The Regents of the University of California

COMMITTEE ON FINANCE
May 19, 2004

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

Members present: Regents Connerly, Dynes, Hopkinson, Lee, Montoya, Moores, Murray, Núñez, Preuss, and Sayles; Advisory members Anderson, Novack, and Pitts

In attendance: Regents Blum, Bodine, Johnson, Kozberg, Marcus, Pattiz, and Seigler, Regent-designate Ornellas, Faculty Representative Blumenthal, Secretary Trivette, General Counsel Holst, Treasurer Russ, Provost Greenwood, Senior Vice Presidents Darling and Mullinix, Vice Presidents Broome, Doby, and Hershman, Chancellors Bishop, Carnesale, Cicerone, Córdova, Tomlinson-Keasey, Vanderhoef, and Yang, Executive Vice Chancellor Gray representing Chancellor Berdahl, Acting Chancellor Chemers, Vice Chancellor Woods representing Acting Chancellor Chandler, and Recording Secretary Bryan

The meeting convened at 9:35 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 March 17, 2004 were approved.

2. **APPROVAL OF UNIVERSITY OF CALIFORNIA 2OO4-05 BUDGET PLAN AND PROPOSED INCREASES IN STUDENT FEES, AND PRELIMINARY DISCUSSION OF 2005-06 BUDGET**

The President recommended that:

A. A University of California 2004-05 budget plan for State and UC General Funds and student fee revenue as proposed in the Governor's May Revision and adjusted by priorities previously approved by The Regents be approved.

B. The expenditure plan for all other fund sources included in the 2004-05 Budget for Current Operations be approved.

C. Student fees be increased for 2004-05 as follows:

(1) Effective summer 2004, mandatory systemwide fees be increased by $700 (14 percent) for undergraduate students and by $1,050 (20 percent) for graduate academic students, with the full increase reflected in the

Educational Fee. It is recommended that the University Registration Fee remain at its current annual level of $713 for 2004- 05.

(2) Effective fall 2004, increases in the Fee for Selected Professional School Students be increased by approximately 30 percent as follows:

Medicine	$4,500
Dentistry	$4,500
Business	$4,500
Vet. Med	$4,000
Law	$3,800
Optometry	$3,800
Pharmacy	$3,800
Theater, Film & TV	$2,600

It is recommended that the Fee for nursing students enrolled in the MS or MN degree remain at its current annual level of $2,925. Further, it is recommended that the President be delegated authority to approve additional increases in consultation with the Chancellors, not to exceed 10 percent of the total of mandatory systemwide fees (Educational Fee and University Registration Fee) and professional fees. The revenue from these additional increases may be used to maintain the quality of the academic program, to provide financial aid, and to aid the programs in attracting and enrolling students.

(3) Effective fall 2004, the Nonresident Tuition Fee be increased by 20 percent for all nonresident undergraduate students and nonresident graduate academic students. It is recommended that the Nonresident Tuition Fee for students paying the Fee for Selected Professional School Students remain at its current annual level of $12,245 for 2004-05.

Secretary Trivette called to the Committee's attention a report of communications received concerning this matter.

Vice President Hershman discussed changes to the University's budget proposed by Governor Schwarzenegger in the May Revision and summarized the new Compact with the Governor that was announced on May 11. He reported that the Compact is a multi-year plan for restoring fiscal health to the University and specifying accountability goals which will measure the University's progress toward achieving outcomes traditionally of importance to the State and the University. While the Compact itself relates to budget development for the years 2005-06 through 2010-11, it was negotiated as part of the discussions with the Schwarzenegger Administration on the budget for 2004-05. As such, the 2004-05 budget plan presented to the Board for approval is linked to many of the funding principles included in the new Compact.

It has been the practice of the President of the University of California annually to submit to The Regents a budget plan for the coming fiscal year for approval at the November meeting. The document, *University of California 2004-05 Budget for Current Operations*, was presented to the Board in November but did not include a budget plan for 2004-05 because of the uncertainty that existed related to the State's budget crisis. Instead, The Regents approved a set of principles to be used in negotiating the budget with the expectation that a budget plan would be approved once the Governor had submitted his own budget proposal. This action was further refined at the January meeting, when the Board supported budget priorities that were expressed as both short-term and long-term goals.

The budget document presented at the November 2003 Regents' meeting did include projected income and expenditure levels for programs funded from sources other than State General Funds, UC General Funds, and student fees for 2004-05. While the State and UC General Funds and student fee income projections are being revised, those for all other fund sources remain unchanged. Approval is being sought for the November projections for fund sources other than State and UC General Funds and student fee revenue as part of the 2004-05 budget plan. All items related to State General Funds, UC General Funds, and student fee income in the revised 2004-05 budget plan presented for approval are based on the Governor's Budget released in January and subsequent revisions announced as part of the Governor's May Revision, and reflect the priorities approved by the Regents at the January meeting.

The recommended State-funded budget and a package of fee increases will maintain quality, accessibility, and the contributions of the UC system to the people of California to the best of the University's ability, given the State's fiscal crisis. This action entails program cuts, enrollment reductions, and fee increases in the short term while, in conjunction with the Compact offered by the Governor, laying the groundwork for the University to recover its fiscal footing over the next several years and begin to grow again. The Compact also provides students and their families, for the first time in recent memory, with the ability to plan for student fee levels over the next several years, assuming the agreed-upon level of State funding is provided.

2004-05 Budget Plan

As reported at the March meeting, the budget proposed by the Governor includes significant student fee increases, along with suggestions for a long-term student fee policy for both undergraduate and graduate academic students; proposes enrollment reductions; assigns further base budget reductions; and provides some increases to the budget. The 2004-05 budget will represent the fourth consecutive year in which base budgets are cut and no funding is provided for basic operating costs such as salaries, merits, inflation, and maintenance.

Stemming from several concerns expressed by the University, the Governor's May Revision includes changes to the January budget proposal for several key issues.

Undergraduate and Graduate Academic Student Fee Increases. As discussed at the March meeting, the Governor has proposed a long-term student fee policy for the University of California and the California State University that calls for increases in student fees equivalent to the rise in California per capita personal income. However, in years in which the segments determine that fiscal circumstances require increases that exceed the rate of growth in per capita personal income, UC and CSU may determine that fee increases of up to 10 percent are necessary to provide sufficient funding for existing programs and to preserve quality.

The University's principles adopted at the November 2003 meeting and further supported at the January 2004 meeting reaffirm the University's interest in developing a new long-term student fee policy. As stated in those principles, it would be the University's preference to have a fee policy accepted by both the University and State government that would provide for annual increases in student fees consistent with an economic measure, such as per capita personal income. Such a policy must be contingent upon the State's being able to provide adequate support for the University's basic needs. Consistent with the principles adopted by The Regents in January, the University will support a long-term student fee policy only if it includes recognition of the need for adequate State support to maintain quality.

For 2004-05, there is wide agreement within the University that an increase of 40 percent in student fees for graduate academic students could not be supported. The University has been striving in recent years to become more competitive in attracting top quality graduate students to California. The Regents established a Commission on the Growth and Support of Graduate Education to examine ways to improve support for graduate students. The dramatic increase in fees proposed in the Governor's Budget would make it more difficult to develop the financial support packages necessary to attract these students. In response to the University's concerns, the Governor agreed to a three-year plan for student fee increases that will require undergraduate students to pay a slightly higher fee increase in 2004-05 in order to help moderate the fee increase for graduate students. In 2004-05, the undergraduate fee increase will be $700, which is an increase of 14 percent over 2003-04 rather than the 10 percent proposed in January, and the graduate fee increase would total $1,050, which is an increase of 20 percent rather than the 40 percent proposed in January. The undergraduate increase is about $200 more than the increase proposed by the Governor in January and the graduate student increase is about $1,040 less. In the second and third year of this plan, undergraduate students would pay increases of 8 percent per year in order to achieve an average increase over the three-year period of 10 percent per year, and graduate fees would rise by 10 percent per year. These increases are specified in the new Compact.

In 2004-05, total UC undergraduate student fees will be about $1,200 below the projected average of public comparison institutions; student fees for academic graduate students will be about $2,000 below the projected average. If the University of Michigan is excluded from the average, because it charges extraordinarily high fees for graduate students, UC estimates that graduate academic fees would be about $500 less than the other three public institutions. The Governor's May Revision also provides $16.2 million in relief for calculation errors that had been made in developing the January budget, primarily related to incorrect numbers of fee-paying students for both undergraduates and graduates. After accounting for corrections, the revised fee plan for 2004-05 will generate about the same amount of revenue as the Governor's January plan.

Concerns about total student cost of attendance have been raised at past meetings of the Board. In 2003-04, student fees represented 31 percent of the average total cost to undergraduate students, which is $17,814 in the current year and includes non-fee expenses such as room and board, and mandatory books and supplies. In past years, the University's average cost of attendance has been above the average of its four public salary comparison institutions, largely due to the high cost of living in the areas in which UC campuses are located. When financial aid is taken into account, the University's average net cost of attendance for needy students falls to a level below the average of its comparison institutions.

The 2004-05 average cost of attendance is estimated to total $19,325. It is anticipated that, in terms of net cost, the University will continue to be slightly below the average of its public comparison institutions.

<u>Fee for Selected Professional School Students</u>. The Governor's Budget assumes the University will develop a plan for achieving the $42.2 million in revenue expected from Professional School Fee increases. The University estimates that in order to achieve this revenue target, fees at each of the schools would need to increase by about $5,000; however, the University has been asked to exempt Nursing from these increases and to implement a smaller-than-average increase for students in the Schools of Medicine. In addition, schools such as Optometry, Pharmacy, and Theater, Film, & TV could probably not sustain increases of $5,000 and still attract sufficient numbers of highly qualified students. Development of a sustainable, long-term plan that takes into account these and myriad other factors cannot be accomplished in time to be able to provide adequate notice to students of fee increases for these programs. Therefore, the University is proposing that fees in each of these disciplines rise by about 30 percent for 2004-05, which will generate $37 million in income, falling $5 million short of the revenue required in the Governor's budget. The increase for each discipline may vary slightly from the 30 percent average, based on considerations of other factors, such as fees at comparable institutions, the market, and financial requirements of the schools. The campuses will be asked to absorb the $5 million shortfall on a temporary basis through cuts to other programs while each professional program develops a longer-term plan for student fee increases in each discipline. These plans are to cover professional fees over the next five years and will include consideration of the following factors: average fees at other public comparison institutions, market factors, average cost of instruction, average cost of

attendance, the need to preserve and enhance the quality of the professional programs, the State's need for more graduates in a particular discipline, and financial aid requirements of professional school students. Cuts taken in temporary ways to address the $5 million shortfall from budgeted revenue in 2004-05 will be permanently accommodated through fee increases in 2005-06, consistent with the long-term plans that are developed over the next several months.

One issue of major concern is the fact that the Governor's proposal does not assume any return-to-aid from the increase in Professional School Fees. The schools are concerned about their ability to maintain the quality of their programs and to be competitive with other professional schools. This is particularly important if students will be paying significantly more to attend these schools. To address the academic quality and financial aid issues associated with this proposal, it is proposed that authority be delegated to the President to raise the fee at any of the professional schools by an additional amount not to exceed 10 percent of total systemwide fees paid by professional school students if it is determined the school must raise the fee higher to provide sufficient financial aid and to maintain quality of the academic program. Any fee increases approved under such authority would be reported to the Board.

Although fee levels will be approved by the Board for each discipline for 2004-05, final fee levels will be approved by the President in consultation with the Chancellors, consistent with delegated authority.

<u>Excess Units Fee</u>. The Governor has proposed establishment of a policy to charge the full cost of instruction for excess units that exceed a specified threshold. The University is developing a plan to phase in such a policy over time in order to avoid placing a sudden burden on students nearing graduation. This plan will involve a four-year phase-in period, beginning in 2004-05, as requested by the Governor. It is estimated that a total of 555 FTE students could be affected by implementation of such a policy; therefore, the University estimates that $4.5 million is the most revenue that can be generated from this fee. Assuming a four-year phase-in of such a policy, only $1.1 million could be generated in the budget year, which is $8.2 million less than the amount proposed in the Governor's Budget. The Governor's May Revision restores the $8.2 million difference to the University's budget as part of the $16.2 million in corrections mentioned earlier.

<u>Financial Aid</u>. The Governor's proposal calls for reductions to the amount of new student fee revenue that can be used for financial aid; however, while the Governor's January budget excluded funding for Cal Grants related to the fee increases, the Governor proposes sufficient funding in the May Revise for Cal Grants to cover the 14 percent fee increase proposed for undergraduate students for 2004-05.

In order to address the issue of affordability for the neediest undergraduates, and consistent with the priorities supported by The Regents in January, the University intends to continue to provide grant aid to mitigate the impact of fee increases for those students with the most need. Because of the shortfalls in funding for financial aid anticipated for 2004-05, $16 million in grant aid previously provided to needy middle-income students who come from families with income of between \$60,000 and \$90,000 will be shifted to help fund grants for lower-income students. Also, it is expected that the student contribution from loan and work in 2004-05 will rise from \$8,600 to about \$9,300.

For 2004-05, the University will implement the Governor's proposal to limit return-to-aid to 20 percent of the total revenue generated from fee increases. For the long term, the University is very concerned about limiting return-to-aid to 20 percent. The new Compact with the Governor calls for return-to-aid from fee increases of between 20 percent and 33 percent. The University will develop a justification for an appropriate level of return-to-aid for 2005-06 and beyond.

Outreach. The Governor's January Budget proposed to save \$33.3 million in the budget year by eliminating all funding for outreach. The Governor's May Revision provides restoration of \$4 million in UC funds that were inappropriately cut in the January budget. In addition, the new Compact with the Governor includes a commitment on the part of the University to provide a total of \$12 million, including the \$4 million restored in the May Revision, from existing UC resources to help sustain these programs. The Compact also states that the level of State funding for student academic preparation programs will be determined each year as part of the annual budget negotiations. The University anticipates that the Legislature will be working with the Administration through the rest of the budget process to determine if State funds can be made available for these programs in 2004-05.

Next Steps for 2004-05

The budget subcommittees in the two houses of the Legislature will review the Governor's May Revision proposals. A budget conference committee usually begins meeting in June to resolve differences between the Assembly and Senate versions of the budget. The Constitutional deadline for the Legislature to send a budget for signature to the Governor is June 15. It is hoped that the University can report a final budget to the Board at the July meeting.

As part of the Compact agreement, it is the Governor's intention that no further reductions occur to the University's budget for 2004-05. University staff will be working with Administration representatives to help the Governor avoid further reductions for UC. This effort will require the assistance of Regents, alumni, students, parents and others in the University community. A well-coordinated, thorough advocacy effort has been implemented this spring and will continue to be the point from which these efforts will be generated. If changes occur to the University's budget in the final budget act, they will be considered at the July meeting.

Planning for the 2005-06 Budget

The Compact was developed within the context of the State's fiscal crisis experienced over the last four years. While it does not meet all of the University's budgetary needs, it does provide the minimum level of support needed to prevent further erosion to the University's budget, accommodate enrollment growth, and maintain quality.

The fiscal provisions of the Compact are designed to provide sufficient resources to achieve the following:

- Block Allocation for Salaries and Other Basic Support. Adjustments of 3 percent in 2005-06 and 2006-07, and adjustments of 4 percent for 2007-08 through 2010-11. The importance of this element of the Compact cannot be overstated. Faculty salaries are estimated to be about 10 percent behind the average of comparison institutions, and there is a similar problem with staff salaries. The Compact will allow the University to stop the erosion in salaries in the first two years and begin to close the gap in later years as the State's fiscal situation improves. Returning to paying competitive salaries is one of the University's highest priorities and is critical to its ability to maintain quality.

- Core Academic Support Needs. Beginning in 2008-09 and continuing through 2010-11, an additional 1 percent adjustment to the base to be used to address annual budgetary shortfalls in State funding for faculty and other instruction and research support for areas of the budget, including instructional equipment, instructional technology, libraries, and ongoing building maintenance.

- Enrollment. Funding for enrollment growth consistent with the Master Plan at the agreed-upon marginal cost of instruction. UC estimates enrollment will grow about 5,000 students per year through this decade.

- Student Fees. Undergraduate fees will increase by 14 percent in 2004-05 and by 8 percent in both 2005-06 and 2006-07. Graduate fees will increase by 20 percent in 2004-05 and by 10 percent in both 2005-06 and 2006-07. For 2006-07, the University will develop its budget plan each year based on the assumption that fees will be increased consistent with the Governor's proposed long-term student fee policy, which states that increases in student fees should be equivalent to the rise in California per capita personal income; however, in years in which the University determines that fiscal circumstances require increases that exceed the rate of growth in per capita personal income, UC may decide that fee increases of up to 10 percent are necessary to provide sufficient funding for programs and preserve quality. Revenue from student fees will remain with the University and will not be used to offset reductions in State support.

  The University will develop long-term plans for increasing professional school fees that consider the following factors: average fees at other public comparison institutions, average cost of instruction, total cost of attendance, market factors, the need to preserve and enhance the quality of the professional programs, the State's need for more graduates in a particular discipline, and financial aid requirements of professional school students. Revenue from student fees will remain with the University and will not be used to offset reductions in State support.

- Other Budget Adjustments. Annual adjustments will be provided for debt service and other basic adjustments.

- One-time Funds and New Initiatives. When the State's fiscal situation improves, additional resources for one-time purposes and new initiatives may be considered.

- Capital Outlay. Continued support for bond financing of at least $345 million annually to meet capital outlay needs.

The Compact also includes accountability measures relating to issues that traditionally have been high priorities for the State. Thus, the University agrees to maintain and improve, where possible, performance outcomes in a variety of areas, including maintaining access and quality, implementing predictable and moderate fee increases, community college transfer and articulation, persistence and graduation rates, time-to-degree, helping the State address the shortage in science and math K-12 teachers, returning to paying competitive salaries and closing long-term funding gaps in core areas of the budget, and maximizing funds from the federal government and other non-State sources. The University will report to the Administration and the Legislature on its progress in these areas by October of each year.

The Compact will form the basis for the 2005-06 budget request. It is anticipated the University's budget plan would include the following:

- a 3 percent budget adjustment to the base;

- an undergraduate student fee increase of 8 percent, a graduate student fee increase of 10 percent, and professional school fee increases based on long-range plans developed by the campuses over the next several months;

- enrollment growth of 5,000 FTE students consistent with the agreed-upon marginal cost of instruction.

State General Funds and student fee revenue levels called for under the Compact for 2005-06 will be sufficient to stop the erosion in faculty and staff salaries and provide funding to help cover employee health benefit increases, maintenance of new space, and other non-salary cost increases. While it provides no restoration of lost funding, it will prevent the University's budget from losing further ground. It will also provide funding to accommodate enrollment growth consistent with the University's most recent enrollment plan, developed in 1999, which called for annual enrollment growth of about 5,000 students per year throughout this decade. The California Postsecondary Education

Commission is planning to release a study on eligibility that will provide a better sense of the degree to which the University is meeting its commitment under the Master Plan to offer access for the top 12.5 percent of California's high school graduating seniors.

It is anticipated that the State will continue to experience financial constraints for 2005-06. The Legislative Analyst projected an ongoing permanent deficit of close to $7 billion in February. This is likely to limit the University's ability to obtain more funding than called for in the basic provisions of the Compact.

Vice President Hershman emphasized that the Compact begins in 2005-06 and goes through 2010-11. He reiterated that the Governor's proposed $2.690 million in 2004-05 represented a reduction from 2003-04, but when the Compact begins, there will be annual increases reflecting the 3 percent base budget increase that will fund salary increases and other cost increases, building up to 4 percent, plus an extra 1 percent starting in 2008-09 that may be used to restore funds for instruction and other core support, including maintenance, libraries, equipment, and instructional technology. In 2004-05, there is a reduction of 3,200 FTE in general campus freshman enrollment, but from then on enrollment growth will be funded at 5,000 per year, so that total enrollment will reach 217,000 in 2010-11, which puts the University back on track in terms of the enrollment plan agreed to by The Regents in 1999. Mr. Hershman observed that this increase will allow the University to honor the Master Plan in accepting eligible students. He recalled that in 2004-05, the Senate passed language asking the Department of Finance to not provide funds for normal enrollment growth and to not provide for salary increases, and the proposal was approved by the Assembly. That action gave the Department of Finance a rationale for not funding enrollment appropriately. This was followed by the Governor's proposal that enrollment be reduced by 3,200 students. He believed that the Legislature regrets having taken that action. Concerning student fees, he was pleased to note that the Governor's proposal for a 40 percent increase for graduate students and a 10 percent increase for undergraduate students, plus major increases for professional students, was modified by the Governor and that a reasonable fee policy will begin which will increase fees every year by per capita personal income growth. He reported that financial aid was a big issue in the negotiations with the State, because the University maintains a high percentage of low-income students. In the Compact it was agreed that the Regents would decide the level of financial aid. Also, the Governor changed his position and agreed to fund Cal Grants in 2004-05. These changes bring some flexibility that will allow the University to maintain its good record. The Governor committed $345 million per year, which is needed to accommodate enrollment growth and other infrastructure needs. Mr. Hershman noted that there is a provision in the Compact that, in addition to basic funding, the State will provide for increases in costs for annuitant health care, future retirement costs, and lease-revenue bond payments. The Governor has asked for only one major new initiative, which is to improve math and science education in K-12.

Mr. Hershman explained how the Compact relates to The Regents' priorities. The Governor's budget had included a reduction in faculty, which the University opposed. With the funding in the Compact, the student-faculty ratio can be stabilized, and in the long term, its restoration should be possible. With the provisions in the Compact for the next few years, there should be enough money to stabilize faculty and staff salaries, which it should also be possible to restore in the later years. Achieving these corrective measures will cost about $200 million, a significant amount of the Compact money. Concerning the research mission, there is flexible money in the budget to help through a 1 percent special allocation in the later years that relates to instructional and research support. On outreach, the struggle to negotiate funding continues. The University is committed to reallocating its money to provide for outreach. The Compact will permit the Regents to decide each year what their priorities should be.

Mr. Hershman spoke briefly about the May revision to the budget, commenting that State revenue had been higher than anticipated. The Legislative Analyst has agreed with the Governor's estimates. The Governor has a reserve of about $1 billion and will carry over about $3.5 billion of unspent deficit bonds. The Department of Finance's analysts believe, however, that by the end of 2005-06, the budget will be in balance.

Turning to the University's 2004-05 budget, Mr. Hershman reported that the Assembly Democrats were unhappy with the Governor's basic proposals and had published a list of augmentations for higher education. He reported that they have suggested providing the University with a 2.4 percent COLA for faculty and staff, and funding a normal amount of enrollment growth of 6,000 students, restoring the cuts to the Labor Institutes and outreach. They have expressed the concern that the professional school fees are too high. Of the total augmentation for higher education of about $500 million, $225 million would go to the University. The final agreement must be negotiated between the Governor and the Legislature. He suggested delaying acting on a total University budget plan until July. When the Compact is in place, the Regents will return to taking actions in November on the total budget plan and making final changes in July. In the meantime, he emphasized that students must be given notice about changes in fees. If there are final enhancements in the budget, the University can notify students that the fees will be lower than expected. He suggested approval of paragraph C. of the President's recommendation, subject to any changes later, and postponing action on paragraphs A. and B. until July.

General Counsel Holst addressed the issue of fee notification timing. He stated that notice must be given at the earliest possible time. A planning process is in place with respect to incorporating notice in the billing statements, which are about to be sent to students.

In response to a question from Regent Johnson about the Compact's 3 percent increase in salaries in 2005-06 and the possible 2.4 percent COLA, Mr. Hershman affirmed that the increases would be for all faculty and staff. She asked what will happen to the students who are redirected this year to community colleges if the increase in enrollment is accepted. Mr. Hershman suggested that all students who have been offered the guaranteed transfer option be offered acceptance to the University as freshmen. If the growth plan is also approved, it may become necessary to increase the number of students in the winter and spring and offer opportunities for more transfer students.

Regent Montoya expressed the hope that the campuses with the largest research programs would not be hurt by the allocation of the income from fee hikes. Mr. Hershman responded that they will not be affected by the 2004-05 budget. One of the main features of the Compact is that in future years the fee income will be the University's money, not offset with cuts in State funds. At that point, it would be up to the President to recommend priorities for that money. Much of it would be returned as financial aid.

Regent Montoya noted that the Compact states that the segments must agree not to increase the proportion of the budget designated for administration above their current levels. She believed that would not be achievable, given the ongoing 25 percent hikes in the salaries of top-level administrators. It has been suggested that administrators sacrifice along with students by accepting a temporary 10 percent decrease in their compensation and that faculty be requested voluntarily to teach one additional course per year in order to get students who were redirected to community colleges back on track with the University. Mr. Hershman recalled that for the past thirty years, the proportion of the University's budget devoted to administration has been declining. It was agreed that if the State refrained from adding to the University's burdens, the University would maintain the current level for administration of under 10 percent of its overall budget. Concerning faculty and staff salaries, he observed that the University must respond to the market, which faculty salaries lag by 10 percent. One of the reasons for entering into the Compact was to assure the faculty that there is hope for the future. It would not be productive to hire new faculty at levels required by the marketplace while leaving existing faculty at lower levels. The University's salaries for administrators also lag the marketplace, by at least 35 percent.

Regent Pattiz, noting that the Legislature is interested in seeing more money directed toward education, asked why agreeing to the Compact does not weaken the University's position. Mr. Hershman recalled that previous agreements with the Governor had proved to be important in the long run in setting a minimum level of funding that had been supported and sometimes enhanced. All of the University's policy goals are spelled out in the Compact. He believed that the agreement, although not perfect, was necessary in order to bring budget cuts to a halt. It provides a floor from which to begin negotiations with the Legislature and Governor from year to year. President Dynes noted that the budget is processed between the Governor and the Legislature. The University does not participate at that stage. The Compact represents a floor from which new programs and initiatives can be proposed in better times.

Regent Núñez was uncertain as to whether the Compact provided the stability and certainty that the University sought. He believed that the Compact would weaken the University's bargaining position and did not represent a floor for negotiating, except for those who want to achieve a higher allotment for the University, because it was not forged in the context of a floor to the Legislature and has not been characterized as such by the media. He noted that it is the Assembly and Senate that are taking the initiative to restore funds to the University. The Legislative Analyst's Office has indicated that the University will face a significant budget deficit in the coming three years. The Compact is nothing more than a promise that may or may not be kept. He believed the University should be looking for ways to build the best leverage possible so as to assure adequate funding. Concerning student fees, he believed that it would be best to inform students immediately about the expected increases, but he advocated not taking Board action until the budget negotiations were concluded. He was optimistic that some funds would be restored.

Regent Murray conceded that it may be a good idea to get an agreement with the Governor about long-term funding, but he was disappointed in the resulting Compact. He was adamant that the University's negotiations in Sacramento should continue vigorously. He was opposed to the fee increases on the basis that they were the outcome of underlying political policies with which he disagreed. He believed that in the interest of fostering broad support, the University should make it clear that administrators are sharing the burden of budget cuts. To that end, he requested a report about senior administrative efficiency over the last ten years. He reported that he was working on a policy statement for the University concerning its engagement in the K-12 system, with a view toward defining its role more clearly, that he would forward to the Board at a future date.

Regent Seigler asked what the education fee pays for. Mr. Hershman responded that, with the cutbacks in State funds, increasingly it is paying for the cost of instruction.

Regent Connerly stated that the idea of a contract between equal partners operating at arms length, each of which is capable of honoring the commitments made, was sensible, but he observed that history does not validate that idea with respect to the University. The reality is that when the State's economy is bad, the agreements become one-sided and are unenforceable. The University finds itself locked into long-range decisions that cannot be reversed easily. He was not in favor of the Compact. On the other hand, he believed that the University does not have a choice in this situation; therefore, he would defer to the President and the Chair of the Committee by supporting the recommendation.

Regent Preuss recalled that in previous months the Legislature had indicated it would force the University to reduce enrollments. In the interim, the President has managed to make some headway with the Legislature by emphasizing that the core mission of the University is to educate students and generate jobs that will improve the state's well-being. He believed there was room for optimism about the situation and that the University should continue actively to push the message that the University contributes to the welfare of the State. He believed that the Compact had at least some value but that communication should be kept open with the Legislature in the hope that affordable solutions favorable to the University may be found.

Regent Lee agreed that educating young people represented an investment for the State. He was opposed to increasing tuition and turning away students who were qualified for admission.

Regent Marcus believed that the Compact represented guidelines that would help the University improve its condition in the future. He did not think it was in anyone's best interest to vote on fees before there was a budget. He emphasized the importance of leadership, as represented by the University's administrators, whose decisions have made the University great, and was opposed to having them singled out for criticism. His opinion was that the Regents had gradually abdicated their authority in the budget process; that being dictated to by line items and fee increases had reduced them from a constitutional body to a legislative subdivision. He suggested taking the matter up at a future meeting with a view toward regaining their authority and responsibility.

Regent Blum agreed that the role of the Board has been compromised. He noted that since March the State had agreed to a large bond issue and is expecting greater income, which has made people more optimistic. Concerning the Compact, he agreed that the government had not been a good partner in the past. Under previous agreements, the State had failed to provide $1.5 billion that was promised to the University. Mr. Hershman indicated that the University will not be advocating more money for 2004-05 than the Governor has proposed to give it, but the University may ask for more money starting in 2005-06. He recalled that previous Governors had provided a greater level of funding than had been contained in the formal agreement. Regent Blum observed that the State is facing new demands; every part of the State budget is underfunded.

Regent-designate Anderson noted that professional students have been hit with a proposed 30 percent fee increase, which would be very burdensome. She was concerned about the impact of a further 10 percent increase the President would be authorized to implement and the timing of the notification of students. She asked whether the University would have legal exposure related to fees, and what planning is being undertaken to ensure that new policies will be in place to address higher fees so that the University can maintain its record of admitting low-income students.

Regent Kozberg also focused on the fee issue, recalling that in the previous year the University delayed announcing a fee structure until the decision on the final budget had been made. When the fees were announced, they had increased. She believed that, as a result, a suit was settled against the University on behalf of disadvantaged students and their families. General Counsel Holst informed her that the suit remains pending. He reiterated his opinion that, to respond to the issue raised in the suit, the preferred course would be for the University to provide information about prospective fees in a timely way by including it in the billing statements about to be mailed.

Regent Sayles advocated informing students and their parents about fees as soon as possible. In response to his question concerning financial aid, Mr. Hershman informed him that under the Compact, the Regents will decide financial aid levels annually within a range of 20 percent to 33 percent of the fee revenue. In 2004-05, financial aid for those families with annual income under $60,000 will cover the fees. Regent Sayles expressed concern about the effect of fee increases on middle-class students, noting that it could alter the demographics of the student body. Mr. Hershman reported that the proportion of low-, middle- and high-income students had remained fairly stable over the years.

Regent Hopkinson recalled that The Regents had established measures regarding the quality and accessibility of the University. She believed that the priority list The Regents established in analyzing the budget needed to be discussed using quantitative measures. To be fully informed, the Regents needed specifics such as what the student-faculty ratio would be in upcoming years and the implications of summer enrollment. She believed also that it would be timely to produce a rational fee policy. Recalling Regent Murray's request for a study on administrative matters, she suggested presenting a two-page summary of the administrative facts to the Regents and allowing them to determine what a next step might be. She noted that the Compact spells out a goal of a 50 percent differentiation between graduate and undergraduate fee structures, which would be a significant change for the University with implications that need to be explored by a group of faculty and administrators. Out-of-state tuition already tops comparison institutions. Those fees were raised disproportionately during a previous crisis. A further drop in international students will affect the quality of experiences gained by Californian students. She noted that some of the figures in the background that was mailed in advance of the meeting did not match a sheet that was handed out at the meeting and require evaluation. Old information needs to be matched with new statistics and disseminated, and the information should be consolidated.

Vice President Hershman agreed that the opportunity should be taken to develop a fee policy. He noted that the University is on record as opposing the 50 percent graduate fee differential, and the Compact language is crafted to reflect that. It says only that the University will move toward that goal. Regent Hopkinson was unconvinced. She asked to be informed of the University's plan in this regard. Mr. Hershman doubted that the level of fees, which is somewhat higher for graduates than undergraduates, would ever approach 50 percent. He shared her concern about nonresident tuition. On the subject of 40 percent summer enrollment, he explained that as part of the agreement for fully funding the summer session, the University would make a commitment to keep enrollment equivalent to 40 percent of the average of the other quarters, as long as the State funds it at that level. Concerning the student-faculty ratio, he believed that if it is viewed as a high priority, money in the budget may be found, if phased. It is a question of priorities among salaries, the student-faculty ratio, and academic support. There needs to be a plan. Regent Hopkinson stressed that the Regents need sufficient information to make decisions for the long term concerning these issues and that the information on which to base that plan should be put forward soon.

Regent Preuss noted the legal requirement to provide notice of the fee increase and stressed the moral obligation of letting incoming students and their parents know what to expect. At the least, a worst-case scenario should be described. He was against postponing a vote.

Regent Marcus was opposed to voting on fees before there was a complete picture of the budget but indicated that he would be comfortable relying on the General Counsel and President to provide adequate information when notifying people.

Regent Pattiz suggested that the University explain to students that there was a strong possibility that fees may be raised but that until the final budget is set, fee levels cannot be determined. Regent Hopkinson recalled that the Governor's proposal and the Legislative proposal are consistent regarding fees except for professional fees. The two entities have nothing further to negotiate on the issue.

President Dynes invited Mr. Matt Kaczmarek, president of the UC Student Association, to comment on the budget. Mr. Kaczmarek recalled that since the beginning of the year, Regents and the administration had maintained they would not sacrifice the quality of the institution. For students, quality means preserving programs that promote teaching, research, and public service, and maintaining the historical commitment that anyone who works hard enough can earn admission and that financial aid will make attendance affordable. He believed that access and affordability were the true victims of the proposed budget. ASUC began an effort, shortly after the release of the Governor's proposal, to have four issues adopted as top concerns: student fees, financial aid, funding for enrollment, and funding for outreach. For the first time since UC students regained the right to lobby in 1999, students have been able to apply pressure in Sacramento, but he believed the Compact did not reflect their opinions and represented a failure of the Governor and the University to the people of California. After preserving quality, a crisis still exists. The budget does not address the crises in access and affordability. He emphasized that the President should begin advocating for funding augmentations for 2004-05 to maintain the current levels of access and return to the principle of affordability.

Regent Sayles believed that the Regents would be forced to approve the fee increase so as to be able to provide timely information to students and their families. President Dynes added that delaying approval would raise the expectation that fees may not increase, which he believed would be misleading.

Regent Pattiz refined his previous suggestion by proposing that students be informed that the Governor has determined that fees should be raised, and if there is no relief from the Legislature, fees will be raised to a certain amount, notwithstanding that the Regents are against that.

Regent Hopkinson noted that the alternative to increasing student fees as proposed in the President's recommendation would be to provide the authority to the President to notify students in a way that is as sensitive as possible, considering the negotiations that are under way between the Governor and the Legislature.

Regent Núñez's view was that a vote against the fee increases would send a message to the Governor that the Regents view the Compact is a floor. A vote in favor of the fee increases would confirm that the Regents were prepared to conform the fees to the Compact and would hamper future negotiations.

Regent Hopkinson read an excerpt from the Compact which makes it clear that funding may be provided in addition to the base budget in order to meet high priority needs; thus, the Compact may be enhanced, as agreed to by the Legislature and the Governor. Regent Kozberg emphasized that the Compact does not control the fee issue until 2005-06.

Regent Sayles persisted that there should be a good way to communicate to students that there is a possibility that fees will be increased. President Dynes asked General Counsel Holst whether sending out a statement of maximum fee increase but noting that depending on the budget process it may be less would expose the University. Mr. Holst believed that a statement of that kind could be developed that would be almost as effective as stating the fees, although it would not be the preferred course. The critical thing is timely communication of the fee circumstances to students. To the extent the University is able to communicate useful information about the likelihood of fee increases, the requirements would be satisfied that appear to be emerging from the ongoing litigation with respect to last year's action.

Regent Hopkinson suggested voting to give the President the authority to write the letters within that general context of guidance and leave the specific vote to a future meeting.

Regent Connerly characterized the issue as a landmine. The President and Vice President have entered into negotiations and signed an agreement with one party that has certain expectations about the Regents' performance, while the Legislature has different expectations. He suggested that action be delayed until the following day.

Regent Moores believed it would be a disservice to students and their parents not to make it clear that fees will increase. Trying to write letters that skirt the issue would not be appropriate or fair. He supported approving the President's original recommendation.

Vice President Hershman noted that students are starting summer session in a few weeks and need to be informed about their fees.

Regent Bodine agreed that parents and students deserved due notice about the probability of fee increases, but accepted that a letter suggesting it was likely that fees would increase would fill the due diligence. She suggested asking the Office of the President to draft such language for the Committee's approval the following day. Regent Hopkinson was opposed to her suggestion. She believed the Committee should vote without delay and send the recommendation forward to the Board. All students have already been informed that fees will likely increase within a range.

> [For speakers' comments, refer to the minutes of the May 19 meeting of the Committee of the Whole.]

Upon motion duly made and seconded, action on paragraphs A. and B. of the President's recommendation was deferred, and the Committee voted on paragraph C. relating to student fee increases, Regents Dynes, Hopkinson, Montoya, Moores, and Preuss (5) voting "aye," and Regents Connerly, Lee, Murray, Núñez, and Sayles (5) voting "no."

As the vote was tied, the motion failed. Regent Hopkinson announced her intention to request that the full Board consider the matter, as provided in the Bylaws.

3. **AMENDMENT OF THE UNIVERSITY OF CALIFORNIA STUDENT FEE POLICY TO INCLUDE CONSIDERATION OF THE FULL COST OF ATTENDING THE UNIVERSITY WHEN SETTING ANNUAL STUDENT FEE LEVELS**

Regent Murray recommended that the University of California Student Fee Policy be amended to include consideration of the full cost of attending the University and comparable institutions when setting annual student fee levels, as shown below:

deletions shown by strikeout, additions by underscoring

THE UNIVERSITY OF CALIFORNIA STUDENT FEE POLICY

Effective with the 1994-95 academic year, a Student Fee Policy affecting the Educational Fee and the University Registration Fee is established with the following provisions.

A. The Educational Fee

The Educational Fee is a Universitywide mandatory charge assessed against each resident and nonresident registered student. The Educational Fee is assessed uniformly across all campuses of the University.

In addition to funding programs and services supported in 1993-94 by the Educational Fee (such as student financial aid and related programs, admissions, registration, administration, libraries, and operation and maintenance of plant), income generated by the Educational Fee may be used for general support of the University's operating budget. For the first time, revenue from the Educational Fee may be used to fund all costs related to instruction, including faculty salaries.

In recommending to the Board the annual Educational Fee level, the President shall take into consideration the following factors:

1. the resources necessary to maintain access under the Master Plan, to sustain academic quality, and to achieve the University's overall mission;

<u>2.</u> <u>the full cost of attending the University, including the cost of housing, food, healthcare, books and supplies, transportation, and other academic and personal expenses;</u>

~~2~~ <u>3</u>. the amount of support available from various sources to assist needy students in funding the <u>full</u> cost of their education;

~~3~~ <u>4</u>. overall State General Fund support for the University; and

~~4~~ <u>5</u>. ~~student charges~~ <u>the full cost of attendance</u> at comparable public institutions.

The President annually shall solicit faculty and student views on the level of the Educational Fee, through the appropriate consultation processes.

* * *

Regent Murray believed that the recommended change would clarify that the Board of Regents is committed to preserving and enhancing the quality, accessibility, and affordability of the University. Student fee levels play an important role in ensuring the University has adequate resources to fulfill its mission. Fees also have a direct impact on the affordability of the institution. Fees are not the only costs that students attending the University must pay, however, and for the University to ensure that attendance remains affordable, the President and the Regents should take into consideration all the costs of attending the University when setting annual fee levels.

Regent Murray recalled that the University's focus on comparing student fees with student charges at comparable institutions incites criticism from students and others who know that students face differential costs in other areas, including housing, transportation, and supplies, and who perceive the University as attempting to ignore those costs. The UC Student Association prepared a critical report in 2002 titled "Dispelling the Myths: The True Cost of Attending the University of California" to bring attention to the need to consider more than just fee levels when evaluating the affordability of the University.

Regent Murray believed that the skewed perspective of the University's affordability that derives from fee comparisons that ignore other costs of attendance invites calls for the University to increase fees substantially so that they match charges at comparable institutions. Pressure for substantial fee increases based on limited information damages the University's overall budget prospects. The University and the State of California will be served best if decisions regarding annual fee levels are made after consideration of all relevant factors so that those decisions are fully informed and justifiable.

At the January 2004 Regents meeting, The Regents agreed in principle to eight priorities to direct the Office of the President in negotiations with the State regarding the University's budget. The third short-term priority stated:

3. Graduate student quality and ratios that exist today shall be maintained. That means that the net cost to attend and related financial support shall be maintained.

This priority recognizes that the "net cost to attend" is the critical component of affordability.

At the January 2003 Regents meeting, Provost King gave a presentation on "Financing the Cost of Attending the University of California" which addressed the total cost of attendance at the University. Regent Murray asserted that consideration of the full cost of attendance at the University should be a routine, integral part of fee discussions at meetings of The Board of Regents, not the topic of occasional presentations. The University of California Student Fee Policy should be amended formally to recognize the full cost of attendance as an important factor to consider for all fee level decisions.

Upon motion duly made and seconded, the Committee approved Regent Murray's recommendation and voted to present it to the Board, Regent Moores voting "no."

4. ESTABLISHMENT OF AN INTERNAL REVENUE CODE SECTION 457(B) TAX-DEFERRED SAVINGS PLAN

The President recommended that:

A. The President be authorized to establish and maintain a 457(b) Tax-Deferred Savings Plan (457(b) Plan) for University of California faculty and staff as defined under Section 457 of the Internal Revenue Code (IRC).

B. The effective date of the 457(b) Plan be as soon as administratively feasible.

C. Implementation of the 457(b) Plan be delegated to the President.

It was recalled that at the February 11, 2004 joint meeting of the Committee on Investments and the Investment Advisory Committee, information was provided on the University's Request for Proposal (RFP) process to solicit bids from firms that could offer record keeping and investment education services for a proposed 457(b) Plan with possible further application to the Tax-Deferred 403(b) Plan (403(b) Plan) and the Defined Contribution Plan (DC Plan), collectively referred to as UC's defined contribution plans. As a second phase of this project, there will be a manager search and selection process for vendors to provide core externally-managed investment options for the 403(b) Plan and the DC Plan, which also may be offered as investment options under the proposed 457(b) Plan at a later time.

UC faculty and staff may voluntarily save and invest for retirement on a tax-deferred basis through the 403(b) Plan. Similar to a 403(b) plan, a 457(b) plan enables a participant to make voluntary pretax contributions and have the earnings grow on a tax-deferred basis until money is withdrawn, usually at retirement, when the participant is typically receiving less income and is in a lower tax bracket. Until recently, an IRC maximum limit applied to the combined annual amounts that could be contributed by participants under both types of plans. Under current IRC provisions, the maximum limit is no longer aggregated but, rather, is calculated separately under a 457(b) plan and a

403(b) plan. Thus, by establishing a UC 457(b) Plan, the potential amount that UC faculty and staff could voluntarily save and invest for retirement on a tax-deferred basis would be doubled.

For 2004, the general contribution limit for either a 457(b) plan or a 403(b) plan is $13,000, resulting in a total limit of $26,000; higher limits are afforded those participants age 50 and over. These limits increase by a fixed amount each year through 2006 and are then indexed annually through 2010, when the legislation allowing the higher contributions is scheduled to sunset. An additional catch-up amount is allowed under the 403(b) Plan for those who under-contributed in previous years and who meet length of service and other eligibility requirements.

During 2003, over 12,000 UC faculty and staff contributed the maximum amount allowed to the 403(b) Plan. This group includes faculty and staff with a wide range of salaries and many with spouses or domestic partners who are employed by organizations that do not offer significant tax-deferred savings opportunities for retirement. Having an additional opportunity to save and invest for retirement at UC through a 457(b) plan would be a significant benefit improvement for University of California faculty and staff.

Proposal

Under the first phase of the proposal, the intent is to make the proposed 457(b) Plan available to UC faculty and staff as soon as administratively feasible. Implementation is contingent upon the successful completion of the current RFP project to select a master record keeper who can provide external 457(b) Plan administration under a reasonable cost structure. The proposed 457(b) Plan is intended to be self-supporting, with record keeping by an external entity, and should not result in an increase in UC's operating costs. Participation in the 457(b) Plan would be voluntary, and contributions would be made though pretax payroll deductions, as with the existing 403(b) Plan. Other features of the proposed 457(b) Plan would be similar to those of the 403(b) Plan. Initially, it is expected that investment choices available to 457(b) Plan participants would be limited to the six UC-managed funds currently offered under UC's defined contribution plans that are internally managed by the Office of the Treasurer.

Next Steps

The administration plans to present further information at the July Regents meeting about the appointment of a master record keeper selected under the RFP process, including review by a Steering Committee chaired by the Senior Vice President–Business and Finance.

After selection of the master record keeper, the second phase of the project will fulfill fiduciary oversight responsibilities delegated by The Regents to the Treasurer and to the President, through Human Resources/Benefits, by initiating an additional process to review the suitability of the external investment options available to participants in UC's defined contribution plans relative to other external options available in the marketplace.

This further joint effort of HR/Benefits and the Treasurer's Office will be done through a manager search and selection process, with assistance from Aon Consulting. The new core fund choices selected through this process will be provided through the new master record keeper and implemented as soon as administratively feasible, and will be offered for the 403(b) Plan, the DC Plan and the 457(b) Plan. The administration intends to present further information about the second phase of the project to the Committee on Investments and the Finance Committee.

Goals of the Project

As described above, the establishment of a new 457(b) plan would be the initial step in a larger project, involving a review of bids by external parties to provide master record keeping and investment options for participants in UC's defined contribution plans. The desired outcomes of the entire process are to provide an additional tax-deferred savings opportunity for UC faculty and staff through establishment of the new 457(b) plan, to provide investment offerings that are easier to understand and communicate for the defined contribution plans, and to ensure that UC is obtaining the best fee structure possible for the investment offerings in the defined contribution plans. In addition, the results of the RFP process should help determine whether it is possible through a master record keeper to provide a more sustainable infrastructure that will support more frequent valuation and improved customer service, including the ability for participants more easily to manage their investments across the University's defined contribution plans.

An extensive consultation and review process with a wide range of University groups, including ongoing meetings with the Task Force on Investments and Retirement of the Academic Council's University Committee on Faculty Welfare, is in progress and will continue through the conclusion of the project. In addition, a number of focus groups have been held to obtain feedback from the University of California community.

To the extent that any of the proposed changes may trigger notice, consultation and meeting and conferring obligations under the Higher Education Employer-Employee Relations Act, the University will take appropriate action.

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

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 Committee adjourned at 11:55 a.m.

Attest:

Secretary