The Regents of the University of California

COMMITTEE ON FINANCE
May 14, 2003

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

Members present: Regents Connerly, Hopkinson, Lee, Ligot-Gordon, Lozano, Montoya, Moores, Preuss, and Sayles; Advisory members Murray and Pitts

In attendance: Regents Blum, Davies, Johnson, Kozberg, Marcus, Sainick, and Terrazas, Regent-designate Seigler, Faculty Representative Binion, Secretary Trivette, Associate Secretary Shaw, General Counsel Holst, Treasurer Russ, Provost King, Senior Vice Presidents Darling and Mullinix, Vice Presidents Doby, Drake, Gomes, Gurtner, and Hershman, Chancellors Berdahl, Bishop, Carnesale, Cicerone, Córdova, Dynes, Greenwood, and Vanderhoef, Vice Chancellor Desrochers representing Chancellor Tomlinson-Keasey, and Recording Secretary Bryan

The meeting convened at 11:15 a.m. with Committee Chair Hopkinson presiding.

1. **APPROVAL OF MINUTES OF PREVIOUS MEETINGS**

   Upon motion duly made and seconded, the minutes of the meetings of December 16, 2002, January 15, 2003, and April 3, 2003 were approved.

2. **PROPOSED INCREASES IN STUDENT FEES FOR 2003-04**

   Vice President Hershman asked that discussion of this matter and the following item, *Considerations Guiding the Development of the 2004-05 Budget and Policy Options Given State Fiscal Constraints*, be delayed until information has been received concerning the Governor’s May Revision to the State Budget.

3. **ESTABLISHMENT OF CAMPUS-BASED STUDENT RECREATION FEE, MERCED CAMPUS**

   The President recommended that a new Recreation Fee of $146 per student per semester be established at the Merced campus, effective fall semester 2004.

   The Committee was informed that the Merced campus will open in fall 2004 with an enrollment of 1,000 students, 75 faculty, and about 275 staff. The campus is expected to grow rapidly, doubling its student population in the second year and adding about 800 students per year thereafter. The campus plans to open with facilities to meet the teaching, research, and public service mission of the University.
It is proposed that, as an exception to University policy, a Recreation Fee be approved by The Regents, without prior student referenda, as there will be no campus student body prior to 2004-05. Without such an exception, no student fee could be collected at the commencement of the operation of the campus. University policy provides that compulsory, campus-based fees may be established or increased following a referendum in which students vote to support such fees. Exceptions to this requirement are made when fees are needed to assure the health and safety of students or to meet legal requirements. On established campuses, all new student fees are adopted through student referenda and are subject to approval by the President of the University. Student fees for subsequent years of operation of the Merced campus will be established in a manner consistent with University policy.

The adoption of a student recreation fee will permit the construction of a recreation and wellness center on the Merced campus. It is essential that the campus open with programs, facilities, and services that are of sufficient breadth to establish a reputation for excellence and desirability among students and faculty and in the greater academic community. In the initial years of operation, only a few facilities and areas are designated for student social or recreational use. Constructing a recreation and wellness center and developing its associated programs is essential for student life programming at the Merced campus, as an emphasis on overall health and wellness will be a hallmark of the campus.

The campus is proposing that a Recreation Fee of $146 per student per semester be established in order that recreation activities and programs will be available to students when they first enroll. It is anticipated that the facility will be completed by December 2005. Approximately $36 of the fee will be used to support recreation programs and activities such as outdoor trips, intramural sports, and non-credit classes. The remainder of the fee will be used for debt service to support the facility when it is occupied. In addition, a $2 million gift in honor of Joseph Edward Gallo has been pledged to help support this facility. Revenue from this portion of the Recreation Fee would provide recreation and athletic facilities sufficient for the first years of operation. The campus proposes to construct outdoor recreation areas and a facility that will include a gymnasium, a weight and cardiovascular room, instructional rooms, locker rooms, and an outdoor recreation office. In addition, the facility will house campus health services and health education offices.

A campus Recreation Fee Oversight Committee will be established in fall 2004 to provide guidance and direction to the Recreation Director regarding the administration of the recreation fee and the recreation and wellness facility, including budget development, program implementation, and facility management. Membership of the Oversight Committee will consist primarily of students and will include representation from faculty and staff. Recommendations from the Oversight Committee will be subject to approval by the Vice Chancellor for Student Affairs.

Regent Ligot-Gordon was opposed to the imposition of a student fee without student input.
Upon motion duly made and seconded, the Committee approved the President’s recommendation and voted to present it to the Board, Regent Ligot-Gordon voting “no.”

4. **AUTHORIZATION OF LEASES AND AGREEMENTS FOR SEISMIC CORRECTIONS AT IRVINE CAMPUS TEACHING HOSPITAL FACILITIES**

The President recommended that for the UCIMC Replacement Hospital project at the Irvine campus, subject to its inclusion in the amended Capital Improvements Budget and subject to adoption by the State Public Works Board of a resolution authorizing the issuance of State Public Works Board Lease Revenue Bonds and a resolution authorizing interim loans from the State's Pooled Money Investment Account or General Fund:

A. The President or the Secretary be authorized to:

   (1) Execute an unsubordinated site lease from The Regents to the State Public Works Board (SPWB) for the project named above, said leases to contain provisions substantially as follows:

      a. The site shall comprise the approximate size of the footprint for the building named above. Said lease shall also include a license to the SPWB for access from campus roads to the site during the term of the lease;

      b. The purpose of the lease shall be to permit construction of the project;

      c. The term of the site lease shall commence on recordation of the lease or the first day of the month following the meeting of the SPWB at which the resolution is adopted authorizing the lease, the issuance of bonds and interim financing for the project, whichever is earlier, and shall terminate on the date the bonds issued by the SPWB are paid in full, subject to earlier termination if such bonds have been retired in full;

      d. The rental shall be $1 per year;

      e. The Regents shall have power to terminate the site lease in the event of default by the SPWB, except when such termination would affect or impair any assignment or sublease by the SPWB and such assignee or subtenant is duly performing the terms and conditions of the lease;

      f. The Regents shall provide to the SPWB and any assignee of the SPWB access to the site and such parking and utility services as are provided for similar facilities on the campus;
g. The Regents shall waive personal or individual liability of any member, officer, agent, or employee of the SPWB;

h. The Regents shall agree to pay assessments or taxes, if any, levied on the site or improvements attributable to periods of occupancy by The Regents; and

i. In the event any part of the site or improvements is taken by eminent domain, The Regents recognizes the right of the SPWB to retain condemnation proceeds sufficient to pay any outstanding indebtedness incurred for the construction of the project.

(2) Execute an agreement between the State of California, as represented by the SPWB, and The Regents for the project named above, said agreements to contain the following provisions:

a. The SPWB agrees to finance construction of the project, as authorized by statute; and

b. The Regents agrees to provide and perform all activities required to plan and construct said project.

(3) Execute a facility lease from the SPWB to The Regents for the project named above, said leases to contain provisions substantially as follows:

a. The purpose of the building’s occupancy shall be to use it as a facility for acute care in-patient service and support-related functions in furtherance of the University’s mission related to instruction, research, and public service;

b. The SPWB shall lease the financed facility, including the site, to The Regents pursuant to a facility lease;

c. The terms of the facility lease shall commence on recordation of the lease or the first day of the month following the meeting of the SPWB at which the resolution is adopted authorizing the lease, the issuance of bonds and interim financing for the project, whichever is earlier, and shall terminate on the date the bonds issued by the SPWB are paid in full, subject to earlier termination if such bonds have been retired in full;

d. If the SPWB cannot deliver possession to The Regents at the time contemplated in the lease, the lease shall not be void nor shall the SPWB be liable for damages, but the rental payment shall be abated
e. In consideration for occupancy during the term of the lease and after the date upon which The Regents takes possession of the facility, The Regents shall pay base rent in an annual amount sufficient to pay debt service on the bonds or other obligations of the SPWB issued to finance or refinance the facility and additional rent for payment of all administrative costs of the SPWB;

f. The Regents covenants to take such actions as may be necessary to include in the University’s annual budget amounts sufficient to make rental payments and to make the necessary annual allocations;

g. During occupancy, The Regents shall maintain the facility and pay for all utility costs and shall maintain fire and extended coverage insurance at then-current replacement cost or an equivalent program of self-insurance, and earthquake insurance if available on the open market at a reasonable cost;

h. During occupancy, The Regents shall maintain public liability and property damage insurance, or an equivalent program of self insurance, on the facility and shall maintain rental interruption or use and occupancy insurance, or an equivalent program of self insurance, against perils covered in (3)g. above;

i. In the event of default by The Regents, the SPWB may maintain the lease whether or not The Regents abandons the facility and shall have the right to relet the facility, or the SPWB may terminate the lease and recover any damages available at law;

j. The Regents shall be in default if the lease is assigned, sublet, or transferred without approval of the SPWB, if The Regents files any petition or institutes any proceedings for bankruptcy, or if The Regents abandons the facility;

k. The Regents shall cure any mechanics’ or materialmen or other liens against the facility and, to the extent permitted by law, shall indemnify the SPWB in that respect;

l. The Regents, to the extent permitted by law, shall indemnify the SPWB from any claims for death, injury, or damage to persons or property in or around the facility; and
m. Upon termination or expiration of the lease, other than for breach or because of eminent domain, title to the facility shall vest in The Regents.

B. The President be authorized to identify assets to be leased in lieu of facilities constructed pursuant to (1) and (3) above, and the President or the Secretary be authorized to execute documents necessary to lease such assets.

The Committee was informed that the recommended actions would permit the construction or renovation of facilities at the University of California Medical Center at the Irvine campus to comply with the Hospital Facilities Seismic Safety Act (SB 1953). This act mandates that the owners of all acute-care hospitals in California perform a seismic evaluation of their facilities. This evaluation, to be conducted in accordance with procedures developed by the Office of Statewide Health Planning and Development (OSHPD), is intended to determine the probable performance during a seismic disaster of each hospital building used for inpatient care. Following this evaluation, a Structural Performance Category rating must be assigned to each hospital facility according to the performance criteria established by OSHPD. Any general acute-care hospital facility determined to be a potential risk of collapse or to pose significant loss of life, and consequently assigned an SPC1 rating, must be taken out of service by January 1, 2008 or be used only for non-acute-care hospital purposes.

Senate Bill 1667 authorizes the State Public Works Board to issue up to $600 million in State Lease Revenue Bonds for seismic corrections to assist the University’s five medical centers in meeting the 2008 requirements of SB 1953. The medical centers have developed plans to comply with SB 1953, and at the November 2000 meeting, an allocation of the $600 million in State Lease Revenue Bonds was approved.

The actions being recommended are similar to previous actions approved by The Regents for projects financed through State Public Works Board Lease Revenue Bonds. These actions are also similar to previous actions approved by The Regents in which an asset other than the project being financed was used to secure financing for different facilities, including the use of an asset from one UC campus to secure financing for facilities on other campuses.

1995 and 1996 Asset Transfer Program. As part of the negotiations for the 1994 and 1995 State budgets, the State authorized the use of $25 million for each year in debt financing for deferred maintenance, shifting deferred maintenance costs from general funds to long-term financing. Initially, it was anticipated that the appropriations for the deferred maintenance program would be funded through the sale of lease revenue bonds issued by the State Public Works Board, a financing method used for a number of State-funded University capital projects in the past. However, as a result of subsequent discussions with the State Department of Finance, it was agreed that the University would finance the two $25 million
deferred maintenance appropriations included in the 1994 and 1995 State Budget Acts, with the State providing funding for the debt service payments.

The University’s financing involved a lease/lease-back mechanism that required the pledge of capital assets. Because there were more than 300 individual deferred maintenance projects in the two-year program, the deferred maintenance projects themselves could not be used as the leased property pledged for the security of the financing. Instead, four University buildings at four different campuses were used to secure the financing. The State has supported this specific asset transfer process by annually funding the University’s debt service for the deferred maintenance program.

Leases and Agreements. Under the facility lease, The Regents agrees to pay rent to the SPWB in an amount necessary to repay principal and interest on the obligations of the SPWB issued to permanently finance the construction of the facility. Negotiations between the University and the Department of Finance will determine the repayment arrangements on the debt service. The options for repayment for the UCIMC Replacement Hospital project are State general fund appropriation or hospital revenues, depending on the hospital’s financial situation from year to year, or a combination of both. While the Legislature and the Governor have indicated their recognition of the need for continuing budgetary support, there can be no absolute assurance of this support through the life of the bonds. In any year in which the State fails to appropriate sufficient funds to make the rental payments, The Regents would be obligated to pay rent from any lawfully available funds. When the obligations are retired, the leases would terminate, and The Regents would obtain clear title to the improvements.

The exact amount of the annual rent for the UCIMC Replacement Hospital project would be based on interest rates and the maturity date of the financial instruments as established by the State Treasurer; however, assuming that the total amount to be financed is $235 million and assuming an interest rate of 6.125 percent, it is estimated that the annual rent would be $17,301,000 during the period of indebtedness if 30-year bonds are sold, not including the additional rent for related financing costs and SPWB administrative expenses.

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

5. APPROVAL OF RESOLUTION TO EXCLUDE ACCESS TO CLASSIFIED INFORMATION FOR A REGENT HOLDING DUAL CITIZENSHIP

The President recommended that The Regents adopt the following resolution pertaining to the University’s respective Department of Defense and Department of Energy Facility Security Clearances:

WHEREAS, current Department of Defense and Department of Energy Regulations contain a provision making it mandatory that the Chairman of the Board, Chief
Executive Officer, and those other officers and officials who are to have access to classified information meet the personnel clearance requirements established for a contractor's facility clearance; and

WHEREAS, said Regulations permit the exclusion from the personnel clearance requirements of certain members of the Board of Regents, provided that this action is recorded in the University Regents’ Board Minutes;

NOW, THEREFORE, BE IT DECLARED that the Chairman of the Board, at least an official quorum of the Board of Regents, and the Chief Executive Officer at the present time do possess, or will be processed for, the required security clearance; and

BE IT RESOLVED that in the future, when any individual enters upon any duties as Chairman of the Board, as a replacement for one of the cleared quorum of the Board, or as the Chief Executive Officer, such individual shall immediately make application for the required security clearance; and

BE IT RESOLVED FURTHER that the following member of the Board of Regents shall not require, shall not have, and shall be effectively excluded from access to all classified information in the possession of the Corporation and does not occupy a position that would enable him to affect adversely Corporate policies or practices in the performance of classified contracts for the Department of Defense, U.S. Department of Energy or contracts with other Federal User Agencies of the National Industrial Security Program:

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<th>NAME</th>
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<td>Haim Saban</td>
<td>Regent</td>
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It was recalled that the University has security agreements with the U.S. Department of Defense and the U.S. Department of Energy in connection with research performed by the University involving classified national security information and the University’s management of the DOE weapons laboratories. The University holds classified contracts involving research in the national defense. Classified research undertaken by the University is not performed on campus, but is carried out off-campus, often at military installations. Weapons design work takes place at the Lawrence Livermore and the Los Alamos National Laboratories.

The University’s security agreement with the DOD incorporates the National Industrial Security Program Operating Manual (NISPOM), which provides that the Chief Executive Officer, the Chairman of the Board of Regents, and at least a quorum of the Board of Regents have security clearances and that all other Regents have clearances unless specifically excluded from access to classified information in the possession of the University. The exclusion provision of the security agreement further requires that the University, by formal action of The Regents, invoke such exclusion procedures designating
the names of all Regents not in process for or who are ineligible for DOD/DOE clearances, and that this action be made a matter of record in the minutes of the Board.

Regent Saban is not seeking any government security clearances because he intends to maintain his dual citizenship with Israel. As a result, the provisions of the security agreement require that he be excluded from all matters or deliberations that would affect corporate policies or practices followed in the performance of classified work under contracts for the DOD, the DOE, or other Federal User Agencies under the NISPOM. Although he must be excluded from possession of classified matter and from other deliberations, as specified above, Regent Saban, along with other uncleared visitors, would be allowed to visit the weapons laboratories in accordance with procedures for uncleared visitors. Therefore, in accordance with NISPOM procedures, the proposed resolution is recommended for adoption by the Board and is consistent with past resolutions.

In response to a question by Regent Terrazas, Committee Chair Hopkinson confirmed that, in order to obtain a security clearance from the federal government, an individual must renounce any other citizenship.

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

6. UNIVERSITY OF CALIFORNIA RETIREMENT PLAN - ASSET/LIABILITY STUDY

Speaking on behalf of President Atkinson, Provost King referred to recent significant declines in the economic markets. The funded status of the University of California Retirement Plan (UCRP) has been affected by these declines in the same way that investors have been affected. However, the retirement plan remains one of the best-funded public pension plans in the country. The University intends to continue carefully to monitor the plan to determine whether contributions will be required.

UCRP Financial Analysis Process

Typically, the components and the key reasons for performing an asset/liability study are to demonstrate fiduciary due diligence, assess the current funding policy and the likelihood of producing previously unexpected negative results, review the effect of future plan changes in benefits, if any, and to determine the adequacies of the plan’s current assets and how they relate to the plan’s liabilities. In an asset/liability study, the baseline is set to equal the present conditions; future liabilities and assets are forecast over a ten- to twenty year period using stochastic modeling to create hundreds of discrete financial scenarios. The forecasting of liabilities and assets provides benchmark information to help assess the probability of
achieving goals based on current policies, to gauge the reasonableness of assumptions, and to determine the probability of adverse results.

The success of an asset/liability project requires that the assets and liabilities be linked, capturing the fundamental dynamics of both the plan and real-world economic factors. In this modeling, decisions are made on the appropriate liability characteristics and sensitivities, customized to incorporate the plan’s provisions and membership and the pattern of joint asset/liability movements over time as the capital market conditions change and those changes affect the plan’s funded ratios. After the baseline results have been prepared, plan changes, asset portfolios, and economic scenarios are analyzed to determine the effect of these changes on the funded status of the plan and any potential contribution requirements.

Historical Background on the Funding of the UCRP

1970s - The Entry-Age Normal actuarial method was adopted by The Regents in 1975 as a means to provide a consistent level of contributions and an accurate measure of plan costs. Under this method, the cost or present value of future benefits for each member is spread over the member’s career as a level percentage of pay from date of hire or date of entry into the plan until the date of retirement.

Before 1974, the cost of the plan was shared almost equally between the University and the members of UCRP. When the Entry Age Normal method was adopted, member contributions were reduced, while University contributions increased to over 10 percent of pay and continued to increase each year based on the results of the annual actuarial valuation.

In 1976, UC employees became eligible for Social Security, which covered all new employees after that date. Existing members had the option to elect Social Security coverage. Because Social Security coverage required significant contributions by both the University and employees, UCRP benefits and contribution rates were coordinated with Social Security such that benefits are reduced under UCRP to reflect the fact that the member will receive benefits from both UCRP and Social Security.

1980s - The funded ratio of UCRP dipped to as low as 80 percent in 1980, then increased to 89 percent by 1983. The University Normal Cost, which represents the cost of benefits each year, peaked at 13.65 percent of payroll in 1980, then dropped to 10.01 percent in 1983. This fluctuation in costs reflects changes in the member population and adjustments to valuation assumptions in 1982 and 1983.

1990s - The Regents adopted the full funding policy in November 1990, when University contributions were suspended because the full funding limitation was met. In addition, member contributions were redirected to the Defined Contribution Plan.
2000 - 2003: UCRP Asset/Liability Studies were presented to the Regents on January 17, 2001 and May 15, 2002. The purpose of the May 15, 2002 asset/liability study was to illustrate the effect on the plan’s funded status of certain recommended benefit improvements. Using January 1, 2002 liabilities and assets, the results of this extended study showed that there was a reasonable probability that no contributions would be required for at least the following five years.

Since that time, however, UCRP assets have not generated the expected return, and Wilshire Associates recently lowered the capital market expectations. In addition, The Regents approved an additional UCRP Capital Accumulation Provision accrual credit of 5 percent of covered compensation for eligible members in order to offset the lack of sufficient funding for salary increases for faculty and staff in the State budget.

Updated UCRP Asset/Liability Study

Associate Vice President Boyette recalled that in previous presentations, the Regents had been assured that the administration would continue to provide updated information on the plan’s funded status, noting that concern had been expressed about future liabilities of the plan given the anticipated growth in enrollment, which likely will result in a corresponding increase in the number of faculty and staff. There will be pressure to hire these new faculty at higher salaries as well as pressure to raise salaries in order to retain the workforce. Amendments may be required to the plan as a result of an aging member population as well as changes in their demographics. The decline in market performance since May 2002 has significantly lowered the expectation that contributions would not need to be made to the retirement fund by the University or the members during the next twenty years.

Ms. Catherine Cole of Towers Perrin presented the Summary of University of California Retirement Plan Asset/Liability Forecast Study - January 2003, which had been mailed to all Regents in advance of the meeting. She noted that the baseline for the updated study is the July 1, 2002 UCRP actuarial valuation results which were provided to the Regents at the November 2002 meeting. The study incorporates the January 1, 2003 market value of assets, recognized losses in market value that were being deferred by the asset valuation method used for UCRP, overall lower capital market expectations, and estimated plan liabilities as of January 1, 2003.

The study objectives and purpose are the following:

- To demonstrate fiduciary due diligence
- To assess the current funding policy
- To address concerns over interest rates and inflation
- To determine the adequacy of assets in conjunction with liabilities
- To update the funding status within the context of current capital markets and the State’s budget crisis
Ms. Cole observed that the study goes into some detail with respect to the modeling used to forecast financial results. The methodology used was consistent for all three of the studies that have been performed to date. She noted that the current plan liability forecasts were developed using UCRP benefit provisions and an active membership growth assumed to be 2.5 percent annually through 2011 and 1.5 percent thereafter. Over the period of the study, the portfolio as defined in the asset allocation plan is expected to earn 7.56 percent.

In presenting the results of the study, Ms. Cole recalled that the current Regental contribution policy calls for no contribution if the plan is fully funded. As the value of the portfolio has declined in recent years, Towers Perrin will continue to evaluate the funded status and suggest future recommendations to The Regents based on those evaluations. The 2002-2003 normal cost, which is the increase in liability due to members’ additional service, represents 15.15 percent of the covered payroll, or $1 billion per year. Ms. Cole reported that, as of January 1, 2003, the funded ratio of the plan is 129 percent, based on the comparison of assets to liabilities. She noted that previous years of significant investment gains had created a cushion of assets due to the use of the smoothing method. She stressed that, if the plan were to lose 10 percent rather than gain the anticipated 7.5 percent, the actuarial loss translates to 17.5 percent. Ms. Cole discussed a graph showing funded ratios for the plan with and without future contributions in five-year increments beginning with 2003. In 2007, the funded ratio with contributions ranges from 86 percent to 114 percent, with a mean of 100 percent; without contributions, the range is 72 percent to 113 percent, with a mean of 92 percent. If no contributions are made over the next twenty years, the funded status could be as low as 19 percent and as high as 90 percent. In accordance with Regental policy, the mean contribution is expected to be 14 percent of covered payroll in 2007, or $1.2 billion. By 2022, the contribution would rise to 21 percent. In concluding her remarks, Ms. Cole reported that, as of April 30, 2003, the plan remains funded above 100 percent on a market-value basis. An experience study of the prior three years is being finalized which compares actual experience for mortality, retirement, termination, and salaries to the expected results.

7. REPORT ON NEW LITIGATION

General Counsel Holst presented his routine Report on New Litigation. By this reference, the report is made a part of the official record of the meeting.
The Committee recessed at 11:40 a.m.

The meeting reconvened at 2:05 p.m. with Committee Chair Hopkinson presiding.

Members present: Regents Connerly, Hopkinson, Ligot-Gordon, Lozano, Montoya, Moores, Parsky, Preuss, and Sayles; Advisory members Murray and Pitts

In attendance: Regents Blum, Davies, Johnson, Kozberg, Lansing, Marcus, Sainick, and Terrazas, Regent-designate Seigler, Faculty Representative Binion, Secretary Trivette, Associate Secretary Shaw, General Counsel Holst, Treasurer Russ, Provost King, Senior Vice Presidents Darling and Mullinix, Vice Presidents Broome, Doby, Drake, and Hershman, Chancellors Bishop, Carnesale, Cicerone, Córdova, Dynes, Greenwood, Vanderhoef, and Yang, Vice Chancellor Desrochers representing Chancellor Tomlinson-Keasey, University Auditor Reed, and Recording Secretary Bryan

8. PROPOSED INCREASES IN STUDENT FEES FOR 2003-04

Committee Chair Hopkinson explained that the President’s recommendation on increases in student fees had been postponed, pending legislative action on the budget, and called upon Vice President Hershman for his comments on the Governor’s May Revision to the State budget. Mr. Hershman expressed his gratitude and that of President Atkinson to Governor Davis for proposing no additional cuts for the University of California, noting that the Governor had placed a high priority on public education. The Governor’s package of solutions to the State’s fiscal crisis proposes both one-time actions to deal with the current-year shortfall as well as permanent reductions to address the ongoing structural imbalance between revenues and expenditures.

Vice President Hershman recalled that reductions in the University’s base budget began in 2001-02, with approximately $11 million in mid-year cuts. The budget act approved in September for 2002-03 included $160 million in base budget cuts; a further $71 million in cuts was implemented as part of mid-year reductions in the current year. For 2003-04, $302 million in base budget reductions are being proposed for UC. In addition to the base budget cuts, salaries, employee benefits, and other cost increases have been funded at insufficient levels since 2001-02, resulting in faculty salaries that are about 9 percent below those at the University’s comparison institutions; staff salaries are similarly below the marketplace. The University had anticipated that the Partnership Agreement with the State would provide the resources necessary to maintain quality during an era of dramatic enrollment growth. Instead, enrollments will have grown nearly 18 percent over a three-year period while the State-funded budget will have declined by almost 6 percent.
With the student fee increases implemented for 2002-03 and those assumed by the Governor for 2003-04, the portion of the overall $1 billion shortfall to be addressed by student fee increases will be less than 20 percent of the solution. The University has placed a high priority on maintaining access and protecting the quality of its instructional program. The Governor’s plan for budget cuts in 2003-04 acknowledges these priorities and assumes about $180 million in reductions that were targeted for instruction programs will be offset by student fee increases, including a $19 million unallocated mid-year reduction to the University’s 2002-03 budget that was offset by mid-year increases in the Educational Fee and the Fees for Selected Professional School Students. The Governor’s plan includes significant reductions ranging from 10 percent to 50 percent in nearly every other area of the budget, resulting in a net overall budget reduction of just under $200 million. Mr. Hershman stressed that if student fees are increased for 2003-04, financial aid will also be increased for needy students, while financially needy students from middle-income families will receive grants to cover a portion of the fee increase.

Turning to the May Revision, Vice President Hershman indicated his view that the Governor had submitted a compromise proposal that may have a chance of being adopted by the Legislature. If this plan is approved, a structural problem of about $8 billion will still remain, which is more than 10 percent of the general fund budget. The Governor anticipates increased revenues in 2003-04, which will be of assistance to K-12 and the community colleges. Expenditures will decline by 10 percent from 2002-03 to 2003-04 under the Governor’s revised plan. Mr. Hershman reported that the Governor now believes the budget gap to be about $38 billion. He is solving this problem through $19 billion in cuts and savings and $6.9 billion in short-term loans and fund shifts. He also proposes an increase in the tobacco tax and in State income taxes for higher-income citizens. The Governor anticipates that the vehicle license fee will be triggered automatically, as intended in the legislation when the license fee was reduced. Finally, the Governor intends to borrow $10.7 billion, which would be repaid by a ½ percent increase in the sales tax for as long as the debt is outstanding. Using funding available under Proposition 98, the May Revision restores $700 million to K-12 and over $300 million to the community college system, which will result in a lower fee increase.

Vice President Hershman acknowledged the deep divisions that are ongoing within the Legislature with respect to solutions to the State’s budget crisis. He stated that the University would strongly support the Governor’s proposal and urged Regents, chancellors, alumni, and other friends of the University to try to persuade the Legislature to do so as well.

He commented on several proposals under consideration in the Legislature, including one by Democrats that would cut the University’s budget by an additional $80 million. The Senate Democrats and Republicans have proposed cuts that could translate to $300 million to $400 million. The Assembly Republicans have designated a cut of $400 million for the University. If any of these cuts were to occur, the Regents would face serious decisions with respect to issues such as student fees, enrollment, and salaries. The University will make a strenuous effort to avoid further cuts to its budget.
Regent Ligot-Gordon asked that, in budget negotiations, the University reaffirm outreach as a core element of its mission. Vice President Hershman recalled that the University was working to have funding for outreach restored; alternatively, an effort would be made to find a source of funding which would allow the programs to continue to operate at existing levels. Representatives of the Department of Finance have indicated a willingness to meet with legislative staff in order to work out a compromise to achieve this end.

Regent Ligot-Gordon underscored the need to provide students with ample notification prior to taking action on the fee increase. He asked that the meeting be held in a location that is accessible to the students and that it take place before the end of the school year.

Committee Chair Hopkinson stressed that the Board cannot act until the Legislature adopts a budget. She requested that Chairman Moores convey to the Governor the Regents’ appreciation for his strong support of the University of California in his May Revision.

Regent Terrazas supported offering students the maximum opportunity to participate in the Board’s decision with respect to an increase in fees. Regent Hopkinson observed that when The Regents meets by teleconference more locations are available where students may attend.

Regent Sayles recalled that on at least two occasions he had raised the issue of structuring fees such that higher-income families would be asked to pay the full cost of instruction and asked whether this was being addressed. Vice President Hershman reported that significant discussions had taken place in the Council of Chancellors; the intention is to address the matter in greater detail at the Committee’s July meeting.

Regent Connerly stated his intention to vote against any fee increase because he believed that students should be provided with the opportunity to plan for higher fees.

Regent-designate Murray suggested that students feel that they are not being heard by the Board and reiterated the need to hold the meeting on student fees in an accessible location. He asked that the chancellors maintain open communications with their student bodies as the budget process evolves.

Regent Montoya expressed her concern about the University’s ability to provide students with adequate financial aid. She asked that Mr. Hershman’s presentation in July address how students throughout the state are taking advantage of financial aid.

Mr. Stephen Klass, chair of the University of California Student Association, observed that the students in attendance at today’s meeting wished that their voices be taken into account when decisions are made with respect to student fees. He urged that consideration be given to holding any special meeting at the Los Angeles campus while school is still in session. Mr. Klass pointed out that for many students, the decision to raise fees would determine whether or not they could stay in school. Those students who do not return to UC in the fall
will have lifetime reduced income, thereby paying lower taxes; this will have a detrimental effect on the state’s economy. Students, recognizing that fee increases are included in the Governor’s budget, are encouraging the Governor and the Legislature to invest in California’s future by not raising student fees. Mr. Klass offered a quotation from Governor Davis in which he stated his strong support for access to higher education. Mr. Klass recalled that when most of the Regents were students, the University was following its mission statement to provide tuition-free education to the residents of the state. This year, students at UC Berkeley paid $4,335 in fees; in 1966, fees totaled $220. UCSA believes that it is the duty of the Regents to adhere to the mission statement of keeping the University accessible to all qualified students who apply. He urged the Regents to join with the other segments of higher education in the state to apply pressure on the Legislature in support of placing a priority on funding higher education while keeping UC affordable.

Mr. Klass reported UCSA’s support of AB 550, a bill which would provide students at the University of California, the California State University, and the community colleges with direct input into the setting of student fees. The bill states that increased fees must be the last resort in addressing the budget shortfall. It also creates a systemwide student fee increase advisory committee on which students would be in the majority. The bill would require that the committee meet to deliberate before The Regents is permitted to raise student fees. This legislation, if enacted, would be advisory until adopted by the Board. Mr. Klass stressed that the underlying philosophy of AB 550 is that fees should be kept as low as possible. He asked that the Board adopt the provisions of the bill in order to ensure that students are afforded a proper role in shared governance.

Regent Kozberg recalled that several speakers in the public comment period had expressed the desire for more open communication, and she suggested that the President may wish to write to all student newspapers to explain how the State’s fiscal crisis will affect the University, what the effects would be of each of the mixture of choices with which the University may be faced, and why the timing of future budget decisions by the University must be predicated on developments that will take place in Sacramento.

Committee Chair Hopkinson spoke of the need for a clear policy on student fees; she suggested that there be appropriate consultation before any recommendation on such a policy is made to the Committee early in 2004.

Regent Johnson asked for comment on the reasoning behind recommending a 25 percent increase in fees. Vice President Hershman recalled that the decision was based upon the Governor’s budget proposal. He believed that the Legislature would concur with the recommendation. Student fee increases will address slightly less than 20 percent of the University’s budget problem.

In response to a comment by Regent Preuss, Vice President Hershman stressed that all needy students would receive full financial aid support for any fee increase, while students from families earning between $60,000 and $90,000 would be provided with grants. Regent
Preuss agreed with the comments made by Regent Sayles with respect to high-income parents being asked to pay the full cost of instruction.

Regent Connerly raised the issue of what the consequences would be if The Regents failed to approve a fee increase. Vice President Hershman suggested that such a decision would lead to larger cutbacks in funding for research, which would have serious implications for quality. He pointed out that many programs are already being scaled back, including libraries and student support services. He felt it would be difficult to propose reductions in salaries.

Regent Connerly asked Mr. Klass for the student viewpoint on how the University should make up its budget deficit, absent of raising student fees. Mr. Klass suggested that a decrease in the quality of the University could be seen as the result of the Legislature’s failure to provide adequate support. He believed that more attention should be given to understanding what student fees pay for. Following a further comment by Regent Connerly, Mr. Klass declined to acknowledge that students would support a fee increase. Vice President Hershman reiterated the point that higher student fees were required to address an $180 million cut to the instructional budget in order to honor the commitment to enroll all students who have been admitted.

Regent Blum commented that, if fees were to go up by 25 percent, the net increase to the University would be $100 million. He asked Vice President Hershman for a description of what the effects would be if the $100 million were cut from the budget and student fees were not raised. Vice President Hershman recalled that The Regents had approved a mid-year fee increase which would net $60 million, leaving a shortfall of $120 million. A failure to raise this revenue through a fee increase would result in fewer classes as well as cuts to research. He believed that the proposal represented a balanced approach to the problem.

In response to the comments by Regent Hopkinson concerning a policy on student fees, Regent Davies recalled that the Board had adopted a student fee policy in 1994 which states that fees would be raised each year according to the increase in family income. These increases have been bought out by the Legislature since that time. Vice President Hershman observed that following the policy since 1994 would have resulted in fees of about $6,000.

(For speakers’ comments, see the minutes of the May 14, 2003 meeting of the Committee of the Whole.)


Vice President Hershman noted that discussion of this item would be postponed until the Legislature has adopted a final budget for 2003-04.
(For speakers’ comments, see the minutes of the May 14, 2003 meeting of the Committee of the Whole.)

The meeting adjourned at 3:10 p.m.

Attest:

Secretary