The Regents of the University of California

COMMITTEE ON FINANCE
March 28-29, 2012

The Committee on Finance met on the above dates at UCSF–Mission Bay Community Center, San Francisco.

Members present: Regents Island, Kieffer, Lozano, Mireles, Reiss, Varner, and Wachter; Ex officio members Lansing and Yudof; Advisory members Mendelson, Powell, and Stein; Staff Advisor Smith

In attendance: Regents De La Peña, Hallett, Makarechian, Newsom, Pattiz, Pelliccioni, Ruiz, and Zettel, Regent-designate Rubenstein, Faculty Representative Anderson, Secretary and Chief of Staff Kelman, Associate Secretary Shaw, Deputy General Counsel Birnbaum, Chief Investment Officer Berggren, Chief Compliance and Audit Officer Vacca, Provost Pitts, Executive Vice President Brostrom, Chief Financial Officer Taylor, Senior Vice Presidents Dooley and Stobo, Vice Presidents Allen-Diaz, Beckwith, Darling, Lenz, and Sakaki, Chancellors Birgeneau, Block, Blumenthal, Desmond-Hellmann, Fox, Katehi, Leland, White, and Yang, and Recording Secretary Johns

The meeting convened at 9:20 a.m. with Committee Chair Varner presiding.

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

Upon motion duly made and seconded, the minutes of the meeting of January 18-19, 2012 were approved.

2. **AUTHORIZATION FOR RESTRUCTURING A PORTION OF THE BERKELEY CAMPUS LONG TERM HOUSING DEBT**

The President recommended:

A. A partial restructuring of the Berkeley campus long term auxiliary (housing and dining) debt portfolio for fiscal year 2011-12 through fiscal year 2020-21 in an amount not to exceed $110 million in restructuring principal plus additional related financing costs.

B. The term of the restructured debt service shall not exceed the current final maturity of the Berkeley campus housing debt, which is fiscal year 2040-41.

C. That the President be authorized, after consultation with the General Counsel, to approve and execute all documents as may be necessary to implement the intent of this item.

[Background material was mailed to Regents in advance of the meeting, and a copy is on file in the Office of the Secretary and Chief of Staff.]

Chief Financial Officer Taylor explained that this item presented an opportunity to save between $1 million and $12 million annually in housing costs at UC Berkeley through debt restructuring. The action would allow the Berkeley campus to maintain housing costs at current levels and to prevent additional increases for the following year and possibly later years.

Faculty Representative Anderson expressed concern about future capital costs for deferred maintenance and potentially for new building. He referred to two debt restructuring scenarios presented in the background material to the item. The first scenario would leave a flat and rather high debt service burden through 2041. The second scenario would leave room at the end of that period for other capital costs. He asked who would make the decision on which restructuring scenario to implement. Mr. Taylor responded that the campus would decide which approach to take.

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

3. **ALTERNATIVE RISK OPTIONS**

[Background material was mailed to Regents in advance of the meeting, and a copy is on file in the Office of the Secretary and Chief of Staff.]

Chief Financial Officer Taylor stated that the purpose of this item was to describe captive insurance companies and the potential to reduce UC costs, smooth overall cost of insurance, gain access at a cost-effective level to certain types of insurance and reinsurance to which the University currently did not have access, and to use more small vendors who cannot currently compete effectively for UC business. He anticipated that an action item for approval of a captive insurance organization would be presented to the Regents at a meeting in the near future. He observed that this approach is already employed by many colleges and universities in the U.S.

Committee Chair Varner stated that the issue was well documented in the materials provided.

4. **ENDORSEMENT OF ENTERPRISE RISK MANAGEMENT PROGRAM**

The President recommended that the Regents endorse the Enterprise Risk Management Program, which is consistent with best practices as reflected in the common standards of the Committee of Sponsoring Organizations of the Treadway Commission Enterprise Risk Management Framework and International Organization for Standardization 31000 Risk Management Standards.

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Chief Financial Officer Taylor recalled that there had been an extended presentation on the University's risk management program at the January meeting. Many public and corporate boards in the U.S. have a formally endorsed risk management program.

Regent Lozano thanked Mr. Taylor and his colleagues for their attention to the area of risk, an essential consideration for a complex organization like UC.

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

5. **REPORT ON REVIEW OF POLICIES AND BEST PRACTICES IN RESPONSE TO CAMPUS PROTESTS**

[Background material was mailed to Regents in advance of the meeting, and a copy is on file in the Office of the Secretary and Chief of Staff.]

Committee Chair Varner recalled that following incidents at the Berkeley and Davis campuses, the President directed General Counsel Robinson and Dean Christopher Edley of the Berkeley Law School to conduct a systemwide review of campus policies and practices in responding to protests.

Mr. Edley stated that a draft report for public comment would be released in seven to 14 days. The draft would be available to the public for two to three weeks, following which it would be revised in light of the public comments received. He anticipated that the revision would take about two weeks. A final document would be presented to President Yudof before the next Regents meeting. The report contains recommendations to President Yudof, who in turn would decide on recommendations to forward to the University through its ordinary decision-making process, including consultation with the Academic Senate, student representatives, and the Regents.

Committee Chair Varner asked about the process of obtaining material for the report. Mr. Edley responded that there had been substantial assistance from the Office of the General Counsel, outside counsel, and research staff at the Warren Institute on Law and Social Policy at the Berkeley Law School. Members of the review team visited the campuses and met with various constituencies, including student groups, police officers, Academic Senate representatives, and community members. There were town hall meetings at three campuses. Mr. Edley stated that the outreach to these constituencies had been effective and informative, providing insights into issues of importance that might otherwise have been overlooked, and suggestions for creative solutions. He anticipated that this process would continue with comments received in response to the draft report.

The team also carried out a detailed review of relevant literature. Mr. Edley observed that while there is a fair amount of literature on the use of force in policing generally, the literature specifically addressing campus-based protests and the use of force is limited. The report emphasizes the special circumstances of policing in a university community.

Committee Chair Varner asked if this would be a report of first impressions. Mr. Edley responded that the report probes campus-based issues in great depth.

Regent Mireles asked why this matter was being discussed by the Committee on Finance. He asked how students would be able to participate in the review process. Mr. Edley responded that there would be a website to receive written and video comments. There would be specific outreach efforts to student organizations, systemwide and on each campus.

Regent Mireles expressed the students' concern that this report should reflect their interests. He asked that particular attention be paid to UC policies on mutual aid; this was likely a source of problems in the events of the past November.

In response to Regent Mireles' first question, Committee Chair Varner explained that because of the involvement of the Office of the General Counsel, this item was under the jurisdiction of the Committee on Finance.

Regent Pattiz asked if the review team interacted with law enforcement. Mr. Edley responded in the affirmative. All UC police chiefs and some of their subordinates were involved. There were also discussions with police in surrounding jurisdictions.

Regent Pattiz praised the approach being taken for its recognition of the unique nature of the University, as distinguished from law enforcement in a general public context. He stressed that police officers must be represented fairly in the discussion of these matters, so that solutions are feasible for all UC constituencies. Mr. Edley expressed agreement with Regent Pattiz and observed that the report would convey the full complexity of campus protest situations and the roles of police, administrators, and student leaders. It is clear that decision-making in complex situations that can arise during mass protests is not easy. Mr. Edley observed that whenever there are rules and laws, there is enforcement discretion. As one example, UC affiliates on campus are supposed to carry identification. Campus police do not enforce this rule as a matter of course. In exercising this kind of discretion in a university context, academic values must be significant in calculations made by administrators, staff, and students. Those academic values must temper the University's approach to enforcement and compliance.

Regent Lozano asked about the University's decision-making process for implementation of the report recommendations. She asked about the time it would to take to implement recommendations, and if it would be possible to act on some more swiftly than on others. Mr. Edley responded that it would be useful to include a memorandum in the final report suggesting an implementation and review strategy. The report contains over 50 recommendations. An overarching issue would be the question of which policy choices were to be made at the systemwide level, and which at the campus level. This would require serious thought and consideration.

Regent-designate Stein asked if any of the recommendations would be brought to the Regents for approval, or if all the recommendations would be approved by President Yudof. He asked if there would be a follow-up discussion at the next Regents meeting on the final recommendations. Mr. Edley stated that he anticipated a full briefing and discussion at the May meeting. In response to Regent-designate Stein's first question, he stated that he did not believe that any of the recommendations would require action by the Regents; at the same time, it was clear that President Yudof would not take significant action without consulting with the Regents.

Committee Chair Varner noted that due to the importance of this topic, the President and the Regents planned to have a full discussion at a Regents meeting at the appropriate time. Chairman Lansing confirmed that this discussion was being planned for the May meeting.

Faculty Representative Anderson expressed the Academic Senate's support for a discussion of the report at a Regents meeting as soon as the report is available, and for distribution of the report to campus administrators in the hope that, by reading the report and being informed by it, they would ensure that past mistakes would not be repeated. However, adoption of a formal policy by the Regents or the President must be done carefully. It would not be appropriate for the Regents to adopt or for the President to issue a policy in May. This would not leave enough time for a deliberative process. The Academic Senate would not be able to provide a full response in two or three weeks; the Senate supports an expeditious approach, but the approach must be correct.

Regent Pattiz urged the University to move quickly to resolve this matter. In the current situation, chancellors and campus police feel limited in what actions they are allowed to take. There is a need for practical solutions soon so that police would know which actions are appropriate or inappropriate in responding to situations on campus. He cautioned that if the deliberative process takes several months, this might lead to a loss of confidence in the University and its ability to deal with matters in a professional manner. UC and higher education would need public support in the November elections.

Mr. Edley noted that the campuses currently have substantial discretion in responding to situations that arise. Even in the absence of formal policies, discussions are occurring on the campuses on doing a better job in policing and enforcement. The report would provide additional ideas. He anticipated that UC would make progress in this area during the coming months, even if it took time to draft rules or policy.

The Committee recessed at 9:45 a.m.

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The Committee reconvened on March 29, 2012 at 11:10 a.m. with Committee Chair Varner presiding.

Members present: Regents Island, Kieffer, Lozano, Mireles, Reiss, Varner, and Wachter; Ex officio members Gould, Lansing, and Yudof; Advisory members Mendelson, Powell, and Stein; Staff Advisor Smith

In attendance: Regents De La Peña, Hallett, Makarechian, Newsom, Pattiz, Pelliccioni, Ruiz, and Schilling, Regent-designate Rubenstein, Faculty Representative Anderson, Secretary and Chief of Staff Kelman, Associate Secretary Shaw, General Counsel Robinson, Chief Investment Officer Berggren, Provost Pitts, Executive Vice President Brostrom, Chief Financial Officer Taylor, Senior Vice Presidents Dooley and Stobo, Vice Presidents Allen-Diaz, Beckwith, Darling, Duckett, Lenz, and Sakaki, Chancellors Block, Blumenthal, Desmond-Hellmann, Drake, Fox, Katehi, White, and Yang, and Recording Secretary Johns

6. **UPDATE ON THE UNIVERSITY'S 2012-13 BUDGET AND PROPOSED STATEWIDE TAX INITIATIVES**

[Background material was mailed to Regents in advance of the meeting, and a copy is on file in the Office of the Secretary and Chief of Staff.]

Executive Vice President Brostrom began the presentation with a few facts and figures indicating the state of UC campuses in 2012. At UC Riverside, student enrollment has grown by nearly 3,000 students while the number of faculty has been reduced by five percent. UC Santa Cruz has left nearly 15 percent of its faculty positions open, but still faces a $38 million campus budget deficit. UC Santa Barbara has over 1,000 more students than three years previously, but the number of staff has declined by 450, while the number of faculty has remained the same. UC Berkeley forecasts that, even with stable fee increases, it could face at least a $200 million budget gap within six years, due to increasing pension contribution costs.

The disinvestment by the State that has led to these drastic conditions on UC campuses is occurring at the same time as mandatory costs to fund the University's pension system are rising dramatically. Mr. Brostrom noted that even following Regents' actions to reduce these costs prospectively, the employer cost of contributions to the pension system would rise by nearly $200 million annually over the next six years, to nearly $1.8 billion in annual costs by 2016-17. Mr. Brostrom stressed that these expenses of almost $2 billion would affect the campuses, medical centers, and all UC enterprises.

The UC system faces an unprecedented threat to its academic quality. Mr. Brostrom quoted former President Clark Kerr: "The University of California has enjoyed a unique status among American public research universities. Somehow, through its 143-year history, it has managed to meet the shifting needs of California while maintaining an unprecedented level of academic quality." At present, however, the University faces new challenges to its quality. The process of disinvestment began with passage of Proposition 13, the impact of which the University did not fully feel until the early 1990s. Other actions by California voters have further reduced the flexibility of State funding. UC funding is included in a dwindling part of the State budget that is truly discretionary. For some time, the University has been able to address the impact of reduced State support through strong growth in its research and medical enterprises, but Mr. Brostrom cautioned that the University's foundation had since shifted, and that unless the

University is able to take immediate action, it would face a permanent and irreversible decline in academic quality.

The foundation of the University has historically rested on four pillars: first, a stable funding relationship with the State; second, wise stewardship of the University's financial resources; third, leveraging other strengths of the University, including its medical centers, private philanthropy, and research; and fourth, predictable funding from other financial resources, including fees from student enrollment.

The first pillar – State support – has eroded in ways unimaginable to previous generations of Californians. While in the middle part of the 20th century California built up the best public research university in the world under Governor Pat Brown, in the early part of the 21st century it is disinvesting in public higher education. Over the past 20 years, UC has had 11 years of cuts from the State, including seven in the last decade. The State's contribution to UC, on a per-student basis, has declined by 60 percent in real terms since 1990. In absolute dollars, UC at present relies on the same level of funding as in 1997-98, even though it now educates 73,000 more students, operates one additional undergraduate campus, and offers many new programs and degrees.

The current year vividly demonstrated this trend. For fiscal year 2011-12, the State reduced funding for the University by $750 million – $650 million in the budget act, and $100 million in a mid-year cut – which represents a 25 percent reduction in the University's State allocation in one year. In addition to this, UC faces over $300 million in mandatory cost increases, over one-half of which represent contributions to the UC retirement system, an expense that the State directly covers for the California State University (CSU) and community college employees. The Regents approved tuition increases twice, but the total revenue generated by these increases covered only one third of the State funding reduction and only one quarter of the overall fiscal impact on the University.

In the face of State reductions, the University has become more aggressive about shoring up its second pillar – wise stewardship of the University's financial resources. Even in times of generous State support, UC has utilized strong and smart fiscal stewardship of its resources. Currently, the University's Working Smarter initiative is designed to use the power of UC's size to fundamentally change the way the University does business through a wide range of administrative efficiency projects. Many of these are campus initiatives, including new programs such as UC Berkeley's Operational Excellence program. Several programs are further developed, having been driven by financial necessity years earlier. UC Santa Cruz, for example, instituted a common service center for human resources, finance and other business transactions nearly ten years ago. There are innovative regional initiatives in which campuses combine services to achieve economies of scale. For example, UCLA provides the financial system for UC Merced and for the Office of the President. UC Berkeley and UCSF recently consolidated their procurement offices. There are also systemwide efforts, which involve all the campuses and are coordinated at the Office of the President. The most immediate example is UCPath, the initiative to create one payroll system for all UC campuses and medical centers. The University combines all these initiatives – campus, regional, and systemwide – under the general rubric of the Working Smarter initiative, for which UC has set an ambitious target of $500 million in positive fiscal impact over five years.

Mr. Brostrom described the third pillar as the huge advantage the University enjoys in its overall $22 billion enterprise, which remains as strong as it is diverse. As one example of this, the research enterprise brings in $4.9 billion in revenues and in 2009 spawned 1,500 new inventions and 47 startup companies, which continue to drive the California economy.

One opportunity to increase revenues from research is to increase research cost recovery, where UC currently is at a disadvantage relative to its private university competitors. The University's goal is to increase the costs it recovers from the federal government by $30 million annually by increasing recovery on campuses through the granting of fewer waivers and more direct charges and by increasing the negotiated rates with the federal government to a level consistent with that which the private universities already receive.

Another potential source of additional research revenue is the acceleration of technology transfer, which currently represents about one percent of UC's total revenue for research and teaching. While a long-term strategy, technology transfer licensing practices have the potential of creating a stable and expanding royalty base.

Another area of strength is private philanthropy. In the last fiscal year, UC campuses raised over $1.6 billion in private support. Mr. Brostrom noted that the University must develop models to turn restricted funding into unrestricted funding for core support.

A final area of growth and strength has been in UC medical centers and their clinical practices. Revenues from the medical centers, over $400 million, are already a major source of support for medical education in the UC system. In fact, UC medical centers provide almost twice the amount of revenue for medical education than does the State.

But even with wise stewardship of the University's financial resources and the strength of its other enterprises, the University must rely on a fourth pillar – student fees. The long-term decline and volatility of State funding has created similar uncertainty and volatility in the University's tuition policy. Rapid fluctuations in tuition have been wrenching for UC students and their families. Over the last 20 years, while State funding declined by 60 percent, there were eight years with no tuition increase or a tuition decrease, eight years where the increase was ten percent or higher, and only four years where it fell between five and eight percent. Depending on when a student started at one of the UC campuses, he or she could have had flat tuition for four years or have seen it nearly doubled during a separate four-year period.

The University has worked hard to maintain financial accessibility, especially for low-income students. About 40 percent of all UC undergraduates receive Pell Grants, and four UC campuses – Berkeley, Davis, UCLA and San Diego – each enroll more Pell Grant recipients than the entire Ivy League combined. These students benefit from the

University's unique and generous return-to-aid model, by which one-third of all fee increases is returned in aid to low-income students. Over the past four years, the level of self-help for the lowest-income UC students has remained remarkably steady, even in the face of a fiscal crisis.

Mr. Brostrom affirmed the University's responsibility for students at every income level. In addition to maintaining in-state tuition and fees at a level that puts UC near the middle of its major public comparator institutions, it offers more need-based aid, grants, and scholarships than comparator institutions. As a result, net tuition per student the previous year was only $4,400 – among the lowest of UC's comparator institutions. UC has very strong State and institutional need-based grant programs, including the Cal Grant program and the Blue and Gold Opportunity Plan, which ensures that 100 percent of in-state tuition and fees is covered by scholarship or grant for eligible financially needy California students who come from families with an annual household income of $80,000 or less. Nonetheless, Mr. Brostrom emphasized that the volatility in fees is not fair to students, families, or the campuses, which are trying to engage in long-term planning during times of steadily increasing fixed costs.

For UC to remain true to its mission and to help fuel the California economy and provide opportunities for its continually changing population, the University must strengthen all its pillars of support.

First, the University needs a consistent and reliable funding agreement with the State. The proposal currently under discussion with the State offers real promise, both in providing the University a predictable source of funding for its pension costs and also in giving it flexibility in restructuring its debt and, thus, in meeting its other obligations. Just as important, it provides contingencies, should the State breach this agreement.

Second, UC needs a student tuition plan that provides the campuses with money they need to begin the rebuilding process necessary to prevent a deterioration in quality and to begin planning for the future. The plan must provide predictability for families who suffer from the volatility in fees and provide necessary support to protect all UC students.

Mr. Brostrom concluded his remarks by noting that UC has been able to maintain academic quality due to its four strong pillars. Strength in only two of them is insufficient to meet current challenges; all four must be strengthened. If UC achieved this, it would continue to prosper, ensure academic quality, and maintain and enhance its mission of teaching, research, and public service to the people of California.

Regent Kieffer recalled that technology transfer accounted for one percent of UC's total revenue for research and teaching. He asked how this compares to other universities. Mr. Brostrom responded that the UC system ranks fifth in the U.S. There is great variability among the campuses. He noted that in some cases, technology transfer revenue is based on single very successful inventions, especially in the pharmaceutical and biotechnology fields.

Regent Kieffer asked about the potential for improvement in results from UC technology transfer. Mr. Brostrom responded that technology transfer would never replace one of UC's major revenue sources, but he described it as an untapped opportunity. UC should examine how it can support early-stage research and commercialization.

Regent Kieffer asked what the specific percentage of increased revenue from technology transfer might be. Mr. Brostrom responded that in his view, the University could double the overall revenue from this source. This would never be a major source of revenue, providing perhaps an additional $125 million to $130 million, but it is an important service to faculty.

Regent Kieffer noted that he had heard anecdotal reports that the campuses would still be in serious financial difficulties five to ten years in the future. Mr. Brostrom responded that the University was discussing with the Governor a framework for UC's basic budget needs. The University must also pursue initiatives that foster academic quality, such as support of graduate students and faculty. He emphasized that these concerns were currently dwarfed by the increase in pension costs. The University must find a predictable and sustainable way of meeting those costs; it could then address initiatives focused on the quality of the institution.

Regent Kieffer stated his sense that pension and health costs in particular were responsible for the widening gap between UC's needs and its resources. Mr. Brostrom concurred that these costs were major challenges for the University. The $200 million budget gap projected for UC Berkeley reflected this impact of pension costs, in spite of the fact that the campus is raising significant private funding for core support and pursuing administrative efficiency measures.

Regent Kieffer emphasized the seriousness and significance of the widening gap between needs and resources, which is a long-term issue. Mr. Brostrom noted that the University cannot subsist on inflation-based funding because it faces a $2 billion expense it did not have three years earlier, or 20 years earlier. The University is attempting to address not only the impact of State budget reductions, but these additional expenses as well.

Regent Makarechian asked about the number of students for whom UC does not receive State support. Mr. Brostrom responded that the University is receiving the same level of funding from the State, in nominal dollars, as it received in 1997-98, when it had 73,000 fewer students. The State has adjusted UC's per-student cost, but this is not very meaningful from the University's point of view, following the reductions the State has made. From the State's point of view, the University has 12,000 students for whom it receives no State funding.

Regent Makarechian raised the issue of costs deferred to the future, such as pension costs and bond refinancing. Mr. Brostrom responded that the University is addressing pension costs directly. This process began two years previously, with the resumption of contributions to the UC Retirement Plan (UCRP). In 2013, employer contributions would be at ten percent of pay, while employee contributions would be at five percent, and contributions would increase. With regard to bond refinancing, Mr. Brostrom observed that this was an innovative offer by the Governor and the California Department of Finance to UC to take over and refinance its portion of State lease revenue bonds. UC has better credit and better financing terms than the State. The State's debt is primarily front-loaded, to be paid off in the next 20 years. If UC can refinance these bonds and extend their term, it could realize operating savings in a responsible manner, matching UC's revenue structure over 30 to 40 years.

Regent Makarechian expressed concern about deferring the payment of bond principals. Mr. Brostrom responded that in his view, the State's approach had been inefficient and ineffective. The University would endeavor to develop debt service to match the rate of growth in UC revenues. This is an approach taken in mortgages or corporate finance.

Regent Pattiz observed that in the past, the University had been able to maintain a balance between the goals of excellence and access, due to available revenue and the ability to borrow money at favorable rates. The University now has less revenue, more people in its system, and a demand for better services. UC does not have the resources to perform all the services it has committed itself to perform for all its constituents. There would be difficult choices and a need for shared sacrifice.

Committee Chair Varner stated that the University would consider its costs and revenue sources, and, supplied with this information, it would address the issue raised by Regent Pattiz. Mr. Brostrom expressed agreement with Regent Pattiz and noted that, even with the Governor's proposed initiative, the University would have to make sacrifices. Every campus would have to continue to increase its number of nonresident students. A sustainable model for the University would consist of many elements.

Vice President Lenz then presented information about 2012-13 State funding for UC. He reported that the Legislature was not likely to make any decisions on funding for the University until the May Revision to the Governor's budget. In its discussions with legislators, the University has pointed out the impact of the cuts it has received in the current year, the mandatory costs it faces, and the fact that UC campuses have absorbed the largest share of the overall reductions, this in spite of tuition increases.

The Governor's proposal for 2012-13 includes a shift in the General Obligation bond debt service that increases UC's budget by about $200 million, the State's first contribution of its obligation to the UCRP, an increase in UC's lease revenue bond debt service, and support for annuitant health benefits. There has been some encouraging discussion with the Governor's administration and the Legislature about the desire to avoid a UC tuition increase in 2012-13; this might entail an augmentation to the UC budget of $125.4 million.

Another aspect of the Governor's budget is associated with his November ballot initiative. The budget recognizes that there would be a mid-year reduction of $200 million to the University if that revenue initiative fails.

In the area of capital facility financing, Mr. Lenz noted that there would be a significant change in State financing and how UC would address capital needs in the future; Mr. Brostrom had alluded to this earlier in the discussion. In the past, UC has faced challenges in seeking issuance of General Obligation bonds or even in selling bonds to move projects forward when capital projects are approved in the State budget. This would be a dramatic shift in General Obligation bonds, with the debt service in UC's budget, increasing UC's base budget by $200 million. With the refinancing of lease revenue bonds, UC would be able to address critical capital projects and potentially generate an ongoing revenue source.

Mr. Lenz then discussed the Governor's recommendations for the Cal Grant program. This is an area that, while not part of the UC budget, is of great concern to the University. The Governor has proposed shifting federal Temporary Assistance for Needy Families funds from the California Department of Social Services budget to support the Cal Grant program; to raise the Cal Grant grade point average requirements, which would have a $131 million impact; to change the Cal Grant award amount for independent, nonprofit colleges and universities, which would have a $112 million impact; and to change the Cal Grant award amount for private, for-profit colleges and universities, which would have a $59 million impact. The Legislature has raised serious concerns about these recommendations; the Assembly has rejected them. It is clear that maintaining funding for Cal Grants is a priority, but it would be a challenge for the Legislature to address the combined cost of not carrying out the recommendations, over $1 billion.

Regent Lozano requested clarification of the impact of the Cal Grant reductions. Mr. Lenz responded that UC students would be affected by the change in the grade point average requirement for Cal Grant A awards. Mr. Brostrom noted that the fiscal impact would be approximately $25 million in the first year, and perhaps slightly more in the second year. The University would have to make up for this with its own institutional aid. Mr. Lenz added that this change would affect 250 students in the current year and about 1,000 students annually.

Regent Newsom stated that the Governor's recommendations would have a disproportionate effect on women and minorities. While the Assembly had rejected these cuts, other reductions would have to be made. He stressed that the proposed Cal Grant reductions would affect those who need education the most. Regent Newsom expressed support for the Governor's November ballot initiative, but questioned the Governor's sincerity in seeking the University's support for a tax measure.

Regent Makarechian expressed concern about future budget gaps, for example, in UCRP funding in the next five years. The plan to refinance lease revenue bonds was currently advantageous for the University's capital projects, but it would result in moving bonds from the State's balance sheet to the University's balance sheet. He reiterated his overall concern that the University is simply deferring costs to the future. Chief Financial Officer Taylor responded that the $2.5 billion in outstanding lease revenue bonds that are on the State's balance sheet are also on the University's balance sheet as capital leases, and are already included in the University's rating agency ratios.

Regent Makarechian observed that currently the payments on the lease revenue bonds are on the UC balance sheet, but not the actual total obligation; there is a significant difference between those two amounts. Mr. Taylor concurred, and stated that in its negotiations with the State, the University would ensure not only that UC receives the money for the lease revenue bond payments that it currently receives, but that the State would also allow UC to continue to pledge a broader amount of revenue so that the University's lenders are better protected. There is a proviso in the draft agreement according to which, if the University's ratings cannot remain the same or improve, the University can withdraw from the agreement's provision on lease revenue bonds. Mr. Taylor stressed that the State does not want UC's ratings to decline. The University has lent the State $1.2 billion, and it could only do this because it has excellent market access.

Faculty Representative Anderson drew attention to the educational impact of the proposed changes to the Cal Grant program. He expressed approval for UC's plan to buy out a reduction in State support. He anticipated that the changes would result in increased time to degree for UC students, but noted that the impact on CSU would be more severe. He expressed the hope that the Governor's recommendations would not be enacted. Mr. Brostrom stated that the University does not have additional resources to meet this potential reduction; the funding for such a buyout would come from reallocating UC resources. Mr. Anderson stated that such a reallocation would be essential, even if funding is taken away from another UC function.

Vice President Dooley then discussed negotiations for a multi-year agreement with the State. He underscored that there was currently no agreement. There had been work on a number of provisions, and the University was encouraged about the process. UC began its discussions on this topic with legislative leaders earlier that week. There are many competing demands on the State, and many competing interests are marshalling their efforts to secure State support. As one example, Mr. Dooley noted that the California Health and Human Services Agency has experienced drastic cuts.

Mr. Dooley observed that some elements of the Governor's budget proposal reflect principles that the University has discussed as part of a multi-year agreement framework. One such element is the transfer of debt service for lease revenue and General Obligation bonds into the University's base budget. The Governor has proposed a consistent growth rate on a larger base budget, although only by four percent.

Mr. Dooley outlined four areas that have been discussed as part of an agreement. One is the definition of a base budget, including the budget floor, and the rate of growth on such a budget in future years. The second area is capital financing, which includes regulatory relief and more control for the University over the management of its capital projects in the future. The University has stressed that past compacts have turned out to be one-year agreements. For this reason, the University has insisted on a third area, a tuition policy as part of this agreement that would provide reasonable and predictable tuition rates and the opportunity for a State buyout of tuition if State revenue is in excess of projected levels. The University has discussed a possible buyout of 2012-13 tuition, about $125 million.

The fourth area concerns performance goals or targets which the University must meet for time to degree, transfer rates, and possibly other criteria. Both the Governor and the Legislature are in agreement that UC should accept more transfer students.

The University has expressed its view that the base budget growth rate in future years should be six percent, in return for which the University could commit to mid-single-digit tuition increases and provide for its minimum needs over the five-year term of this agreement. Mr. Dooley noted that these terms would not give the University a robust budgetary position, and that the University would still have to make the difficult decisions alluded to by Regent Pattiz.

Committee Chair Varner asked what the percentage increase would be in dollar amounts. Mr. Dooley responded that a six percent increase, calculated on a $2.5 billion budget in the first year, would be about $150 million.

Committee Chair Varner asked what the increase in tuition would be in dollars per student. Mr. Brostrom responded that the University has presented models to the State of base budget growth with a roughly five percent tuition increase after 2013, equivalent to about $600 per student.

President Yudof stated that he would like to secure a five-year tuition buyout, but that the State can only make commitments for one year at a time. The University now needed to determine a specific amount for the buyout to present in its discussions with the State. Mr. Dooley noted that earlier compacts had no consequences for the State if it failed to meet its obligations. In this case, if the agreement is reached, there would be a clear understanding that if the State fails to meet its obligations, the University would make up the losses through tuition increases. It is important to exercise pressure on the State to honor its commitments.

Regent Reiss praised the University’s efforts in negotiating with the Legislature as well as with the Governor. Without an agreement, there would be no guarantee that UC would benefit from a tax initiative. Student advocacy was and would continue to be important. She stressed that any multi-year agreement would be fairly meaningless if it did not include the Legislature and was not expressed in a trailer bill or other legislative language. Mr. Dooley noted that this last point is addressed in the current framework.

Regent Reiss stated that an agreement with the Legislature should not indicate that the University would find it easy to raise tuition after the first year, even if the increase were only by four, five, or six percent. She stressed that the proposed reductions and changes in eligibility requirements to the Cal Grant program would be painful for students and suggested that UC work with legislators to avoid these changes.

Regent Mireles stated that if UC enters into an agreement with the State, there should be a process for determining tuition policy every year. The University should make no commitments to tuition increases without students having an opportunity to speak on their own behalf. He asked about previous agreements with the State, the State’s long-term financial health, and the Governor's and Legislature's real ability to enter into this kind of agreement. Mr. Brostrom responded that this agreement with the State would differ from earlier compacts in three ways. First, it would include involvement and endorsement by the Legislature; second, the agreement concerned new revenue; third, the University would seek to include consequences for the State into the agreement, directly connected to UC's tuition policy. He noted that a drawback to the agreement is the limited time frame for revenue from the tax initiatives; sales tax revenues would end in four years, and personal income tax revenues in seven years.

Mr. Lenz briefly outlined the Governor's revenue initiative. He explained that the Governor had developed a compromise with the proponents of the Millionaires Tax on an initiative for the November State election. This initiative would increase personal income tax on annual earnings over $250,000 for seven years, increase the sales and use tax by a quarter-cent for four years, add to the State Constitution a tax shift to local governments to pay for incarceration and State services that were realigned in the 2011 State budget, and allocate temporary tax revenues, with 89 percent for K-12 schools and 11 percent for community colleges. The California Legislative Analyst's Office (LAO) and the California Department of Finance (DOF) have put forward different estimates of revenue that would be raised by the Governor's initiative. The LAO estimates that these revenues in 2012-13 would be $6.8 billion, while the DOF estimates them to be $9 billion. Annual revenues in the period 2013-14 through 2017-18 would be $5.4 billion according to the LAO, $7.6 billion according to the DOF. The difference in these estimates is due to the volatility of personal income tax revenues. Mr. Lenz concluded by recalling that UC would face a $200 million mid-year budget cut if this measure fails.

Regent Blum stressed that the State has been for a long time and continues to be an unreliable partner in support for UC and higher education in general. UC can no longer afford to have the State as an unreliable partner. He expressed support for the Governor's tax initiative in the hope that it would provide increased funding for the University. Support for the Governor in this case concerned much more than a simple tax proposal; it expressed a profound value of the United States: the idea of a meritocracy where all have an opportunity to succeed. Regent Blum drew attention to income inequality in the U.S., which is increasing annually. In a listing of 140 of the world's nations ranked by income inequality, the U.S. is ranked 40th from the bottom. Over the long term, it has been shown that extreme inequality makes a society unstable. Income for college graduates has risen by 15.7 percent over the past 32 years, adjusted for inflation, while income for a worker without a college diploma has dropped by 25.7 percent over the same period. While lack of college education is not the only reason for the creation of an income gap in the U.S., education and training are absolutely vital if the nation is to compete and be successful in a fast-changing, innovative, information-oriented global environment. Regent Blum recalled that tuition when he attended UC Berkeley was $75 a semester. Nevertheless, UC tuition at this time is a relative bargain in the current environment. UC tuition would be substantially lower if the State had not consistently underfunded the University for at least 25 years. Regent Blum praised the University's efforts in recent years to become more efficient and to better finance its system. UC should explore new ways to teach, including online learning opportunities, and it should be more aggressive in its fundraising, especially for scholarship support. Further reductions would hurt the University's academic mission. When the State cuts funding to the University, this suggests to the world that UC is in decline; at the same time, attempts by other universities to hire away UC's best faculty are unrelenting. Regent Blum asked that the Board consider a resolution to endorse the Governor's proposal. In the meantime, the University should follow the discussions in Sacramento closely. In order to support the proposal, there must be some real gain for the University.

Regent Pattiz stressed that if the University is being asked to support the Governor's initiative, it must secure a guarantee that it receives its fair share of the revenue under this agreement. In his view, the proposed agreement under discussion was not yet satisfactory.

Regent Island expressed regret that the University included annual tuition increases as an element of negotiations. In his view, UC should reserve the question of tuition increases for the moment when they are necessary, and not earlier. The University should try to resist tuition increases as much as possible; it was a mistake to agree to a regime of annual tuition increases. He observed that no matter with whom an agreement was reached, if funding was not available, UC would not receive it.

Regent Newsom stated that the University was wise to enter into negotiations with the Governor and Legislature, but underscored the limited value of an agreement that cannot extend beyond one fiscal year. He expressed support for the Governor's tax initiative, but doubted that it would help secure the position of UC and CSU. He stated his view that the University's expectations were too low and described a possible gain of $125 million as modest. If the University continued these negotiations, it should raise its expectations and remove tuition increases as an element of the agreement. The University should be more aggressive in pursuing a guaranteed benefit for itself.

Mr. Lenz clarified that the proposed State budget currently included $90 million for UCRP funding and $15 million for other UC costs. The $125 million would be in addition to this funding. He stressed that the University was making a concerted effort to secure fiscal stability. Over the course of the previous 18 months, UC had received a $371 million increase, a $500 million reduction, a $150 million reduction, a $100 million reduction, and it now faced another possible $200 million mid-year budget reduction if the Governor's initiative failed. The University has been asking the State to define priorities for which it can provide funding, such as UC student enrollment, financial aid, or tuition relief. The University cannot carry out its planning if its budget is cut every six months by $100 million or $200 million; this was the reason for seeking a commitment from the State.

In response to questions by Regent Wachter, Mr. Lenz explained that the proposed allocation of temporary tax revenues for K-12 schools and the community colleges represented a temporary adjustment to Proposition 98 funds. A portion of the new revenues, at least 40 percent, would be allocated to K-12 schools and community colleges based on the Proposition 98 guarantee. New revenues go into the State's General Fund and the share based on Proposition 98 is allocated on the revised base. Mr. Lenz confirmed that there is no special set-aside for the University; UC can negotiate for its share of the new revenues.

Regent Wachter expressed agreement with Regent Newsom, stating that the University's expectations were far too low. He stressed that the University would not gain much from the agreement as it stood, based on the current information.

Regent Blum observed that among the competing demands on the State, California prison guards had recently received a minimum three percent pay increase and generous vacation time. The cost to the State was estimated at $600 million or greater. He asked why prison guard salaries had to be more competitive than university faculty salaries, and if this action was a payback for political contributions by the prison guards' union. He also asked about the State's legal obligation to reimburse UC for contributions to the UCRP, and if the State can arbitrarily abrogate that obligation. In response to the first question, Mr. Dooley stated that the prison guards' union had an open contract negotiation; he could not speak to the reason or motivation for the outcome. In response to the second question, he and Mr. Brostrom stated that the University's position is that the State has a legal obligation to fund the UCRP. Mr. Brostrom added that funding for the UCRP is not as simple as the pass-through funds received by CSU or the community colleges. In the past budget year, $400 million was directed into the California Public Employees' Retirement System (CalPERS) for community college employees.

Regent Blum asked about possible legal action in the courts, if the State has a legal obligation. General Counsel Robinson responded that the University has considered this matter.

Regent Kieffer stated his view that the Regents should wait and see how the negotiations develop. He cautioned the Board against becoming involved in political issues. If the Board were to endorse or officially express support for the Governor's proposal, the Regents should be aware that they were taking a special step. There should be a real benefit to the University from the proposal. He expressed concern about the accountability measures, the performance goals mentioned by Mr. Dooley earlier. While these standards appear easy for the University to meet, they might set a precedent such that the Legislature establishes rules by which the University must operate in order to receive funding. Regent Kieffer expressed his wish to ensure that UC, which is constitutionally independent, would not establish a precedent such that conditions would be imposed on the University in a State budget. Mr. Brostrom responded that the University has always had accountability measures with the Legislature; it is moving to reduce those measures, especially in the area of capital projects. The accountability measures currently in the agreement are aligned with the University's goals. UC would work with the Governor's administration over time to ensure that the measures were appropriate, because many of the measures are based on lagging indicators.

Regent Kieffer asked if these accountability measures were written into legislation. Mr. Lenz responded that they have been included in previous compacts or agreements with the State. He stated that the University considers accountability measures carefully to determine if they are applicable to UC and if they are practical and consistent with the revenue UC is receiving.

Committee Chair Varner stated that the University's negotiating team was aware of and had a good understanding of all the concerns that had been raised. He expressed confidence in the team's effort to develop the best possible agreement with the State.

Regent Newsom suggested that the University had not received its fair share of State funding because it relied only on moral authority rather than legal action. If the University considers that the State has a legal obligation to the UCRP, it would be wise to consider legal action. He stressed that this is part of the political process in Sacramento. The Governor needs the Regents' support for this tax initiative because the public supports education; the Regents' support would be an important point in his favor. The tax initiative might reduce stress on the State's General Fund, but would not prove exceptionally beneficial to higher education. In his view, the Regents should not engage in any further discussions of support for the Governor's initiative unless it provided a much more substantive benefit to the University.

Chairman Lansing stated that this had been a productive discussion. She noted that the Regents' personal positions on the Governor's initiative were a different matter from their position as a Board. She reminded the Board that the agreement with the State is a work in progress. She expressed the general sentiment of the Board that the Regents wish to know what substantial benefit there would be for UC and all the higher education segments in supporting this initiative. The University would continue to pursue this effort, working with its students.

Mr. Dooley noted that there were no specific numbers in the agreement model or framework for tuition. The University was pursuing a tuition buyout through the term of the agreement. In negotiations, the University has made it clear that it would like to express support for the initiative, if there is a real benefit for the University. The legislators' response had been that these are two separate issues. He asked the Regents to bring this issue up with the legislative leaders. This would make it possible for the administration to be more direct with legislators and to emphasize this point more. Mr. Dooley underscored that the University is mindful of the political environment in which it is negotiating.

The meeting adjourned at 12:40 p.m.

Attest:

Secretary and Chief of Staff