is evaluating the effect that Statement No. 83 will have on its financial statements.

In January 2017, the GASB issued Statement No. 84, *Fiduciary Activities*, effective for UC Merced's fiscal year beginning July 1, 2019. This Statement establishes criteria for identifying fiduciary activities of all state and local governments. Governments with activities meeting the criteria should present a statement of fiduciary net position and a statement of changes in fiduciary net position. This Statement describes four fiduciary funds that should be reported, if applicable: (1) pension (and other employee benefit) trust funds, (2) investment trust funds, (3) private-purpose trust funds and (4) custodial funds. Custodial funds generally should report fiduciary activities that are not held in a trust or equivalent arrangement that meets specific criteria. UC Merced is evaluating the effect that Statement No. 84 will have on its financial statements.

In March 2017, the GASB issued Statement No. 85, *Omnibus 2017*, effective for UC Merced's fiscal year beginning July 1, 2017. The Statement addresses practice issues that have been identified during implementation and application of certain GASB Statements including issues related to blending

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component units, goodwill, fair value measurement and application and post-employment benefits. UC Merced is evaluating the effect Statement No. 85 will have on its financial statements.

In May 2017, the GASB issued Statement No. 86, *Certain Debt Extinguishment Issues*, effective for UC Merced's fiscal year beginning July 1, 2017. This Statement establishes standards of accounting and financial reporting for in-substance defeasance transactions in which cash and other monetary assets acquired with resources other than the proceeds of the refunding debt are placed in an irrevocable trust for the sole purpose of extinguishing debt. In addition, this Statement revises existing standards for prepaid insurance associated with extinguished debt. UC Merced is evaluating the effect Statement No. 86 will have on its financial statements.

In June 2017, the GASB issued Statement No. 87, *Leases*, effective for UC Merced's fiscal year beginning July 1, 2020. This Statement establishes a single approach to accounting for and reporting leases based on the principle that leases are financings of the right to use an underlying asset. Under this Statement, a lessee is required to recognize a lease liability and an intangible right-to-use lease asset, and a lessor is required to recognize a lease receivable and a deferred inflow of resources. Limited exceptions to the single-approach guidance are provided for short-term leases, defined as lasting a maximum of twelve months at inception, including any options to extend, financed purchases, leases of assets that are investments and certain regulated leases. UC Merced is evaluating the effect Statement No. 87 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 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.

Cash and cash equivalents at June 30, 2017, and 2016, consist of the following:

(in thousands of dollars)

	UC Merced		UC Merced Foundation	
	2017	2016	2017	2016
Checking accounts	\$ 183	\$ 235	\$ 5	\$ 5
University of California Managed Short Term Investment Pool (STIP)	71,869	71,603		-
Total cash and cash equivalents	\$ 72,052	\$ 71,838	\$ 5	\$ 5

The checking accounts at June 30, 2017 and 2016 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.

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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	
	2017	2016	2017	2016
Under management of The Regents of University of California (not subject to categorization)				
General endowment pool (GEP)	\$ 36,235	\$ 32,417	\$ 10,462	\$ 8,959
Total Return Investment Pool (TRIP)	67,542	63,843		
Total investments	\$ 103,777	\$ 96,260	\$ 10,462	\$ 8,959

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 requirements and the risk. TRIP is considered to be an external investment pool from UC Merced's perspective.

GEP. The General Endowment Pool (GEP) is 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 UC Merced and the Foundation's perspective.

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. Alternative investment strategies and their underlying assets and rights are subject to an array of economic and market vagaries that can limit or erode value. 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.

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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, bankruptcy, litigation and/or adverse political developments.

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.

Asset-backed securities are debt obligations that represent claims to the cash flows from pools of commercial, mortgage, credit card or student loans. Mortgage-backed securities issued by Ginnie Mae are backed by the full faith and credit of the U.S. government.

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 core fixed-income benchmark for GEP and TRIP is the Barclays Capital US Aggregate Bond Index, comprised of 25.3 percent corporate bonds and 30.5 percent mortgage/asset-backed bonds, all of which carry some degree of credit risk. The remaining 44.2 percent is government issued bonds.

Credit risk in TRIP and GEP is managed primarily by diversifying across issuers. In addition, portfolio guidelines for UCRS and GEP mandate that no more than 15 percent of the market value of fixed-income securities may be invested in issues with credit ratings below investment grade. Further, the weighted average credit rating must be A or higher.

In addition, the investment policy for GEP allows for dedicated allocations to non-investment grade and emerging market bonds, an investment which entails credit, default and/or sovereign risk.

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

Custodial credit risk

Custodial credit risk is the risk that in the event of the failure of the custodian, the investments may not be returned. 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

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.

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The University's portfolio guidelines for the fixed-income portion of TRIP and GEP limit weighted average effective duration to the effective duration of the benchmarks (Barclays 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 2016–2017 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, 2017 and 2016, the investments and deposits held by trustees were held by the University on behalf of UC Merced for capital related projects.

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4. Accounts Receivable

Accounts receivable and the allowances for uncollectible amounts at June 30, 2017 and 2016 are as follows:

(in thousands of dollars)

	UC Merced			UC Merced Foundation
	State and Federal Government	Other	Total	
<i>At June 30, 2017</i>				
Accounts receivable	\$ 9,039	\$ 3,834	\$ 12,873	\$ -
Allowance for uncollectible amounts	(248)	(391)	(639)	
Accounts receivable, net	\$ 8,791	\$ 3,443	\$ 12,234	\$ -
<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	\$ -

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, 2017 and 2016 is summarized as follows:

(in thousands of dollars)

	UC Merced		UC Merced Foundation	
	2017	2016	2017	2016
Total pledges receivable outstanding	\$ 765	\$ 915	\$ 599	\$ 723
Less: Unamortized discount to present value	(4)	(7)	(7)	(12)
Allowance for uncollectible pledges	(315)	(315)		-
Total pledges receivable, net	446	593	592	711
Less: Current portion of pledges receivable	(150)	(150)	(380)	(433)
Noncurrent portion of pledges receivable	\$ 296	\$ 443	\$ 212	\$ 278

Payments of pledges receivable for the fiscal years subsequent to June 30, 2017 and thereafter are as follows:

(in thousands of dollars)

	UC Merced	UC Merced Foundation
<i>Year Ending June 30</i>		
2018	400	380
2019	200	179
2020	165	15
2021		14
2022		11
2023-2027		
Total payments on pledges receivable	\$ 765	\$ 599

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6. Capital Assets

The campus' capital asset activity for the years ended June 30, 2017 and 2016 is as follows:

(in thousands of dollars)

	2015	Additions	Disposals	2016	Additions	Disposals	2017
Original Cost							
Land	\$ 13,360	\$ 21,332		\$ 34,692	\$ 5,384		\$ 40,076
Infrastructure	36,577	102		36,679	2,654		39,333
Buildings and improvements	592,963	64,133		657,096	4,266		661,362
Equipment, software and intangibles	54,426	7,073	\$ (3,119)	58,380	10,280	\$ (1,766)	66,894
Libraries and collections	16,923	1,713		18,636	1,778		20,414
Special collections	132			132			132
Construction in progress	39,377	(32,235)		7,142	104,901		112,043
Capital assets, at original cost	\$ 753,758	\$ 62,118	\$ (3,119)	\$ 812,757	\$ 129,263	\$ (1,766)	\$ 940,254
		Depreciation and Amortization	Disposals		Depreciation and Amortization	Disposals	
Accumulated depreciation and amortization	2015			2016			2017
Infrastructure	\$ 12,680	\$ 1,451		\$ 14,131	\$ 2,318		\$ 16,449
Buildings and improvements	135,949	19,670		155,619	21,028		176,647
Equipment, software and intangibles	34,769	4,455	\$ (2,836)	36,388	5,318	\$ (1,702)	40,004
Libraries and collections	5,522	1,129		6,651	1,242		7,893
Accumulated depreciation and amortization	\$ 188,920	\$ 26,705	\$ (2,836)	\$ 212,789	\$ 29,906	\$ (1,702)	\$ 240,993
Capital assets, net	\$ 564,838			\$ 599,968			\$ 699,261

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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, 2017 and 2016 is as follows:

(in thousands of dollars)

	2017	2016
Interim Financing:		
Commercial paper	\$ 11,009	\$ 5,827
Long-term Financing:		
University of California General Revenue Bonds	621,612	624,475
Note payables to UCOP	34,686	39,795
Other borrowings	43,650	
Total outstanding debt	710,957	670,097
Less: Commercial paper	(11,009)	(5,827)
Current portion of outstanding debt	(92,967)	(92,053)
Noncurrent portion of outstanding debt	\$ 606,981	\$ 572,217

General Revenue Bonds of \$81.4 million are variable-rate demand bonds which reset weekly, and, in the event of a failed remarketing, can be put back to The Regents for tender. UC Merced has classified \$81.4 million of these bonds as current liabilities as of June 30, 2017.

Other UC Merced borrowings consist of contractual obligations resulting from the construction of buildings, infrastructure and other certain facilities.

More detail about the University of California's debt can be found in the 2016–2017 annual report of the University.

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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, 2017 and 2016 is as follows:

(in thousands of dollars)

	UC Merced		UC Merced Foundation	
	2017	2016	2017	2016
Restricted				
Endowments and gifts	\$ 16,414	\$ 16,309	\$ 8,327	\$ 7,592
Nonexpendable	16,414	16,309	8,327	7,592
Expendable				
Endowments	17,452	13,993	2,937	1,844
Funds functioning as endowments	8,305	7,239		
Gifts	7,104	8,150	848	710
Total	32,861	29,382	3,785	2,554
Unrestricted	1,575	1,390	290	311
University endowments and gifts	\$ 50,850	\$ 47,081	\$ 12,402	\$ 10,457

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 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 \$1,517 and \$1,382 for the years ended June 30, 2017 and 2016, respectively.

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9. Operating Expenses by Function

Operating expenses, by functional classification, for fiscal years ended June 30, 2017 and 2016, are as follows:

<i>(in thousands of dollars)</i>	2017	2016
Instruction	\$ 64,910	\$ 62,680
Research	25,815	24,958
Public service	6,242	5,117
Academic support	26,066	25,770
Student services	26,986	25,185
Institutional support	63,790	77,726
Operation and maintenance of plant	19,468	20,188
Student financial aid	17,385	16,154
Auxiliary enterprises	30,043	22,652
Depreciation and amortization	29,906	26,705
Other	2,425	3,010
Total	\$ 313,036	\$ 310,145

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>	Net Pension Liability	Net Retiree Health Benefits Liability	Debt Refunding	Total
<i>At June 30, 2017</i>				
Deferred outflows of resources	\$ 13,880	\$ 35,874	\$ 21,624	\$ 71,378
Deferred inflows of resources	10,175	42,969		53,144
<i>At June 30, 2016</i>				
Deferred outflows of resources	\$ 47,815	\$ 39,876	\$ 24,281	\$ 111,972
Deferred inflows of resources	15,753	15,126		30,879

11. Retiree Health Plans

The University administers single-employer health and welfare plans to provide health and welfare benefits, primarily medical, dental and vision, to eligible retirees (and their eligible family members) of the University of California and its affiliates through UCRHBT. The Regents has the authority to establish and amend the plan. Additional information on the retiree health plans can be obtained from the 2016-2017 annual reports of the University of California.

The contribution requirements of the eligible retirees and the participating University locations, such as UC Merced, are established and may be amended by the University. Membership in 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 who are employed by the University after July 1, 2013, and retire at the age of 56 or older, become eligible for a percentage of the

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University's contribution based on age and years of service. Retirees are eligible for the maximum University contribution at age 65 with 20 or more years of service. Retirees employed by the University prior to 1990 and not rehired after that date are eligible for the University's maximum 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 are subject to graduated eligibility provisions that generally require 10 years of service before becoming eligible for 50 percent of the maximum University contribution, increasing to 100 percent after 20 years of service.

Contributions

UC Merced contributions toward retiree health benefits, at rates determined by the University, are made to UCRHBT. The University receives retiree health contributions from retirees that are deducted from their UCRP benefit payments. The University also remits these retiree contributions to UCRHBT. The University acts as a third-party administrator on behalf of UCRHBT and pays health care insurers and administrators amounts currently due under the University's retiree health benefit plans for retirees who previously worked at a campus or Medical Center. UCRHBT reimburses the University for these amounts.

Participating University locations, such as UC Merced, 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. The assessment rates were \$2.93 and \$2.98 per \$100 of UCRP covered payroll effective July 1, 2016 and 2015, respectively.

UC Merced's contributions for the years ended June 30, 2017 and 2016 were \$2,919 and \$2,742, respectively.

Net Retiree Health Benefits Liability

UC Merced's proportionate share of the net retiree benefits liability as of June 30 is as follows:

<i>(in thousands of dollars)</i>	2017	2016
Proportion of the net obligation	0.9%	0.9%
Proportionate share of the net obligation	\$ 167,368	\$ 188,812

UC Merced's net retiree health benefits liability was measured as of June 30, 2017 and 2016 and calculated using the plan net position valued as of the measurement date and total retiree health benefits liability based upon rolling forward the results of the actuarial valuations as of July 1, 2016 and 2015, respectively. 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. Significant actuarial methods and assumptions used to calculate UC Merced's net retiree health benefits liability were:

	2017	2016
Discount Rate	3.6%	2.9%
Inflation	3.0%	3.0%
Investment rate of return	3.0%	3.0%
Health care cost trend rates	Initially ranges from 5.0 to 9.5 decreasing to an ultimate rate of 5.0 for 2031 and later years	Initially ranges from 6.3 to 9.0 decreasing to an ultimate rate of 5.0 for 2031 and later years

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 are based upon the results of an experience study conducted for the period of July 1, 2010 through June 30, 2014. For pre-retirement mortality rates, the RP-2014 White Collar Employee Mortality Tables (separate table for males and females) projected with the two-dimensional MP-2014 projection scale to 2029 were used. For post-

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retirement, healthy mortality rates are based on the RP-2014 White Collar Healthy Annuitant Mortality Table projected with the two-dimensional MP-2014 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 MP-2014 projection scale to 2029, and with ages then set back one year for males and set forward five years for females. For disabled members, rates are based on the RP-2014 Disabled Retiree Mortality Table, projected with the two-dimensional MP-2014 projection scale to 2029 and with ages then set back one year for males and set forward five years for females.

Sensitivity of Net Retiree Health Benefits Liability to the Health Care Cost Trend Rate

The following presents the June 30, 2017 net retiree health benefits liability of UC Merced calculated using the June 30, 2017 health care cost trend rate assumption with initial trend ranging from 5.0 percent to 9.5 percent grading down to an ultimate trend of 5.0 percent over 15 years, as well as what the net retiree health benefits liability would be if it were calculated using a health care cost trend rate different than the current assumption:

(in thousands of dollars)

	1% Decrease (4.0% to 8.5% Decreasing to 4.0%)	Current Discount (5.0% to 9.5% Decreasing to 5.0%)	1% Increase (6.0% - 10.5% Increasing to 6.0%)
UC Merced	\$ 142,241	\$ 167,368	\$ 202,107

Discount Rate

The discount rate used to estimate the net retiree health benefits liability as of June 30, 2017 and 2016 was 3.58 percent and 2.85 percent, respectively. The discount rate was based on the Bond Buyer 20-Bond General Obligation index since UCHRBT plan assets are not sufficient to make benefit payments.

Sensitivity of Net Retiree Health Benefits Liability to the Discount Rate Assumption

The following presents the June 30, 2017 net retiree health benefits liability of UC Merced calculated using the June 30, 2017 discount rate assumption of 3.58 percent, as well as what the net retiree health benefits liability would be if it were calculated using a discount rate different than the current assumption:

(in thousands of dollars)

	1% Decrease (2.58%)	Current Discount (3.58%)	1% Increase (4.58%)
UC Merced	\$ 200,532	\$ 167,368	\$ 142,837

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Deferred Outflows of Resources and Deferred Inflows of Resources

Deferred outflows of resources and deferred inflows of resources for retiree health benefits were related to the following sources as of the years ended June 30:

<i>(in thousands of dollars)</i>	2017	2016
Deferred Outflows of Resources		
Changes between expected and actual experience	\$ 762	
Changes of assumptions or other inputs	34,917	39,855
Net difference between projected and actual earnings on plan investments	30	21
Change in proportion and differences between employer contributions and proportionate share	165	
Total	\$ 35,874	\$ 39,876
Deferred Inflows of Resources		
Difference between expected and actual experience	\$ 13,187	\$ 14,977
Changes of assumptions or other inputs	29,651	
Net difference between projected and actual earnings on pension plan investments	131	149
Total	\$ 42,969	\$ 15,126

The net amount of deferred outflows of resources and deferred inflows of resources related to retiree health benefits that will be recognized in retiree health benefit expense during the years ending June 30 is as follows:

<i>(in thousands of dollars)</i>	
2018	\$ (293)
2019	(293)
2020	(296)
2021	(299)
2022	(302)
Thereafter	(5,612)
Total	\$ (7,095)

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

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Regents have the authority to establish and amend the benefit plans. Additional information on the retirement plans can be obtained from the 2016-2017 annual reports of the University of California Retirement System.

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, 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, 2017 and 2016 are as follows:

<i>(in thousands of dollars)</i>	2017	2016
UC Merced	\$ 13,808	\$ 13,026
Employees	6,683	7,071
Total	\$ 20,491	\$ 20,097

Net Pension Liability. UC Merced's proportionate share of the net pension liability for UCRP as of June 30, 2017 and 2016 is as follows:

<i>(in thousands of dollars)</i>	2017	2016
Proportion of the net pension liability	0.9%	0.9%
Proportionate share of net pension liability	\$ 90,927	\$ 122,101

UC Merced's net pension liability was measured as of June 30, 2017 and 2016 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, 2016 and 2015, respectively. 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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	2017	2016
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 2017 and 2016 were based upon the results of an experience study conducted for the period July 1, 2010 through June 30, 2014. For pre-retirement mortality rates, the RP-2014 White Collar Employee Mortality Tables (separate table for males and females) projected with the two-dimensional MP-2014 projection scale to 2029 were used. For post-retirement, healthy mortality rates are based on the RP-2014 White Collar Healthy Annuitant Mortality Table projected with the two-dimensional MP-2014 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 MP-2014 projection scale to 2029, and with ages then set back one year for males and set forward five years for females. For disabled members, rates are based on the RP-2014 Disabled Retiree Mortality Table, projected with the two-dimensional MP-2014 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%	6.1%
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%
Treasury Inflation Protected Securities	4.5%	0.4%
Real Estate	5.5%	4.8%
Private Equity	8.0%	11.2%
Absolute Return/Real Assets	6.5%	4.2%
Real Assets	3.0%	4.4%
Total	100.0%	5.6%

Discount Rate. The discount rate used to estimate the net pension liability as of June 30, 2017 and 2016 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

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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.

Sensitivity of the Net Pension Liability to the Discount Rate Assumption. The following presents the June 30, 2017 net pension liability of UC Merced calculated using the June 30, 2017 discount rate 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	\$ 164,406	\$ 90,927	\$ 29,568

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)

	2017	2016
Deferred Outflows of Resources		
Changes in proportion and differences between location's contributions and proportionate share of contributions	\$ 5,230	\$ 7,323
Changes of assumptions or other inputs	7,042	16,020
Net difference between projected and actual earnings on pension plan investments		23,279
Difference between expected and actual experience	1,608	1,193
Total	\$ 13,880	\$ 47,815
Deferred Inflows of Resources		
Changes in proportion and differences between location's contributions and proportionate share of contributions	\$ 3,669	\$ 5,481
Changes of assumptions or other inputs	3,395	7,851
Net difference between projected and actual earnings on pension plan investments	1,757	-
Difference between expected and actual experience	1,354	2,421
Total	\$ 10,175	\$ 15,753

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Deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense during the year ending June 30, 2017 as follows:

(in thousands of dollars)

2018	\$ (2,988)
2019	8,640
2020	3,801
2021	(5,821)
2022	73
Total	\$ 3,705

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 \$37,715 and \$40,711 at June 30, 2017 and 2016, respectively.

UC Merced leases buildings and equipment under agreements recorded as operating leases. The terms of operating leases extend through June 2021. Operating lease expenses for the years ended June 30, 2017 and 2016 were \$2,748 and \$1,360, 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	
2018	\$	5,372
2019		4,876
2020		4,478
2021		39
Total	\$	14,765

Contingencies

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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.

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.

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
2017	0.9%	\$ 90,927	\$ 98,627	92.2%	84.0%
2016	0.9%	\$ 122,101	\$ 93,049	131.2%	77.2%
2015	0.9%	86,419	87,460	98.8%	82.9%

The schedule of the Medical Centers' proportionate share of UCRHBT's net retiree health benefits liability is presented below:

(in thousands of dollars)

As of June 30	Proportion of the retiree healthcare liability	Proportionate share of retiree healthcare liability	Covered-employee payroll	Proportionate share of the retiree healthcare liability as a percentage of its covered-employee payroll	Plan fiduciary net position as a percentage of the total retiree healthcare liability
2017	0.9%	\$ 167,368	\$ 100,375	166.7%	0.6%
2016	0.9%	\$ 188,812	\$ 93,049	202.9%	0.3%
2015	0.9%	161,683	87,460	184.9%	0.3%

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