The Regents of the University of California

COMMITTEE ON FINANCE
October 17, 2001

The Committee on Finance met on the above date at UCSF–Laurel Heights, San Francisco.

Members present: Regents Atkinson, Connerly, Hopkinson, S. Johnson, Lee, Montoya, Morrison, and Preuss; Advisory member Ligot-Gordon

In attendance: Regents Bagley, Bustamante, Davies, T. Davis, O. Johnson, Lozano, Marcus, Moores, Pattiz, Sayles, and Seymour; Regents-designate Sainick and Terrazas, Faculty Representatives Binion and Viswanathan, Associate Secretary Shaw, General Counsel Holst, Provost King, Senior Vice Presidents Darling and Mullinix, Vice Presidents Broome, Gómez, Gurtner, and Hershman, Chancellors Berdahl, Bishop, and Vanderhoef, Vice Chancellor Brase representing Chancellor Cicerone, and Recording Secretary Bryan

The meeting convened at 1:25 p.m. with Committee Chair Preuss presiding.

1. **CONSENT AGENDA**

A. ***Incremental Funding of Fixed-Price Construction Subcontract, Lawrence Livermore National Laboratory***

The President recommended that, as an exception to Standing Orders 100.4(dd)(1) and (8) and subject to appropriate University pre-bid concurrence and approval of the Department of Energy, the Lawrence Livermore National Laboratory (LLNL) be authorized to solicit and execute an incrementally funded, fixed-price construction subcontract at LLNL for the construction of Building 453, Terascale Simulation Facility. This project is authorized in connection with work done under the University's master operating contract for LLNL, where the total value of individual subcontracts would exceed the amount appropriated for project work on a fiscal year basis.

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

2. **POLICY CONSIDERATIONS GUIDING THE DEVELOPMENT OF THE 2002-03 UNIVERSITY OF CALIFORNIA BUDGET**

It was recalled that discussion of the policy considerations guiding the development of the budget for 2002-03 began at the May Regents' meeting and continued at the July meeting. The proposed budget for 2002-03 will be presented to The Regents for approval at the November meeting.

Operating Budget

For the last seven years the University's highest budget priority has been full funding of the Partnership Agreement (or Compact prior to 1999-2000). The funding principles in the Partnership represent the University's best estimate of the minimum needed to maintain quality while providing access to eligible students.

Regents' items associated with discussion of the policy considerations guiding development of the 2002-03 budget, based on the Partnership Agreement, were distributed for both the May and July Regents' meetings. The May item explained the major principles and funding strategies the University will use in developing its request to the State. At the July meeting, Regents requested that the document prepared for the May meeting be revised to describe better the University's capital needs and to reflect the importance of graduate enrollment growth and adequate graduate student support to the University's ability to maintain quality.

The May item was developed before the release of the Governor's May revision, which proposed a reduction of 3 percent in the University's Partnership funding. The July Regents' item explained the changes that had taken place in terms of the University's 2001-02 Partnership funding as part of the May revise and anticipated that the University's highest priority in 2002-03 should be full funding of the Partnership Agreement for next year, including: (1) the 4 percent basic budget adjustment, (2) 1 percent for core needs, (3) funding for enrollment growth, (4) State support for summer instruction at the five remaining general campuses, and (5) funding for cost adjustments to fee-funded programs in order to avoid fee increases, as well as restoration of the $90 million in Partnership funds eliminated from the 2001-02 budget. These priorities alone could require an 11 percent increase over the current year budget. Thus, the University is presented with a significant budgetary challenge for 2002-03. The State's fiscal situation has deteriorated over the last several months, reflected in the sharp decline in revenue from capital gains and stock options and a slower rate of revenue growth from other sources. The State's just-completed revenue estimates for the 2001-02 budget assume levels that are $3 billion lower than revenue levels in the previous year. To minimize the impact of lower revenues, the Governor and the Legislature reduced the State's reserve from $6.3 billion in 2000-01 to a projected $2.6 million in 2001-02. Expenditures overall for the State in 2001-02, which are 1.7 percent lower than expenditure levels for the previous year, will exceed revenues by $3.7 billion on an annual basis, creating a significant problem for future years' budgets.

As a result of this imbalance between revenue and expenditures, State funding in 2002-03 may not be sufficient to meet basic needs. Due to the State's fiscal situation and the importance of focusing efforts on obtaining adequate funding for the Partnership, the University has been advised by the Department of Finance that it would not be prudent to seek funding for research, public service, and other initiatives above the Partnership until the State's fiscal situation improves. Also, the Department of Finance has asked the University, along with others, to look at options for base budget cuts.

With the loss of Partnership funding in 2001-02 and the prospect of further reductions in Partnership funds and/or base budget cuts in 2002-03, the University must look at a variety of options for the short term until the State's economic situation improves. While economists predict that California's economy will turn around in 2002, this may not produce a corresponding increase in State General Fund revenue because capital gains and stock options revenue could drop again next year; however, the fundamentals of the California economy are strong and should produce healthy growth over the long term. Therefore, consideration of options should be in the context of a temporary slow-down that may require more than one year for recovery.

The University is faced with the challenge of how to maintain quality during a time when full funding of the Partnership is problematic. It is vital that options be considered in the context of fiscal and political reality. A variety of constituencies are involved in setting priorities for the University—Regents, faculty, staff, students, and external constituencies such as the Governor and the Legislature. Solutions to the University's fiscal problems will require broad, ongoing consultation with all these groups and will evolve throughout the entire budget process.

All options should be considered to address funding shortfalls over the near term, including increasing fees, delaying implementation of State-supported summer instruction, reducing funding for research and public service initiatives, and slowing enrollment growth (i.e., moderate the plan for 6 percent annual growth in community college transfer students and delay implementation of the Dual Admissions program), to list but a few. Discussion must also focus on the implications of funding shortfalls in key areas of the budget, such as faculty and staff salaries, as well as the trade-offs that might need to occur in the short term until the State's fiscal situation improves. For instance, faculty and staff salaries were particularly affected during the budget cuts of the early 1990s; staff salaries have not yet fully recovered from those shortfalls. During that time, campuses had to absorb over $400 million in budget cuts. Reductions in recently-funded initiatives may be necessary in order to protect base budgets that have been particularly hard hit by past cuts. Nevertheless, it is important to consider these options with the expectation that the State's fiscal situation is temporary and not as serious as the recession of the early 1990s, and that restoration of all lost Partnership funding will be provided as soon as the State's fiscal situation improves.

The University must make every effort to obtain as much as possible of the new Partnership funding required for 2002-03 and restoration of the lost Partnership funds from 2001-02 as soon as the State's fiscal situation permits. Yet, the fiscal reality is such that it may take more than one year to achieve these goals. The University's plan for addressing shortfalls should reflect this fact. It is anticipated that discussions will continue at each Regents' meeting, beyond the November approval of the budget, as the budget process proceeds. Five-year projections for campus budgets submitted in

January will reflect not only the revised budget for 2001-02 but also lowered expectations for State funds in the near term.

Capital Outlay

The Partnership Agreement acknowledges the administration's support for general obligation bond funding and lease revenue bonds for capital needs beyond 2001-02. This is a critical issue for the University in terms of its ability to accommodate students and continue to maintain quality. Without adequate facilities to attract faculty and teach students, it will be difficult to live up to a commitment under the Master Plan to accept all eligible students.

The University estimates it will need approximately $600 million per year in capital funding for core academic space, about half of which would be used for projects related to enrollment growth and the other half for projects related to seismic and life-safety needs, infrastructure, and renovation of space that can no longer support the academic program. The University received $210 million per year from the State in Proposition 1A bond funding for four years through 2001-02. This amount is insufficient to meet its needs. The University has been working diligently in Sacramento to secure approval of a larger bond for the four-year period beginning in 2002-03. As part of this process, the Speaker of the Assembly requested that the University work with the community colleges and California State University to develop a proposal for a new bond for higher education. Together, the segments have agreed on a four-year, $4.8 billion proposal. It has several components:

- $4 billion over the four-year period for the capital needs of the higher education segments, to be divided equally ($333 million per year per segment);

- $200 million for development of new campuses and off-campus centers, which can be used for funding the development of the Merced campus and a new off-campus center in the Silicon Valley;

- $200 million for funding joint-use facilities;

- $200 million for modernization of community college facilities;

- $200 million as multi-purpose funds that can be used to augment any of the above categories, providing more flexibility.

This proposal is being debated in the legislature. President Atkinson has appointed a Capital Needs and Funding Strategies Task Force that is reviewing both capital needs and funding strategies for both State and non-State sources.

Vice President Hershman commented that all of the University's options for dealing with the unfavorable budget were difficult and politically sensitive. He recalled that it has been known for many months that revenues and expenditures were out of balance in the budget and that the State was using up most of the budget surplus. The Governor has indicated that since the May Revision the State's estimated reserve has declined by $1.5 billion and would likely be depleted by year's end. Every State program has been asked to plan for budget cuts of up to 15 percent, which for the University is $475 million. While federal research money has been growing by about 10 percent per year and there is strong sentiment in Congress to keep increasing these funds, there is a concern about sustaining increases in private funds; further, the threat to the State budget could affect the University's hospitals, which are heavily dependent on supplemental funds for treating a disproportionate number of indigent and low-income patients through Medi-Cal.

Mr. Hershman reported that consultation has been taking place throughout the University on how to address these difficulties. He expected that the State's fiscal circumstances will continue to change during the coming year. In terms of the University's basic budget, the University intends to request funding based on the Partnership. He indicated that the budget document to be considered by the Regents will be mailed within the next two weeks. It will provide history, background, and rationale for the University's budget proposal, which will include a core 4 percent increase, mostly for salaries; money for other core needs such as maintenance and instructional technology; money for enrollment at the agreed-upon marginal cost formula; funding for summer instruction; and money to ensure that fee increases will not be necessary. In addition, the University intends to keep open for discussion the fact that it did not receive full funding this year and that it hopes for restoration of that $90 million and any money not provided for next year.

Mr. Hershman talked about options for dealing with the potential budget cuts. He suggested five main options. First, he discussed salaries, noting that when money is tight, the first tendency is not to provide salary increases. He believed that the minimum salary increase should be 1.5 percent and that if the faculty receives the increase, so should the staff. He recalled that when faculty salaries fell behind in the early 1990s, they did not recover until 2000. He noted that the University is in a period of growth and needs to be competitive in the marketplace. Second, he noted that full State funding for year-round operations had been started at three campuses this year and that the remaining campuses had been proposed to receive similar funding for next summer. He was not optimistic that the money would be made available by the State. His third suggestion was to increase fees, which are very low compared to other high-quality public institutions and have not been increased for seven consecutive years. In fact, there was a 10 percent fee reduction for undergraduate students and a 5 percent reduction for graduate students during that period. Noting that fee increases historically have been extremely unpopular, he recalled that during the last severe economic downturn, the University continued to take the number of students it had originally planned for regardless of the fact that it had reductions in the funding that would have supported them. The University has never recouped these losses. He believed that if the University's core instructional budgets were cut, enrollments should be brought in line with resources. He advised against continuing to expand enrollments. He suggested that the remaining option was to make undesignated budget cuts and abandon The Regents' goal of preserving quality.

Mr. Hershman recalled that in the last few years there have been huge increases in programs that the Legislature, the Governor, and The Regents believed were important to the state. These included helping K-12 students through professional development institutes and outreach efforts. They are important programs, and it will be controversial to discuss reducing their funding. As a result of capital gain and stock option revenue, the State had the money to fund these programs when they were begun, but that turned out to be a short-term situation.

Mr. Hershman noted that in order to be able to get a satisfactory budget, the University must work diligently with the Governor and the legislature to reach agreement. The Regents' priorities must be stated in order to form a basis for this negotiation.

Committee Chair Preuss emphasized the importance of maintaining the quality of the institution, believing that it was the primary responsibility of The Regents to do so. He observed that strong arguments may be made both in favor of and in opposition to each of Mr. Hershman's suggestions for accommodating budget cuts. The University is already faced with the difficult task of accommodating Tidal Wave II student increases.

Regent Hopkinson agreed that preserving quality is key. She believed that all options should be on the table and that prioritizing budget cuts will be difficult. She recalled that some specific goals had been set previously, such as maintaining a certain student-faculty ratio. She suggested that, while some goals may have to be suspended temporarily, the University should not be allowed to slip backwards.

Regent Lee also agreed that quality was the most important thing. He was concerned about increasing fees for students who are already on campus. He advocated instead assessing the relevance of individual programs.

Regent Bagley commented that long-range proposals for improving K-12 may have to be delayed. He believed that growth overall may need to be curtailed. He noted that 85 percent of the State budget goes to entitlements. If there is to be a real State deficit, the 15 percent budget cut will have to come from the remaining portion of the State budget. The legislature may be faced with increasing taxes in an election year.

Regent Seymour asked how much time the Board had to make its decisions. Mr. Hershman responded that the process will continue to evolve. The Governor makes decisions on his budget in mid-December. The Regents should indicate their priorities by December 10, but he predicted that the situation will likely become worse during the May revise. Regent Bustamante believed that the Governor's budget will reflect a conservative estimate in order to prepare for the worst. The decision points are in December, April, May, and June. Generally, the budget becomes more specific during that process. He believed that the Governor will look to The Regents to help him determine a realistic budget that will not compromise quality. The University needs to determine what information would be most helpful to him during his deliberations. Second, the University should provide a description of the consequences of its suggested cuts to give the Governor and Legislature a clear picture of the situation. He hoped that, despite overall cuts, there could be an increase in the budget for security.

Regent Connerly observed that all programs need to be examined to make sure that they are still relevant and appropriate. He advocated trying to leave the basic organization intact so that recovery, when it comes, will be smoother. He supported raising student fees, which he believed should have been increased in good times when students and their families could have afforded to pay more.

Regent Davies stated that a doomsday plan will have to include not just some but all of the suggested options. There may have to be not only large fee increases but also early retirement programs.

Chairman S. Johnson stated that she did not want the University to endure accepting students for whom funding was not provided. She advocated shrinking enrollments as a first priority in order to preserve resources for core needs. She commented that the University had been given the task of providing many programs beneficial to California society. These programs have reached large sums in the University's budget, yet they do not reflect the core mission of the institution. It may be necessary to reduce these programs until such time as there is adequate funding available.

Regent Pattiz noted that $40 billion had been earmarked by the federal government to fight terrorism. He asked whether the University is working to get some of that money. Regent Atkinson responded that the Livermore and Los Alamos national laboratories and many University research groups are at the center of those discussions.

Regent-designate Ligot-Gordon asked what factors go into constructing fair student fees. Mr. Hershman recalled that the California Postsecondary Education Commission had grappled with the issue of fairness and found no easy answer. The use of comparison institutions is valuable. The University has ensured that needy students receive financial aid, and the State has maintained low fees as a matter of public policy.

Regent Montoya noted that undergraduate and graduate student fees should be considered separately. She believed that professional fees deserve to be increased.

Regent Lozano believed that the University's stated fee policy should be upheld and should be long-term. It should be predictable and stable regardless of the State's economy. She noted that the University's mission is to ensure not only quality but access and affordability. She hoped that in examining programs consideration be given as to their effect on all aspects of the University. Mr. Hershman recalled that maintaining a stable fee policy has always been a priority for the University; unfortunately, the University's policy tends to be set aside during the political process.

President Atkinson introduced Mr. Kenny Burch, Chair of the University of California Student Association, who discussed the budget priorities of the association's board. He focused on three budgetary priorities: no student fee increases for either resident or non-resident students; funding increases for student services; and increases in support for graduate students. He noted that, although it is aware of the State's economic situation, UCSA believes that raising fees would be detrimental to the University's affordability and would offset recent gains in increasing economic and ethnic diversity of the UC system. He believed that the cost of living in campus areas continues to increase dramatically.

3. **LONG-TERM CAPITAL OUTLAY ISSUES**

Committee Chair Preuss commented that one of the cornerstones of the University's long-range planning, the Partnership Agreement with the Governor, seemed to have been weakened over time. Vice President Hershman discussed how that fact was affecting the planning process for capital outlay.

Mr. Hershman recalled that the University had entered the Partnership Agreement with the understanding that it would guarantee to provide the minimum amount necessary to accommodate enrollment growth and maintain quality, including funding salary increases, enrollments, either increasing student fees or offering equivalent dollars to take care of cost increases on fee-funded programs, and making up for some of the cuts of the early 1990s. New initiatives were to be considered individually. He observed that if that basic funding is not made available during an extended period or is not restored within a reasonable amount of time, it will become necessary to revise the University's long-term planning goals.

Mr. Hershman was optimistic that a bond proposal had been developed that would be acceptable to the legislature and the voters. The bond proposal provides the University with a core amount of $330 million per year for the campuses, about half of which would be for new space and half would be for keeping existing facilities up to date and seismically safe. Extra money for UC Merced and the California Institutes for Science and Innovation would be provided. The Regents' budget proposal, which will be close to $500 million, will be built on the basis that the bond money will be available. Regent S. Johnson commented that if the bond issue does not happen and there is no extra money for the first buildings of UC Merced, all capital planning will be upended. It will be necessary to consider delaying development of UC Merced for a year or two. She wondered how salaries would be funded for faculty already hired for the tenth campus. She believed all money-saving options must be considered. Committee Chair Preuss believed, however, that UC Merced should be protected from budget cuts because of the important role it will have in the UC system in future years.

Mr. Hershman was confident that, given the needs of all of education, that there will be a bond issue on the ballot in November 2002. He was less certain that it would be supported by voters. If the bond issue does not pass, the University will have to reassess how to meet its capital needs for the entire system and how to address growth. He recalled that the State has used lease-revenue bonds for funding when bond issues had failed in the past. Concerning UC Merced, he noted that much of its initial development is to be funded from lease-revenue bonds in the current year, but there are other needs, including the hiring of faculty, the funds for which are in danger. Committee Chair Preuss observed that if the bond measure should fail, all segments of education will be deeply affected.

Mr. Hershman recalled that the Capital Needs and Funding Strategies Task Force appointed by President Atkinson, with representatives from all the campuses and the Office of the President, is working on an assessment of need and on strategies for trying to meet that need. He reported that the campuses have been asked to develop plans for their non-State capital needs. At its November meeting, a five-year State funding plan will be presented to The Regents, followed by a non-State funding plan at the January meeting. He believed that, based on the data at hand, if the large bond issue succeeds and that level of funding can be sustained over the decade, and if non-State fund efforts and fund raising can be sustained, the University will not be unduly affected. Every effort is being made to prevent the University from falling too far behind in terms of funding. The task force is considering a strategy whereby significant enrollment growth would take place by 2010 and would then cease until 2017, providing a period during which the University could catch up financially. The task force is also grappling with a series of options involving changes in policy that may be proposed to The Regents in the future.

The meeting adjourned at 2:55 p.m.

Attest:

Associate Secretary