Office of the President

TO MEMBERS OF THE COMMITTEE ON FINANCE:

ACTION ITEM

For Meeting of November 17, 2011

POWERPOINT PRESENTATION

APPROVAL OF UNIVERSITY OF CALIFORNIA 2012-13 EXPENDITURE PLAN FOR
CURRENT OPERATIONS AND 2012-13 BUDGET FOR STATE CAPITAL
IMPROVEMENTS

RECOMMENDATION

The President recommends that:

(1) The Committee on Finance recommend to the Regents that the expenditure plan included
in the document, 2012-13 Budget for Current Operations, be approved as the
University’s request to the State for 2012-13 funding.

(2) The Committee on Finance concur with the recommendation of the Committee on
Grounds and Buildings to the Regents that the 2012-13 Budget for State Capital
Improvements be approved.

EXECUTIVE SUMMARY

The 2012-13 Budget for Current Operations, included in the meeting packet, provides the basis
for the recommendation that the 2012-13 expenditure plan for current operations be approved.
Discussion of the revenue side of the 2012-13 budget is being deferred to a later meeting.
Therefore, the Board is being asked only to approve the expenditure side of the budget as the
University’s request to the State for funding in the coming year at this time. The 2011-21
Consolidated State and Non-State Capital Financial Plan, also included in the meeting packet,
provides the basis for approval of the State-funded capital plan for 2012-13. Vice President Lenz
will make a detailed presentation on the proposed expenditure plan for current operations and the
State-funded capital outlay budget.

BACKGROUND

Proposed 2012-13 Operating Budget Expenditure Plan

Operating revenue, estimated at $22.5 billion in 2011-12, funds the University’s core mission
programs of teaching, research, and public service, as well as a wide range of other activities,
including teaching hospitals, the Lawrence Berkeley National Laboratory, University Extension, housing and dining services, and sponsored research.

The University’s “core funds,” comprised of State General Funds, UC General Funds, and student fee revenue, provide permanent support for the core mission and support activities, including faculty salaries and benefits, academic and administrative support, student services, operation and maintenance of plant, and student financial aid. Totaling $6.1 billion in 2011-12, these funds represent approximately 27 percent of the University’s total budget. Much of the focus of the University’s strategic budget process and negotiation with the State is dedicated to the uses of these fund sources.

Historically, the State portion of the University’s core funds has been the largest single fund source providing core support for the University. This is no longer the case. With the State cutting UC support in three of the last four years, including a $650 million cut in 2011-12, State funding has dropped from $3.25 billion in 2007-08 to $2.37 billion in 2011-12. The reductions in State funds have translated directly into the corresponding rise in student tuition and fee revenue, which totals $2.97 billion (including $2.5 billion in Tuition alone). For the first time in history, student tuition and fee revenue exceeds State funding.

The University’s budget plan for 2012-13 was developed in the context of the continuing uncertainty over the State’s ability to fund basic costs. The State’s recent fiscal crisis led to dramatic reductions in State funds over a two-year period. Permanent and one-time cuts to UC’s budget for 2008-09 totaled $814.1 million, although these reductions were largely offset on a one-time basis with $716.5 million in American Recovery and Reinvestment Act (ARRA) funds. For 2009-10, State funds totaled $2.6 billion, reflecting permanent and one-time cuts in State funding of $637.1 million compared to the 2007-08 budget. While the 2010-11 budget restored less than half of these cuts with $199 million in permanent funds and $106 million in additional ARRA funds, and provided some relief toward the University’s over-enrollment ($51.3 million for 5,121 FTE), the University’s budget remained constrained. Even steeper reductions occurred with the adoption of the 2011-12 budget, which included $650 million in base budget reductions and the threat of an additional $100 million reduction if assumptions about additional State revenue are not realized. The $2.37 billion State-funded base budget for 2011-12, represents a 21.3 percent reduction from the prior year. In addition, unfunded cost increases totaling $362.5 million estimated for 2011-12 mean the University’s budget gap totals more than $1 billion.

The 2011-12 State budget provides some permanent solutions to the State’s ongoing structural deficit, although estimates indicate the State currently faces a continuing $5 - 8 billion deficit. Thus, it is likely the State will once again face significant challenges in developing the 2012-13 budget. While it is recognized that the State would have considerable difficulty fully funding the University’s request, the expenditure plan developed and justified in the attached documents reflects the priorities identified by University administrative leadership as critical to maintaining the twin pillars of access and quality.

Display 1 of the Summary of the 2012-13 Budget for Current Operations (which is also attached to this item) outlines the proposed expenditure plan and request to the State for 2012-13. This
plan has been developed in the context of continuing volatility in State funding balanced against
the need to restore the fiscal health of the University. Discussion of potential budget scenarios
for addressing the long term fiscal situation over the next four years occurred at the March, May,
and September 2011 meetings of the Board of Regents. While it is clear there is a need to
identify stable funding sources over the near term, the discussion of potential revenue sources for
supporting the 2012-13 expenditure plan will continue over the next several months, and as such,
the plan for 2012-13 presented for approval in November 2011 reflects the expenditure side only.

Key Elements of the Expenditure Plan

Each of the proposed expenditure items is discussed in detail in the 2012-13 Budget for Current
Operations document included in Regents’ packets. Key elements are outlined below.

Enrollment Growth and Instructional Programs. The State’s current fiscal crisis has
dramatically altered the enrollment landscape. The State was unable to provide funding for
enrollment growth that occurred during 2008-09 and 2009-10. As a result, in 2009-10, UC
enrolled more than 15,000 FTE students for whom the State had not provided enrollment growth
funding.

In response to the State’s inability to provide the resources necessary to support enrollment
demand, the University took steps to curtail enrollment growth. For 2009-10, UC planned to
reduce the number of new California resident freshmen by 2,300 students as a means of slowing
enrollment growth, and for 2010-11, the planned reduction was increased by another 1,500
students, for a total reduction of 3,800 students. Fewer students were admitted to the campus
or campuses of their choice and more applications were sent to the referral pool for
accommodation, primarily at Merced. For 2011-12, campuses expected little change in total
enrollment over the prior year. Campuses fell short of the planned reduction, achieving a
reduction of only 2,850 students over the two-year period. The freshman reductions were
partially offset by a planned increase of more than 1,000 California Community College (CCC)
transfer students over the two-year period. The University took this action in order to preserve
the transfer option in difficult economic times.

As noted earlier, in 2010-11, the State budget provided UC with enrollment growth funding of
$51.3 million to support 5,121 FTE students. Even with these new resources, the extraordinary
reduction in State support over the last several years effectively means that the State is not
providing support for more than 24,000 California residents.

While acknowledging that access is important, the University cannot indefinitely accommodate
larger numbers of students without adequate resources needed to provide them a UC-caliber
education. The dilution of State funding over larger numbers of students results in a lower
quality experience for all members of the UC community.

While growth in the number of California high school graduates is expected to slow over the
next several years, UC expects continuing growth in demand for a UC education from high
school graduates and community college transfers. Graduate enrollments should also increase to
meet the State’s workforce needs: the last decade’s undergraduates are this decade’s graduate
students. The University’s expenditure plan includes funding for enrollment growth of 1%
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during 2012-13, an increase of 2,100 FTE.

UC’s priority is to enroll all eligible California residents for whom the State has provided funding; however, nonresident students are also essential to the quality of the University and a crucial part of the economic future of California. They contribute to the academic quality and educational experience of all students and enhance the diversity of backgrounds and perspectives on the campuses at which they enroll. Their contributions help prepare all UC students to effectively live and work in an increasingly global world. In addition, because nonresident students pay supplemental tuition not charged to California residents ($22,878 in 2011-12 for undergraduates, an amount that far exceeds the State support provided for California residents) they provide extra revenue that enables UC to improve educational programs for all students. Systemwide nonresident undergraduate enrollment represents only 7 percent of the undergraduate population at UC; all campuses are attempting to modestly increase their nonresident undergraduate enrollments, consistent with the recommendation of the University’s Commission on the Future.

In addition to funding for general campus enrollment, the University is requesting State funds to support continued expansion in the health sciences for both medicine and nursing. Over the last several years, the University began to expand medical school enrollment through PRIME programs (Programs In Medical Education), designed to attract and prepare more medical students to provide care to underserved populations in the state. The University is requesting funding for 218 MD and 61 MS students in 2012-13. Also, in recent years, the University began a multi-year plan to increase undergraduate and graduate nursing programs to help meet the state’s critical shortage of both practitioners and nursing faculty. The University expects to receive $12 million of Workforce Investment Act funding over five years ($3 million during 2012-13) through the Governor’s Nursing Education Initiative to train and graduate limited single cohorts totaling about 350 nursing students across multiple degree programs. In addition, the University is requesting $4.8 million to support an increase of 426 nursing students on a permanent basis.

Also included in the enrollment funding request is support for establishing a new medical school. Responding to the State’s need for more physicians in the workforce, the Riverside campus plans to establish a four-year School of Medicine that would be the first new allopathic medical school to open in California in more than 40 years. The 2010-11 State budget included a provision requiring the University to redirect $10 million from existing resources to continue planning for the medical school. However, redirecting resources to fund a major new initiative such as a medical school is not sustainable. Thus, the University is requesting permanent State funding of $15 million for 2012-13, which will be used to develop academic programs and support the salaries of initial medical school staff and faculty.

Compensation and Employee Health Benefits. Earlier cuts to the University’s budget have resulted in significant disparities in faculty and staff salaries compared to the market. In 2010-11, UC faculty salaries lagged the market by 12.8 percent, and there is a similar or greater problem with respect to staff salaries in most workforce categories. The University is deeply concerned about the widening gap between funds available for compensation and the resources needed to fund competitive salaries. The most recent study of UC’s total compensation program indicates that, in general, average UC salaries are significantly below the market median, but the
total compensation package, including salaries and health and welfare benefits for employees as well as post-employment benefits (pension and retiree health), was close to market. Plans to eliminate the salary lags for faculty over four years and for staff over a longer period were initiated in 2007-08, but the State’s ongoing fiscal crisis has delayed implementation of those plans. While the merit and promotion system for academic employees has been maintained, no general salary increases were provided for faculty or non-represented staff in 2008-09, 2009-10, or 2010-11. In 2011-12, faculty and non-represented staff (excluding executives and those with salaries at or above $200,000) are eligible to receive merit-based increases representing 3% percent of salary funding, though these increases are already partially offset by increases in employee contributions to the UC Retirement Plan (UCRP).

Changes in the costs and structure of the University’s employee benefits programs will intensify pressure for salary increases over the next several years. While the initial 2 percent member contributions to UCRP during 2010-11 were made by redirecting previous employee payments to the Defined Contribution Plan, the 1.5 percent increase in member contributions that began on July 1, 2011 and further increases in subsequent years will have an impact on employee take-home pay. In addition, inflationary cost increases in health and welfare benefits will likely require that employees pay an increased amount in medical insurance premiums. Although the benefits provided by UC are an important component of the packages offered to candidates, the salary component itself must be competitive to attract and retain quality faculty and staff employees if the University is to retain its preeminent stature.

Furthermore, a national economic recovery is likely to have daunting repercussions on recruitment and retention of high-performing faculty and staff for UC. Campuses are already experiencing significant faculty retention challenges from other institutions within California, across the country, and around the world. Continuing competition with both public and private institutions, some of which have come through the recession more strongly positioned than UC, is likely to have an impact on both faculty and staff hiring and retention. To ensure that UC is able to recruit and retain faculty and staff and avoid further growth in salary lags, the University must develop a stable, predictable program for compensation increases. In 2012-13, the expenditure plan includes an assumption of funding for the normal merit salary increase program for faculty and a 3 percent salary increase pool for all employees.

With regard to employee health benefits, employees have been required to bear a larger responsibility for the rising costs of these benefits, partially offsetting earlier salary increases. In 2002-03, the University instituted a progressive medical premium rate structure (based on full-time salary rates) designed to help offset the impact of medical premium increases on lower-paid employees. Although UC pays approximately 86 percent of monthly medical premiums for employees on an aggregate basis, the University made a strategic decision to cover an even larger portion of the premium for those in the lower salary brackets. In the current environment, with limited new funding and growing cost pressures, it is expected that some of the increases in cost will continue to be borne by most employees. UC will continue to review its total compensation program to ensure that all elements move toward being more competitive in the market. Employee health benefit costs for core-funded programs are projected to increase by $22.8 million in 2012-13.

**Contributions to UCRP and Retiree Health Program.** The University of California Retirement Plan (UCRP) provides pension benefits for nearly 56,000 retirees and survivors and
has nearly 116,000 active employee members, as of July 1, 2011.

The University restarted contributions to UCRP in April 2010, with an employer contribution of 4% and member contributions of 2% through the 2010-11 fiscal year. Because the State is not currently contributing to UCRP, the State’s share is being funded by redirecting resources from existing programs and student tuition and fee increases.

In September 2010, the Regents approved increases to both the employer and employee contributions for 2011-12 and 2012-13. Employer contributions rose from 4 percent to 7 percent for 2011-12 and will rise to 10 percent for 2012-13. Member contributions rose from 2 percent to 3.5 percent for 2011-12 and will rise to 5 percent for 2012-13. At this meeting, the Regents will also consider increasing employer and member contribution rates to 12 percent and 6.5 percent, respectively, effective July 1, 2013. Employer contributions are expected to continue to rise by 2 percent annually through at least 2015-16.

In December 2010, the Regents amended retirement plan benefits to reduce long-term costs. Most significantly, the Regents approved the establishment of a new tier of pension benefits applicable to employees hired on or after July 1, 2013, which would increase the early retirement age from 50 to 55 and the maximum age factor from 60 to 65, but otherwise retain many of the features of the current plan.

In 2011-12, the University is projected to contribute more than $200 million from core fund sources and nearly $450 million from other sources to UCRP. To date, the State has provided no funding for UCRP contributions. As employer contribution rates rise over the next several years, UC contributions are expected to rise to at least $500 million from core funds and nearly $1.2 billion from other sources. The State’s share, based on State and student tuition and fee-funded employees, is projected to be approximately $256 million in 2012-13 and will rise to $450 million in 2015-16.

The cost pressures created by these rising contributions are far too vast to be addressed through efficiencies or cost-cutting at the margin. If the State is unable to provide funding for contributions to UCRP, the University will need to identify alternative sources of new revenue or savings to cover the growing cost.

As part of the benefit package, UC also provides medical and dental benefits for about 48,900 eligible retirees and their dependents. Unlike UCRP, UC retiree health benefits are currently funded on a pay-as-you-go basis – that is, from current operating funds rather than from a trust account. In 2011-12, the cost to the University for retiree health benefits is estimated to exceed $270 million. This amount is projected to increase significantly over the next several years, as both health benefit premiums and the number of annuitants rise rapidly. The University’s expenditure plan includes the State’s share of this cost, which in 2012-13 is projected to be $5.2 million.

Deferred Maintenance. The University’s physical plant expanded rapidly in the 1950s and 1960s and again in the late 1990s and 2000s. Before the mid-1990s, the State provided the University with nearly $20 million a year in permanent deferred maintenance funding. With the State’s fiscal crisis deepening, however, State support for deferred maintenance was eliminated in 2002-03; since that time, the State has provided no funding, either one-time or permanent, to address UC’s deferred maintenance backlog. Yet the need for this funding has never been more
acute as the University’s inventory of aging buildings continues to grow (about 60 percent of University facilities are more than 30 years old) and severe cuts in operation and maintenance funding have forced campuses to reduce building maintenance services and curtail, or in some instances eliminate, preventive maintenance programs. Without reliable and predictable funding to address the highest priority needs, campuses face an ever-increasing risk of catastrophic failure of building and infrastructure systems. The University’s expenditure plan includes $25 million in permanent funding to support restoration of a modest deferred maintenance program. While insufficient to address the University’s substantial backlog of deferred maintenance, this amount would provide an initial, predictable source of funding which campuses could use for their most urgent deferred maintenance needs. The University would seek to increase the budget for deferred maintenance in future years.

**Keeping Pace with Inflation.** To maintain the quality of the instructional program and all support activities, the University must regularly replace, upgrade, or purchase new instructional equipment, library materials, and other non-salary items. The University must also purchase utilities to provide energy to its facilities. Just as costs for salaries and benefits for employees rise, the University’s non-salary spending is affected by inflation. Costs of goods and services employed for education generally rise faster than the typical basket of goods and services used to measure inflation. In addition, between 1999-00 and 2009-10, costs of electricity and natural gas have risen by over 120%, resulting in significant cost increases for UC campuses despite only modest increases in consumption. Yet, with the continuing fiscal crisis, the State has not funded non-salary price increases for several years. Even with the efficiencies described earlier, to offset the impact of inflation and maintain the University’s purchasing power, without State funding to support cost increases, the University has been forced to redirect funds from existing resources to cover non-salary price increases. The University’s 2012-13 expenditure plan includes $21.8 million for non-salary price increases.

**Reinvesting in Academic Excellence.** As described earlier, State funding cuts and unfunded cost increases have forced the University to redirect funds and have led to academic program reductions across the system. Despite enrollment growth in recent years, campuses have delayed hiring of new faculty and eliminated course sections, resulting in larger class sizes, narrower offerings for students, and less opportunity for students to interact with faculty. Furthermore, in order to fund cost increases such as rising retirement plan contributions, library hours have been shortened and campuses have delayed purchases of necessary instructional equipment and technology.

Savings achieved through cost reduction efforts and new revenues will allow the University to restore program budgets. This in turn will enable campuses to reinvest in faculty, course offerings, instructional and academic support, and student services.

**Proposed 2012-13 State-Funded Capital Outlay Program**

Adequate funding for facilities is essential to the University’s commitment to maintain progress on seismic and other life-safety improvements, address essential infrastructure and building renewal needs, and upgrade and expand academic facilities necessary to support enrollment growth.
Current financial and economic challenges have compelled the State of California to delay sales of bonds needed to fund capital projects approved by the State Legislature. Approximately $476.9 million of previously approved Lease Revenue and General Obligation bonds for the UC system have been stalled, some dating from 2007. The State currently proposes to sell Lease Revenue bonds in November 2011 for three projects at the Berkeley, Los Angeles, and Merced campuses, totaling $268 million of project costs. If this bond sale is successful, UC will still have a backlog of $208.9 million in approved but unfunded projects.

The State’s long delays in selling bonds will seriously affect UC’s projects, which may no longer be viable at the amounts approved.

To avoid that outcome, UC proposes to pursue special legislation to provide interim financing through UC’s commercial paper program. Because UC has a higher credit rating than the State, it can arrange interim financing for these projects at interest rates lower than those for State bonds. A Memorandum of Understanding (MOU) with the State Treasurer’s Office (STO), the Department of Finance (DOF), and the State Public Works Board (SPWB) has been proposed wherein the parties agree that the Regents of the University of California will provide interim financing for construction costs and related interest expense in the amount of $163 million for its approved lease-revenue bond projects.

Although the STO, DOF, and SPWB are in agreement to move forward, the Attorney General has opined that the relevant statute allows UC to be reimbursed only for the principal amount financed and not for interest costs or costs of issuance. Therefore, the University proposes that this statute be amended through legislation to permit repayment of interest costs and costs of issuance, as well as for the principal, from SPWB bond proceeds.

The University’s State capital budget proposal for the 2012-13 year totals $1.13 billion for critical seismic and life-safety improvements, for facilities to accommodate enrollment growth that has already occurred, and for facilities renewal.

Of this need for State funding, approximately 52 percent will address critical seismic and life-safety corrections, 18 percent will address needed programmatic improvements, 17 percent will address existing enrollment needs, 12 percent will be directed to infrastructure deficiencies and building-systems renewal, and 1 percent will address infrastructure for future enrollment growth at Merced and Riverside.

The University also proposes to pursue legislation to place a new general obligation bond on the ballot for the November 2012 statewide general election. There has been no higher education facilities bond measure since 2006, and consequently a serious backlog of capital projects has developed. The proposed measure would provide funding for capital projects over a four-year period, 2012-13 through 2015-16. The projects to be funded from the proposed four-year bond would address some of the University’s highest capital priorities, which include seismic-corrections, life-safety, and modernization projects.

The State of California’s recovery from the economic recession has been slow and halting, and unemployment rates in California remain the second highest in the nation. The construction industry has been particularly hard-hit, experiencing the most severe employment decline of California’s economic sectors, losing over 400,000 jobs since the peak of August of 2006, when 966,000 workers were employed in construction. In April 2011, that number had fallen to 554,000, a decrease of 43 percent since August 2006. Bonds to finance capital projects at the
University of California will help both to improve student access to higher education and result in immediate job creation and thus improve economic activity in the state.

The University’s 2012-13 request for State funds for capital improvements is presented in more detail in the document included in the meeting packet titled, *2011-21 Consolidated State and Non-State Capital Financial Plan*.

(Attachments – Display below)
### Display 1: REVISED

#### 2012-13 OPERATING BUDGET EXPENDITURE PROPOSAL – Request to the State

Display 1: 2012-13 Expenditure Proposal (Dollars in Millions)

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<th>2011-12 Current Operating Budget</th>
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<td>UC General Funds</td>
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<td>Student Tuition and Fees</td>
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<td>Student Financial Aid</td>
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<td>Core Funds Net of Financial Aid</td>
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<th>2012-13 Proposed Increases in Expenditures</th>
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<tr>
<td>Enrollment Growth and Instructional Programs</td>
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<td>Compensation and Non-salary Items</td>
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<td>Academic Merit Increases</td>
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<td>Other Compensation Increases</td>
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<td>Finalized collective bargaining agreements</td>
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<td>All other employees</td>
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<td>Instructional Equipment, Library Materials, and Other Non-salary Items</td>
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<td>UCRP Contributions</td>
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<td>Retiree Health Programs</td>
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<td>Savings, Alternative Revenues, and Restorations</td>
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<td>Total Increase in Expenditures</td>
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<td>Percentage Increase ²</td>
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¹ Represents one-fourth of the $255.6 million State share of the employer contributions to UCRP.
² Calculated as a percentage of core funds net of financial aid.