The Regents of the University of California

**COMMITTEE ON LONG RANGE PLANNING**
January 21, 2015

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

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| Members Present: | Regents Engelhorn, Gould, Kieffer, Lozano, Ruiz, and Saifuddin; Ex officio members Brown, Napolitano, and Varner; Advisory member Hare; Staff Advisors Acker and Coyne |
| In attendance: | Regents Atkins, De La Peña, Elliott, Island, Lansing, Leong Clancy, Makarechian, Pattiz, Pérez, Reiss, Wachter, and Zettel, Regents-designate Davis and Oved, Faculty Representative Gilly, Secretary and Chief of Staff Shaw, General Counsel Robinson, Chief Compliance and Audit Officer Vacca, Provost Dorr, Executive Vice President and Chief Financial Officer Brostrom, Senior Vice President Stobo, Vice Presidents Brown, Budil, Duckett, and Sakaki, Chancellors Block, Blumenthal, Gillman, Hawgood, Katehi, Leland, Wilcox, and Yang, and Recording Secretary Johns |

The meeting convened at 2:05 p.m. with Committee Chair Gould presiding.

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

Upon motion duly made and seconded, the minutes of the meeting of November 19, 2014 were approved.

2. **STATUS REPORT ON RECOMMENDATIONS OF THE UC COMMISSION ON THE FUTURE**

[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.]

Committee Chair Gould recalled that the UC Commission on the Future was an extensive effort in response to the dramatic reduction in State funding during the recent economic recession. The University needed to react and make changes in how it educates, conducts research, and serves the people of California. Regents, chancellors, students, faculty, outside experts, and business and community leaders participated in the work of the Commission, which resulted in 20 recommendations. These recommendations were a work in progress, with some goals accomplished, and others requiring renewed attention and dedication.

Executive Vice President and Chief Financial Officer Brostrom reminded the Board that the Commission was formed in July 2009 and finished its work in November 2010. It had five working groups and more than 100 members. He emphasized that the Commission report had not been left on a shelf; it had been used as a roadmap and guide for the University in its academic, financial, and administrative activities. The Commission was launched in the face of a severe and rapid decline in the State's fiscal condition. At that time, the State's structural deficit had grown from $6 billion to $14 billion, and would grow to $26 billion. This led to unprecedented cuts in State funding. From fiscal year 2007-08 to fiscal year 2011-12, the State reduced its support for UC by nearly $1 billion, from $3.3 billion to about $2.3 billion. At the same time, the University had taken action on post-employment benefits and faced significant new mandatory costs, especially for its pension fund. UC's pension costs in 2009-10 were zero; by 2014 they had risen to $1.3 billion, and a third of that cost falls on the University's general fund. The University raised tuition during that period, but the increase has covered only about 40 percent of the amount of State reductions and mandatory costs combined. UC added 8,000 new California resident students during this period of fiscal recession. Funding from the State on a per-student basis amounts to about half its level 15 years earlier. Adjusted for inflation, State support per student was $16,200 in 2000-01, but $8,300 in the current fiscal year. In spite of tuition increases, overall core funding per student declined by nearly 15 percent during this period.

Provost Dorr presented a list of 11 Commission recommendations focused on academic areas. The University had made good progress on some recommendations, but lagged on others. In the area of access and affordability, in line with the Commission's recommendation, UC has continued to honor its guarantee under the California Master Plan for Higher Education to offer eligible students a place somewhere in the UC system. Students may not be offered admission to the campus of their choice, but it is still an opportunity for the applicant to receive a UC education. The Commission also recommended that the University reaffirm its commitment to undergraduate financial aid and affordability. Even with the tuition increases of the recent past, UC continues to maintain very strong financial aid programs. With aid from UC and State programs, more than half of UC undergraduates pay no net tuition, and nearly half of them graduate with no debt. The debt level for those who do borrow is substantially below the national average for public universities. For these reasons, UC's student body continues to include very large proportions of low-income students, far more than any other research university in the country. Five UC campuses each enroll more Pell Grant recipients than the entire Ivy League combined.

Another recommendation by the Commission was to improve the ASSIST website for transfer students. Ms. Dorr stated that improvements would be completed by the end of the year. The Commission also recommended that UC create lower-division transfer pathways to assist community college students in planning their academic programs. In June 2012 the Academic Senate Assembly added two additional transfer pathways. One pathway is a UC transfer curriculum for the top 18 to 20 majors, the other is an acknowledgment that the Associate Degree for transfer between the community colleges and the California State University (CSU) is a good basis for assuming that a student might be well prepared for UC, and that UC should review that student's application. The following year, the Academic Senate Assembly created general education requirements for students who want to major in the fields of science, technology, engineering, and mathematics. UC has long had a goal, tied to Master Plan targets, to increase the proportion of students who enter as transfers to 33 percent. The University made good progress toward this goal until 2011. Progress stalled at this point, largely due to financial challenges faced by the community colleges. Transfer enrollment has ranged between 27 percent and 31 percent over the last several years. The State was again providing funding for the community colleges and the University now expected increases in transfer applications. Accommodating this growth without new enrollment funding would be a challenge for UC and CSU, and it was still not clear how this challenge would be met.

The Commission recommended that UC adopt strategies to reduce students' time to degree. Among public research universities, UC does very well in the area of time to degree and graduation rates. Ms. Dorr presented a chart showing that the majority of UC undergraduates who enter as freshmen complete their degrees in four years. Likewise, about two-thirds of transfer students finish in two years, and most of the rest within three years. The campuses are sharing best practices to improve students' time to degree. She noted that even when campuses implement changes in this area, it may take many years for the effects of these changes to become apparent. The University would pay close attention to any possible consequences of the recent financial downturn for UC graduation rates. Low-income, first-generation students and students from underrepresented groups generally take longer to complete their degrees. The University is very much concerned to help these students succeed and graduate within four years, or two years for transfer students. The University should also further examine three-year completion and make this pathway clearer for students. Ms. Dorr noted that shorter time to degree saves money for students and their families, but does not save money for the University.

The Commission recommended that UC continue timely exploration of online education, and the University has done so, substantially increasing UC Extension online courses, graduate professional online courses, and graduate for-credit online courses open to students from all campuses. UC has created some new, fully online graduate professional master's programs. Two of UC's current online master's programs were ranked first in their areas by *U.S. News and World Report*. Online education offers important benefits, including the opportunity for UC to capitalize on its multiple campuses. The University is still working to find the right balance in using online approaches, especially in undergraduate education. It was not yet clear whether online education saves or increases costs. UC offers online education for high school students in low-income communities in California. The UC Scout program offers honors and Advanced Placement courses that students would not otherwise have access to, a benefit to K-12 students. The University's California Digital Library is a tremendous resource, serving all the campuses and realizing savings of at least $15 million annually through digital media.

The Commission recommended that the University increase and cap nonresident undergraduate enrollment. The University has carried this out, and more rapidly than the Commission envisioned. Nonresident undergraduate enrollment was currently at about 13 percent, still a low level compared to UC's peer public institutions, but higher than the ten percent level considered by the Commission. Nonresident tuition is used entirely to support academic programs that benefit all undergraduate students, and to provide additional financial aid for California resident students. Nonresident enrollment has become an important part of the University's approach to meeting its budget needs. All nonresident students must meet UC eligibility requirements and demonstrate academic qualifications at least as high as those of California residents being admitted to the same campus. Applications from well-qualified nonresident students are increasing annually. Many Californians would like to see the growth in nonresident students slow down. Ms. Dorr explained that even if there were no growth in this enrollment, the proportions of nonresident students would increase, as classes already admitted with more nonresidents enter the University and replace classes that had fewer nonresidents. It would take a number of years to even out or reduce the number of nonresident undergraduates. The University faces the sensitive matter of determining the appropriate tuition level for nonresidents. The Long-Term Stability Plan for Tuition and Financial Aid includes up to five percent increases in nonresident tuition for each of the next five years. The University believes this is feasible, but is concerned that nonresident tuition is already very high, and wishes to avoid losing applicants. The time seems right for an in-depth discussion of the future of nonresident enrollment.

Finally, Ms. Dorr discussed the status of Commission recommendations for increasing graduate student enrollment, supporting Ph.D. programs, and multi-campus research. The University has not increased graduate student enrollment. The percentage of graduate student enrollment, about 21 percent systemwide, has remained steady. The University has also not increased the percentage of its doctoral students, about 11 percent. UC's doctoral programs were still not sufficiently competitive in student support. Although the University continues to develop multi-campus research programs, the systemwide investment in multi-campus research has decreased. The amount of the decrease is difficult to calculate, but a reasonable estimate would be that in 2009, there was more than $50 million in systemwide funds devoted to multi-campus research; currently there was about $27 million for this purpose. The Master Plan assigned to UC the responsibility and privilege of being California's research university and educating the state's Ph.D. students. While UC is performing well in these areas, it has yet to achieve the applicable goals set by the Commission.

Mr. Brostrom presented a chart showing Commission recommendations in the area of administrative efficiencies and new revenues. The Commission had recommended that UC accelerate its efforts on the Working Smarter initiative, to enhance the fiscal impact to the campuses. The University has exceeded its goal, reaching $660 million in the first four years. This has been a systemwide effort. Every campus has made efforts to reduce its energy costs, optimize the use of space, and eliminate redundancies in departments. There have been regional efforts as well. UCSF has merged its procurement department with UC Berkeley's. Systemwide efforts have focused on economies of scale, such as procurement and risk management, asset management, and debt management.

Another Commission recommendation focused on increasing fundraising. This has been a successful effort systemwide over the past five years. UC has also tried to increase fungibility, moving funds from restricted uses to UC's core mission. UC Berkeley has introduced the Hewlett Chairs, providing matching funds for endowed chairs, with 75 percent of the payout used to support faculty salaries or graduate students. President Napolitano has also introduced the President's Endowed Chairs. The University's aim is to move restricted funds to support the core budget. Ninety-eight percent of gifts to UC are highly restricted, and very little of this can substitute for core funds.

Mr. Brostrom then remarked on areas of potential revenue, recommended by the Commission, that still require work by the University. All the campuses have made substantial progress in indirect cost recovery, the overhead and administrative costs UC can recover on federal grants. UC campus recovery rates range from 52 percent to 55 percent; the recovery rate at Johns Hopkins University and the Massachusetts Institute of Technology is 68 percent, and 62 percent at Stanford. For UC, on a base of $3 billion, this is a significant amount of money. UC has successfully negotiated increases at seven campuses. Unfortunately, due to federal sequestration and budget cuts, even though recovery rates have increased, the amount of federally sponsored research has declined, and so UC's indirect cost recovery has remained level. Research sponsored by corporations, foundations, or the State has sometimes taken the place of federally sponsored research, but these sponsors do not pay UC's full indirect costs.

Mr. Brostrom briefly noted that self-supporting graduate professional programs have grown. There are 12 new programs, and 56 more are proposed. Revenues from these programs amount to about $170 million. President Napolitano's Senior Advisor for Innovation and Entrepreneurship Regis Kelly has been examining ways to increase patent and licensing revenues with the campuses. Following another Commission recommendation, UC has enhanced its efforts to foster public support for the University, highlighting the impact UC has on the economy.

Regent Island observed that some students who are admitted, while eligible for UC, require more assistance when they arrive at UC. Many of these young people work multiple jobs to support themselves and their families; this affects their time to degree. The University should not act in a way that closes off opportunity for or impedes the progress of first-generation and low-income students. Regent Island referred to figures displayed earlier, showing undergraduate nonresident enrollment at 13.4 percent systemwide. This figure seemed benign, compared to the AAU average of 26 percent. He asked for specific nonresident enrollment data by campus. Ms. Dorr responded that the administration, the President, and the chancellors are in agreement with Regent Island about UC's commitment to providing first-generation and low-income students with a good education with a reasonable time to degree. These are students who can succeed at UC; they would not be admitted if this were not the case. Mr. Brostrom added that although there is a gap of about eight percent in the University's four-year graduation rate between Pell Grant recipients and others, there is almost no gap between them in the six-year graduation rate. The University compiles detailed data on students who work while attending UC, and how work hours affect time to degree. Working 20 hours per week is the point at which students' time to degree begins to be delayed. In levels of nonresident enrollment, the campuses fall in three broad categories. The level of nonresident undergraduate enrollment at UC Berkeley, UCLA, and UC San Diego is about 20 percent or higher; it is about ten percent at UC Santa Barbara, UC Davis, and UC Irvine; and it is two or three percent at UC Santa Cruz and UC Riverside, while there is almost no nonresident enrollment at UC Merced.

Regent Island asked if the percentage of nonresident enrollment at UC Berkeley was 27 percent, as was sometimes reported. Mr. Brostrom responded that the overall percentage was less than 25, but the numbers in incoming classes would be higher, closer to 30 percent. Regent Island asked about the percentage of nonresident enrollment in the next incoming class. Mr. Brostrom responded that it was 28 percent.

Regent Lansing asked about this percentage for the incoming class at UCLA. Chancellor Block responded that it was about 25 percent. He noted that 40 percent of UCLA's third- and fourth-year students are transfer students, and many of these are California residents. About five years earlier, UCLA made a commitment to maintain a constant number of California resident students. UCLA has maintained about 4,100 California resident freshmen each year, while increasing the number of nonresident students.

Regent Island expressed misgivings about the fact that nonresident students would be paying about $200,000 to $250,000 for a UC education, the impression this might give of selling a UC education to the highest bidder, and that some displacement of California students must be occurring. Mr. Brostrom responded that when UC increased the number of nonresident students during the economic recession, it also added 8,000 California residents, all of whom were not funded by the State. The University was able to add these students due to the revenue that came from nonresident students. Nonresident tuition supports financial aid. Ms. Dorr added that there is an understanding that campuses will keep California resident enrollment at least at the number of students for whom UC receives State funding; California resident enrollment would not go below this number for any reason.

Regent Kieffer stressed that UC is extraordinary compared to other universities in the percentage of its students who are Pell Grant recipients or who pay no tuition. The University succeeds in creating a diverse student body and it spends money in order to achieve this goal.

Regent Lozano recalled that the report of the Commission was issued at a time of great urgency, when the Regents felt that there was not a minute to spare in finding new and innovative ways to achieve UC goals. She expressed concern about the fact that the recommendations did not have deadlines and that progress toward goals was not measured along the way. She encouraged the University to embrace the Commission recommendations that are still relevant and to revive that sense of urgency. She asked that UC provide deadlines and quantify results, and report this back to the Regents. Regent Lozano recalled that some recommendations were not included in the final Commission report. She asked that UC reexamine those recommendations.

Regent Lozano noted that many factors are involved in the University's approach to nonresident enrollment. She asked that the University develop a policy that could be debated by the Regents. The policy on nonresident enrollment, at the campus level, should be considered by the Regents. She asked President Napolitano to bring forward such a policy, meeting the needs of the institution and recognizing the challenges mentioned earlier by Regent Island.

Committee Chair Gould anticipated that the Select Advisory Committee would identify additional recommendations for the University. He expressed agreement with Regent Lozano on the need for a comprehensive policy on nonresident enrollment and encouraged President Napolitano to work on this.

Chairman Varner raised the issue of the real dollar economic impact of the University in California and nationwide and the return on State investment in UC. He recalled that there had been an economic impact study, used in advocacy discussions. This study should be reintroduced. It is important to emphasize this economic impact to the Legislature and the Governor, above and beyond the public service UC provides, such as several hundred million dollars in medical services that are not reimbursed. Mr. Brostrom responded that the University would update this information. He concurred that this impact is staggering. Support for UC is very different from appropriations to any other State agency; $2.8 billion invested by the State in UC generates $50 billion in direct impact. In addition, for every dollar contributed by the State, UC receives three dollars in federal support. This does not even take into account the scores of companies and jobs created by UC research. He also noted UC's impact in underserved regions of California. The growth of UC Merced during the economic recession was an important positive development in Central Valley at that time.

Regent Pérez stated that the University was not using effective language to convey its message to the State, and using language different from that used by the State to discuss the same matters. He referred to disinvestment at the height of the economic crisis and fee increases. In rough terms, there was an $800 million reduction in State funding and fee increases amounted to about $1.2 billion, to cover the cost of the reduction and the return to aid. He expressed approval of the policy to cover the return to aid to avoid creating a new negative impact on the University's neediest students. Describing the situation in these terms is very different from the way it had been presented in the present discussion, according to which the fee increases passed on to students only had a 40 percent replacement value for the loss of State revenues and increased costs. The difference is due in part to how one defines the increased costs and in part to increased pension costs from a 20-year pension holiday, for which the University and the State blame each other. In order to sustain the costs of UC in the future, and to persuade the Legislature and the Governor to increase the proportion of newly available funds to be reinvested in UC, the University must use numbers that make sense to the Legislature. Regent Pérez further observed that while the University has not wavered from its commitment to maintaining a certain number of spots for California residents, the growth in nonresident enrollment has had an impact on in-state students. Increased nonresident enrollment affects course offerings, course selection, and time to degree. Students may select courses because they are available rather than courses that are best for the education they are pursuing. While it considers its policy on nonresident enrollment, the University must also consider the secondary effects on in-state students, not merely the question of access.

Committee Chair Gould emphasized the University's need to meet its obligations to the UC Retirement Plan (UCRP). UC has reformed its retirement system to reduce costs. The University should reflect on its net position and cannot ignore its retirement costs, which currently amounted to $1.3 billion annually. The University might improve its communications and the language it uses, but UCRP costs are an essential reality.

Regent Pérez stated that the numbers and narrative in the background materials were a blame assignment that would undermine the University's ability to arrive at common solutions with the State. Discounting the replacement value of student fees was not appropriate. Mr. Brostrom responded that the University's narrative did not intend to cast blame on any sector, but to counter a national narrative about the rising costs of college education. UC is educating students for less than in years past. While it is true that students bear more of the cost, the actual cost of educating students has gone down. The University is educating about 75,000 more students with the same funding it had in 1997-98.

Regent Pérez stressed that the cost to students had not diminished. Mr. Brostrom responded that 55 percent of UC students pay no tuition. Regent Pérez distinguished between the averaging out of costs and the effect on individual students. Given rising student loan debt in the U.S., at a rate higher than for any other consumer good, it was hard to believe that the cost of education at UC had been reduced. Some proportion of students had been spared, but there was a real number of students who have experienced a real increase in cost. Regardless of the availability of financial aid, there is a perception of lack of affordability that reduces the number of students who consider applying to UC, especially students who are the first in their families to apply to college. Mr. Brostrom acknowledged that the problem of "sticker shock" is real and that the University should do a better job of communicating about the availability of financial aid to California high school students.

Regent Atkins stated that the University's formula in the background materials was not a shared conversation with the Legislature. Both the University and the State try to make a case for what they have done. The dialogue has been shaped in difficult way. It would be necessary to address the public's perception that the cost of education has risen. There is a need for shared, agreed-upon definitions, for example, about "funded" and "unfunded" students. Mr. Brostrom responded that UC added 7,000 California students during the recession with no enrollment funding from the State.

Governor Brown remarked that he did not recognize the category of "funded students." He recalled that in 1975 the State provided funding for the University for specific purposes. It was only in recent years that the University began to receive a "bulk" budget. The State does not fund students or research specifically; it provides funding, and the

University manages as best it can. The increases in State base budget funding for the University were not based on whether UC was carrying out more or less research, or enrolling more or fewer students. The essential question was about how much funding the University needs to fulfill its mission. Governor Brown reflected on the fact that in the past he and many of his family members attended UC Berkeley; he shared his perception that currently, the campus had many foreign students and students with 4.0 grade point averages, but that ordinary students with good grades were being shut out of UC Berkeley.

President Napolitano confirmed that over the past decades, the State did not fund per student, but funded the University, allowing UC to manage the funding. The University's accounting systems were set up for this model. Under AB 94, the University would now be required to disaggregate the funding that had been aggregated. The University was preparing to file its report required by AB 94, and a key difficulty was this shift in the paradigm of how financial records are maintained.

Regent-designate Oved asked about the decrease in the cost of education. He asked if this was due to UC efficiencies or due to increased enrollment. Mr. Brostrom responded that both these factors contributed to the decrease. The most significant factor was the student-faculty ratio; the University increased student enrollment while the number of faculty remained the same or declined. Administrative efficiencies also contributed to the decrease, but not as significantly.

Regent Reiss suggested that the Select Advisory Committee on the Cost Structure of the University examine the issue of effective language in the University's communication with the Legislature. She recalled changes UC had made to student eligibility criteria in its efforts to increase diversity and encourage promising students from disadvantaged backgrounds to attend UC. These students are often unaware of the financial aid available to them. There should be a statewide education effort to inform these students and their families about these opportunities.

Regent Pérez noted that each campus makes efforts in this area of outreach. He praised UC Irvine for its parent academy program, which brings parents to campus. This is an intervention with a low cost and high impact.

Regent Ruiz acknowledged the need for more effective communication and referred to the great future demand for UC and CSU education that would result from current increased funding for the community colleges and the K-12 system. The University must prepare for an oncoming wave of students. He urged the Select Advisory Committee to keep this in mind.

Governor Brown observed that State funding for the community colleges and the K-12 system comes essentially from Proposition 98. Proposition 98 would absorb much of the new State revenues available. He stated his understanding that the University had opted not to participate in Proposition 98 when it was developed. Referring to the demographic future of the state, he stressed that the population of California is aging and anticipated that high school graduation levels would remain flat. In the interest of education, there should be efforts to break down barriers between the community colleges, CSU, and UC, so that students could pick and choose courses. Digital technology today would not destroy boundaries and barriers, but the boundaries and barriers would be changed. There would be a flow of opportunity across the higher education system. The University should consider what these developments might portend in the coming years for efficiencies, savings, and expanded opportunity.

Regent Makarechian pointed out that many relevant University statistics which had been raised in the discussion can be found in the UC Accountability Report, such as cost per student and student debt. Fifty percent of UC undergraduates have no student debt. The remaining 50 percent have debt that is $4,000 lower than the national average for public universities, in spite of the fact that UC campuses are located in areas with high real estate costs.

Chancellor Katehi recalled that in 1979, when she attended UCLA, the student demographic was different. The costs were much lower, but there were different students with different needs, a different cohort. Most of the 50 percent of UC students who pay no tuition come from low-income backgrounds. They face challenges not necessarily imposed by the cost of attending UC, but by the common economic constraints in California and the nation. Some of these students, when they receive financial aid, are earning the highest income in their families, and give money back to their families to address serious needs. The students themselves may then not have enough money for rent and food. The numbers of these students are sufficiently large that UC Davis is seeking to institute programs to subsidize food or rent costs. After the last recession, the income of middle-class families has remained level. The cost of living, including rent and food, has increased. The University was being challenged in a changed demographic and socioeconomic landscape to assist these students while maintaining quality and fulfilling obligations to faculty and staff.

Regent Lansing noted that the situation described by Chancellor Katehi exists on every campus. There are students who receive full financial aid but who do not have enough money for food. She anticipated that the Regents’ actions in the next months and the work of the Select Advisory Committee would be crucial for the quality of the system.

3. **ESTABLISHMENT OF THE SELECT ADVISORY COMMITTEE ON THE COST STRUCTURE OF THE UNIVERSITY**

The President of the Regents and the President of the University recommended that:

A. A Select Advisory Committee on the Cost Structure of the University shall be established, effectively immediately.

B. The charge of the Select Advisory Committee shall be to develop and evaluate proposals to reduce the University’s cost structure, while improving access, quality, and outcomes.

C. At a minimum, the Select Advisory Committee shall consider proposals in the following areas:

(1) Cost Drivers: Campus-specific specialization and disciplinary consolidations; teaching loads; curriculum design; enrollment; compensation and benefits, including pension and retiree and current employee health benefits; capital projects and deferred maintenance; University and campus administration; and regulatory burdens and other costs imposed by the State.

(2) Undergraduate Access, Completion, and Time-to-Degree: Improved pathways for transfer students, with specific emphasis on recognition at the University of SB 1440 (2010) degrees; credit for work experience, military training or other pathways; cross-campus enrollment and streamlined registration; and undergraduate degrees requiring three years of study.

(3) Role of Research: The role of a public research university; the University's research profile, activities, budget, and financing, and the impacts of research on the economy and other areas.

(4) Use of Technology to Enhance Education: Online education, including courses and outcomes; use of adaptive learning technology to adjust instruction based on the educational needs of individual students; and use of predictive analytics to determine how to help individual students succeed.

(5) Role of Graduate Education: An analysis of the AB 94 (2013) report on costs of undergraduate instruction, graduate instruction, and research; time-to-degree in graduate academic and professional school programs; and number and proportion of students enrolled in graduate academic and professional school programs.

D. The President of the Regents and the President of the University shall serve as the members of the Select Advisory Committee.

E. The Select Advisory Committee shall be jointly staffed by State officials from the Governor's Office and the Department of Finance and staff in the Office of the President.

F. The Select Advisory Committee shall receive testimony from and have discussions with University and national experts in these areas and may conduct any other studies or audits necessary to accomplish its charge.

G. The Select Advisory Committee shall present a preliminary report at the March 2015 Regents meeting. The Select Advisory Committee shall update Regents on its progress at subsequent meetings and shall make recommendations to the Regents regarding changes to the University's cost structure.

[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.]

Committee Chair Gould introduced the item. This action reflected the intention of the University, in partnership with the State, to examine ways to maintain and improve access, quality, and accountability, while keeping tuition and fees as low as possible.

Regent Kieffer referred to paragraph C. in the recommendation language. He asked that in each of the areas to be considered, the Select Advisory Committee on the Cost Structure of the University examine proposals on a comparison basis. He asked if the Select Advisory Committee would be considering the University alone, or in comparison to other institutions and how they operate. Committee Chair Gould advised that this might best be left to the judgment of the Select Advisory Committee.

Regent Saifuddin asked that data be provided to support the policy proposals that the Select Advisory Committee would put forward. She emphasized that the University should begin with data and move toward a policy, rather than the other way around.

Faculty Representative Gilly noted that most of the areas to be studied, identified in the recommendation language, involve academic policy, such as conditions for admission, the granting of degrees, and courses and curricula. The Regents have delegated to faculty the responsibility for managing these issues. She asked how faculty and the Academic Senate would play a role in providing information and responding to proposals.

Governor Brown stated that he and President Napolitano intended to speak with faculty members. He described the work of the Select Advisory Committee as an inquiry that was advisory and preliminary. The results of that inquiry would come before the Board, which was the ultimate authority. He emphasized that he understood the principle of shared governance and shared decision-making, and this understanding would guide the work of the Select Advisory Committee.

President Napolitano stated the intention of the Select Advisory Committee to examine the University and its future. She stated that she would keep the leadership of the Academic Senate apprised of developments and recognized the importance of faculty expertise and faculty governance.

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

## 4. REVIEW OF DEBT STRATEGY TASK FORCE

[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 and Chief Financial Officer Brostrom began the discussion of the University's debt needs and capacity by referring to earlier remarks by Governor Brown. About 15 to 20 years earlier, the State provided funding for specific areas, such as deferred maintenance, capital projects, and enrollment. Currently the University receives one lump sum for the operating budget and capital budget.

In 2014 the University's credit ratings were downgraded twice by Fitch and Moody's, by one notch. The University's core general revenue bond credit is now rated Aa2/AA/AA. The University still enjoys a historically low cost of capital, both because secular interest rates are low and because UC's credit is seen as strong. UC has been hurt by the decrease in State appropriations and lack of capital. UC is no longer receiving lease revenue bonds. There has been no general obligation bond on the ballot since 2006, when UC was allocated almost $900 million in capital funding. The University hopes to be included in a school bond in 2016 which could help offset some of UC's capital needs. The University has $5 billion in State-eligible projects that have no identified funding source.

UC Berkeley Vice Chancellor John Wilton commented that over the same period referred to by Mr. Brostrom, State appropriations had declined by about $200 million for the Berkeley campus, from $475 million to $283 million. Using industry standards from the private sector to determine what one should spend on deferred maintenance, a per-square-foot maintenance charge, the cost at UC Berkeley has usually been two percent of replacement value, or about $180 million. The campus spends $30 million because it does not have the resources to fund the deferred maintenance it knows it needs. If one increased deferred maintenance to the level that is required it would mean redeploying $100 million away from operating the campus. UC Berkeley is running its campus at about 0.3 percent to 0.5 percent of replacement value when the industry standard would be about two percent.

Mr. Brostrom recalled that the University has used its own assets, $2.7 billion in commercial paper and from the Short Term Investment Pool to help pre-fund the UC Retirement Plan (UCRP). He described this as a very positive move, but these assets could have been used for deferred maintenance, capital renewal, or other needs. Mr. Wilton added that if UC Berkeley's employer contribution to the UCRP is added to the $200 million reduction he mentioned earlier, the campus has experienced a reduction of $300 million since 2007.

Associate Vice President Sandra Kim emphasized the University's critical need to invest in facilities and infrastructure to accommodate enrollment growth and to provide competitive research and teaching space. Capital renewal needs are estimated to amount to hundreds of millions of dollars per campus. Over half of the University's State-supported facilities are more than 35 years old and do not receive Operation and Maintenance of Plant funding from the State. Undergraduate and graduate students enrolled at the University have grown by approximately 16,000 over the past five years. As part of its commitment under the California Master Plan for Higher Education, the University is seeking to grow its new campus at Merced to meet an enrollment goal of

10,000 students over several years. Facilities play a critical role in faculty retention and recruitment. Inadequate facilities are cited as a challenge in both areas.

Currently, the University finances debt through three main revenue credits. UC's general revenue bonds are rated Aa2/AA/AA with a stable outlook. These bonds are a primary financing vehicle for core academic and research-related projects. The current debt outstanding is $10.4 billion. UC's limited project revenue bonds are rated one notch below the general revenue bonds. They are used for certain auxiliary projects, mainly housing and parking. The current debt outstanding is just under $2 billion. The University's medical center pooled revenue bonds are used for medical center financing, mainly for seismic needs mandated by the State. The current debt outstanding is $2.8 billion.

Ms. Kim then enumerated UC capital needs. Based on campus and medical center projections, the University's estimated capital needs over the next five years are approximately $8 billion without any State infusion: $3.6 billion for general campus needs, primarily research and teaching, life safety, and deferred maintenance; $1.7 billion for auxiliary needs, primarily student housing and dining; $1.6 billion for medical center needs, primarily expansion and new facilities; and $1.2 billion for energy efficiency initiatives.

Mr. Brostrom continued by contrasting UC's capital needs, about $8 billion, with its debt capacity, which is between $2.5 billion and $3 billion. The Debt Strategy Task Force, including representatives of eight campuses and two medical centers, explored how UC could deliver capital projects more efficiently with less debt capacity. The Task Force identified three primary strategies. The first is to move from a budget-centric to an integrated profit and loss and balance sheet-focused financial planning model. Historically, UC has looked at itself in terms of its operating budget and the relationship of debt service to operations. UC has a strong balance sheet and should take a holistic approach in determining whether it can afford projects.

The second strategy is to use liens more effectively. He recalled that UC's general revenue bonds have about $10 billion in outstanding debt, while the limited project revenue bonds only have about $1.9 billion. The University would consider moving as much as it can from the general revenue bonds to the limited project revenue bonds, freeing up more capacity for teaching, research, and campus building projects. This may result in the limited project revenue bond rating going down, but it is more important to have a strong credit rating for general revenue bonds than for bonds used for projects like parking garages.

The third strategy is the use of cost-effective alternative financing structures for stand-alone projects. The most significant example of this is the Merced 2020 project, developing the campus with a public-private partnership. Every campus is examining ways to use its real estate more effectively, as well as private sources of capital rather than UC's credit capacity.

Mr. Wilton noted that UC Berkeley's limited debt capacity is reserved for core needs, such as seismic safety renewal, needed for about 1.5 million square feet of space on the central campus. UC Berkeley is considering alternative financing for housing, parking, and office space. The various forms of financing would be looked at in different ways by the rating agencies and would have different financial impacts on the campus' balance sheet and debt service capacity. UC Berkeley is also experimenting with third-party builder arrangements. One can build buildings at lower cost with this approach, and it might relieve many impediments faced by the campus.

Mr. Brostrom concluded that UC is also increasingly examining how to use its own funds and assets. Chief Investment Officer Bachher has been examining financing for UC real estate projects and energy projects needed to achieve climate neutrality and how UC might use the General Endowment Pool and the UCRP. The University hopes that using its own balance sheet will help preserve external debt capacity. The Task Force would develop a comprehensive debt policy to be submitted to the Regents for review and approval. This policy would concern the University's approach to credit ratings, financial ratios, variable rate debt, and reporting.

Governor Brown observed that the University is a large, complex system whose workings are not easy to grasp. He noted that the State of California's long-term liabilities are enormous, perhaps $300 billion by a conservative estimate, while California's overall funding is about $155 billion. The State's cost of retiree health care, which is not pre-funded, was currently estimated at $73 billion. The State would ask its employees to contribute pre-funding. The State's pension costs were somewhat under $50 billion and deferred maintenance costs, mostly for roads, were at $66 billion. Mr. Brostrom clarified that the University's pension costs were about $8 billion and its retiree health care costs about $14 billion.

Governor Brown commented that the current low interest rate environment was unusual. This might portend a low rate of return over the long term, in which case growth would be slowed, and it would be difficult to pay back obligations. On the other hand, if an inflationary regime were to return, borrowing costs would rise. He stated that he would follow the University's policy in this area with great interest. He stressed that UC has an enormous long-term obligation and that borrowing has limits. The University's revenue sources – State, federal, and tuition – would be variable, while it would face an increasingly fixed set of commitments. In the past the conjunction of these two factors has brought an end to other institutions. The University must proceed with great caution. While UC was seeking to expand, it must also secure its base. UC buildings must be seismically safe. Maintenance is crucially important, and Governor Brown remarked that he would also be following how the University addresses its deferred maintenance needs. He cautioned that private funding and public-private partnerships are more expensive, particularly with regard to interest rates. Mr. Brostrom responded that the University was currently facing the tension between cost of capital and speed of delivery. The Merced campus needs to grow to accommodate more students. When the other most recently founded campuses, UC Santa Cruz and UC Irvine, were growing, they enjoyed State support. The University currently does not have that support and therefore must innovate and find ways to construct buildings more cost-effectively and more quickly. He acknowledged that deferred maintenance and capital renewal are significant challenges for UC, among the biggest burdens for every campus. Many campuses had reached a stage where core buildings and whole systems would have to be replaced.

Governor Brown referred to a point raised earlier about how facilities and infrastructure influence faculty recruitment and retention. He urged the University to focus on essentials rather than amenities.

Regent Pattiz remarked that the State's fiscal situation was worse than that of the University. UC would have to consider some fundamental changes to ensure its long-term future.

Committee Chair Gould requested that the administration report annually to the Regents on the status of the University's debt strategy.

Governor Brown observed that the State's credit rating was improving as a result of cuts made to the budget.

Regent Makarechian recalled that the University's net worth had decreased by $2 billion annually over the past four years. There would be dire consequences if this trend continued. He raised the question of how the University could be expected to admit more students, provide financial aid for low-income students, and assist undocumented students if it did not borrow money, did not receive more support from the State, and did not raise tuition. Many UC buildings are in a dangerous condition and a private sector business might be prosecuted for using them. The only way the University could carry out the project envisioned for UC Merced would be to engage a private sector builder and obligate itself to a 50-year lease payment. UC could not provide services without increased resources. The current situation was untenable.

The meeting adjourned at 4:15 p.m.

Attest:

Secretary and Chief of Staff