The Regents of the University of California

COMMITTEE ON FINANCE
July 16, 2003

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

Members present: Regents Atkinson, Connerly, Hopkinson, Lee, Lozano, Montoya, Moores, Murray, and Sayles; Advisory member Pitts

In attendance: Regents Blum, Bodine, Bustamante, Davies, Johnson, Kozberg, Lansing, Marcus, Parsky, Pattiz, and Seigler, Regents-designate Novack and Ornellas, Faculty Representative Binion, Secretary Trivette, General Counsel Holst, Treasurer Russ, Provost King, Senior Vice Presidents Darling and Mullinix, Vice Presidents Broome, Doby, Drake, Gurtner, and Hershman, Chancellors Berdahl, Bishop, Carnesale, Cicerone, Córdova, Dynes, Greenwood, Tomlinson-Keasey, Vanderhoef, and Yang, and Recording Secretary Bryan

The meeting convened at 9:25 a.m. with Committee Chair Hopkinson presiding.

1. **APPROVAL OF MINUTES OF PREVIOUS MEETING**

   Upon motion duly made and seconded, the minutes of the meeting of May 14, 2003 were approved.

2. **PROPOSED INCREASES IN STUDENT FEES FOR 2003-04 AND UPDATE ON THE 2003-04 BUDGET**

   The President recommended that student fees be increased as follows to ensure that quality of the University's instructional programs is maintained to the extent possible:

   A. Effective with summer 2003, mandatory systemwide student fees be increased by 25 percent above the levels previously approved by The Regents, with the full increase reflected in the Educational Fee, as shown in Table 1, below. It is recommended that the University Registration Fee remain at its current level for 2003-04. It is also recommended that the President be given the authority to increase mandatory systemwide student fees by another 5 percent, for a total increase of 30 percent, if the President determines that the final outcome of the 2003-04 State budget for the University warrants a further increase. The President shall consult with the Chairman of the Board and the Chairman of the Committee on Finance before taking this action.

Table 1

	25% Increase in Educ/Reg Fee			30% Increase in Educ/Reg Fee
	Fee Increase per Quarter	**Fee Increase per Semester**	**Educ/Reg Fees Total Annual Fee Levels**	**Educ/Reg Fees Total Annual Fee Levels**
Resident Undergraduate students	$320	$480	***$4,794***	***$4,984***
Resident Graduate students	$335	$502	***$5,019***	***$5,219***
Professional and Nonresident students	$352	$528	***$5,260***	***$5,464***

A portion of the revenue generated from the increases in the Educational Fee will be set aside to ensure that all grant-eligible students receive a UC grant or Cal Grant to offset the full increase in the Educational Fee and that other needy students receive a grant to cover a portion of the approved increase.

B. Effective fall 2003, Fees for Selected Professional School Students be increased by 25 percent, as shown in Table 2, below. It is also recommended that the President be given the authority to increase the Fees for Selected Professional School Students by another 5 percent, for a total increase of 30 percent, if the President determines that the final outcome of the 2003-04 State budget for the University warrants a further increase. The President shall consult with the Chairman of the Board and the Chairman of the Committee on Finance before taking this action.

Table 2

	25% Increase in Fees for Selected Professional School Students			30% Increase
Professional Degree Program	**Fee Increase per Quarter**	**Fee Increase per Semester**	**Total Annual Professional Fee Levels**	**Total Annual Professional Fee Levels**
Law (JD/LLM)	N/A	$948	***$9,472***	***$9,894***
Business (MBA) at Berkeley, Davis, Irvine, and LA	$600	$900	***$9,000***	***$9,360***
Business (MBA) at Riverside	$933	N/A	***$9,000***	***$9,360***
Medicine (MD)	$548	$822	***$8,220***	***$8,549***
Dentistry (DDS)	$517	N/A	***$7,750***	***$8,060***
Veterinary Medicine (DVM)	$421	N/A	***$6,313***	***$6,565***
Pharmacy (Pharm D)	$313	N/A	***$4,689***	***$4,875***
Optometry (OD)	N/A	$313	***$4,689***	***$4,875***
Nursing (MS/MN)	$188	N/A	***$2,814***	***$2,925***
Theater, Film, & TV (MFA at UCLA only)	$204	N/A	***$3,062***	***$3,185***

Consistent with past practice, an amount equivalent to one-third of the revenue generated from the increases in the Fees for Selected Professional School Students will be set aside for financial aid to mitigate the effect of the fee increases on needy students.

(3) The Nonresident Tuition fee be increased by 10 percent for 2003-04, as shown in Table 3, below.

Table 3

	Fee Increase per Quarter	**Fee Increase per Semester**	**Total Annual Nonresident Tuition Fee**
Undergraduate students	$417	$625	***$13,730***
Graduate students	$371	$556	***$12,240***

It is proposed that one-third of the nonresident tuition revenue generated from the graduate student increase be set aside for financial support for graduate students.

Update on 2003-04 Overall State Budget

Vice President Hershman recalled that the Governor's May Revision indicated a deficit of about $38 billion over a two-year period and addressed the deficit through a combination of budget cuts, tax increases, borrowing, and further fund shifts beyond those proposed in the January budget. There appears to be bipartisan agreement within the Legislature to borrow $10.7 billion in 2003-04 as suggested by the Governor to defer taking permanent actions on a portion of the deficit until future years; however, at issue is the method of repaying the loan. The Governor and legislative Democrats favor a ½ cent sales tax increase to repay the loan over five years. Republicans continue to oppose tax increases of any kind and instead favor further budget reductions to pay off the debt within existing revenue sources.

There also continues to be wide disagreement about the level of budget reductions for many programs including health, social services, local government, transportation, and corrections. The Governor's May Revision proposed restoring some of the cuts he proposed in his January budget in these areas as well as K-12; however, legislators are still reluctant to approve even the revised level of cuts proposed for many of these programs.

With regard to K-12 education, agreement was reached by the budget Conference Committee on a package related to Proposition 98 funding. The package includes maintaining Proposition 98 funding while implementing reductions in certain categorical programs agreed to by all sides. For the University of California and the California State University, however, most of the major issues remain open.

The Conference Committee has not met since it recessed on June 10. All four legislative caucuses have developed their own versions of a budget, but none of them has garnered sufficient votes to pass. It is unclear when the budget issues will be resolved.

Update on the University's Budget

Vice President Hershman recalled that under the original Governor's Budget for 2003-04, the University's Partnership Agreement will be underfunded by $1 billion. About $360 million of this problem is being addressed through base budget cuts to existing programs in 2001-02, 2002-03, and those proposed for 2003-04; another $180 million in cuts targeted at instruction is expected to be offset by student fee increases; and the remaining $420 million represents funding the University has not received for faculty and staff salaries, inflation, and other cost increases.

The impact of this underfunding is significant. Over a three-year period, the University's student enrollments will have grown 18 percent, while the State-funded budget, under the Governor's plan, will have declined 6 percent. Faculty salaries next year will lag the average of the University's comparison institutions by 9 percent, and there will be a similar problem with respect to staff salaries. All non-instructional programs are taking significant cuts, including administration, research, outreach, student services, and Cooperative Extension, and layoffs are being planned or implemented in all of these areas. In addition to the State base budget cuts, the University is contending with $100 million in other cost increases for which there is no new funding, including faculty merit increases, employee health benefit costs, energy costs, and other inflationary increases.

Rising student fees are another unfortunate effect of this budget crisis. In December 2002, the Board approved an increase of $135 in the Educational Fee for all students effective spring 2003 in order to address an unallocated reduction contained in mid-year budget cuts proposed by the Governor and later approved by the Legislature. When annualized, this fee increase totaled $405. The Governor's Budget released in January assumed additional student fee increases for 2003-04. It had been the President's intention to bring to The Regents an action item on 2003-04 student fee levels at the May meeting, but the item was deferred due to the continuing uncertainty over the State budget outcome. The uncertainty has only continued to grow. As it stands, the University is facing three major issues that are creating a great deal of uncertainty about the University's budget:

- Additional cuts: In addition to the base budget reductions in the Governor's Budget, it appears nearly certain that the University will take an additional $80.5 million reduction in 2003-04. This reduction has been opposed by the Governor but is currently proposed as a one-time cut in both the Assembly and Senate versions of the budget. The Governor's office has committed to restoring this funding in the 2004-05 year, but with an ongoing structural problem in the State budget of between $8 billion and $10 billion, the University may well face other budget cuts next year even if the $80.5 million is restored. Furthermore, Assembly Democrats have issued a new budget proposal that would mean $45 million in further cuts for UC in 2003-04; Assembly Republicans have issued a plan that would mean at least $400 million in additional cuts to UC in 2003-04; and Senate Republicans are also considering significant additional UC cuts.

- Outreach: The Governor's Budget called for a 50 percent reduction to outreach programs, a total cut of $37.7 million. The Assembly version of the budget would restore the entire budget for outreach, while the latest Senate version supports the Governor's 50 percent reduction. As such a reduction to these critical programs is unacceptable, other options will need to be considered if adequate State funding is not provided.

- UC Merced: The Assembly version of the budget supports the Governor's proposal to provide $11.3 million in one-time funds to allow the campus to continue recruiting faculty and staff needed in order to open by 2004. The Senate version delays the opening of the campus for one year and removes $4 million in associated savings from the Merced budget.

Proposed Actions to Address Additional Budget Reductions

Mr. Hershman observed that it is clear that a plan must be developed for coping at least with the additional $80.5 million reduction and perhaps the need to fund outreach programs, and the University must brace itself for further cuts should they occur in the final budget. Because students for the 2003-04 academic year have already admitted, and because further cuts to programs would harm the quality of the student educational experience, the following actions are proposed:

- Borrowing: The University should seek one-time debt financing for approximately $45 million of the additional $80.5 million cut, to be paid off through an additional 6 percent increase in nonresident tuition. Regental approval of the University's final budget, including this proposed debt financing, will be requested when the State budget is final.

- Student fees: Mandatory systemwide student fees should be raised to address the remainder of the $80.5 million cut. The action being requested of the Board is to approve the following:

  A minimum student fee increase of 25 percent above the current fee level (which reflects the $405 annualized increase that was adopted for the spring 2003 term). For resident undergraduates, the additional 25 percent increase would raise fees $960 annually, or $165 more than the $795 fee increase assumed in the Governor's Budget. Graduate and professional school fees would be raised by a similar percentage, and nonresident tuition would be increased 10 percent, or 6 percent higher than was proposed in the Regents' Budget last November.

- Granting authority to the President to raise mandatory systemwide fees up to a total of 30 percent if necessary. The fee would be increased only to the extent necessary to address additional cuts facing the University when the budget is final, including the potential need to restore some portion of the funding for outreach. A 30 percent increase would mean a resident undergraduate would pay an additional $1,150 in 2003-04, rather than the additional $960 under the 25 percent scenario.

Committee Chair Hopkinson emphasized that, if the one-time cut is not restored or if other cuts are made, the decision to cap enrollments for next year must be made by January. If sufficient funding is not committed in the next State budget by January, enrollment caps will need to be considered if the University is to be able to repay its one-time debt financing.

Mr. Hershman continued that a 25 percent increase in mandatory systemwide fees and professional school fees over approved fee levels will generate approximately $24 million of additional fee revenue, net of financial aid, above the amount included in the Governor's Budget. If these same fees are increased by a total of 30 percent, another $27 million in additional fee revenue, net of financial aid, would be generated, resulting in $51 million of new fee revenue above the Governor's Budget level.

Resident mandatory systemwide fees at the University remain well below the average of UC's public comparison institutions. Even with an increase of 30 percent, total resident fees for undergraduates for 2003-04 would be approximately $1,250 below the average of the total tuition and fees at the University's public comparison institutions, and total fees for resident graduate students would still be more than $2,000 below the average at comparable public institutions. Tuition and fees for nonresident graduate and undergraduate students will be about $1,000 higher than the average at the University's public comparison institutions.

The differential between UC fees for selected professional programs and the tuition and fees charged at comparable public institutions has grown significantly over the past five years. Fee levels for 2003-04 at the comparable public institutions are not yet available; however, even with the mid-year increases and the proposed increases for 2003-04 in UC professional school fees, the fees for resident students enrolled in these programs will remain below the average of tuition and fees charged by comparable public institutions when compared to current year levels.

If the Legislature adopts even deeper budget cuts for the University in 2003-04, a special meeting of the Board will be called to consider additional budget cuts and fee increases above the 30 percent level.

Under any fee scenario, it is expected that, in general, financially needy students with family incomes of $60,000 or less will have the fee increase fully covered by financial aid; and in the case of financially needy students with family incomes of between $60,000 and $90,000, a UC fee grant will cover approximately half of the increase. Mandatory systemwide student fees for undergraduates today are just $35 per year more than they were in 1994-95, and a number of efforts have been undertaken to warn students and parents of a fee increase.

Potential Reductions in 2004-05 Enrollments

While it is not feasible to consider enrollment reductions for 2003-04 because the new students for 2003-04 have already been admitted, enrollments could be curtailed for 2004-05. If restoration of the additional $80.5 million reduction is not included in the 2004-05 Governor's Budget or if other additional budget cuts are made, there may be no alternative but to institute enrollment reductions for the fall 2004 entering class. Such an action would be taken no later than January 2004. Enrolling 5,000 fewer freshmen and transfer students than is currently planned for 2004-05 would save $45 million in State funds. The remainder of the additional $80.5 million cut would be absorbed through the higher student fees that will already have been implemented. Specific fee levels for 2004-05 will be set only after there is a full understanding of the 2004-05 State budget. Reducing enrollments would be a major departure from

University and State policy, but deepening State budget cuts could leave the University with no choice.

Regent Montoya quoted from an article in the *San Francisco Chronicle* which reports that the Legislative Analyst's Office has implied the need for further studies in order to prove that the University needs as much money as it is requesting and makes reference to an expected report from the California Postsecondary Education Commission concerning UC eligibility and access. Mr. Hershman reported that the Legislative Analyst believes that the University's enrollment will not be as high as projected and that therefore less funding will be needed, a charge which the University disputes based on its enrollment growth of the past ten years. He noted that the Assembly had accepted the University's projections. The CPEC study will not be issued until March 2004.

Regent Davies believed that the determination as to whether an enrollment cap or reduction should be set for fall 2004 would need to be made at the November meeting. He believed that the Regents would not receive sufficient information about the 2004-05 budget until next July, which would be too late for setting enrollment levels for the following fall. He emphasized that, as the University has been told not to expect any increase in next year's budget, enrollment decisions should be based upon the budget that is disclosed this November. Regent Hopkinson noted that at the September meeting a discussion is planned of all issues relating to the University's budget and that it would be appropriate to follow those up at the November meeting.

Mr. Stephen Klass, President of the University of California Student Association, reported that UCSA opposes the proposal to raise student fees up to 30 percent because of the magnitude of the increase within a single year and is concerned about the lack of assurance that the fees would be decreased if funding were restored. The Association is skeptical that this is the best or only solution to the University's financial problems. He maintained that, when taking into account the total cost of education in California, the fee level plays only a minor role, and housing, dining, and transportation raise costs above comparison institutions. He believed that a gap exists between striving for the primary goal of keeping the academic excellence of the UC system and the continuing actions to raise the price of admission. He hoped that if fees must be raised dramatically, that fact would be advertised as soon as possible.

Regent Bustamante was opposed to the fee increase. He asserted that the State and the University were attempting to balance their budgets on the backs of students and middle-income families. He pointed out that no other group in the state was facing a 40 percent increase in fees. He submitted a comparison of UC to comparable universities with regard to the cost of tuition, fees, room, and board to support his contention that the proposed fee increases would price out working and middle-class families.

Committee Chair Hopkinson recalled that a recent study presented to the Regents that included all costs of attending the University illustrated that even with an increase, its fees would still be lower than comparison public universities and that need-based grants would bring down total UC costs for needy students. At the suggestion of President Atkinson, Senior Vice President Darling distributed three charts that supported the study. The first, which compared University fees to the University of Virginia, SUNY Buffalo, the University of Illinois, and the University of Michigan, indicated that the University's fees, even after the most recent $135 increase per quarter, were approximately $4,000. The comparison institutions ranged from $5,000 to nearly $9,000. The second chart showed the total cost of education, including housing, food, transportation, books, and other expenses that the financial aid offices budget for the total cost of education, which makes the University's overall price higher than Virginia and SUNY but lower than Illinois and Michigan. When need-based grants are factored in, UC is about $9,000 compared to about $11,000 for SUNY, Illinois, and Michigan. Only Virginia is lower at about $6,000. He noted that, while many other universities are retreating from their commitment to financial aid, UC is maintaining its commitment. Regent Bustamante observed that the chart covered costs only for needy students. Mr. Darling informed him that the term "needy" is defined by uniform federal standards. Generally, grants apply to students with families whose incomes are $60,000 or less but could be as high as $90,000 depending on the families' financial circumstances and number of children.

Regent Davies believed that it would be necessary to increase fees and that the increase represented a fair proportion. He was hopeful that the University would avoid its past mistakes and would establish a policy of increasing fees annually based on household income or other reasonable method.

Regent Murray also asked that students be notified as soon as possible once a decision about fees is made so that they and their families may plan their budgets. He asked when the decision would be made by the President as to whether an additional 5 percent would need to be added to the fee increase. He asked also that the administration continue to find ways in which to improve the University's financial aid package. Vice President Hershman responded that President Atkinson will need to make a decision about the 5 percent fee increase within the next two weeks, whether or not the State has passed a budget. President Atkinson added that if the Senate Democratic proposal is approved, he would not add the 5 percent increase to fees. Otherwise, he would add the 5 percent and would return to The Regents mid-year to request a further increase. He reported that the University has made a determined effort during the past six months to inform students and their parents as to what they might expect. Mr. Hershman reported that this year, for the first time, the campuses had been given special funds to provide financial aid for hardship cases.

Regent Connerly believed that an increase in student fees of 40 percent in a year was not acceptable, especially in the depressed economy. He noted that if the Legislature had allowed the University to raise student fees incrementally over the years, the University would not be facing such a sudden, large fee increase. He asked whether the increase could be phased in at a more modest level over a longer period, even if that would affect quality. Committee Chair Hopkinson noted that the 40 percent fee increase was planned to be phased over two academic years.

Regent Pattiz acknowledged the University administration's efforts to put together a thoughtful budget proposal. He asked what would happen if the proposal were to fail. Mr. Hershman responded that the University would be underfunded by $420 million and would still be faced with increasing student fees or restricting enrollment in upcoming years.

Regent Lansing emphasized the importance of protecting the quality of the education provided by the University and the accessibility for all qualified students. She believed that the University's analysis confirmed that it would continue to have fees lower than its comparison institutions and that there were no immediate alternatives to the ones offered. She urged the Regents to consider a sliding scale that had fees predicated on income level, taking into account the number of children being educated per family. President Atkinson responded that the administration is studying the concept and would report to the Board on such a model.

Regent Johnson agreed with Regent Bustamante's assessment of the overall cost of attending the University. She agreed that The Regents should adopt a fee policy that would make increases moderate and predictable. Committee Chair Hopkinson observed that the issue would be discussed further at the September and November meetings along with other issues relating to long-term budget planning. She noted that the net total cost of attending the University of California, including room and board, factoring in student aid, is lower, with one exception, than at comparable institutions.

Regent Sayles emphasized that it should be recognized that every student who attends the University receives a $9,000 scholarship without regard to the income of his parents. He believed that if a surcharge of $1,000 were imposed on upper-income people, the University could raise $40 million. He was concerned that middle-income families were being forced out of the University.

Regent Lozano observed that the State Legislature had passed its responsibility to the Regents, who were being asked to make difficult decisions that would burden students. She noted, however, that other segments of the University were also being cut. She supported the development of a fee policy. President Atkinson reiterated that the University does have a fee policy but that the Legislature has chosen year after year to buy out any proposed fee increase.

Regent Blum was concerned about the timing of the decision, recognizing that students needed adequate notice. To the extent that the Legislature knows that The Regents will increase fees, it will take for granted that the University does not need additional funds. It was his view that a decision on fees should be deferred until the State budget becomes final. Mr. Hershman responded that the budget committees of the Legislature have gone along with the fee increases that were in the Governor's budget. When the $80 million additional cut surfaced, it became clear that larger fee increases would be necessary. The problem is that in any of the four possible versions of the State budget that may be adopted, other than the Governor's, the $80 million cut is included. The 25 percent fee increase proposal with a possible additional 5 percent was so structured because it is clear that the University is going to be cut by at least an additional $80 million.

Regent Parsky concurred with Regent Lansing's comments about the Regents' responsibility to preserve the quality and access to the University. He believed that the views of some legislators about, for instance, the possibility of lowering salaries notwithstanding, the University has worked hard to reduce expenditures. Mr. Hershman reported that, unlike many other State employees, the University's employees have no built-in salary increases pursuant to labor negotiations. Administrative costs, which historically have accounted for about 12 percent of the budget, have been reduced to 9 percent. Among other things, administration includes police, purchasing, accounting, auditing, and insurance. He believed that all segments of the University were bearing their share of the burden.

Regent Parsky asked about the impact of some suggestions that legislators have made about financial aid. Mr. Hershman reported that the Senate Republicans have proposed to reduce financial aid by $52 million, which he believed would be devastating. It would alter the analysis of the University's costs relative to comparable institutions. The total grant financial aid from all sources is about $600 million. He pointed out that the University has a very high percentage – 30 percent – of low-income students in attendance.

Regent Parsky recalled that a policy had been adopted by The Regents with respect to the setting of fees. He believed that, as it was one of the prime responsibilities of The Regents, the President should not be given the right to increase fees by 5 percent, even though it would be done consultatively. President Atkinson explained that fees may be collected only three times a year on the quarter system or twice a year on the semester system. He believed that, as campuses will open soon, he will need the flexibility to respond quickly to the State's decisions concerning the University's budget, particularly in that the amounts of the various budget cuts are known. The proposed delegation is in response to an unusual set of circumstances.

Regent Parsky discussed the interrelation between the University's fee policy and the State Legislature. He concurred with other Regents that a fee policy should reflect accurately the cost of living and that it may be worthwhile to discuss graduated fees. He recalled that the current Regental policy, which involves increasing fees annually, has not been followed, at the request of the Governor and Legislature, which now are asking the University to raise fees. They have broken the pact they had with The Regents.

Regent Marcus agreed that the Regents are obligated to protect the quality of the institution and access to it. He believed that the University had done everything possible to avoid raising fees. The issue is a political one in that fees may be considered taxes, something The Regents does not have the authority to raise. When asked, Mr. Hershman reported that the increase for an undergraduate student would amount to about $100 a month. Regent Marcus was adamant that the recommendation to raise fees should be supported in order to maintain the University's quality, which he believed was superior to that of its comparison institutions.

Regent Lee expressed opposition to raising fees. He believed that higher education should be free because it is an investment for the State that turns out productive citizens who pay taxes. On the other hand, he believed that maintaining quality was important. He advised against approving higher fees before the Legislature has acted on the budget.

Regent-designate Seigler thanked the administration for its thoughtful evaluation of the budget situation and its efforts to inform the public. He was opposed to a multi-tiered tuition program, based mainly on the fact that the University offers generous financial aid to students. He stressed that students, their parents, and the State expect high quality from the University and that those expectations should be met.

Regent Kozberg stated that the Regents had been left with little choice concerning fees. She was opposed to postponing the decision any longer, given that the Legislature has provided a sufficient indication of the boundaries of its plans for the Regents to move forward with a decision.

Regent Montoya believed that more administrative savings would be found over time and that it will be necessary to rank the importance of outreach, financial aid, and research. At the same time, she agreed with Regent Kozberg that the Regents have been boxed in and must make a timely decision so that students may plan their budgets.

Regent Bustamante believed that the Regents should send a strong message to the Legislature by not compromising the quality of or access to the University by raising fees. He suggested that the cigarette tax should be raised instead of student fees.

Upon motion duly made and seconded, the Committee approved the President's recommendation, Regents Atkinson, Hopkinson, Lozano, Montoya, and Moores voting "aye" (5) and Regents Connerly, Lee, Murray, and Sayles voting "no" (4).

[For speakers' comments, refer to the July 16, 2003 minutes of the Committee of the Whole.]

3. **CONSIDERATIONS GUIDING THE DEVELOPMENT OF THE 2004-05 BUDGET AND POLICY OPTIONS GIVEN STATE FISCAL CONSTRAINTS**

Vice President Hershman recalled that policy options had been prepared concerning student fees and enrollments. He noted that it was the University's intention to present a partnership 2004-05 budget based on its minimum needs that argues for funding for salary increases of 4 percent, enrollment increases, to restore the one-time $80 million cut, and for the summer session, which together amount to about a 10 percent increase, but as the State's budget problems have expanded it has become clearer that the University may receive no increase. The normal consultation has begun with the Department of Finance. Considering the circumstances, Mr. Hershman believed it would be timely to decide what the University will do if the State is unable to fund the budget it submits.

Mr. Hershman believed that the University is no longer in a position to accept students for whom State funding is not available or to fail to provide appropriate salaries for professors. Because the federal budget is also in the red, the University may not receive adjustments even for inflation in its federal funds, and private funds have started to decline. Given these circumstances, the University is facing options that include further fee increases and establishing a surcharge for students whose family incomes exceed a chosen amount, a suggestion that will undergo review during the coming months. Other options include increasing professional school fees, charging full cost to undergraduate students who take more than a certain number of units, and increasing nonresident tuition. There are also options related to enrollment. He noted that the University has enrolled about 13,000 more students than was budgeted for, the equivalent of about $108 million in State money. Options for bringing down enrollment include accepting the existing percentage of eligible UC students but requiring them to go to community college and then transfer to UC, and putting a constraint on enrollment by campus, possibly tied to available State funding. He stressed the importance of letting the people of California know how difficult choosing any of these options will be and how costly to the University's accessibility.

Regent Sayles asked about the economic demographic of the University. Mr. Hershman reported that about 58,000 of the University's 170,000 undergraduate students have parental incomes above $90,000, about 20,000 have parental incomes of over $150,000, and about 10,000 exceed $200,000. He noted that the University's student population is about one-quarter each from low-income, low middle-income, high middle-income, and high-income families. He believed that governors and legislators have always been the most concerned about the middle income group. The

University offers a very generous financial aid package for low-income students, but he suggested the possibility of fine tuning the financial aid system to provide more help for those in the middle. About 40 percent of students in the $60,000 to $90,000 parental income category qualify as financially needy under the federal definition used by the University. In response to a further question by Regent Sayles, Mr. Hershman reported that the options will be discussed at the September meeting, with action anticipated at the November meeting.

Regent Lee believed that the quality of the University was unsurpassed and should not be allowed to deteriorate, nor should accessibility to it be limited. Mr. Hershman agreed that limiting accessibility should be the last choice, but he emphasized that if the State continues to cut the University's budget, it will be the only remaining choice.

Regent Connerly noted that financially independent students are the ones who have the most difficulty responding to changes in the cost of attending the University. Mr. Hershman reported that they number about 7.5 percent of undergraduates and noted that they are eligible for financial aid.

While acknowledging the importance of access and affordability, Regent Bodine believed that providing top quality is the most important of the University's missions. She observed that letting quality slip in the short term would be an unfortunate choice in that it would lead to further decline and over time an inability to recruit the best students and faculty. Once an institution's reputation starts to slip, it becomes very difficult to build it back up. She believed the same did not apply to access and cost.

Regent Montoya asked about increasing fees for professional school students and undergraduates who have more than a certain number of units. Mr. Hershman responded that a determination may need to be made as to how much subsidy students should receive if they change their majors. It might be best to encourage students to finish their college careers earlier. He reported that, although some progress has been made in closing the gap between the costs of the University's professional schools and those of its comparison schools, there remains room to increase fees further to meet the average.

Committee Chair Hopkinson noted that the costs of the University's professional schools vary and that some seem not to be keeping pace with the overall fee structure. She suggested the possibility of making them comparable be discussed at the next meeting.

Regent Murray was concerned about the possibility of enrollment caps in that they could mean taking fewer than those in the top 12.5 percent of high school graduates.

4. **AUTHORIZATION TO ESTABLISH INDENTURE FOR GENERAL REVENUE BONDS TO FINANCE AND REFINANCE DEBT FOR UC PROJECTS**

The President recommended that:

A. He be authorized to establish a new indenture to refinance existing debt of the University of California and to finance debt for new University projects, subject to the following:

(1) General revenues of the University of California be used to secure and repay debt service on bonds issued under the indenture, provided that the following shall be excluded from General revenues:

a. Appropriations from the State of California, except as permitted under Section 28 of the State Budget Act or as authorized by other legislative action; and

b. Monies which are restricted as to expenditure by granting agency, donor, or University designation.

(2) Bonds may be issued as fixed-rate bonds or variable-rate bonds, or as taxable or tax-exempt bonds or with other such terms and conditions as may be determined in supplemental indentures.

B. The President be authorized, when appropriate and subject to the concurrence of the Chairman of the Board and the Chair of the Committee on Finance, to approve interest rate swaps to achieve a lower synthetic fixed borrowing rate for the bonds issued or otherwise to achieve the University's desired interest rate risk profile.

C. The Officers of The Regents be authorized to execute all documents necessary, including the indenture and supplemental indentures, in connection with the above.

Senior Vice President Mullinix recalled that last fall, in a competitive process the University selected an investment banking firm, Lehman Brothers, to perform an analysis of the debt capacity of the University, undertake an analysis of the University's debt structure, and assist with a debt strategy and recommendation of debt restructuring based on market evaluation and the University's debt position with the goal of positioning the University to take advantage of its varied and strong revenue sources, to increase the debt capacity of the University in this period of rapid enrollment growth, and to take advantage of historic low interest rates.

A steering committee and campus advisory groups were established to work with Lehman on these analyses. In addition to participation by the staff from the Office of the President (OP) and the Treasurer's Office, each campus was represented, as were the academic medical centers. Lehman and OP staff visited each campus to review projected capital needs of the campuses and medical centers and alternative financing options. Originally, it was anticipated that comprehensive recommendations for any changes in debt policies would be submitted to The Regents at the conclusion of this review; however, because the substantial decline in interest rates provides an opportunity for significant savings through refinancing at this time, the first phase of this review, which addresses issues related to a refinancing, is being presented now. It examines opportunities to increase the University's borrowing capacity and to lower the cost of servicing debt. In the second phase of the analysis, other debt and financing issues will be explored, including asset-liability management and financing structures for third-party financing.

General Revenue Financing

The University pledges specific revenue sources to secure and repay its existing debt. It is recommended that the University consolidate and broaden the sources of the revenues used to secure and repay most refinanced and new debt more appropriately and effectively to demonstrate the breadth and depth of resources that the University has available to service its debt and facilitate the establishment of a new bond indenture that provides more financing options and flexibility to the University.

New Bond Indenture

The task force analysis recommends the creation of a new general revenue bond indenture that would serve as the primary financing vehicle for University debt, with the exception of debt for the medical centers and new financing for auxiliary activities. The University would no longer issue additional series of bonds under the 1991 Multiple Purpose Projects indenture, which has served as the University's primary financing vehicle for the last decade.

The general revenue bond indenture would make four key changes:

- Establish flexibility as to the principal payment date;

- Allow interest to be paid on any date, which would facilitate the use of new variable rate borrowing products;

- Expand the pool of funds available to pay the debt service on the bonds and relax debt covenant restrictions to reflect current market practices and the financial strength of the University; and

- Remove the need to fund a debt service reserve fund, thereby saving at least $1 million in surety bond costs for the first debt issuance planned for summer 2003.

The general revenue bond indenture will become the primary vehicle for financing University projects. While new auxiliary service projects could be funded through this indenture, the University is exploring other alternatives for these projects. Each medical center will continue to pledge its respective revenues for its debt-funded projects. The Commercial Paper Program will continue to provide interim construction and acquisition financing at the lowest interest rates, as well as financing for intergovernmental transfers required for supplemental funding for the University's medical centers.

Current Debt Structure

There is currently outstanding approximately $4.5 billion of University revenue bonds and certificates of participation, with a weighted average interest rate of 5 percent. Not included in this total is the University's Commercial Paper Program, which has $550 million authorized and outstanding at an approximately 1 percent interest rate, and approximately $1.2 billion in State of California State Public Works Board (SPWB) lease revenue bonds.

The University's issued debt totals $5 billion outstanding as of June 30, 2003, including Commercial Paper but excluding State SPWB bonds. Assuming full restructuring under the general revenue bond indenture, the University's debt profile for the currently outstanding debt will be simplified.

Project Approvals

All projects to be financed will continue to be individually reviewed and approved by The Regents. For auxiliary enterprise projects, such as student housing and parking, the auxiliary will continue to demonstrate that enterprise revenues are sufficient to pay for operating expenses and debt service, with a required surplus for major maintenance and debt service cushion. Education and general projects for the core programs will benefit from a broader revenue pledge, but campuses will also need to demonstrate the ability to generate sufficient revenues from core activities to pay debt service and provide a debt service cushion.

Interest Rate Swaps

It is recommended that the general revenue bond indenture include the flexibility to employ interest rate swaps when appropriate. Swaps will be employed only upon the further approvals of the Chairman of the Board and the Chairman of the Committee on Finance. Analyses will be provided which will demonstrate the risks and rewards of the particular type of swap being recommended.

Interest rate swaps are contracts to exchange the payment of interest based on a notional amount, generally tied to a bond issuance. In the case of a floating-to-fixed interest rate swap, the University would pay a fixed interest rate which is typically 30 to 100 basis points lower than could otherwise be achieved through the issuance of fixed rate bonds of the same maturity, while receiving a variable rate payment from a counterparty. As appropriate, the University could enter into fixed-to-floating rate swaps to convert fixed rate bond payments into a lower floating rate payment. The risks associated with these transactions need to be carefully assessed relative to potential savings.

The University employed an interest rate swap for the UC Davis Medical Center refinancing in March, 2003, which enabled the medical center to reduce its interest rate by approximately 1.36 percent in comparison to a traditional fixed rate transaction.

Current Market Opportunities

The proposed general revenue bond debt strategy recommends the refinancing of existing University revenue bonds when they can be refinanced economically into the new general revenue bond indenture. It is contemplated that the first issue under the new indenture would refund an aggregate amount of approximately $1.2 billion of existing UC debt comprised of the UC housing system bonds, series A of the research revenue bonds, the UCLA chiller/cogeneration certificates of participation, series C of the 1989 multiple purpose projects, and series B and C of the 1991 multiple purpose projects. Over time, the remaining bonds, 1991 multiple purpose project bonds ($1.7 billion), research revenue bonds ($261 million), and other certificates of participation ($120 million), will be candidates to be refunded into the new general revenue bond indenture.

Interest rate markets are at historic lows. Refinancing the proposed existing bonds under the general revenue bond indenture will result in estimated present value debt service savings over the life of the instruments of $84 million, based on current rates and assumptions, due to lower interest rates and also extending the final maturity of bonds for many projects to the useful economic life of these projects. No interest rate swaps are contemplated for this first series of bond refundings.

Bond Ratings

The ratings for University revenue bonds are currently in the AA category, (Standard & Poor's and Moody's Rating Agency), despite the financial difficulties of the State of California. Based on discussions with these agencies, it is anticipated that the ratings for the general revenue bonds will also be in the AA category.

Summary

Pledging general revenues of the University under a new bond indenture will expand the revenues that may be pledged for debt service. This expansion is critical to enabling the issuance of additional debt for capital projects to support the enrollment expansion, the development of academic programs, and the repair and replacement of critical campus infrastructure. Individual projects will continue to be brought to the Board for approval of external financing. The new general revenue bond indenture will provide greater flexibility as the University proceeds to refinance its existing debt to reduce debt service costs and to finance new project debt.

Mr. Mullinix introduced Mr. John Augustine, of Lehman Brothers, who discussed debt capacity, noting that the University's current debt is conservative and front loaded and represents an impressive use of the debt capital markets by the institution over time. He reported that for the debt capacity study, Lehman Brothers analyzed the institution from both qualitative and quantitative factors, examined key ratios, and then stressed those ratios based on capital markets assumptions across a variety of interest rate and economic scenarios. The study also compared the University to its peers.

In the current economic environment, it was the view of Lehman Brothers, based on the study and meetings with campuses, that the University could issue an additional $1.5 billion of debt over the next five years in addition to what is slated for SPWB debt. Provided that the State credit rating stays in the A category, the University could have access to the capital markets within the AA category. If The Regents decided to pivot to the capital markets from the A category, the debt capacity would be increased by an additional $1 billion within the A category.

Mr. Augustine reported that making the transition to a consolidated general revenue bond approach will allow the University to move away from thinking about the source of credit and the source of payment in the same terms. Historically, the University has approached the capital markets project-by-project, a stance that is being abandoned by major public research universities around the country.

Mr. Mullinix reported that the second part of the study, to be presented in the fall, will explore the use of the flexibility the University has in the general covenants and ways to finance at a lower credit rating that would help in areas where the cost of financing may be only slightly increased. Many of the savings this could provide will be derived through discounting over the period of the issue.

Committee Chair Hopkinson believed this approach will have significant practical benefits for the University. She asked what is expected under current economic conditions to be the spread between the University's previous kind of debt and this debt. Mr. Augustine recalled that the University had been successful over time in presenting the multiple-purpose projects pledge as being its primary debt financing vehicle. From a spread perspective, it is unlikely that cost to capital will be lowered; however, a greater debt capacity, estimated at 20 percent, may be achieved.

In response to a question by Regent Marcus, Mr. Mullinix explained that at the AA level the University would not have the debt capacity needed during the five-year period. The Regents has no taxing power and therefore is not pledging its general credit. Mr. Augustine commented that the first move related to the general revenue credit will be to consolidate the housing, research, and multiple purpose projects into one credit to increase flexibility and drop the covenants that are extant that might prohibit future moves. Then consideration will be given to non-core auxiliary for financing as a separate credit. The idea is to move to a broader general revenue pledge that gives more flexibility to come back and do other things along the spectrum.

Mr. Mullinix reported that it was thought that in the area of medical center debt it might be possible either to move to a consolidated credit or to change the relative status of the debt to achieve savings. After extensive discussions, however, it was concluded that the strategy did not fit into the current management structure. The relative position of that debt seems appropriate and should not be incorporated at this time in a general credit.

Regent Marcus assumed the University could refinance on a project basis and save the same amount of money. He was concerned that if issues were to develop relative to the general obligation, the University could be jeopardized. Mr. Mullinix responded that that is the reason for leaving the housing and financing auxiliary debt at a lower rating. Here, only general obligation debt basic to the University is being discussed. The longer term talked about for the fall is to move some of that housing and other debt into a different credit. The current housing is being left in this credit because of its beneficial cash flow implications.

Regent Lee assumed that overall the University is attempting to refinance to realize lower interest rates wherever possible. Mr. Mullinix responded affirmatively but noted that the simultaneous adoption of new covenants for the University's debt will provide greater flexibility. He emphasized that nearly all private and most major public universities have moved in this direction in the last few years because of the capacity issue.

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

> [For speakers' comments, refer to the July 16, 2003 minutes of the Committee of the Whole.]

5. **PROPOSED POLICY REGARDING UNIVERSITY SUPPORT OF RACE-, ETHNICITY-, OR SEXUAL ORIENTATION-TARGETED ACTIVITIES**

Regent Connerly recommended adoption of the following policy:

> POLICY REGARDING UNIVERSITY SUPPORT OF RACE- OR ETHNICITY- OR SEXUAL ORIENTATION-TARGETED ACTIVITIES
>
> It shall be the policy of The Regents that the University shall not sponsor non-academic events that are race restrictive, nor shall any University funds be used to finance, in whole or in part, any function that is restricted or limited to or designed to be targeted to individuals of specific race, ethnic, or sexual orientation groups. This shall include but not necessarily be limited to freshman orientation events and graduation ceremonies or celebrations.

It was recalled that at the July 1996 meeting of the Committee on Educational Policy, in response to a request from Regent Connerly, the Regents received a report on ethnic commencement celebrations. At its June 18, 1998 meeting, the Committee on Educational Policy received an update on the 1996 report, at which time General Counsel Holst referred to his letter to the Regents on this matter in which he expressed the opinion that the above-described funding is permissible as long as it is done without regard to race or ethnicity. The letter states, "In the making of such allocations for events of this type, organizations with a racial or ethnic focus can neither be favored nor can they be discriminated against, with the result that an organization with a racial or ethnic focus may be funded, but only on the basis of the general funding standards that are unrelated to race or ethnicity." It was also noted that membership in registered student organizations at the University is open to all students regardless of any emphasis on race, ethnicity, or sexual orientation.

The report that was presented in July 1996 described which campuses have separate ethnic graduation events and how they differ from official graduation ceremonies; which ethnic groups are involved; the rationale for these events; and the funding sources.

The general findings of the report have not changed. In addition to official campus ceremonies for degree conferral, a number of related supplemental activities take place across the spectrum of ethnic groups. At these events, a speaker may address participants, and some recognition of achievement, such as a certificate of participation, may be bestowed. The supplemental activities take a variety of forms from campus to campus and from group to group and are typically sponsored by an academic unit or a student graduation celebration committee or other student organization.

The purpose of these events is to offer an informal setting for a more personalized recognition of graduates than may be afforded by commencement exercises.

There are a variety of funding sources for these supplemental events, including admission fees, the proceeds of student fundraising activities, departmental funds, allocations from student government, and central campus funds. As a matter of University policy, any student who objects to the use of campus-based mandatory student fees for this purpose is entitled to a pro-rata refund.

During their deliberations in both 1996 and 1998, concerns expressed by Regents included the following: that University-sponsored events should serve to bring people together rather than separate them; that University support for multiculturalism should further the development of one America; whether such activities were sufficiently beneficial in inspiring others to attend the University; whether the use of public funds to support such activities was appropriate; and the potential similarity or contrast of public subsidy to other campus organizations such as fraternities.

Regent Connerly announced that, although he still considered it an important issue, he would like to withdraw his request for action on this item because he wished to reconsider some of the issues related to freshman orientation, based on a conversation with Regent Murray. He recalled that one of the great strengths of the University was that its governing board was made up of people from different regions, different sectors of the economy, and various other differences that allowed them to aid the University by presenting diverse views to their contacts and constituencies. He maintained that, although his fellow Regents may disagree with many of his views, Californians at large did not and that as the fiscal crisis escalates, it becomes more important to assess those outside views accurately. He believed that the concept of holding separate graduation ceremonies based on race was foreign to a lot of people and that the University's diversity initiatives should be designed with a view toward not just tolerating others but accepting them in the spirit of inclusion. He was concerned that in maintaining separateness, the University was losing touch with the people of the state, although he acknowledged that many students have views to the contrary. In consideration of these views, he suggested that they attend and encourage their families and friends to attend as many of the various ceremonies as they can, which he believed did not happen very often. That effort would signify a belief in diversity as inclusive and accepting and make students, in particular, full members of the University.

Provost King summarized the types of events in question, reporting that the large majority are not built around groups that deal with race or sexual orientation. All events are open to all members of the campus community. The funding comes from a variety of sources, including price of admission. Any University funds provided to registered student organizations sponsoring such events are allocated without regard to race or ethnicity. The events are celebrations at which no degrees are conferred. He reported that no campus has any separate student orientation event that is based upon one of these criteria. The various registered student organizations do hold welcoming events to introduce themselves to new students.

Provost King concluded his remarks by emphasizing that every campus has a mechanism to refund compulsory campus-based student fees that go to support a particular event to which a student may object.

General Counsel Holst confirmed his previous opinion that organizations with a racial or ethnic focus may be neither favored nor discriminated against. They may be funded, but only on the basis of general funding standards unrelated to race or ethnicity.

Regent Sayles agreed with Regent Connerly that students should be encouraged to attend as many of these functions as they can.

Regent Johnson reported that she had attended many of the separate graduation celebrations and viewed them as inspiring and memorable. She noted that many students attend not only the graduation ceremony of their individual school but also the ethnic celebrations, which welcome people from many different groups.

Regent Murray acknowledged Regent Connerly for considering his point of view, but he supported the views of Regent Johnson, noting that Regent Connerly's proposal would have negative ramifications for many activities other than graduation and orientation ceremonies.

Regent Bodine agreed that the proposal was too broad. She noted that of thirty different kinds of groups, only four are based on race or ethnicity. She believed that such groups provide leadership opportunities for students. She discounted Regent Connerly's assertion that the proposal reflects the feelings of the state's residents.

Faculty Representative Pitts reported that a poll of the Academic Council indicated almost unanimous opposition to the proposal.

Regent Sayles then moved the item, in response to which Regent Connerly restated that he was not requesting action. Committee Chair Hopkinson explained that the item was on the agenda as an action item and had not been formally withdrawn. The motion was duly seconded.

A roll call vote was taken, and the motion failed, Regents Connerly, Lee, and Moores voting "aye" (3) and Regents Atkinson, Hopkinson, Lozano, Montoya, Murray, and Sayles voting "no" (6).

[For speakers' comments, refer to the July 16, 2003 minutes of the Committee of the Whole.]

6. 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 Committee adjourned at 12:20 p.m.

Attest:

Secretary