The Regents of the University of California

**COMMITTEE ON FINANCE**
September 18, 2013

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

Members present: Regents Blum, Flores, Island, Kieffer, Reiss, Ruiz, and Wachter; Ex officio members Brown and Varner; Advisory members Jacob, Leong Clancy, and Saifuddin; Staff Advisors Barton and Coyne

In attendance: Regents De La Peña, Feingold, Makarechian, Pattiz, Schultz, and Zettel, Regent-designate Engelhorn, Faculty Representative Gilly, Secretary and Chief of Staff Kelman, Associate Secretary Shaw, General Counsel Robinson, Co-Acting Chief Investment Officer Stanton, Provost Dorr, Executive Vice President Brostrom, Chief Financial Officer Taylor, Senior Vice President Dooley, Vice Presidents Duckett, Lenz, and Sakaki, Chancellors Block, Blumenthal, Desmond-Hellmann, Dirks, Drake, Khosla, Leland, Wilcox, and Yang, and Recording Secretary Johns

The meeting convened at 1:25 p.m. with Committee Chair Ruiz presiding.

1. **REMARKS OF THE PRESIDENT OF THE UNIVERSITY OF CALIFORNIA STUDENT ASSOCIATION**

UC Student Association (UCSA) president Kareem Aref outlined current UCSA campaigns. One campaign is focused on professional development for graduate students to allow them to enter the job market in fields outside academia. UCSA would like to implement programs on UC campuses to ensure that these graduates are supported and can succeed in a variety of career fields. Three UCSA campaigns are focused on undergraduate concerns. The Invest in Graduation, Not Incarceration, Transform Education (IGNITE) campaign seeks to combat the school-to-prison pipeline and the prison-industrial complex, and the trend of the State to invest in prisons rather than in education. The campaign for the California Modernization and Economic Development Act is for a proposed oil severance tax that could provide $2 billion in revenue for public higher education, of which $300 million would go to UC. The third campaign is for a Fossil Free UC. It encourages the Regents to remove UC investments in fossil fuel companies and to seek more environmentally friendly investments.

Mr. Aref briefly outlined some UCSA priorities for the 2014-15 UC budget – improved graduate student support, improvement in the student-faculty ratio through hiring of more faculty, and more funding for student outreach and retention centers and for student services. Mr. Aref reported student concerns about the appointment of President Napolitano, especially about her background in the Department of Homeland Security and as Governor of Arizona. He hoped that there would be more campus visits by Regents and more communication between students and Regents in the coming year.

2. **APPROVAL OF MINUTES OF PREVIOUS MEETING**

Upon motion duly made and seconded, the minutes of the meeting of July 17, 2013 were approved.

3. **REVISED LONG-TERM BUDGET MODEL**

[Background material was provided 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 by recalling that there had been discussion of the University's long-term budget model a few years previously. Many things had changed since that time, such as UC's revenue and expenditure assumptions. This seemed an appropriate time to update the Regents on the major factors that influence UC revenue and costs.

Earlier UC budget modeling assumed restoration to 2007-08 funding levels. Mr. Brostrom noted that this was now an unrealistic expectation. The University seeks to maintain and restore quality, but cannot look to funding levels that are long gone. During recent years UC has managed to protect access and affordability, but some measures taken by UC during the fiscal crisis have affected the quality of the institution, as reflected in the student-faculty ratio, the faculty salary gap, and faculty hiring.

UC is still able to offer a place for all eligible freshmen, in spite of dramatic increases in the number of applicants. The number of California freshman applicants for the current year had grown by more than six percent over the previous year. In 2012-13, UC enrolled nearly 240,000 students. In fall 2011, 40 percent of UC's undergraduate students were first-generation college students; at UC Merced, this figure is closer to 60 percent. This truly reflects the University's role as an engine of transformation and opportunity for the state.

The University also continues to enroll a higher proportion of Pell Grant recipients than any comparable public or private institution. For the past full year, the proportion of Pell Grant recipients was over 40 percent; at the Riverside and Merced campuses, the figure would be closer to 50 percent. In California, these are students with an annual family income of $50,000 or less. Four UC campuses, on each single campus, have more Pell Grant recipients than the entire Ivy League combined.

In spite of dramatic tuition increases, the University has taken measures to ensure that low-income students are not affected. Over 50 percent of all California resident undergraduates pay no systemwide tuition or fees. About half of UC's graduating undergraduates have no student loan debt; those students who do borrow have an average debt well below the national average. The University is concerned that some families were using home equity to finance a UC education and it continues to monitor this situation, given the downturn in the housing market.

Mr. Brostrom identified the chronic volatility of UC's tuition policy as a serious problem. Presenting a chart that showed year-to-year percentage changes in UC tuition and fees since 1980, he pointed out that there had been periods of no tuition growth or tuition declines and periods of steep increases. There had been a 40 percent increase in the 1990s, a 30 percent increase in the early part of the previous decade, and most recently a 25 percent increase. This could have been normalized as a steady increase. Depending on when an undergraduate entered UC, he or she could have seen tuition remain level or double. Mr. Brostrom stressed that this situation was not fair to students and their families, and not fair to the campuses, because they cannot engage in meaningful long-term planning when revenue is volatile.

UC tuition and fees are still low compared to those at other public institutions. The University has much higher return-to-aid than other State universities. UC also benefits from the generous Cal Grant program. The fact that 50 percent of UC students pay no tuition is attributable to federal Pell Grants in combination with generous State and institutional aid.

In the most recent Shanghai Jiao Tong University ranking of world universities, four UC campuses were listed among the top 20, and nine were in the top 150. In a ranking by *Washington Monthly*, four UC campuses were in the top ten, including UC San Diego, which was in first place. By any measure, UC continues to compete with the best public and private universities in the world.

Fiscal necessity has led to certain actions by the University with undesirable outcomes. The student-faculty ratio has risen. Over the past 20 years, the growth rate for students has been nearly twice that for faculty. This trend had been even more dramatic in the previous three years, during which the University added 4,400 students and lost 300 faculty members; more faculty members retired or left than were hired. Reversing this trend is an important focus for UC.

Faculty salaries are another significant concern. Over the past decade, UC faculty salaries had continued to lose against the market. In the past, the UC defined benefit plan was a positive benefit for faculty, but beginning in the current year, UC employees would be contributing 6.5 percent of their pay to the defined benefit plan; in the following year that contribution would rise to eight percent. The University was engaged in a new total remuneration study to determine how competitive UC is relative to its public and private peer institutions.

Mr. Brostrom expressed the University's view that there are four fundamental elements for a long-term sustainable funding plan for the institution. One element is stable and predictable funding from the State, and at the moment it seemed that this had been secured in the near term with the passage of Proposition 30. A second element is leveraging of alternative revenues. Mr. Brostrom recalled that core funds represent only about 25 percent of UC's total enterprise. The University must examine all elements of its enterprise, including medical centers, private philanthropy, and contracts and grants, and do all it can to leverage these funding sources for core purposes. The third element is administrative efficiencies, which are being pursued at the campus, regional, and systemwide levels, and the fourth element is a stable and predictable tuition plan.

Regent Kieffer requested clarification about medical centers as a source of alternative revenue. Mr. Brostrom responded that in the last few years, UC medical centers have been contributing more revenue to support UC medical and health sciences schools than the State has.

Regent Kieffer asked how the University could depend on this revenue, given the many uncertainties surrounding the Patient Protection and Affordable Care Act. Mr. Brostrom responded that this is a major concern for the University; every medical center is showing strains on its financial performance.

Regent Kieffer recalled that UC medical centers had been in difficult financial circumstances in the past. A shift in the health care industry has significant implications for the University. Mr. Brostrom responded that UC must be nimble and able to react quickly. A few years previously, UC had pointed to its successes in indirect cost recovery; campuses were raising their recovery rates and UC was recovering more revenue from its contracts and grants. Now, due to federal budget sequestration, UC was projecting a $50 million decline in the current year in indirect cost recovery. The University cannot depend on this funding source every year.

Mr. Brostrom continued the presentation with discussion of the Governor's multi-year funding plan, which he described as a solid foundation for a sustainable financial model for UC. The plan includes creative measures such as debt restructuring and general obligation bond debt service. He drew attention to the fact that State General Funds currently accounted for only about 40 percent of UC's core funds. These core funds comprise three main categories: (1) State appropriations, (2) tuition and fees, which have eclipsed State funding in the past few years as the largest source of core funding, and (3) UC general funds, including nonresident tuition, indirect cost recovery, and patent revenues. He noted that a five percent increase in State General Funds to UC in 2014-15 would yield an overall increase of only about two percent in core funds, assuming no increases in tuition and UC general funds. This is exacerbated by the University's need to contribute about half this amount directly to the UC Retirement Plan (UCRP), given the increase to the employer contribution rate. Although the Governor's multi-year funding plan is strong, it cannot be the only pillar of UC's overall financial plan.

Regent Makarechian stated his understanding that the State had increased its support for UC from $2.3 billion to about $2.8 billion for the current year; $400 million of this is debt service-related capital. He asked about the percentage of State funding in UC's total operating funds, recalling that the total budget is approximately $24 billion and that the $2.8 billion in State funding is less than tuition revenue, about $3.5 billion. Mr. Brostrom distinguished core funding, about $6.5 billion, from the overall enterprise, about

$25 billion. State funding accounts for about 11 percent to 12 percent of the overall enterprise and for 40 percent of core funds.

Regent Makarechian emphasized the fact that State funding represented only about ten percent of the total UC operating budget, and that tuition revenue exceeded State support. He also stressed that the $80 million savings in refinancing was a one-time occurrence. If the State did not increase State General Fund support by five percent, the University might have to scale back student enrollment. Mr. Brostrom responded that the $80 million savings through debt restructuring would last about ten years, but with no incremental savings beyond that point. Debt would remain level for about ten years, but would increase for the years 2025-40.

Regent Makarechian asked why the State was funding the employer pension contribution for the California State University (CSU), about $400 million, but only $10 million for the same expense at UC. Mr. Brostrom responded that this is the subject of an ongoing discussion with the Governor's office and the Legislature. UC receives the same percentage increase in funding as CSU, but the State's contribution to the CSU pension is completely funded, as is the pension for the community colleges. This had been the case for UC before 1990-91, when it began its contribution "holiday" and stopped making contributions to UCRP. The UCRP was currently one of UC's greatest cost liabilities.

Regent Makarechian emphasized that when the State does not contribute to the UCRP employer cost, the University takes this amount from its operating funds, and lowers the amount available to pay faculty merit increases. The employee UCRP contribution has doubled, resulting in a de facto salary reduction. It made no sense for the State to contribute only $10 million to UC while contributing $400 million for the CSU pension system. Vice President Lenz recalled that UC resumed UCRP contributions in April 2010. The State provided approximately $91.3 million in the 2012-13 budget for the UCRP. In 2013-14 the State afforded UC the ability to carry out debt restructuring, which enables the University to provide $67.5 million for the UCRP. He stressed that the State's contribution had been greater than $10 million and that there had been a concerted effort to address these costs. It was true that this funding had not been built into the multi-year funding plan.

Regent Makarechian underscored that in the process of debt restructuring, the University took on debt owed by the State because UC has a better credit rating, and that this represented a burden to the UC entity overall. Mr. Brostrom responded that in the current fiscal year, UC would put $1 billion into its pension system. About $320 million of this amount is from general funds. This expense has prevented regular compensation increases. In the past six years, there had been only two general compensation increases.

Governor Brown observed that through the Cal Grant program, the State General Fund contributes another $750 million to UC. The State is funding about 59 percent of UC's core education expenses. When tuition rises, the State must automatically increase the Cal Grant program, which is an entitlement program. During the UCRP contribution holiday, there was a misperception that conditions were better than they were; UC was now trying to correct this. He noted that when the defined benefit plan is added to a UC salary, the total compensation is close to market. The defined benefit plan, at this point in history, had become a rare benefit, a government-sponsored, vested right, an annuity program that most people do not enjoy. Governor Brown stated his view that when employees are asked to contribute more to their pension, they should feel good about this. Government spending in California is about $140 billion; the General Fund is about $96 billion. Decisions are made in the Legislature about prisons, health care, child care, and welfare. The desires of the various constituencies in California are endless. He observed that desires have a way of being transformed into needs, needs into rights, and rights into lawsuits. The University's mechanism for advocating its desires or needs had not been as effective as the mechanism deployed by the State prisons. The State had just allocated $315 million to purchase more prison beds, solely due to pressure from the three federal judges currently in charge of the California prison system. He suggested that the University seek a way to turn its needs into rights, which are addressed in the judicial process and not controlled by politicians. The process of deciding which desires should be validated is a difficult one for the Regents, the Legislature, and the people. Specific desires or needs must be considered, weighed, and traded off against others. UC is remarkable, compared to Ivy League and other universities, in the financial aid provided for low-income students. The new middle class scholarship would represent several hundred million additional dollars in aid. On a yearly basis, this would be more than the State General Fund increase to UC. Governor Brown emphasized that the University's overall cost structure must be examined. All the goals the University wishes to fund are worthy, but Governor Brown noted that his work requires that he sometimes curtail good programs in order to avoid deficits and other problems. He concurred with the importance of maintaining tuition levels that are steady and not volatile and stated that he would work to keep tuition lower. He stressed that all factors that drive up costs must be examined in an objective manner, no matter how desirable they may be, such as enrollment growth, lowering the student-faculty ratio, and the capital program.

Committee Chair Ruiz thanked Governor Brown for his remarks and noted that the University was examining cost factors and working diligently to make its operations more efficient.

Governor Brown stated that for historical and political reasons, Regent Makarechian's argument must be made to the Legislature. This issue is not under the control of the Regents. The Regents have control over and responsibility for factors such as the student-faculty ratio, enrollment growth, and compensation. The Regents must make difficult decisions and compare factors that are not commensurate, but Governor Brown emphasized that people make difficult decisions and live within budgets. He observed that the University has relied on tuition as a source of revenue in difficult times, regarding it as a "free good." He stated his intention to oppose this approach, but not without adequate consultation and study of the issue, and consideration of the implications of whatever action is taken.

Regent Kieffer asked if the University is required to meet enrollment growth targets. Mr. Brostrom responded in the negative, but stated that the University has met these targets to accommodate the California Master Plan for Higher Education and due to its own commitment to offer admission to the top nine percent of California high school students and students in the top nine percent of their graduating class at a participating high school.

Regent Kieffer requested information about how other public universities have addressed tuition costs. In 1959 the University followed a model of no tuition, while other university systems have followed a model of higher tuition and higher financial aid. Other systems have also suffered budget reductions, and it would be useful to know how other major State university systems have approached these challenges. He requested an overview of five or six other State institutions. Mr. Brostrom responded that he would provide this information. Many State systems, such as the Universities of Michigan, Virginia, Colorado, and Washington, are very different from UC in their nonresident enrollment levels. These levels are close to 40 percent in Michigan and Virginia and over 20 percent in Washington and Colorado. This is a very different strategy, but some of these states have suffered more severe budget cuts and do not have the same in-state growth in the number of high school graduates as California.

Regent Kieffer acknowledged this difference, observing that some of these State systems are in the center of a region that they serve, while California and UC are in some ways like an island.

Regent Island referred to information presented earlier about average student loan debt. He asked if the University had information on the debt load for underrepresented minority students. Mr. Brostrom responded that UC produces a very detailed document annually on student financial support with this information. Interim Director – Student Financial Support David Alcocer stated that low-income students are more likely to come from underrepresented minority backgrounds and more likely to borrow. Among students who borrow, however, the average debt at graduation is fairly similar, regardless of income level.

Regent Island asked how the average debt of underrepresented minority students at UC was related to the average amount of $19,751 that had been presented. Mr. Alcocer responded that because underrepresented minority students are likely to come from low-income backgrounds, they were more likely to graduate with debt.

Regent Island clarified that he wished to receive information on the average debt specifically for underrepresented minority students. He recognized that these students may also fall into the category of low-income students. Mr. Alcocer responded that underrepresented minority students are on average more likely to graduate with debt. The level of their debt is similar to the level of other students who borrow.

Regent Island asked if anecdotal information that underrepresented minority students are graduating with debt loads significantly higher than $19,751 was incorrect. Mr. Alcocer responded that the trend among underrepresented minority students was the same as among all other students who happen to have a lower income.

Faculty Representative Jacob referred to the holiday from UCRP contributions and recalled that the Academic Senate had been a strong advocate for ending the holiday and resuming contributions. The notion that the defined benefit plan makes up for the market lag in faculty salaries is based on obsolete data; this is not the case now. The University would carry out a careful study to determine precisely the amount of the lag in total remuneration. He anticipated that this information would be available in about nine months. He emphasized that the salary lag was not being made up by benefits. He recalled that faculty generate about $5 billion in contracts and grants, and that these funds contribute directly to undergraduate and graduate education. If the University failed to address the issue of total remuneration for faculty, it would put this $5 billion at risk.

Governor Brown referred to the average student debt of $19,751. He requested information on students with the lowest, median, and highest debt. These data might illuminate the question more fully than merely the figure for average debt. Mr. Brostrom responded that this information would be provided.

Governor Brown asked which students had the most debt, or were the most significant "debt consumers." He supposed that some students might have a debt burden as high as $30,000. Debt burdens of this magnitude would affect students' ability to continue to graduate school. Mr. Alcocer responded that the distribution of debt over time, including median debt, is shown in the Annual Accountability Report. Over the previous decade, there had been no significant change in the percentage of students who borrow a little and the percentage who borrow a large amount. Students who borrow a great deal are often those who have taken more than four years to complete the undergraduate degree, or students whose parents are considered capable of contributing to their tuition under the federal formula, but who do not contribute. He stated that the University could provide a more detailed analysis of the profile of students with debt.

Governor Brown requested this information, including data on students in UC law and medical schools, and other graduate and professional schools. Mr. Alcocer noted that the University has less information on the parents of these students than it has for the parents of undergraduates, but it does have data on debt distribution. In UC's professional degree programs, which have seen substantial tuition increases in the past few years, there has been a rising level of debt.

Governor Brown requested information on the debt load of graduate students relative to the income levels they might expect after completing their degrees.

Regent Reiss echoed Governor Brown's request for specific data on the debt load for students by income category, and for graduate and professional students. Information on student debt load by category would be helpful to the Regents in future decision-making. She asked if increased State funding was contingent on there being no increase in tuition. Mr. Brostrom responded in the affirmative.

Regent Reiss emphasized that the Regents might have to make difficult decisions among competing priorities – student enrollment, faculty compensation, and the capital program, for example – and that solid data and specific figures were necessary for all cost elements and to show how much money the University might save by taking a specific action. Mr. Brostrom responded that the remainder of the presentation would address some of these questions. He noted that some figures were presented in aggregate, which does not reflect the differences between campuses and other fund sources campuses have. In addition, State funding and tuition are a small part of UC's overall enterprise. It would be foolhardy to halt building projects when they are being funded with other revenue sources.

Regent Makarechian asked if faculty salary comparisons take health benefits into account. Many private universities do not offer defined benefit retirement plans. He also asked about possible UC involvement with the newly established health care exchanges. Mr. Jacob responded that the upcoming study of total remuneration, to be presented in about nine months, would be an actuarial study taking all these points into consideration, including salaries and health and retirement benefits. He anticipated that the study would provide clear answers to these questions. Mr. Brostrom observed that health benefits make up a large part of UC's costs, about $1.6 billion. In the current year, the University re-bid all its health insurance programs and introduced a new self-funded health insurance program, essentially run through UC's medical centers at lower cost. The University was able to maintain the increase to its health benefits costs below five percent in the current year.

Regent De La Peña stressed that the perception that the UC health system generates a great deal of revenue was not accurate. The system currently enjoyed profits of less than ten percent. He anticipated that the Patient Protection and Affordable Care Act would have a negative impact on reimbursements to the UC health system and cautioned that a ten percent loss in reimbursements would put the University in a very difficult position. He suggested that the University should examine how it could increase its patient base, for example by delivering health care to State employees.

Governor Brown recalled that there had been discussions a few years earlier about the possibility of UC taking charge of the State prison health care system, a $2.1 billion enterprise. The State spends approximately $17,000 per inmate, and the federal judges in charge of the prison system feel that this spending is not sufficient. He observed that there is a paradox in this situation, as the prison health system is in receivership; the State has no control over it. The State controller must pay checks issued by the receiver under penalty of contempt of court. Spending on the State prisons had doubled in the past six years. Governor Brown suggested that there might be an opportunity for some part or all of the UC medical system to participate in this $2 billion enterprise; the University should examine this possibility again.

Regent De La Peña asked about the possibility of UC providing health care to State employees. Governor Brown noted that the California Public Employees' Retirement System was already in place. Mr. Brostrom reported that CSU had expressed interest in participating in the UC Care program, if that program is successful.

Regent De La Peña underscored the advisability of a contingent budget and suggested that the University could take action in the health services area to address this.

Regent Feingold stated that an accurate account of student debt must include the debt of students who do not graduate or who leave UC and graduate from other institutions. He asked if the University had any data on students who leave the system and what debt burden they take with them. The figure for average debt cited in the presentation was misleading, if in fact UC was creating more debt for California citizens. If UC does not succeed in moving students through the system, it creates debt for families.

Staff Advisor Barton stated her understanding that the total remuneration study would concern faculty. She asked what the challenges would be in carrying out such a study for staff employees. Mr. Brostrom responded that studies on staff compensation had been carried out in the past and stated his view that he found the data to be less meaningful, because there are many regional and sector differences among staff. While the University can bring the value of health and pension benefits to market levels, each campus can study the situation of its own staff employees. Faculty are part of a global market, although their situation is not uniform and there are significant differences among academic disciplines.

Mr. Brostrom then continued the presentation, focusing on factors that increase costs. He noted that figures were presented in the aggregate for all ten campuses, while there are differences among the campuses. A cost factor that has a great impact on one campus might not have the same impact on another campus. He distinguished three elements of the long-term budget model: mandatory costs, high-priority costs, and reinvestment in quality. Mandatory costs include the employer contribution to the UCRP, health benefits, annuitant health benefits, non-salary price increases, and the academic merit program. UC is one of only a few institutions that offer a performance-based merit program for faculty after tenure. High-priority costs include compensation, deferred maintenance, enrollment growth, and capital projects. Efforts to reinvest in academic excellence include enhancing undergraduate instructional support, reducing the student-faculty ratio, supporting start-up costs for new faculty, and reducing the faculty and staff salary gap.

Mr. Brostrom then outlined the University's assumptions about its cost factors for 2013-14 through 2016-17. UCRP costs would be $244 million, assuming that the employer contribution would be 14 percent in 2014-15 and increase to 16 percent in 2015-16. This assumption would be reviewed after the University's actuarial report in November. Employee and retiree health benefit costs would be $108 million. The University has assumed a growth rate of five percent in this area. The cost of the academic merit program would be $120 million or $30 million annually over the four years. The cost of non-salary price increases would be $92 million. The total of these mandatory costs would be $564 million over the four-year period. Health and post-employment benefits account for 60 percent of these costs, an enormous cost factor; the resumption of UCRP contributions represents $1 billion in the UC budget and this amount is growing.

High-priority costs include compensation, an estimated cost of $534 million. This is an area where the University made sacrifices during the economic downturn. Over the previous six years, there had been only two general salary increases, at a time when employee UCRP contributions rose to 6.5 percent and would soon rise to eight percent. Staff members had experienced a real decline of nearly ten percent in base pay. Mr. Brostrom cautioned that the University would suffer as an institution if it did not address this matter. Deferred maintenance represented an assumption of $100 million in costs, although Mr. Brostrom estimated that the real cost might be higher. The cost of enrollment growth was assumed to be $88 million if the University increased enrollment by one percent, or about 2,000 California resident students. Many of the campuses have the capacity to take more students. UC Merced has an ambitious plan to increase enrollment to 10,000 students by 2020. If these students are not funded, however, this would have a negative impact on other quality-related initiatives UC is undertaking. Capital funding costs would be $60 million. These costs were supported by the State in the past through lease revenue bonds and general obligation bonds. Capital funding is necessary for purposes of life safety, seismic upgrades, and to accommodate student enrollment. Together, these high-priority costs totaled $782 million.

The cost for reinvestment in academic quality was assumed to be $200 million or $50 million annually. This cost was not broken down into categories because the campuses' needs are different. At one campus, the faculty salary gap might not be as pressing an issue as graduate student support or the need for more faculty hiring.

Mr. Brostrom then outlined revenue sources to address these costs. The 2013-17 augmentation in State funding of $576 million would cover UC's mandatory costs. Asset management, debt management, and other fiscal strategies might generate $120 million. There was an assumption of $65 million in revenue from nonresident supplemental tuition and indirect cost recovery. He cautioned that the level of indirect cost recovery would remain flat, given actions by the federal government. He described the estimate of $80 million for philanthropy as conservative. These revenue sources combined still left a funding gap of $705 million, assuming no tuition increases during the four-year period.

Mr. Brostrom expressed his view that if UC were to increase tuition, steady predictable increases linked to the inflation rate would be the best option, with students aware that their tuition would increase with the rate of inflation. Such an increase would make up about half the budget gap being contemplated. A situation of no tuition increase would be regressive and would mostly help wealthy Californians.

Other possible actions to reduce costs should be considered and discussed. One such action would be to slow the growth of the employer contribution to the UCRP after it rises to 14 percent. This could be discussed in November when the University's actuarial report is available. UC has enjoyed success with its asset management, and another possible action would be to fund deferred maintenance from UC assets. The University could extend its balance sheet strategies. The University has moved more of its liquid assets into the General Endowment Pool and the Total Return Investment Pool; this could be pursued more aggressively. In the past, the University had borrowed from its reserves for the UCRP; it might consider this again, especially if it puts a limit on contributions. Mr. Brostrom argued that UC should be treated like CSU by the State with regard to pension contributions. If the State did not wish to build this element into its operating budget, excess State revenues, one-time funding, could be contributed. UC could reduce enrollment growth, reduce the projected salary increase from three percent to 2.5 percent or two percent, or implement additional budget cuts. These were all potential actions to reduce the University's budget gap over four years.

Regent Blum urged the Regents to read the Annual Accountability Report, stating that it provided answers to many of the questions raised during the present discussion.

Regent Reiss asked if and how increases in student enrollment necessarily represent an additional cost. She suggested that a small increase in undergraduate enrollment, without increase in faculty hiring, would produce additional revenue. Mr. Brostrom responded that the University had studied this question carefully and had considered decreasing enrollment. Small increases in undergraduate enrollment would not have a large impact and would generate some additional tuition revenue. Over time however, and on a larger scale, increasing undergraduate enrollment and maintaining quality would require increases in graduate students and faculty.

Committee Chair Ruiz anticipated that the number of applicants to UC would grow in the coming years. He emphasized that the University's long-term plans must be based on established facts.

4. **DISCUSSION OF THE 2014-15 BUDGET**

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

Vice President Lenz began his discussion by indicating that, while the University is grateful for the predictability in the level of State funding, this level falls short of meeting even UC's mandatory costs, and it falls short for reasons both within and outside the Regents' control. One issue over which the Regents exercise some control is indirect cost recovery. The Regents asked the campuses to pursue indirect cost reimbursement for research grants far more aggressively, and the University succeeded in this. UC had anticipated receiving approximately an additional $3.4 million in 2013-14; however, due to federal budget sequestration and reductions in federal research funding, the University would lose about $50 million. This assumption of increased funds had been built into the multi-year funding plan for UC developed by the State Department of Finance. Mr. Lenz noted that the revenue from nonresident student tuition was growing faster than anticipated and would almost replace the loss of indirect cost recovery funding. Members of the Legislature often ask about the University's efforts to enroll more California resident students. Mr. Lenz acknowledged that this is a fair concern, but emphasized the need for a balanced view. California resident students are served by revenue from nonresidents. Mr. Lenz summarized the overall budget situation by noting that added together, the approximately $150 million in mandatory costs and the costs of compensation and student enrollment exceed UC's revenue assumptions at this time.

Referring to Regent Makarechian's concerns expressed earlier, he reported that he and Executive Vice President Brostrom had met with the new State Department of Finance Director Michael Cohen to discuss establishing parity between the UC and California State University (CSU) systems with regard to multi-year funding and pension funding. In the current year, CSU was able to increase its enrollment by 1.47 percent, while UC was not. There must be clarity about the State's expectations of UC, given the current funding assumptions. Mr. Lenz concluded by stating that the University was in a good position to address its greenhouse gas emissions with Proposition 39 funding. UC hopes to engage in discussions with the State to secure resources for clean energy projects and efficiency efforts.

Regent Flores recalled that graduate student support had been identified as a priority in the budget planning for reinvestment in academic quality. She asked whether this support applied to graduate programs or individual graduate students, and observed that graduate student programs vary greatly and that support for these programs would vary also. Regent Flores asked if the University was considering nonresident enrollment increases over time and if students had been consulted about what a reasonable projected increase would be for each campus. Mr. Brostrom responded that the University was engaged in an enrollment management plan involving all the campuses. Long-range enrollment projections would include both resident and nonresident students. Although the University often refers to systemwide averages, there are distinct pools of nonresident students at each campus. He described the situation of graduate student support as varying greatly by campus and discipline. Some departments can fund graduate students from their grant support. Referring to the life sciences, Chancellor Desmond-Hellmann observed that if funding for graduate student support must come from grants, this can be a disincentive for investigators to take on graduate students and can put pressure on the amount of scientific research that can be accomplished. It has become preferable for graduate students in the life sciences to rely on philanthropic support and training grants. This was very different from the teaching assistantship model in other disciplines.

Regent Flores expressed her desire to work with the administration to develop a plan that would address each graduate program and campus effectively, emphasizing that each program has different needs.

## 5. CHIEF FINANCIAL OFFICER DIVISION CAMPUS BENCHMARKING REPORT

[Background material was provided 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 introduced this semi-annual report on campus benchmarking. There had been incremental progress since the last report and he expressed confidence that there would be even greater advances in the coming six months.

Regent Zettel asked if the various benchmarks detailed in the report were being quantified as dollar savings. Mr. Taylor responded that more robust data would be available in six months, particularly for the procurement area. It would be possible to show how much is saved by purchasing on contract and the fiscal impact of these decisions, department by department. He anticipated that significant savings would be generated by the University's e-procurement system.

Committee Chair Ruiz asked about the data to be provided in six months. Mr. Taylor responded that better data would be available. The administration has also discussed best practices and new approaches with the campuses. The University has negotiated new contracts with Southwest and United Airlines, generating significant savings.

In response to another question by Committee Chair Ruiz, Mr. Taylor confirmed that the current report contained a number of benchmarks that would be used to measure progress by campus. He recalled that President Yudof used this report in the annual performance evaluation of chancellors.

6. **PROGRESS REPORT ON *WORKING SMARTER*: SYSTEMWIDE ADMINISTRATIVE EFFICIENCIES AT THE UNIVERSITY OF CALIFORNIA**

[Background material was provided 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 recalled that the Regents had charged the University in 2010 to develop ways of using University resources more efficiently. There had been significant progress over the past three years. The current annual progress report showed that at the end of its third year, the Working Smarter initiative had made a positive fiscal impact of $461 million. "Positive fiscal impact" meant either cost savings, through spending money more intelligently, or additional revenue, usually from asset management programs. Most Working Smarter projects are anticipated to be multi-year implementations. The initiative is focused on investing in the future, eliminating redundancies, leveraging new technology, and embracing innovation. A typical Working Smarter project envisions a new, streamlined approach to some aspect of UC's administrative operations. Achieving the goals of the initiative requires some up-front investment, but Mr. Taylor reported that so far, the return has far exceeded the investment made. He presented a chart showing the fiscal impact of Working Smarter by project. The benefits redesign project would provide ongoing annual savings of $35 million. The online booking system for travel would save $7.9 million a year. The Enterprise Risk Management program continued to pay significant dividends, including about $20 million due to reductions in Workers' Compensation premiums. Other savings were generated by liquidity management and $23 million by the P200 strategic sourcing/procurement program. The Statewide Energy Partnership program had provided an additional, incremental savings of $18.5 million in the past fiscal year.

Director Cathy O'Sullivan reported that besides the 34 projects currently in progress in the Working Smarter portfolio, there are efforts to extend collaboration with the California State University (CSU) system. Subject matter experts in a variety of areas from UC and CSU have been meeting, with progress in the procurement area. A joint UC-CSU conference on shared services took place in July.

Chancellor Yang discussed the Operational Effectiveness initiative at UC Santa Barbara, established in October 2010. The initiative had completed three cycles of strategic projects over three years. He emphasized that employee layoffs were not a part of this effort. A campus steering committee plans and executes the Operational Effectiveness effort.

UCSB Senior Associate Vice Chancellor Marc Fisher drew attention to the title of the campus' initiative, which uses the term "effectiveness" rather than "efficiency." This was to make it clear that the campus was not contemplating layoffs. The Santa Barbara campus is a very efficiently staffed, lean institution. Based on industry standards, UCSB staffing is about 23 percent below that of a comparable, first-tier research institution. UCSB has suffered attrition in the past few years, and current staff payroll is approximately the same as it was in 2008, even with salary increases. The efforts of Operational Effectiveness focus on how best to use resources, in 18 areas over the last three years. These include an administrative clustering initiative in the College of Letters and Science, condensing operating units for payroll and human resources services; core competency training for staff; E-ESCI, an online student evaluation form system; consolidation of email, calendaring, events and scheduling, and ticketing systems; energy management funding; a new PeopleSoft financial system; a new information technology governance structure; the North Hall Data Center for campus computer servers; a new procurement system; an online tool for recruitment; efficient space allocation, specifically as it affects energy management and research funding; a new student information system; and implementation of the UCPath payroll system. Operational Effectiveness has examined best practices and drawn on the experience of other campuses and organizations. Mr. Fisher mentioned three priorities for 2013-14: for the campus financial system, moving off the 42-year-old mainframe computer; deploying the Kronos online timekeeping system in all departments; and preparation for the UCPath system.

Committee Chair Ruiz asked what the campus had learned from the experience of implementing these many programs. UCSB Executive Vice Chancellor Gene Lucas responded that in the face of a crisis, people worked together across the campus in a way they had not before. For example, about 400 people were involved in implementation of the e-procurement system. The campus had invested about $250,000 in the system, is now saving about $2 million annually, and might save more in the future.

Regent-designate Saifuddin asked if the campus had sought student feedback on these projects, noting that programs like administrative clustering can affect the quality of services provided to students. Mr. Lucas responded that there was not much student involvement with many of the Operational Effectiveness programs because the programs concerned administrative processes that are not visible to students on campus. A student committee was involved with the implementation of a new email system, a transition which functioned well.

Mr. Taylor observed that one of the principles of the Working Smarter initiative is that it strives not only for cost savings, but to use new technologies to deliver better customer service, and to maintain a balance between these two goals.

Regent Makarechian suggested that the University make use of direct procurement or national accounts for manufacturers of construction material, such as drywall, doors, windows, sinks, and bathtubs. There was the possibility of rebates and millions of dollars in savings for the University. Mr. Taylor responded that by bundling construction bidding for materials and supplies, the University could save tens and perhaps hundreds of millions of dollars; there was enormous potential in this area. A program like this might be more challenging to implement than other Working Smarter programs currently under way, because of the distributed manner in which purchases are currently made.

7. **UNIVERSITY OF CALIFORNIA RETIREMENT PLAN – AMENDMENT TO PROVIDE VESTING CREDIT FOR ELIGIBLE EMPLOYEES TRANSFERRING FROM CHILDREN'S HOSPITAL AND RESEARCH CENTER AT OAKLAND**

The President recommended that:

A. The University of California Retirement Plan (UCRP) be amended to grant an eligible employee of Children's Hospital and Research Center at Oakland (CHO) who transitions employment directly from CHO to the University of California, San Francisco (UCSF) on or after the closing date of the Affiliation Agreement between UCSF and CHO, and in furtherance of the affiliation, service credit under UCRP for vesting purposes that is equivalent to the vesting service accrued by the employee under the Retirement Plan for CHO (CHO Retirement Plan) as of the employee's transition date, taking into account the different methods of crediting vesting service under the UCRP and the CHO Retirement Plan.

B. Authority be delegated to the Plan Administrator to amend the UCRP as necessary to implement the change.

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

Vice President Duckett explained that this item was a recommendation to amend the UC Retirement Plan (UCRP) to recognize, for purposes of the five-year vesting requirement, the service earned under the Children's Hospital and Research Center at Oakland (CHO) retirement plan by employees who transition employment to UCSF as part of the affiliation agreement between UCSF and CHO. The vesting credit is seen as a way to further the affiliation agreement and the same concept was approved by the Regents in 1989 when Mount Zion Hospital was acquired. Under this proposed amendment, an employee with three years of service under the CHO plan who then earned two more years under UCRP would be considered vested under UCRP, as the total would be five years of service. The UCRP portion of the benefit, however, would be based on only the two years of service under the UCRP.

As of the February 28, 2014 affiliation agreement closing date, it is intended that four CHO executives would transition employment to UCSF to initiate the affiliation process. Plans for transitioning additional CHO employees to UCSF had not been fully developed and are subject to a number of factors, including complex collective bargaining requirements applicable to any represented employees who might transition. Based on estimates from Segal Consulting, the financial impact on UCRP for providing this vesting service credit to transitioning CHO employees would be very small, even if all CHO employees transitioned to UCSF. There would be either a slight increase in actuarial accrued liability (AAL) or a slight decrease in the overall total present value of future benefits (PVB). The impact on the AAL or PVB would be approximately $3 million in each respective direction. Mr. Duckett stated that the administration anticipated returning to the Regents in the future on issues related to the UCRP and the affiliation agreement as necessary.

Regent De La Peña stated his understanding that the affiliation agreement had not yet been finalized and would be brought to the Regents in spring 2014. The University had not yet finished its due diligence on the agreement. He stated that if the University did not agree to all terms and conditions, it could still leave this agreement without penalty. He requested clarification about the current proposed action and the transfer of certain CHO employees to the UCRP. He stressed that the University must make it clear that it would not take CHO employees into the UC system if the affiliation agreement is not carried out. UCSF Associate Vice Chancellor David Odato responded that the CHO employees in question would not become UC employees unless the affiliation agreement is reached, which is anticipated in late February 2014. The current proposed action would not move these CHO employees into the UCRP.

Regent De La Peña requested clarification of what the Regents would be approving with the current item. Mr. Duckett responded that the Regents would approve the ability for CHO employees, should the deal close, to move into the UCRP. It is contingent on the agreement being reached. Chancellor Desmond-Hellmann stated that UC was proceeding with this action assuming the success of the agreement. She acknowledged that certain critical financial factors could end the deal. This pension agreement was being proposed in the spirit of proceeding according to plan. If the financial requirements were met in February 2014, all aspects of the agreement, including the transitioning of employees, would be in place.

In response to another question by Regent De La Peña, Mr. Duckett confirmed that the impact on the UCRP would be about $3 million plus or minus, should all CHO employees move to UC employment.

Committee Chair Ruiz requested clarification of the positive or negative $3 million amount. Mr. Duckett responded that this was the amount of the AAL for new employees moving into the UCRP, as well as the present value of their benefits when they retire, and confirmed that this was based on the condition of closing the agreement.

Regent De La Peña stated that it must be clear that this action was being made in good faith; it would not grant anyone any type of benefit unless the agreement closed.

General Counsel Robinson suggested that the recommendation be amended by adding the following language to the beginning of the first sentence: "Subject to the transaction closing under procedures previously approved by the Regents,…"

Regent Flores asked if, contingent on the agreement closing, all transitioning employees would be covered by the UCRP, both those in recognized labor organizations as well as those in organizations that have not been recognized by UC. Mr. Duckett responded that the question of whether or not employees are included is subject to collective bargaining. The University's intention is to include all of them in the UCRP; some labor organizations might have thoughts on the terms of their inclusion. Mr. Odato added that at the projected time of the closure of the agreement, the transition would only involve a small senior management population of CHO.

Regent Kieffer asked if this action would establish a precedent for future hospital acquisitions. Mr. Duckett stated his view that this action would not constrain the University to any particular future course. He recalled that the University acted in a similar manner in the Mount Zion Hospital agreement. It is not uncommon, when two large organizations with similar pension plans are merged together, for the acquiring organization to acknowledge service under the other organization's previous plan. In the future the University might choose to act differently in response to other circumstances. Chancellor Desmond-Hellmann added that the model for this agreement with CHO is very much like the Mount Zion model, an acquisition or merger. She did not anticipate this kind of arrangement at this time with any other hospital other than CHO, and distinguished it from other arrangements, more like affiliations, that UCSF might have with other institutions, which refer patients to UCSF for certain kinds of care.

Regent Kieffer asked if UCLA's agreement with the Santa Monica Hospital was an affiliation or an acquisition. Mr. Robinson responded that he could provide this information.

In response to another question by Regent De La Peña, Mr. Duckett confirmed that all CHO employees who transition to UC employment would be eligible to receive service credit under the UCRP.

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

The meeting adjourned at 3:35 p.m.

Attest:

Secretary and Chief of Staff