The Regents of the University of California

COMMITTEE ON FINANCE
November 19, 1999

The Committee on Finance met on the above date at Covel Commons, Los Angeles campus.

Members present: Regents Atkinson, Bagley, Davies, Hopkinson, S. Johnson, Lee, Montoya, Pannor, and Preuss

In attendance: Regents O. Johnson, Khachigian, Kozberg, Lansing, Leach, Moores, Sayles, Taylor, and Vining, Faculty Representatives Coleman and Cowan, Secretary Trivette, General Counsel Holst, Treasurer Small, Provost King, Senior Vice President Kennedy, Vice Presidents Broome, Darling, Gomes, Gurtner, and Hershman, Chancellors Carnesale, Cicerone, Dynes, and Yang, Vice Chancellor Suduiko representing Chancellor Greenwood, and Recording Secretary Bryan

The meeting convened at 9:40 a.m. with Committee Chair S. Johnson presiding.

1. UNIVERSITY OF CALIFORNIA FINANCIAL REPORT

The 1999 University of California Financial Report was mailed to all Regents in advance of the meeting.

Vice President Broome discussed the report in detail, noting that it focuses on the University’s financial position and operating results. She noted that in 1999, the University recorded total revenues of $13 billion, which included $3 billion in revenues and expenses associated with the Department of Energy laboratories. The University recorded nearly $12.8 billion in expenditures, $3 billion of which was for the laboratories. Of the remaining $9.8 billion of University expenditures, $7.2 billion was spent for educational and general purposes, almost $1.9 billion was for the medical centers, and $500 million was for auxiliary enterprises. Non-mandatory transfers of $93 million were made to UC plant and endowment funds. The result was an increase of $314 million to the University’s current fund equity.

Ms. Broome noted that the current operating revenues of approximately $10 billion represent a growth of $673 million over the past year, an increase of 7.2 percent. The largest growth came in State funds, which increased by $353 million. This increase in State appropriations provided the University with funds for increased enrollment, a student fee reduction for California residents, the expansion of outreach and research programs, the start up of academic programs, and planning for the Merced campus. Revenues from the federal government, which include appropriations, grants, and contracts, grew by $110 million, to $1.6 billion. This was due to an increase in award levels and in the number of awards granted. In the category “educational activities,” Ms. Broome noted that medical center revenues decreased by $28 million, while
revenue from private gifts, grants, and contracts increased by $83 million. A growth in student tuition and fees of $25 million is attributable to a 2.2 percent increase in enrollment and an increase in nonresident tuition. This was offset by a reduction of 5 percent in student fees, which was made up for in the State appropriations.

Mr. Broome observed that during the past year, operating expenditures, which totaled $9.7 billion, grew by $625 million, an increase of 6.9 percent. The biggest change was in academic support, where an increase of $211 million was attributable to growth in support facilities such as libraries and clinics. Patent royalty payments increased significantly also. A growth in research spending of over $155 million was due mainly to increased funding from federal resources for research in a variety of academic disciplines including medicine, engineering, biological and physical sciences, and health professions. Instruction, which includes academic salaries and other expenditures related to UC’s instructional programs, increased by about $149 million. Salaries and wages accounted for $110 million of this increase, which was related to a commitment to adjust faculty salaries in order to regain a competitive position with peer institutions. The remainder of the increase was attributable to instructional technology and equipment. The increase in public service of about $41 million was due to the current emphasis on academic outreach programs.

Ms. Broome recalled that the University’s revenue sources are fairly diverse. State funds provide 26 percent of revenue, while student tuition and fees provide 11 percent. Although State support and student tuition and fees are the core components of the funding that supports the instructional mission of the University, State funding also supports some public service activities. Gifts, grants, and contracts, which make up 23 percent of the University’s sources of funds, support the research mission. This source enables student participation in a variety of research projects alongside prominent researchers and also provides financial aid to students. The medical centers provide 19 percent of the funds, which help support health science programs and provide a variety of training and research opportunities for medical students. The University’s educational activities, which include income from its faculty practice plans, account for 9 percent of revenue and also help with the cost of providing medical education. Auxiliary enterprises such as student housing, food service, and parking operations account for 6 percent of the revenue. The remaining 6 percent is derived primarily from patent revenue and sales of publications.

The distribution of expenditures by functional category shows how the University spends its money. Ms. Broome noted that, exclusive of DOE funds, the cost of instruction accounts for 24 percent of expenditures. That cost covers primarily academic salaries and all direct expenditures for instructional programs at the University. Research accounts for about 20 percent of expenditures. Public service programs, mainly for outreach, account for 3 percent. Although these three categories of functional expenditures directly support the University’s mission, there are other important categories. Expenditures for academic support include libraries, clinics, and other expenditures directly assisting the academic function. Student services such as student health and counseling account for 14 percent of expenditures, while auxiliary
services to provide housing and career services to students account for 5 percent. Medical centers account for 20 percent of expenditures. Institutional support for physical plant infrastructure accounts for 9 percent of expenditures.

Ms. Broome observed that the University’s financial position is evidenced by the strength of its balance sheet and the growth in its fund equity. She noted that since recording of the fair value of investments in the financial statements began, the major change in the growth in equity has been attributable to the investment markets. Endowment funds grew by about $600 million in 1999, largely related to investment appreciation, although the University received about $50 million in gifts. The University’s equity in its plant grew by $472 million, resulting in a total of $12 billion in plant equity. Total equity for the year grew from $58.2 billion to $63.8 billion.

Ms. Broom noted that over the next two years certain portions of the financial statements will be affected by recent government pronouncements on how government accounting will be reported that will require the University to depreciate its fixed assets as if it were a commercial enterprise. These changes will be demanding to comply with for the University because of its size and complexity.

Regent Lee asked whether the University’s balance sheet will reflect large losses following the wind up of UCSF Stanford Health Care. Ms. Broome responded that, to the extent there are losses, UC’s investment and therefore its assets will be reduced. Regent Preuss expressed his hope that by the time the merger is dissolved, major losses at UCSF will have been curtailed.

Chairman Davies recalled that it is helpful to know what percentage of the cost of instruction student fees and tuition currently cover, net of financial aid. Vice President Hershman estimated that it was about 15 percent.

2. **ENDORSEMENT OF SCHOOL FACILITIES BOND INITIATIVE FOR MARCH 2000 BALLOT**

The President recommended that the Board take a position in support of Proposition 26 on the March 2000 Primary Election ballot, which amends the California Constitution to allow passage of local school bond issues with a simple majority, rather than the two-thirds vote currently required.

It was recalled that Proposition 26, the Majority Rule Act for Smaller Classes, Safer Schools, and Financial Accountability, would amend the California Constitution to allow passage of bond issues for local schools, community college districts, and county education offices with a simple majority. This would make the voter requirement for passage of local school bonds the same as for passage of statewide bond measures. The Act would also implement measures to provide accountability for local school bonds by including annual performance and financial audits and a requirement that a specific list of projects to be built with bond money be provided to voters.
In addition, the measure requires that public school facilities should be shared fairly among all public school pupils, including those in charter schools. The initiative stipulates that each school district shall make available to each charter school operating in the school district facilities sufficient for the charter school to accommodate all of the charter school’s in-district students in conditions reasonably equivalent to those of other public schools of the district.

The state’s K-12 public school enrollment is expected to increase by nearly one million students over the next decade, according to California Department of Finance projections. In order to accommodate these students, the California Department of Education estimates that as much as $46.6 billion will be needed to repair existing facilities and to build new facilities. More than half of California schools were built at least 30 years ago, and more than 30 percent of school buildings in California are temporary.

In addition to the growth expected in public school enrollment, as a result of legislation passed in 1996, K-12 schools have reduced their class sizes to 20 students in the lower grades. Prior to class size reduction, the ratio had been 36 to 1. An additional 28,000 new classroom spaces will be required to accommodate this class size reduction. This situation, coupled with the fact that class size reduction is being considered for higher grades, exacerbates the need for new and renovated facilities.

At the same time schools are feeling the pressure of burgeoning growth, standards for the quality and level of instruction provided K-12 students have been significantly raised by state and local boards of education. Moreover, new measures of accountability for student learning outcomes at all grade levels are pressing hard on schools and teachers throughout California. In short, the public and its authorized representatives are demanding results from a system that is severely strained in terms of its capacity to deliver.

The University of California has a long history of distinguished service to the state’s K-12 system and, at this critical time, is intensifying its efforts. For example, the University is committed to doubling the number of students prepared in its teachers’ education program within the next three years, preparing 400 principals per year for service in disadvantaged schools and districts, and offering intensive training programs for under-prepared (non-credentialed) teachers in reading and algebra as well as for teachers of English language learners. Within the context of these efforts, UC draws heavily on applied faculty research to formulate program designs and continually monitor and evaluate quality and effects. Complementing these efforts is a vast array of University outreach programs designed to assist students in overcoming educational disadvantages to prepare them better for admission to UC.

The ultimate success and sustainment of the University’s efforts to improve K-12 education and attract the best and brightest young people to the education profession depend in large measure on the extent to which K-12 facilities are structurally safe, modernized, and educationally sound.
If this measure enables more K-12 and community college facilities to be funded at the local level, the pressure on the State to fund these facilities through general obligation bonds will lessen and will potentially allow for more State support for public university facilities. According to the Legislative Analyst’s Office (LAO) and the California Department of Finance (DOF), passage of the Act would result in major annual savings in state debt service costs. The LAO and DOF further stated that while the State would realize annual savings in debt service costs, there could potentially be annual increases of a similar amount in local debt service costs for kindergarten through community college facilities.

**Historical Background: 2/3 vote requirement**

The State constitution requires a 2/3 vote on all local general obligation bonds. Since 1986, when local school district bonding capacity was reinstated, there have been 473 attempts by school districts to pass general obligation bonds, with half passing during that time.

The successful measures authorized more than $8.7 billion in capital expenditures, while the aggregate of the unsuccessful measures totaled $6.8 billion. More than 94 percent of school bonds on local ballots since 1986 would have passed if they required a simple majority.

There have been several legislative efforts to remove the 2/3 vote requirement since 1990, including SCA 12 (O’Connell) in 1997, which was co-sponsored by Governor Wilson. In 1993, Proposition 170, which would have authorized majority approval for local general obligation bonds of school districts, community college districts, and counties, failed at the polls.

**Other Background**

In 1998, California voters approved Proposition 1A, a statewide education bond act to provide $9.2 billion, over four years, for new construction and repairs of public elementary schools, high schools, community colleges, and universities. Of that amount, $6.7 billion was allocated to K-12 schools. However, school districts can receive Proposition 1A funds only if they can generate matching funds through any combination of local bonds, developer fees, and other sources of local funds.

**Arguments in Support of and Against Proposition 26**

The Secretary of State’s Office will issue the March 2000 ballot measures for public display on November 23, at which time official authors of arguments for and against each measure will be available.

The Proposition 26 website provides the following among its list of endorsements: The California Building Industry Association, California Business Roundtable, California Chamber of Commerce, California Manufacturers Association, California School
Boards Association, California Teachers Association, College League of California, and the California State Association of Counties. In addition, the CSU Board of Trustees endorsed the measure at its November 16-17 meeting. The only known opposition at the present time is the Howard Jarvis Taxpayers Organization which has formed a group, “Save Our Homes!” to defeat Proposition 26.

Regents Bagley, Preuss, and Kozberg voiced their support for the recommendation.

Upon motion duly made and seconded, the Committee approved the President’s recommendation and voted to present it to the Board.

3. **REPORT ON NEW LITIGATION**

General Counsel Holst presented his **Report on New Litigation.** By this reference the report is made a part of the official record of the meeting.

The meeting adjourned at 10:10 a.m.

Attest:

Secretary