The Regents of the University of California

COMMITTEE ON FINANCE
September 17, 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, Preuss, and Sayles; Advisory members Anderson, Novack, and Pitts

In attendance: Regents Blum, Bodine, Davies, Huerta, Johnson, Kozberg, Marcus, Pattiz, and Seigler; Regent-designate Ornellas, Faculty Representative Blumenthal, Secretary Trivette, General Counsel Holst, Treasurer Russ, Provost King, Senior Vice Presidents Darling and Mullinix, Vice Presidents Broome, Doby, Drake, Gomes, Gurtner, and Hershman, Chancellors Bishop, Carnesale, Cicerone, Córdova, Dynes, Greenwood, Tomlinson-Keasey, Vanderhoef, and Yang, Laboratory Director Nanos, University Auditor Reed, and Recording Secretary Bryan

The meeting convened at 10:47 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 July 16, 2003 were approved.

2. **ADOPTION OF FINAL 2003-04 BUDGET FOR CURRENT OPERATIONS**

The President recommended that the 2003-04 Budget for Current Operations, as modified by actions of the Legislature and the Governor, be adopted.

It was recalled that the University of California 2003-04 Budget for Current Operations document presented at the November 2002 Regents meeting summarized the University's budget request for 2003-04 and reflected projected income and expenditure levels in both State and non-State funded programs for 2003-04 as they stood at the printing of the document. The Committee was informed that the projections made in the 2003-04 Regents Budget document continue to represent the University's estimates for non-State sources of funds. Projections for State General Funds and student fees have changed significantly, however, and the Board has been provided with updates as changes have been proposed by the Governor and the Legislature, beginning with the December, 2002 special meeting of the Board and at each subsequent meeting. In addition, the Board was informed of final changes, as reflected in the budget passed by the Legislature, in President Atkinson's July 30 letter to The Regents. The capital budget remains as originally approved in November and requires no further action.

The Committee was informed that the Legislature completed its work on the 2003-04 budget on July 29, 2003, and the Governor signed the budget on August 2. With the final State budget approved by both the Governor and the Legislature, The Regents is asked to approve the final 2003-04 budget for the University as it has been reflected in the 2003-04 Regents' Budget document, with the exceptions related to actions taken by the Governor and the Legislature which are described in more detail below.

Summary of Overall State Budget

As reported to the Board in July, the Governor estimated the total State deficit to be $38.2 billion. The final budget enacted into law on August 2 addressed the State's shortfall through a combination of actions including $10.7 billion in borrowing to be paid off over five years from existing sales tax revenue; $4.5 billion in other revenues, including $2.2 billion in federal one-time funds received by the State through the fiscal relief provisions of the recent federal tax bill; about $4 billion in new revenue from the vehicle license fee, which will return to previous levels based on a "trigger" pulled by the Director of Finance upon his assessment that there are insufficient State General Funds to support the previous buy down of the fee; about $6.7 billion from other borrowing and fund shifts; and $13.7 billion in spending reductions and savings, including $1.1 billion, about half of which is General Funds, in reduced compensation costs for State employees, equivalent to about a 10 percent cut, to be accomplished through a combination of renegotiated employee contracts and the elimination of up to 16,000 positions. The package includes no tax increases other than the return of the vehicle license fee to previous levels, provides a minimum funding guarantee for Proposition 98, and suspends all statutorily-required new cost-of-living adjustments in 2003-04. The budget assumes a reserve of $2 billion.

The implications for 2004-05 of the newly adopted budget are serious. The Legislative Analyst estimates that the structural imbalance built into that budget is about $8 billion and will continue unless further action is taken to bring expenditures in line with revenues. Moreover, the budget deal itself was accompanied by trailer bills that are needed to implement legislative changes in law, one of which includes the following language:

> The Legislature finds and declares that the State of California faces an unprecedented fiscal crisis that requires legislative budget actions to control spending growth. It therefore is the Legislature's intent that, in assisting the Governor in preparing the State Budget for the 2004-05 fiscal year, the Department of Finance not include any proposed funding for any of the following:

(a) State, University of California, or California State University employee salary increases that have not already been approved prior to the enactment of this act.

(b) Discretionary price adjustments to State, University of California, or California State University operations.

(c) Local mandate reimbursements, including payments for prior-year reimbursements, except that the continuing funding for mandates funded in the 2003-04 fiscal year may be included in the budget for 2004-05.

(d) For General Fund capital outlay, beyond a minimal amount of $50 million for emergencies and contingencies.

(e) The All American Canal.

(f) Proposition 98 spending in excess of the minimum guarantee for the 2003-04 and 2004-05 fiscal years.

(g) Enrollment growth at the University of California or the California State University.

Points (a), (b), and (g) of this language have very serious consequences for the University's budget.

UC Operating Budget – State Funds and Student Fee Revenue

The final State General Fund budget for 2003-04 totals $2.9 billion, which is nearly $320 million less than the State General Fund budget was in September, 2002 when the last budget act was adopted. The difference accounts for both mid-year reductions for 2002-03 and current year changes.

Cuts proposed by the Governor in January, all of which were approved in the final budget act, totaled $373.3 million and were explained in detail at the March meeting. The Governor's budget assumed that $179 million of these cuts would be offset by increases in student fees. Further cuts to the University's budget proposed by the Legislature and ultimately added to the final budget include an additional unallocated reduction of $98.5 million, of which $80.5 million is designated as one-time and $18 million is designated as permanent. Other cuts approved include $6.6 million related to the California Digital Library Project, which provides access to the high-speed Internet for K-12 schools, leaving $14 million in its budget; $455,000 from the Labor Institutes ($4 million remains in its budget); and $1.3 million from the Community Teaching Fellowships for Math and Science, essentially eliminating the program. The final budget also includes $4 million less in one-time start-up funds for Merced. The Governor's Budget had provided $11.3 million for this purpose; the legislative action reduces this amount to $7.3 million. The cuts included in the final Budget Act total $484 million, including $71 million in cuts that first occurred as part of the mid-year cuts for 2002-03 and were made permanent in 2003-04, and $413 million in further cuts related to 2003-04. Actions included and not included in the Governor's January budget related to the Partnership, most of which was approved as proposed with the exception of the funding for Merced, show that the University received funding for 13,000 additional FTE students at the agreed-upon marginal cost of instruction, funding for health benefits for annuitants, debt service, and other routine one-time budget adjustments; however, much of the Partnership was not funded, including the 4 percent annual adjustment to the base budget; funding for core needs including instructional equipment, instructional technology, maintenance, and libraries; and the restoration of a $29 million reduction in 2002-03 to core areas of the budget that had previously been approved as a one-time cut.

As a result of these actions on the budget, the University's Partnership Agreement will be underfunded by nearly $1.1 billion. About $230 million of this is offset by increases in student fees, constituting about 21 percent of the overall solution to the shortfall; $424 million of this problem is being addressed through base budget cuts to existing programs; and $423 million is being offset by foregoing salary increases and other unfunded inflation costs. The impact of this underfunding is significant. Over a three-year period, the University's student enrollments will have grown by 18 percent, while the State-funded budget will have declined by 14 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. In addition to the base budget cuts enacted by the State, the University is contending with more than $100 million in other cost increases for which there is no new funding. These include faculty merit increases, employee health benefit costs, energy costs, and other inflationary increases.

The University is implementing the targeted cuts as required. As a result, 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, based on what was known about the University's budget at the time, The Regents took action in July to approve a student fee increase of 25 percent for 2003-04 in both mandatory systemwide student fees and professional school fees, as well as an increase of 10 percent in nonresident tuition. At that time, The Regents also authorized the President to raise student fees by an additional 5 percent, for a total increase of 30 percent, if the President determined that the final outcome of the 2003-04 budget would warrant such an action. Consistent with University practice, financial aid will be provided to mitigate or eliminate the impact of the student fee increases for needy students. On July 30, one day following adoption of the budget by the Legislature, the President informed the Board by letter, after consulting with the Chair of the Board and the Chair of Finance, that the additional 5 percent increase would be necessary, given the significant additional reductions contained in the State budget for UC.

In addition to offsetting the $179 million unallocated reduction originally proposed in the Governor's Budget, the actions to increase student fees will generate sufficient revenue to provide an additional $51 million to help offset a portion of the additional $98.5 million unallocated reduction ultimately included in the final budget. The remaining $47.5 million will be funded for 2003-04 through internal borrowing. The increase in nonresident tuition will be used to pay the debt service on this loan. As noted above, $80.5 million of this unallocated reduction is designated as one-time. The Regents were informed in July that if, because of the State's continuing fiscal crisis, the University's budget is further reduced in 2004-05, options that will need to be considered include reductions in enrollment and further student fee increases.

Actions are being taken to grant faculty merit increases and to provide some assistance with rising health benefit costs, including extra relief for employees whose salaries are $40,000 or less. The faculty merits will be funded by reallocation of funds that would have otherwise been used for faculty purposes, and the additional assistance on health benefit costs will be funded by other reallocations in the budget. In other words, the University will be making additional budget cuts beyond those included in the budget act.

Reductions proposed for outreach programs have presented a major problem for the University. Contrary to expectations, the 50 percent cut proposed in the Governor's Budget in January was ultimately approved by the Legislature. Vice President Doby is working with UCOP and outreach program staff to develop a transition plan that will implement these cuts and, at the same time, make every effort to ensure that the University's commitment to support improvement of K-12 education and to enhance diversity in the University community is upheld.

In the budget crisis of the early 1990s, the University took a balanced approach to addressing budget shortfalls that over a four-year period totaled approximately $900 million from a normal workload budget. One-half of the shortfall was taken through budget cuts to the campuses and the Office of the President, one-fourth of the shortfall through foregone salary increases for faculty and staff, and one-fourth through student fee increases net of financial aid. The University also borrowed funds at that time to help address the funding cuts. The actions the University is taking in the current fiscal crisis again constitute a balanced approach, with about one-fifth of the problem being addressed through student fee increases and about 40 percent each through budget cuts and foregone salary and other inflationary cost increases. This crisis differs from the early 1990s in one major respect: these shortfalls are occurring during a time of significant enrollment growth, while enrollments were essentially flat during the early 1990s.

The University of California is doing all it can to minimize the impact of budget cuts on instructional programs. It has been the position of the University that it is better for students to get the classes they need to graduate in a timely manner, even if they must pay higher fees to attend. Moreover, the provision of financial aid for needy students continues to help make UC affordable. Nevertheless, students, faculty, and staff, will feel the impact of these cuts in many ways other than student fee increases and foregone salary increases. The basic infrastructure of the University has been significantly reduced, and that will have an impact on all services provided for the University community.

Committee Chair Hopkinson emphasized that overall the University is facing an $848 million budget reduction. In addition to the specific cuts, there will be no increases for additional students or additional costs. That amounts to a 25 percent decrease in the University's effective usable dollars.

Regent Montoya noted that outreach had been cut by $1.3 million, essentially eliminating teaching fellowships in math and sciences. She had understood that this was done in conjunction with the State Finance Department based on the expectation that the University would compete for federal money under the No Child Left Behind program. She asked for clarification of that and also of how the marginal cost of educating a student is calculated and negotiated with the Legislature. She observed that faculty were being hired at UC Merced at above average salaries but were not teaching students. She suggested that they should be teaching year round.

Mr. Hershman responded that it is hoped that money from the No Child Left Behind program could make up for some of the loss to outreach and teaching professional development and subject matter projects. The money goes to the school districts, with which the University may contract. He suggested that at a future meeting Vice President Doby discuss the University's plans for outreach. He reported that the formula for determining the marginal cost per student is governed by an agreement between the University, the Department of Finance, and the Legislature that was developed jointly with CSU. It is based on a scaled-down version of the cost of faculty, teaching assistants, instructional support, and libraries. He agreed to circulate the formula. Concerning UC Merced, he reported that the plan was to build up faculty to a level necessary to open the campus. The chancellor believes that 60 full time faculty are needed, plus 15 temporary faculty, in order to open with 1,000 students. While there are not yet students, the faculty must be in place to develop courses. A phasing plan was worked out with the Department of Finance to build up to the level needed to open. When the students arrive, Merced will be funded as any other campus in terms of the marginal cost formula plus student fee revenue. The plan that was worked out for UC Merced is consistent with the historical practice for opening new UC campuses. UC Merced's budget has been reduced and its opening date has been delayed. The University presented a proposal at the request of the Senate Budget Committee on what would be saved by postponing the opening for a year. The Senate took the cut of $4 million from what was in the Governor's Budget. The number of faculty has been frozen for a year.

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 minutes of the September 17 meeting of the Committee of the Whole.]

3. **CONSIDERATIONS GUIDING THE DEVELOPMENT OF THE 2004-05 BUDGET**

As described in paragraph 2. above, the final State budget for 2003-04 uses a combination of borrowing, fund shifts, transfers, and significant budget cuts to address what the Governor estimated to be a $38.2 billion shortfall. The final budget includes $484 million of base budget cuts for the University, approximately $230 million of which are being offset by student fee increases. The University's Partnership Agreement will be underfunded by nearly $1.1 billion. The portion of this shortfall offset by increases in student fees constitutes about 21 percent of the overall solution to the shortfall; $424 million (40 percent) of this problem is being addressed through base budget cuts to existing programs; and $423 million (40 percent) is being offset by foregoing salary increases and other unfunded inflation costs. In addition, a trailer bill accompanying the budget was adopted, indicated that funding for salaries, non-salary price increases, and enrollments will be frozen at current levels. As a result, campuses are being urged to keep 2003-04 enrollments down as much as possible in order to lessen the impact on 2004-05.

It was recalled that, since the first Compact with Governor Wilson was developed in 1995-96, and continuing with the Partnership Agreement with Governor Davis, the University has premised its annual budget request on the funding agreement with the Governor. The Partnership Agreement with Governor Davis represents the minimum level of resources the University needs to accommodate enrollment while maintaining quality. If previous practice were followed, the University would be requesting a State funding increase of about 10 percent for 2004-05. This percentage increase, however, would be sufficient to cover only normal salary, benefit, non-salary, and enrollment increases as well as restoration of the $80.5 million one-time cut in the 2003-04 budget. It would not include any restoration of Partnership funds.

The Partnership has not been fully funded for the last three years. In fact, the shortfall under the Partnership is nearly $1.1 billion. The Legislative Analyst estimates that the State will begin 2004-05 with an ongoing structural deficit of at least $8 billion. In this context, and given the legislative and Department of Finance directives about funding freezes, it would not be reasonable to base a budget request upon the Partnership in 2004-05. In fact, if the legislative language were followed, the University's only request for State funds would be limited to restoration of the $80.5 million unallocated reduction designated as one-time in the final 2003-04 budget.

Major Budget Considerations for 2004-05

Given current fiscal realities, the University is facing several major issues related to the 2004-05 budget, including enrollment, student fees, salary increases, and other issues related to unfunded costs for 2004-05.

Enrollment. In 1999, when the University's enrollment plan was last updated, the University expected to grow by about 5,000 students per year, consisting of between 2,000 and 3,000 new students and between 2,000 and 3,000 continuing students. By 2010, it was estimated UC would reach budgeted enrollment of 217,000; however, in recent years, the University has been averaging enrollment growth of about 8,000 FTE, a much greater rate of growth than the last enrollment plan assumed. For 2003-04, budgeted enrollment will total approximately 190,000. This represents an increase of 13,000 students over the previous year, including 5,000 FTE related to overenrollment in 2002-03. As a result of the rapid growth rate that has occurred in recent years, enrollments in 2003-04 will be about 12,000 students over the level envisioned in the 1999 plan.

The Legislature has expressed its intent that no funding is to be provided in 2004-05 for enrollment increases, and the Department of Finance has issued instructions for developing the 2004-05 budget based on a similar assumption. There is a range of possibilities regarding funding for enrollments the University should consider as the 2004-05 budget is developed:

- The University will enroll approximately 47,000 new freshmen and transfer students, and another nearly 11,000 new graduate students in 2003-04, for a total of over 58,000 new students. If the State were to fund normal enrollment growth, UC would be requesting funding for an increase of about 5,000 students. This includes approximately 2,250 additional new students and, because new enrollment increased substantially over the past several years, about 2,250 more continuing students.

- If the legislative language can be interpreted to mean the State will not fund new student growth but will fund the increased costs associated with continuing students, UC would request funding for over 2,000 students.

- If the legislative language is interpreted to mean that the State will not fund enrollment growth of any kind, the University must consider the possibility of reducing the number of new students enrolled for 2004-05 in order to have sufficient resources to support the additional 2,000 continuing students expected next year.

- If the University sustains further base budget cuts, it may be necessary to consider much deeper reductions in the number of new students enrolled next year.

Without funding for normal enrollment growth, it must be assumed that for the first time since the implementation of the Master Plan for Higher Education in 1960, the

University of California must consider changing its promise of educational opportunity for all eligible students wishing to attend.

Student Fees. After seven consecutive years without increases in mandatory systemwide student fees, and in fact two years in which undergraduate student fees were reduced by a total of 10 percent and graduate student fees were reduced by 5 percent, students paid an additional $135 for mandatory systemwide student fees in the spring quarter of the 2002-03 academic year. In 2003-04, student fees will increase by an additional 30 percent. This means that undergraduates will pay an additional $1,150, in 2003-04; mandatory systemwide fee increases for graduate, professional school, and nonresident students are slightly higher. Similar percentage increases are occurring for the Fee for Selected Professional School Students.

Even with the fee increases instituted for 2003-04, UC undergraduate students will be paying $1,200 to $1,400 below the average of the total tuition and fees at the University's public comparison institutions, and graduate students will be paying about $2,000 below the average. The relatively high cost of living in California and UC's requirement for health insurance coverage drive up the total cost of attending UC; however, UC's financial aid programs compensate for these higher costs. In 2002-03, the total cost of attending UC was $809 above the average for its comparison schools. After scholarship and grants were taken into account, the University's net cost for need-based aid recipients was the second lowest in the group, $562 below the comparison school average.

For 2004-05, current estimates indicate UC student fees will be about $1,800 below the average of the comparison institutions.

The University has continued its historic commitment to provide financial aid to mitigate the impact of the fee increases for needy students. All students who normally receive grant aid will have their entire fee increase covered with additional grants. In general, this means that students from families with incomes of $60,000 or less will have their fee increase fully covered by grants. Other needy students who normally do not receive grant aid – in general, those students from families with incomes of between $60,000 and $90,000 – will have one-half of their increases covered with grant aid.

Salaries and Employee Benefit Costs. A major problem confronting the University has resulted from the continuing inability of the State to fully fund the Partnership. The 4 percent base budget adjustment called for in the Partnership is used primarily to fund cost-of-living and merit salary increases for faculty and staff, health benefit increases for all employees, and non-salary price increase costs. Faculty salaries have fallen 9 percent behind the average of the comparison institutions, and a similar problem exists with respect to staff salaries. The University is deeply concerned about this growing salary gap, given the need to hire thousands of faculty over this decade. Even if enrollment growth is slowed or curtailed, the University will need to hire and retain faculty and staff to accommodate enrollment growth that has already occurred and to replace faculty and staff who retire or leave the University.

A similar problem occurred during the fiscal crisis of the early 1990s. Faculty salaries fell significantly behind the comparison average. Once the State's fiscal situation recovered, over time the gap in faculty salaries was closed; however, staff salaries continued to lag the market. The University had just begun to address the staff salary gap when the State's fiscal situation began to deteriorate. Two years of additional funding above the Partnership for certain categories of employees whose salaries significantly lagged a highly competitive market and for lower-paid staff had made some progress in addressing market lags. Unfortunately, that effort came to an end.

It is vital that the University begin to address this shortfall in salaries and benefits. If the gap grows beyond what may reasonably be expected to close over time, the University will find itself in a constant catch-up mode, making UC salaries highly non-competitive for hiring and retention purposes over the long-term.

Other Unfunded Costs. In 2003-04, the campuses are dealing with unfunded cost increases for faculty merits, health benefits, energy, maintenance of new space, non-salary prices, and workers' compensation. Campuses face a similar situation in 2004-05 if these costs are not funded again next year. Campuses are having to make additional cuts, beyond those approved in the final Budget Act, in order to deal with these cost increases. With the prospect of continued underfunding of the Partnership, this situation will be exacerbated.

Options for Addressing Major Budget Issues in 2004-05

The options discussed below do not include further base budget cuts. By 2003-04, after accounting for the $230 million of student fee increases that will offset a portion of the cuts, UC's base budget will have been reduced by more than $424 million. Reductions targeted at existing programs already equal from 10 percent to 50 percent of program budgets. Additional budget reductions during a period of dramatic enrollment growth would affect the quality of the academic enterprise.

Budget cuts are severely affecting operations that support the instructional mission, such as academic support, student services, and administration. These programs, which provide necessary operational functions that support the University's ability to accommodate the students, have never recovered from the last set of cutbacks. It would cause irreparable harm to increase enrollment at the predicted rate and continue to cut deeper into these programs. Other areas that have a direct impact on the instructional program, such as instructional equipment and instructional technology, for which State funding has been historically inadequate, are losing their ability to keep up with fast-pace changes.

Research has been cut so deeply that the ability to attract funds from the federal government is being jeopardized. These programs were cut 20 percent during the early 1990s and will sustain another 20 percent in cuts through 2004. Research is an important element in the State's ability to recover economically. Economists attribute at least 50 percent of the nation's economic growth since World War II to innovation resulting from research and development, with university research playing a key role. Many believe that California's recovery from the recession of the early 1990s was due, in large part, to the commercial effects of research and training conducted by major institutions like the University of California.

Public service programs were reduced by 20 percent during the cuts of the early 1990s and are once again being cut by 25 percent to 50 percent. In some instances funding will have been entirely eliminated. Agricultural research and public service programs have been hit particularly hard, given the fact that most of their funding comes from State resources. With inadequate funding for maintenance and no funding for deferred maintenance, the physical plant is falling into greater disrepair. Costs in other areas of the budget, such as health benefits and energy costs, are increasing significantly but are not being funded by the State. The need for adequate resources has always been great, but the pressure has built significantly due to the fact that budgets have been woefully short for several years in a row.

Given the likelihood that the State will be unable to provide the necessary funding to meet the University's minimum needs again in 2004-05, additional options must be considered for increasing revenue and decreasing costs. The one option the University has historically opposed, even in the toughest fiscal circumstances, is permanently reducing the quality of the University's instructional program. Certainly, the University's ability to continue to provide a quality academic experience has been diminished, but campuses are doing all in their power to address the situation without permanently affecting their ability to strive for excellence.

Options to Reduce Costs

In order to preserve the quality of the instructional program, it is critical that adequate resources are received for the number of students the University enrolls. Yet, the University is facing a funding freeze for enrollments in 2004-05 that would mean no resources for further growth in enrollments. In effect, the University's doors would be closed to thousands of new students who are eligible to attend. Moreover, there is a problem to contend with related to the 2,000 FTE growth in the number of continuing students expected to be enrolled in 2004-05.

If the unallocated cut of $80.5 million designated as one-time in the 2003-04 Budget Act is restored, and no other budget reductions occur, the University may opt to request funding from the State for the 2,000 FTE continuing students. An argument could be made that the legislative language freezing funding for enrollments in 2004-05 applies only to new student growth and that support for continuing students should be funded. If such an interpretation is not permitted, the University may need to consider reducing the number of new students enrolled from 58,000 to 56,000 in order to have sufficient resources for the 2,000 continuing students. If the former option were funded, the degree to which enrollments exceed the 1999 enrollment plan would be reduced to 9,000 FTE. If the latter option were taken, enrollments would exceed the plan by only 7,000 FTE. If, however, the University sustains further base budget cuts, it may be necessary to consider much deeper reductions in the number of new students enrolled next year.

A rationale discussed previously for constraining enrollments was to phase in a return to the enrollment levels envisioned in the 1999 enrollment plan, which projected a total of 217,000 students by 2010. Enrollments could be restricted over the next six years so that the total reached in 2010 remains at the 217,000 FTE level. The State currently provides about $9,000 for each new student. Phasing in a restriction of 12,000 enrollments over the rest of the decade could ultimately save over $108 million per year in State funds.

This could be accomplished in a number of ways:

- UC-eligible students could be admitted by a specific campus but asked to attend a community college for the first two years of college, using a plan similar to the dual admissions program.

- The University could gradually scale back to the level envisioned in the previous plan by freezing the number of freshmen it enrolls to existing levels. Currently, UC enrolls about 33,000 freshmen per year. This number has been increasing by about 1,000 to 2,000 students annually.

- Another option would be to restrict the growth in community college transfers. The Partnership Agreement calls for growth in the number of community college transfers to UC of 6 percent per year, or about 700 students. This commitment would result in the University's exceeding the Master Plan recommendation that it maintain a 60:40 ratio between upper division and lower division undergraduate students. The University could return to a level of community college transfers that meets the 60:40 ratio in the Master Plan, or a decision could be made to change that ratio even further.

Any of these options could be adopted temporarily for those years in which the State could not afford to support the level of funding called for under the Partnership Agreement. They could involve a major change in policy for the University and for the State.

<u>Options to Increase Revenues</u>

The University's options for raising additional revenue are very limited, given the fact that most of the fund sources supporting its budget are constrained by the same factors that are constraining the State's financial situation. One source of revenue that could be increased is student fees. The following possibilities could be considered:

- Institute a general fee increase that would apply to all students. Each $100 increase would yield about $13.3 million, net of financial aid, assuming the policy of using 1/3 of the student fee revenue for financial aid. Student fees could be increased by $1,800, or some portion of that amount to generate new revenue (an $1,800 increase would generate $240 million, net of financial aid).

  Such a fee increase could be accompanied by a refinement in UC's financial aid policies to mitigate the impact of the fee increase on both low- and middle-income students and to ensure that UC remains financially accessible to all students in terms of total cost. Under the refinement, all students with financial need would first receive grant funding to offset all or a portion of any fee increase. The amount of the fee grant offset would depend on the parental resources of the student. One option would be to continue the practice established this year of fully covering the fee increase with grant aid for those needy students currently receiving grant aid. For those students who qualify as needy but who generally receive no grant aid, the University could continue the practice established in the current year of covering half of the current year increase with grant aid; or a graduated scale could be established to cover more of the increase with grant aid for those students closer to $60,000 and cover less with grant aid as family incomes get higher. In addition to the grant funding to assist with their fees, lower-income students with financial need would continue to receive supplemental grant assistance to help keep their total cost of attendance manageable.

- Institute a higher fee increase for students from families with higher incomes. For example, undergraduate students whose family income is $90,000 or above would pay higher fees. The State provides a subsidy that equals about 2/3 of the cost of education for undergraduate students. By increasing student fees for students from families with higher incomes, this subsidy could be reduced to one-half, or one-fourth, of the cost. If such a proposal were implemented, each $1,000 increase for students with family incomes above $90,000 could generate roughly $58 million. There would be no need to provide financial aid for this group of students, so the total revenue generated would be available to help fund the budget. Approximately 58,000 students would fall into this category.

- Completely eliminate the $1,800 gap that exists between UC fees and those charged at its comparison institutions for students from families with higher incomes. Doing so would raise approximately $104 million. Administrative costs and challenges associated with verifying incomes for this group of students could be significant. While this option may seem attractive to some, it yields less revenue than a general student fee increase.

- Further increase professional school fees so that they reach the average fee level charged at public comparison institutions for the same disciplines. If the student fee levels for all professional school disciplines charging these fees were raised to reach that average, current estimates indicate an additional $25 million, net of financial aid, would be generated. Increases in student fee levels would range from zero to $5,000 depending on the discipline, with medical school requiring the largest increase. Another possibility would be to go only half way toward closing the gap the first year and the rest of the way the second year.

- Charge undergraduate students the full cost of instruction – equivalent to nonresident tuition – if the number of credit units they are taking exceeds a threshold of, for example, 5 percent to 10 percent above the normal number of credit units one needs to graduate. There are not many students who exceed such a threshold. Most of them are students pursuing an approved courseload for a double major and thus need extra time to complete their course of study. Therefore, policy considerations related to how double majors ought to be treated would have to be reviewed. To the extent that there are students taking an excessive number of credit hours who are not double majors, the proposed increases in student fees could reduce the number of such students.

- Increased nonresident tuition, although UC's nonresident tuition levels are currently above the average of public comparison institutions and reflect the full cost of education at UC. Nevertheless, a decision could be made to exceed the average and in turn UC's cost of education. An increase of $1,000 targeted at undergraduate students, for example, would raise about $8 million. A less desirable option would be also to increase nonresident tuition for graduate students, which would raise nearly $9 million.

  Throughout the mid to late 1990s and early 2000s, nonresident tuition increased steadily by about 4 percent per year. For 2002-03, in addition to the 4 percent per year implemented for all nonresident students, undergraduate nonresident students paid a 12 percent increase to help restore budget reductions for UC's outreach programs and to help fund increases in employee health benefits. In July, the Board approved an increase of 10 percent for all nonresident students for 2004-05.

Next Steps

The 2004-05 budget presented to the Board in November will reflect the priorities discussed at both the July and this meeting and options for addressing other possible significant funding shortfalls in 2004-05.

Committee Chair Hopkinson noted that this was the first of three meetings during which the development of the budget plan will be discussed. Today's session is intended to address the parameters within which the future discussions will take place and to lay out the issues that will be brought to the table later.

Vice President Hershman emphasized that the level of funding that had been promised under the Partnership Agreement had been considered to be the minimum needed to maintain quality and support enrollment growth. He acknowledged that it will not be possible to close the $1.1 billion gap in that funding during the coming year. Under normal circumstances, the University would present a budget in November that involved a 10 percent increase to take care of enrollment growth, prevent further slippage of salary levels, pay faculty merit increases, provide funding for summer programs, and restore the $80.5 million one-time cut. It does not seem plausible that a 10 percent increase would be granted. The dilemma is whether to ask for what is actually needed or for what is thought the State might be willing to provide. He believed that the best approach would be to adopt a set of principles at the November meeting to guide the budget negotiations with the Legislature and the Governor. He described what a 20 percent budget cut, or $600 million, would mean. That could result in a $4,000 increase in student fees; or reducing enrollment by 60,000 new students, which would mean there would be no freshman class, no transfer students, and no new graduate students; or closing three of the smaller campuses. He emphasized that the University does not save money by accepting fewer students, it saves money by having fewer faculty and staff. To cut 60,000 students would mean reducing faculty and staff by 13,000. Cuts of that magnitude would damage the future of the State. The principles that will be presented in November will focus on maintaining quality, salaries, the student-faculty ratio, enrollment funding, the base budget, access, and affordability. In the past, the University has had a clear, moderate, and predictable student fee policy that raised fees in conjunction with per capita personal income. Unfortunately, during good times fees were reduced or bought out by the Legislature. He noted that despite rising fees, the University has continued its excellent financial aid program.

Committee Chair Hopkinson asked how the State has addressed the issue of salaries for its employees. Vice President Hershman responded that originally State employees were scheduled to receive a pay raise, although University employees were not. The pay raise was undone in terms of the cost to the State by providing employees with equivalent time off. The State also is continuing to pay full health benefits and has promised its employees a pay raise next year.

Regent Blum expressed concern about the Cal Grant program that supports low-income students. Mr. Hershman assured him that the program is secure for the current year but reported that it will be reconsidered next year along with all other programs.

Mr. Hershman noted that possible options for addressing budget cuts had been divided into three groups. He described them and explained what the effects of each would be. The first covered additional base budget reductions that would further reduce quality. These options include reducing salaries, faculty, research, libraries, outreach, other public service programs, and administration. The second group of options focused on student fees. These included closing the gap in fee levels between the University and its comparative institutions, tying fee increases to a student's family income, increasing graduate school fees, charging students the full cost of education for credit units that they take above a fixed threshold, and increasing non-resident tuition beyond the comparison group average. The third set of options addressed enrollment levels.

Mr. Hershman discussed some possible scenarios, which ranged from requesting a budget for the normal addition of about 5,000 additional students and $45 million to fund them to freezing the number of freshman and transfer students. He was hopeful that any drastic action that might be taken would be temporary. The University could ask students who were eligible to attend the University to attend community college first and guarantee them a spot when they transfer to UC. The commitment to increase the acceptance of transfer students could be revised. Whatever choices are made, it will be necessary to work closely with the California State University and the community colleges to try to minimize the impacts on individual students. Finally, plans to open UC Merced could be revised.

Provost King discussed the effects of scheduling decisions concerning enrollments. He described the admissions process, which begins with application filing in November and is followed by the selection process beginning in December, release of the Governor's Budget in January, admissions decisions being completed in February and March, notifying applicants during March, the process of accepting transfer students continuing for another month, and June 15 the final budget being known. There are certain key dates. On January 10, when the Governor's budget is released, the University becomes aware of the funding involved. Admissions notifications must be completed by the end of March because that is the national standard and students need to make their decisions regarding other institutions. He advised that the Regents could discuss their enrollment options at the November meeting and adopt a policy at the January meeting. The final budget becomes known well after the University has completed is notification of admissions process.

Committee Chair Hopkinson noted that this year the University had received a $110 million budget reduction in June. Mr. Hershman observed that the Governor could propose tax increases as one way to correct the State budget deficit, but if they are not implemented, the Legislature could make further budget cuts during June and July when the University is having to make a commitment to students.

President Atkinson invited Mr. Matthew Kaczmarek, Chair of the UC Student Association, to address the Committee. Mr. Kaczmarek reported that the statewide Association was opposed to Proposition 54 and in support of student outreach efforts and the adoption of the green building and sustainable energy policy. The Association's position was that a 40 percent fee increase in any one year was unacceptable and that a second increase the following year would be unthinkable. He urged the Regents to take a stand against increasing fees.

Committee Chair Hopkinson asked for comment as to what the Regents would like to have included in the analysis that would be provided in preparation for setting principles at the November meeting.

Regent Pattiz noted that the budget crisis faced by the University is unprecedented and threatens the fabric of the University. He asked that clarity be provided on how to get more out of current resources, including details about the effects of increasing the faculty workload.

Regent Kozberg believed that the University would need multiple strategies. She wanted to know whether the payout from unrestricted endowment funds could be used effectively, how private support could be increased, what type of regulatory relief could be received from the Legislature and what that would cost, and details showing how the University has become streamlined in the past ten years. Concerning the suggestion that the Legislature might provide regulatory relief, Vice President Hershman noted that the trend is in the opposite direction. The Legislature is putting more obligations on the University and more costs. Regent Kozberg suggested showing what those costs are and what their effect has been. Assistant Vice President Arditti added that recently the University had fought against bills that would increase the University's costs by $80 million per year.

Regent Johnson requested that it be made clear that any scaling back of plans for UC Merced would receive negative reactions from parents, students, valley residents, and legislators.

Regent Montoya reported that she had left the July meeting happy in what proved to be the mistaken belief that she had voted to allow every student who was eligible to attend UC in 2003-04. She later realized that 1,600 students were kept out of the University, which she believed had violated the spirit of the Master Plan for Higher Education. She believed that rather than sending back the students' applications, the applications should have been kept until next September. Committee Chair Hopkinson recalled that the action that was taken in the Committee on Finance at that meeting related to the admits for the beginning of the year. Mr. Hershman responded that the reason the action was taken was that historically when the University has been over-enrolled the State has funded the extra students in the following year; therefore, campuses have been allowed to over-enroll every year. Now the situation is one in which the State has refused to fund more students. If campuses over-enroll with transfer students, more freshman would have to be cut. The dilemma for the campuses was how to manage their enrollments related to this year versus next year and how many eligible freshman might have to be turned away next year. Regent Montoya asked why the University could not borrow from internal funds as it had the previous year to augment the number of students admitted. Mr. Hershman explained that previous borrowing was to address what were anticipated to be one-time costs. The current situation represents a permanent change in the level of support.

Regent Lee supported the principle of maintaining quality and taking care particularly of students who were already at the University. He noted that for every 1,000 students who were directed to community college the University would save $18 million over two years. He observed that the Central Valley has waited a long time for a campus and that upholding the commitment to students in the area was of paramount importance. The year's delay in opening UC Merced will save only $4 million.

Regent Bodine observed that the option of sending students to community college and then accepting them as transfers is often mentioned. Acknowledging that all segments of California higher education were under pressure, she asked to be provided with a sense of the abilities of the community college system and CSU to accept students. Mr. Hershman explained that the legislative language indicates that UC and CSU enrollment growth will not be funded, but the community colleges are funded under Proposition 98.

President Atkinson proposed that consideration be given to increasing the numbers of out-of-state and foreign students significantly, and their fees, while maintaining fee levels for in-state students. The out-of-state fees could be set to be comparable to the fees charged at other universities. He noted that several large universities have done this.

Regent Lozano commented that the principles of maintaining quality, access, and affordability were too general to help guide a discussion about tradeoffs. She believed that the Regents would need to understand the impact on key indicators when making decisions about the budget, with the goal of minimizing those choices that would have the greatest long-term risk to the University. She hoped that the options presented in November would be presented in a way that would illustrate their possible effect on the stability of the institution. She believed it would be necessary to understand the risks in the assumptions concerning, for instance, fees being offset by financial aid. She believed that the options that are chosen should represent a comprehensive approach to a solution and should reflect the University's first priority, which is to serve the public.

On this point, President Atkinson reported that recently the agricultural community had been communicating its concern about the University's 20 percent cut to agricultural support over the past few years. The next 20 percent cut to that enterprise will wipe out the University's historic commitment to the agricultural industry of the state. He emphasized that considerations must extend to the whole range of the University's activities.

Regent Sayles requested clarification about eligibility for financial aid. Mr. Hershman reiterated that this year to counter the fee increase the University has committed itself to provide grants to all students who would have received them previously, which encompasses those with family income of up to $60,000. Needy students who would receive loans normally, those in the $60,000 to $90,000 family income group, will receive financial aid sufficient to cover one-half of the fee increase.

Regent Connerly returned to the topic of efficiencies. He advocated examining every possible way to cut costs. Mr. Hershman commented that every aspect of the University's activities was being examined. The administration has been working to deal with the budget cuts that have happened already. He agreed that ways to economize must continue to be sought.

Regent Davies believed that it would be helpful in preparation for the November meeting to have an assessment of the impact of the options on the quality of the University. He observed that quality covers not just education but also research and public service. He agreed with President Atkinson's suggestion that one of the options listed should be to adopt the model of drastically increasing out-of-state admissions and their fees.

Regent Huerta supported the suggestion that the administration present options such as increasing the teaching workload that are based on saving money rather than on cutting funding. She expressed concern about students who hope to transfer from community colleges, who tend to be the children of blue-collar workers, and about the status of UC Merced, which she noted will serve many of the children of agricultural workers. President Atkinson commented that the University has a strong commitment to community college transfers, whose numbers have been increasing significantly for some time. He agreed that the possibility of increasing the workload of faculty and staff should be examined along with all other options, but he noted that the University must consider the prudence of placing burdens on its employees that the State is unwilling to put on other State employees. Mr. Hershman noted that faculty and employees have not been receiving pay increases for the past three years. To ask faculty to accept even less money for working more could damage the already high student-faculty ratio at the University, which would affect the quality of the education that students receive.

Regent Blum believed that efforts such as asking teachers to work a bit harder would not approach generating the degree of savings that will be required to address the dire budget situation. He emphasized that delaying the opening of UC Merced, in which $350 million had been invested, will save only $4 million. He was adamant that at some point the Regents should draw a line in the sand and state that they will not allow the institution to be ruined and will proceed with a plan to admit only the number of students the State is willing to fund. He suggested that the Board consider taking a position on a ballot initiative to lower the requirement to pass the State budget to 55 percent. He did not believe that the University could address the problem by paying faculty less and increasing student-faculty ratios.

Regent Montoya asked if fees generated by increasing the number of graduate students would be offset by concomitant increases in their fellowships. President Atkinson responded that, although graduates may become state residents within a year, undergraduates from out of state retain that status. Committee Chair Hopkinson requested that the ratio of potential revenue for overcharging from the percent relative to cost for out-of-state students and increasing their number be analyzed.

Regent Lee suggested the possibility of generating greater revenue from University-owned licensing, perhaps by forming a team to study how to improve income from technology transfer. President Atkinson commented that the money for research that the University receives from the State leverages major projects with industry and the federal government that bring in huge amounts of money that gets spent in California. In University cooperative research programs, for instance, a small amount of State money is augmented by contributions of industry that support the educational experience and result in the kinds of high-quality research that drive the California economy.

Regent Marcus was of the opinion that quality was the single most important consideration. He believed that because the budget is not yet known, attention should be given to developing principles to guide the Regents' choices. Mr. Hershman responded that he was hopeful that the November meeting would result in an agreement about basic principles and that specific decisions could be made in January when the Governor's budget was known. Regent Marcus agreed with the sentiment expressed by Regent Blum that if the State expects the University to take all qualified students as defined in the Master Plan but refuses to provide sufficient funding, the most effective option could be for the University to accept fewer students. Mr. Hershman noted that the Master Plan is specific about the State's obligation to provide those resources.

Faculty Representative Pitts reported that the faculty had been conducting discussions about productivity and related issues. He offered to provide recent data on faculty instructional initiatives. He noted that the effect of non-competitive salaries on recruitment was difficult to measure, but he believed that over time there is a risk that inadequate resources will have adverse effects. He stressed that the faculty had demonstrated its commitment to the University in the past and intended to do so into the future. Determining how to do that with restricted resources was the key problem.

Regent Murray believed that one important principle should be that whatever the Regents decide should be shared with the students, faculty, staff, and public in order to make it clear that every possible option is being examined. He requested that the November discussion include options concerning borrowing money, faculty workload, and executive pay scales, and a written analysis of their effect on quality. He believed that having all data on the table would be important in unifying the approach and obtaining public support. The goal should be to convince the State of the Regents' commitment both to quality and accessibility and to obtain the support of the Legislature.

Regent Seigler commented that the issues that the University was facing mirrored those of K-12. He believed that the question underlying the problem is to what degree society values education and how much can be squeezed out of the education dollar that Sacramento is willing to provide. He suggested that all segments of the State educational system should unite in an effort to garner more tax money for education.

Regent-designate Ornellas believed that it would be necessary to inform the state populace in general about the importance of maintaining public finance for education.

4. **PROPOSED SEISMIC/LIFE SAFETY FEE, SANTA CRUZ CAMPUS**

The President recommended that a new compulsory seismic/life safety fee of $25 per student per quarter be assessed to all UC Santa Cruz students enrolled in the fall, winter, and spring terms and to students enrolled in State-funded summer programs, beginning winter quarter 2004 through spring quarter 2007.

It was recalled that the 1998 Building Seismic Survey conducted by the Santa Cruz campus revealed that safety improvements are needed in several facilities that are partially or entirely supported with student fees. To address those buildings with a rating of "poor," a series of seismic correction projects are planned for completion over the next several years. Seismic safety work on space that is State-supportable is included in the State-Funded Five-Year Capital Improvement Program. Safety improvements in facilities that house student fee-funded activities and programs are ineligible for State-funded maintenance and must be supported with non-State funds.

Revenue from the fee will be used to fund seismic retrofitting projects and health and safety improvements in various buildings. Projects include work in West Field House gymnasium, the Cardiff House, and the Cowell Student Health Center. Because the Hahn Student Services building houses both State-supportable programs and student fee-funded activities and programs, the seismic safety work will be funded from State funds and student fee revenue on a proportional basis. The planned safety improvements include seismic retrofitting, replacement of fire alarms and sprinkler systems, outdoor safety lighting in the immediate vicinity of the facility, and replacement of fire escape stairways.

It is proposed that two-thirds of the compulsory fee revenue be used to support seismic-life safety projects and one-third be directed to student financial aid. It is estimated that the fee will generate approximately $365,000 in the first quarter it is collected, of which $121,666 will be used for financial aid purposes. Initially, the campus will use approximately $2.6 million of the revenue generated by the fee over 11 quarters to complete several smaller safety projects and to offset the cost of engineering assessments and the detailed plans required to determine the cost and scope of the seismic retrofit projects in the Cowell Student Health Center and the West Field House.

Subsequently, revenue from the fee will be used to repay the debt service associated with external financing to complete $4.5 million of seismic retrofit projects in the student-fee-funded facilities.

The UC Santa Cruz Student Fee Advisory Committee, comprised of ten undergraduate students, one graduate student, one faculty member, and one staff representative, will review the allocation of the seismic/life safety fee to specific projects annually.

The seismic-life safety fee is proposed in accord with the University's policy on campus-based student fees, which states:

> 93.00 Exceptions to Referenda Requirements
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> An increase in compulsory campus-based fees does not require a student referendum when any of the following circumstances apply:
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> * * *
>
> 93.20 The Chancellor determines that an increase is necessary for the health and safety of students such as the maintenance of the safety of a building or facility that is funded wholly or in part by student fees. Safety issues are those which are potentially dangerous such as risk of fire, asbestos, earthquakes, or structural deficits. For buildings or facilities with multiple uses, the costs to students for funding safety-related or health-related maintenance should be based, whenever possible, on the proportion of current student use of the facility. A portion of revenue from these fees may be set aside for financial aid purposes.

In response to a question by Regent Montoya, Committee Chair Hopkinson indicated that a discussion of supplemental fees was scheduled for the November meeting.

Regent Murray asked about student input for this fee. Chancellor Greenwood believed that the fee had been discussed adequately with student representatives. She noted that individual projects would be reviewed by the Student Fee Advisory Committee and would then be submitted to The Regents for approval.

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

> [For speakers' comments, refer to the minutes of the September 17 meeting of the Committee of the Whole.]

5. REPORT ON NEW LITIGATION

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

The meeting adjourned at 1:23 p.m.

Attest:

Secretary