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Office of the President

TO MEMBERS OF THE COMMITTEES ON FINANCE AND LONG RANGE PLANNING:

ACTION ITEM

For Meeting of November 19, 2015

APPROVAL OF UNIVERSITY OF CALIFORNIA 2016-17 BUDGET FOR CURRENT OPERATIONS

EXECUTIVE SUMMARY

The Regents are being asked to approve the University's operating budget plan for 2016-17.

After years of financial volatility, the University can now look forward to a stable financial outlook that will provide an opportunity to increase access to its educational programs and rebuild academic excellence. The University has built its 2016-17 budget plan on the foundation of a renewed partnership with the State: the University will continue to pursue efficiencies and alternative revenue strategies to help address a major portion of its budgetary needs and it welcomes the additional State investment to help meet these needs and maintain the financial health of the University.

The budget framework announced by Governor Brown as part of his May Revision to the 2016-17 budget heralds a renewed State investment in UC, providing much-appreciated financial stability and a solid foundation from which to plan. It also includes several programmatic initiatives and efficiencies that reflect the shared goal of enhancing the educational experience at UC. Specifically, the framework provides for the following provisions:

- Four-percent base budget increases for four years, extending by two additional years the Governor's commitment to support this base budget adjustment.

- Additional one-time funding to address high-priority costs, including deferred maintenance, energy projects, and unfunded liabilities in the University of California Retirement Program (UCRP). In return for the one-time funds for the retirement program, the University has agreed to bring to the Regents by July 1, 2016 suggested changes to UCRP that include adopting a cap on pensionable consistent with the state's 2012 pension reform law.

- Modest and predictable tuition increases beginning in 2017-18. UC has agreed to continue to freeze Tuition at 2011-12 levels for the 2015-16 and 2016-17 academic years.

This will mean Tuition will have remained flat for six consecutive years. Beginning in 2017-18, the framework provides for predictable Tuition increases, pegged generally to the rate of inflation.

In addition, the framework calls for programmatic innovations that will help improve time-to-degree, graduation rates, transfer, and delivery of the academic program.

A key element in the 2016-17 budget plan is the assumption that enrollment of California resident undergraduate students will increase by 5,000 over 2014-15 levels by the 2016-17 academic year, consistent with the State's proposal in the 2015-16 Budget Act. UC intends to demonstrate to the Director of Finance by May 1, 2016 that it has taken sufficient actions to meet this goal. In addition, the University is requesting $6 million from the State, above the four-percent base budget adjustment supported by the framework with the Governor, to fund graduate enrollment growth of 600 students. This growth is necessary to support and complement growth in undergraduates.

The budget plan calls for an increase in expenditures of $481.3 million, plus a combination of cost reductions, efficiencies and new revenue to support these expenditures. In addition to the funding for enrollment growth, the budget plan assumes funding for mandatory and other high-priority cost increases.

RECOMMENDATION

The President of the University recommends that the Committee on Finance recommend to the Regents that the budget plan included in the document, *2016-17 Budget for Current Operations*, and summarized in Attachment 1, be approved.

BACKGROUND

The *2016-17 Budget for Current Operations Summary and Detail* provides the basis for the recommendation that the 2016-17 budget plan for current operations be approved. Executive Vice President Brostrom and Associate Vice President Obley will make a detailed presentation on the proposed budget for current operations for 2016-17.

Overview of Current-Year Budget

Operating revenue, estimated at $28.3 billion in 2015-16, funds the University's core teaching, research, and public service programs, 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 tuition and fee revenue, provide permanent support for 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 $7.3 billion in 2015-16, these funds represent 26 percent of the University's total budget.

Other sources of funds include federal research funds, teaching hospital revenue, private gifts and endowments, and income from self-supporting enterprises. Use of these funds is restricted, which means they generally cannot be used to support activities other than those for which they are designated. But such funds help augment and complement the University's core activities of instruction and research, providing support functions, public service to the state and its people, and a rich social, cultural, and learning environment on UC campuses. The University's annual budget is based on the best estimates of funding available from each of these sources.

Context for Development of the 2016-17 Budget Plan

The *Washington Monthly* ranks institutions on their contributions to the public good, evaluating factors such as social mobility, research, and public service. In its 2015 college survey, the *Washington Monthly* recognized UC for its role as an engine of social mobility and for its research and public service, noting, "As it has in previous years, the University of California system dominates our national university rankings, with a combination of research prowess and economic diversity among undergraduates." The recently published *College Access Index*, a *New York Times* measure of economic diversity and social mobility at top colleges, awarded six of the top seven spots to University of California campuses, reflecting the University's high proportion of low-income students, affordable price, and ever-improving graduation rates. At 42 percent, the University has a much higher proportion of Pell Grant recipients in its undergraduate population than any other major research university in the country. Enrolling at UC is a life-changing pathway to economic success for tens of thousands of students every year, which in turn contributes to the economic prosperity of the state.

The State's past support for the University has yielded an impressive return on investment and both the State and UC share the goal of protecting that investment. Although the depth and breadth of the great recession earlier in this decade was a challenge to UC and many other State entities, the years of financial volatility have subsided.

The current stable financial outlook allows the University an opportunity to increase access to its educational programs and rebuild academic excellence. UC has built its 2016-17 budget plan on a foundation of renewed partnership with the State that acknowledges the University's imperative to continue pursuing efficiencies and alternative revenue strategies to help address a major portion of its budgetary needs. UC is grateful for additional State investment to help meet these needs and maintain the University's financial health.

The budget framework announced by Governor Brown as part of his May Revision to the 2015-16 budget provides much-appreciated financial stability as well as several programmatic initiatives and efficiencies that reflect the shared goal of enhancing the educational experience at UC. Specifically, the framework calls for:

- **A commitment to additional annual increases in State funding.** In 2013, the Governor proposed regular annual increases in direct appropriations to the University of five percent in 2013-14 and 2014-15 and four percent in 2015-16 and 2016-17. The Governor has now committed, subject to agreement with the Legislature each year, to extend the four-percent increases for two additional years, through the 2018-19 fiscal year, giving the University predictability in its long-term fiscal outlook. This amounts to a total increase in State funds of $507.3 million in UC's base budget over the next four years.

- **One-time funding to address high-priority costs.** The Governor's January budget proposed one-time funding of $25 million to support high-priority deferred maintenance needs across the University's ten campuses. The Governor's May Revision proposed an additional $25 million in one-time Cap and Trade funds to address energy efficiency projects. (The deferred maintenance funding was appropriated to the University in the State Budget Act of 2015; the Legislature is expected to act on the Cap and Trade funding after it convenes in January.) These one-time funds cannot be used for other purposes.

- **Modest and predictable tuition increases.** UC has agreed to continue to freeze Tuition at 2011-12 levels for the 2015-16 and 2016-17 academic years – a total of six years with no tuition increases. Beginning in 2017-18, the framework provides for predictable tuition increases, pegged generally to the rate of inflation. It also provides that the Professional Degree Supplemental Tuition (PDST) plan adopted by the Regents at their November 2014 meeting will remain in effect, except that PDST for the University's four law schools will remain at 2014-15 levels through 2018-19.

- **Shared commitment to addressing UC's long-term pension liability.** The Governor has agreed, subject to the Legislature's approval, to provide a total of $436 million in one-time funding over three years to address a portion of UC's pension obligations: $96 million in 2015-16 (which was approved as part of the 2015-16 budget), followed by an additional $170 million in each of the following two years. This funding will come from Proposition 2 funds, which the State Constitution specifies must be supplemental, above contribution rates approved by the Regents, and used to help pay down the UCRP's unfunded liability. This funding is contingent upon implementation of the State's Public Employee Pension Reform Act's pensionable salary cap, effective for new hires on or after July 1, 2016. The UC Retirement Options Task Force, in consultation with the Academic Senate, staff and other stakeholders, is examining options for implementation of the cap and will make recommendations to the President for her recommendation to the Regents for approval in the spring. The approved retirement benefit plan will not apply to current employees. For represented employees, it will be subject to collective bargaining.

- **Enhanced commitment to the transfer function.** In May 2014, the University's Transfer Action Team recommended ways to streamline the transfer function and increase transfer enrollment. As part of the framework agreement, UC is committing to specific timeframes for implementing several key recommendations. Specifically, UC has agreed to complete transfer preparation pathways for 20 of its top majors over the next two academic years. The first ten pathways were completed in June 2015. These pathways will be consistent across all nine undergraduate campuses, as consistent as possible with the California State University (CSU) pathways created for community college Associate Degrees for Transfer, and will specify clearly any differences between the CSU and UC pathways. In addition, consistent with the intent of the Master Plan for Higher Education, UC will increase the proportion of its

California resident students who enter UC as transfers (conditioned on there being a sufficient pool of qualified applicants), achieving by the 2017-18 academic year its goal of having one-third of entering students start as transfers, both systemwide and at every undergraduate campus (with the exception of UC Merced). The President has also asked the Academic Senate to consider adopting the state's Common Identification Numbering (C-ID) system to further simplify identification of similar courses across campuses in each of the segments.

- **Innovations to support student progress and improve time-to-degree.** In discussions with experts and campus visits that were part of discussions that led to the budget framework, UC and the Governor identified promising practices than can be expanded across the UC system to increase student success and reduce time-to-degree. These include:

    - Reviews of major requirements to determine whether the number of upper-division units required to complete a major can be reduced without compromising quality, with a goal of not exceeding one academic year's worth of coursework (generally the equivalent of about 45 quarter units). This type of review has already been conducted at UCLA in some disciplines and will be completed on all undergraduate campuses by July 1, 2017.

    - Development of three-year degree pathways for ten out of the top 15 majors at each campus by March 1, 2016. Merced, which has far fewer majors than the other campuses, will develop three-year degree pathways for three out of its top five majors, which is proportional to expectations for other UC campuses. UC will promote these accelerated pathways for use by students where appropriate, with a goal that five percent of UC undergraduate students will have access to these accelerated tracks by the summer of 2017.

    - Enhanced use of summer session to reduce time-to-degree. Enrollment in one or more summer sessions has been shown to be a key element allowing UC students to complete their degrees more quickly. As a way to encourage more UC students to enroll in summer session, three campuses will pilot alternative pricing models in summer 2016. The models focus on expanded availability of summer session financial aid, a cap on the number of units for which a student is charged fees (allowing free enrollment for units above the cap), and low summer housing rates for continuing students who enroll in summer courses.

    - Information on how UC's online initiative has prioritized development of online versions of gateway or potential bottleneck courses.

    - Reexamination by the Academic Senate of current policies for Advanced Placement courses and the College Board's College-Level Examination Program tests.

    - Guidance for advisors to better assist students in planning their time at UC and successfully completing their degrees within four years or fewer if they are native freshmen, two years if they are transfer students, or three years if they are native freshmen on a three-year pathway.

- **Continued innovation in the use of technology and data analytics to understand instructional costs and improve student outcomes.** A number of innovative new approaches are currently being piloted at UC campuses, including, but not limited to:

  - Expansion of predictive analytics and other technologies to identify students at risk of academic difficulty and monitor their progress. All campuses will describe their data and technology efforts, how this information is used, and how use of the data helps close achievement gaps.

  - Piloting activity-based costing in the College of Humanities, Arts and Social Sciences at UC Riverside. UC Riverside is seeking to serve as a U.S. pilot for this new approach. Two other campuses are conducting scoping studies to determine the feasibility and cost of expanding this pilot.

  - Use of adaptive learning technology to help students master challenging coursework, by tailoring instruction to individual needs, which helps students stay on track for graduation. UC Davis is leading a multi-campus pilot to investigate this technology.

  - Investigating expansion of online certificate and master's degree programs to address critical workforce needs in California. UC convened industry and academic leaders this fall to discuss areas of significant need where UC can contribute by providing online programs.

The University's 2016-17 budget plan has been developed in the context of this framework and is based on the continued long-term financial modeling begun several years ago to help plan for the long-term financial sustainability of the University. Consistent with the strategic priorities underlying the University's longer-term financial planning, the 2016-17 budget plan is built on an unwavering commitment to protect UC's longstanding excellence while recognizing the limitations presented by the funding environment within which the University and other State agencies operate.

The Budget Plan for 2016-17

The University's budget plan for 2016-17, presented in the Attachment, reflects the priority placed on California resident enrollment growth, as well as the need to address ongoing mandatory costs and continue investing in the quality of core instruction and research programs.

Proposed Increases in Revenue

The University's plan assumes increases in revenue from State funds and non-State sources (UC General Funds), as well as alternative revenue sources and cost savings, totaling $481.3 million,. These increases fall into four revenue categories.

Cost Savings/Alternative Revenue Sources. The budget plan assumes $40 million in funding related to strategies to manage liquidity and $30 million from savings achieved through new systemwide procurement contracts in 2016-17, as well as $15 million associated with the new self-insurance initiative, Fiat Lux, and $10 million in additional funding available to the operating budget from new models of philanthropic giving. These initiatives continue the University's practice of resolving a portion of its funding needs through internal actions to reduce costs, promote efficiencies, and generate new revenue.

The plan also assumes phase-out of the need-based aid currently provided to nonresident undergraduate students. While currently enrolled nonresident students receiving this aid will not be affected, beginning in 2016-17, the University will begin to phase out this aid component. It is expected the University will save $14 million in 2016-17 that can be used to help fund the enrollment increase planned for the budget year.

State General Funds. The plan includes a four-percent base budget increase, or $125.6 million in new State General Funds, as proposed in the Governor's multi-year funding plan. The plan assumes receipt of $25 million in permanent State funding in 2015-16 associated with enrolling an additional 5,000 undergraduate California residents in 2016-17 as compared to 2014-15 levels. It also includes a request for $6 million from the State to support graduate enrollment growth to complement and support dramatic increases in undergraduate enrollment. Finally, the plan proposes $25 million in one-time funds for deferred maintenance, similar to the funding provided in the 2015-16 budget.

UC General Funds. Most campuses have expanded their nonresident enrollment to help backfill reductions in State support. The budget plan proposes $68.7 million in new revenue from Nonresident Supplemental Tuition (net of instructional costs associated with these students) based on an eight-percent increase in nonresident tuition and a projected increase in nonresident enrollment of 1,200 students. This constitutes a reduction in the level of growth from the prior year. The plan assumes no change in indirect cost recovery from federal research contracts and grants due to continuing declines in research funding, which are offset by increases in higher federal indirect cost rates recently negotiated by several campuses and some increases in funding from non-federal resources.

The plan also assumes phase-out of the need-based aid currently provided to nonresident undergraduate students from the University Student Aid Program. While currently enrolled nonresident students receiving this aid will not be affected, beginning in 2016-17, the University will begin to phase out this aid component. It is expected the University will save $14 million in 2016-17 that can be used to help fund the enrollment increase planned for the budget year.

Major Expenditure Categories for 2016-17

The budget plan includes a $481.3 million increase in expenditures. Proposed expenditures address mandatory and other high-priority cost increases, enrollment growth to provide increased access for California students, and investment in core academic programs, as summarized below.

Enrollment Growth. UC is dedicated to the mission of access for California residents consistent with its founding as the state's land-grant institution and in accordance with the Master Plan for

Higher Education. Moreover, as a research university, UC must have sufficient graduate enrollment to meet the state's economic development and workforce needs for Ph.D. graduates, help advance knowledge through its research mission, and work with faculty and undergraduate students as part of the education continuum. The 2016-17 budget plan envisions growth at both the undergraduate and graduate level.

The State Budget Act of 2015 adopted language that would augment the University's 2015-16 budget by an additional $25 million if UC demonstrates to the Director of Finance, by May 1, 2016, that it will enroll no later than the 2016-17 academic year at least 5,000 more undergraduate California residents than it enrolled in 2014-15.

The University strongly shares the Legislature's interest in providing increased access for Californians and is committed to taking the actions necessary to meet the State's enrollment goal. Because the state's proposal for increasing enrollment over two years came after the 2015-16 admissions process was essentially complete, most of the increase will need to be accomplished in a single year, 2016-17.

The 2016-17 budget plan assumes $25 million is appropriated in 2015-16 and continues in 2016-17 as a permanent augmentation to fund half the cost associated with the 5,000 undergraduate student enrollment growth. The Budget Act suggests several ways UC can fund the other $25 million needed for this enrollment level, including using Nonresident Supplemental Tuition revenue and eliminating financial aid provided to nonresident undergraduate students from Tuition return-to-aid funds.

UC's budget plan assumes elimination of return-to-aid for nonresident students, which will be phased in so that current students receiving this aid are not affected by the change. The remaining half of the enrollment will be supported with funds redirected from this program. Until this redirection is more fully phased in, bridge funding will be allocated from the $25 million in one-time funds that are to be provided in 2015-16 once the University has shown that it will enroll the full 5,000 student increase.

As the State's research university, UC is also concerned with enrollment of graduate students to complement and support dramatic undergraduate growth. As faculty are added to meet the increased enrollment demand, graduate students must increase to support faculty in the research mission of the University and to help with the teaching and mentoring associated with additional undergraduates. Therefore, the University is requesting an additional $6 million above the base budget increase to support the enrollment of 600 more graduate students by 2016-17.

Actions taken for 2016-17 have implications for future years – as new classes of students coming in are larger than classes graduating, total enrollment grows. The University intends to sustain expanded access in 2017-18 and beyond, enrolling 2,500 new California resident undergraduate students each year in 2017-18 and 2018-19 such that, at the end of four years, total California resident undergraduate enrollment will have increased by 10,000 students, providing access to thousands more students each year than otherwise would have occurred. The multi-year enrollment plan being developed by the University will reflect this intention for future years.

Mandatory Costs. The University must pay a variety of cost increases each year, regardless of whether new funding is provided to support them. Below is a description of the major mandatory cost increases projected for 2016-17.

- **UC Retirement Plan.** The UCRP provides pension benefits for more than 65,365 retirees and survivors and has about 121,200 active employee members as of July 1, 2015.

  Prior to November 1990, contributions to UCRP were required from both the University as the employer and from employees as members. As it did with all other State agencies, the State provided funding for the employer contribution associated with State-funded employees. In the early 1990s, the Regents and the State agreed to suspend University contributions to UCRP after actuaries confirmed that it was adequately funded to provide for service costs for many years into the future.

  In the nearly 20 years during which employer and member contributions were not required, the State saved more than $2 billion. However, the funded status of UCRP declined as future service costs accrued and the accrued liability rose. Furthermore, the recent national economic crisis diminished the value of UCRP assets. The funded ratio is 81 percent as of July 2015.

  The University restarted contributions to UCRP in April 2010. The employer contribution rate increased by two to three percentage points per year until 2014-15, when it was stabilized at 14 percent. Employee contributions rose 1.5 percentage points each year and stabilized in 2014-15 at eight percent for most employees (some represented employees contribute nine percent of pay and members of the new 2013 tier contribute seven percent of pay).

  In December 2010, the Regents reformed retirement plan benefits to reduce long-term costs and approved a new tier of pension benefits for employees hired on or after July 1, 2013, which increased the early retirement age from 50 to 55 and the maximum age factor from age 60 to 65.

  In 2012-13, the State augmented the University's budget with $89.1 million intended to be used toward the State's share of the employer contribution to UCRP. Since that time, the State has not provided targeted funds for its share of the annual employer's contribution to UCRP, as it does for other State agencies. In 2015-16, the University is contributing $407.5 million from core fund sources and $1.4 billion from all fund sources to UCRP.

  The 2016-17 budget plan includes $24.1 million for increases in core-funded employer contributions to the retirement system. With no expected change in the 14 percent current employer contribution rate, this increase represents only new costs associated with anticipated employee growth in faculty and other academic staff and compensation increases. UC's employer contributions are expected to rise to $431 million from core funds and $1.4 billion from all fund sources in 2016-17.

  UCRP's unfunded liability is being addressed through several actions approved by the Regents.

In addition to increasing contributions, the University has also borrowed to supplement the employer and member contributions to meet the Annual Required Contribution (ARC or “modified” ARC), which is the amount needed to fund annual costs plus interest on the unfunded liability. Without future borrowing and assuming a 7.25 percent investment return, the Plan is estimated to be 100 percent funded by the year 2045. Additional borrowing is proposed for 2015-16, 2016-17, and 2017-18 in a separate item being brought to the Board for approval at the November meeting. This would shorten the time for the Plan to reach 100 percent funded by five years (or 2040).

As noted above, part of the budget framework agreed to with the Governor in May 2015 calls for the University to add a cap on pensionable salaries consistent with the cap established in the Public Employees’ Pension Reform Act adopted by the State in 2013, in return for $436 million in Proposition 2 funds over three years. A task force is developing recommendations for the President that will conform to this requirement. A proposal will be brought to the Board of Regents so that retirement benefit changes can be implemented on July 1, 2016. Because these changes will be prospective and only affect new employees hired on or after July 1, 2016, they will not affect the cost increases anticipated for 2016-17. Proposition 2 funds being directed to the unfunded liability cannot be used to offset cost increases or otherwise relieve the impact of employer contributions on UC’s operating budget. The 2016-17 budget plan assumes the University will implement the salary cap as requested and that the second increment of Proposition 2 funds, $170 million, will be provided, consistent with the framework with the Governor.

- **Employee Health Benefits.** Until recently, employee health benefit costs have risen rapidly, typically between 8.5 percent and 11 percent annually. Because no State funds have been provided for this purpose since 2007-08, campuses have redirected funds from existing programs to address these cost increases.

  Significant efforts have been made in the past several years to limit health benefit cost increases and reduce pressure on already strained operating budgets. Through negotiations with providers and other measures, UC was able to limit health benefit cost increases to 7.1 percent in 2011, 2.4 percent in 2012, 5 percent in 2013, and 5 percent in 2014. Overall health benefit costs in 2016-17 are expected to increase by about 5 percent, or $28.4 million.

  In addition, employees have been required to bear a larger responsibility for the rising costs of these benefits, partially offsetting any salary increases they may have received in recent years. In 2002-03, the University adopted 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. While UC pays approximately 87 percent of monthly medical premiums for employees on an aggregate basis, the University covers an even larger portion of the premium for those in the lower salary brackets. In the current environment, with limited new funding and continuing cost pressures, it is expected that some of the cost increases will continue to be borne by most employees.

- **Retiree Health Benefits.** In 2015-16, more than 60,302 UC retirees and beneficiaries are eligible to receive or are receiving an estimated $287 million of health benefits paid for by the University. The State has historically provided funding to the University equivalent to the per-employee funding provided for other State employees for the increased number of annuitants expected in the coming year. In the 2014-15 budget, the State stopped funding these costs separately, adding them to the expenditures to be covered within the base budget increase provided under the Governor's multi-year funding plan. The annuitant health costs are estimated to increase by $4.2 million in 2016-17.

Because accumulated future retiree health benefits costs are not pre-funded, UC has an unfunded liability for retiree health representing the cost of benefits accrued to date by current faculty, staff, and retirees based on past service, estimated to be $17.3 billion in 2015-16. In December 2010, to reduce long-term costs and the unfunded liability for retiree health, the Regents approved changes to retiree health benefits that included reductions in UC's aggregate annual contribution to the Retiree Health Program, and a new eligibility formula for all employees hired on or after July 1, 2013, existing employees with fewer than five years of service credit, and existing employees whose age plus service credit is less than 50 as of June 30, 2013.

- **Contractually Committed Compensation.** Salary increases for represented employees are governed by collective bargaining agreements with each represented bargaining unit. These agreements call for compensation increases totaling $26.9 million in 2016-17.

- **Faculty Merit Program.** The University has maintained the faculty merit program each year – even through years of fiscal crisis – because of the importance of this program to the quality of the University. Faculty are generally eligible every two to three years to be considered for a merit increase, which is intended to reward them for excellent teaching and research, as well as fulfillment of their public service mission. This program requires a rigorous peer review process before a merit salary increase is awarded. The cost of the faculty merit program is estimated to be $32 million in 2016-17.

- **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. Throughout the recent recession, inflationary pressures remained relatively soft. However, as the state economy has improved, cost pressures have begun to build. The University's 2016-17 expenditure plan includes $29.7 million for non-salary price increases, consisting of a two percent general non-salary price increase, as well as an adjustment to cover projected increases in purchased utility costs above inflation.

Investment in Academic Quality. As noted earlier, the President has made it a top priority to invest in the academic infrastructure of the University for the benefit of UC students, faculty, and researchers, focusing on areas that directly impact the quality of the University's instructional, research, and public service programs as well as the fiscal health of the system. While there are no agreed-upon standards in the higher education community for determining quality, there are clear criteria that are commonly used when rating great universities. They include, among other things, maintaining an outstanding faculty, measured in terms of individual achievements as well as adequate numbers to teach and train, and recruiting and educating outstanding undergraduate and graduate students. The areas identified for investment in academic quality are critical to maintaining excellence and have all been identified by the Regents as high priorities for many years, prior to the onset of the most recent fiscal crisis. Consistent with the University's long-range plan, the University's 2016-17 budget proposal proposes $50 million for this investment for the following types of programs:

- **Enhancing Undergraduate Instructional Support.** The previous two compacts with former Governors proposed an additional one-percent per year base budget increase to help address chronic shortfalls in key areas of the budget that directly affect instructional quality – expanding cutting-edge technology essential to instructional delivery in the classroom of the 21st century, restoring library collections, and more adequately supporting ongoing building maintenance. The University must continue reinvesting in these areas – all of which were chronically underfunded before the recent fiscal crisis – if it is to keep up with technical innovations.

- **Improving the Student-Faculty Ratio.** During the recent fiscal crisis, the University's student-faculty ratio deteriorated dramatically, standing currently at about 21:1 (well below the budgeted ratio of 18.7:1). Improving the student-faculty ratio will allow the University to offer smaller class sizes where possible, improve the quality of the educational experience and adequacy of course offerings, and help students complete requirements and graduate more quickly. A lower student-faculty ratio increases opportunities for contact outside the classroom, guidance in internships and placements, and undergraduate participation in research and public service. Reducing the student-faculty ratio is also important as the University seeks to make further improvement in performance outcomes as requested by the State in budget trailer bill language.

- **Supporting Startup Costs for New Faculty.** As campuses begin to hire faculty once again – to replace those who have retired or separated, to hire those needed to help meet growing enrollment demand, and to generate research that will enhance innovation and quality – one of the major challenges they face is the cost of startup packages for new faculty. Startup costs include renovation of laboratory space; equipment; graduate student, postdoctoral scholar, and technical staff support; and other costs necessary for new faculty to establish their research teams and projects. In some disciplines – especially health sciences, life sciences, physical sciences, and engineering – startup costs can exceed $1 million per faculty member. Since UC's faculty candidates have multiple job prospects and UC is in competition for these hires, UC's ability to provide facilities and staff to support cutting-edge research has a direct impact on the quality of faculty campuses are able to recruit.

- **Addressing Faculty Salary Gaps.** A recent study on ladder-rank faculty compensation concluded that faculty salaries lagged the market by 10.3 percent in 2014-15. As the University's budget stabilizes, closing this gap is a high priority. The faculty salary lag is discussed in more detail below in the section on Compensation.

- **Augmenting Graduate Student Support.** Graduate education and research at the University have long fueled California's innovation and economic development, helping establish California as one of the ten largest economies in the world. The strength of UC's graduate programs is key to attracting and retaining top faculty. The University must ensure that the amount and duration of graduate student support remains competitive.

High-Priority Costs. In addition to the categories above, additional cost increases are required in several other areas as part of the normal cost of operating a major research university:

- **Compensation.** The recent fiscal crisis made it difficult for the University to keep pace with the market with respect to faculty and staff salaries. As noted above, recent studies show UC falling further behind its comparator institutions.

  The rapid increase over several years to eight percent of pay in employee contributions to the retirement program has further affected employee take-home pay, as have increases in health benefit costs. 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 high-quality faculty and staff employees if the University is to maintain its preeminent stature.

  Consistent with UC's longer-term financial planning, the 2016-17 budget supports a salary program for faculty and staff consisting of a 3 percent pool to be allocated based on merit and other factors, with a total cost of $129.4 million for non-represented staff and faculty. Actual salary and benefit actions for represented employees are subject to notice, meeting-and-conferring, and/or consulting requirements under the Higher Education Employer-Employee Relations Act.

- **Deferred Maintenance.** The University maintains 135 million gross square feet of space at the ten campuses, five medical centers, and nine agricultural research and extension centers. Nearly half of this space – 64.8 million square feet – is eligible for State support, including space used for classrooms, laboratories, offices, and some research and academic support activities. Nearly 60 percent of the University's State-eligible space is more than 30 years old, with 43 percent of that space built between 1950 and 1980 when the University was in a period of rapid expansion. The University faces an immense and growing deferred maintenance backlog as the electrical, heating and ventilation, elevator, plumbing, and other building systems in these aging buildings and supporting campus infrastructure reach the end of their useful life. The 2016-17 budget plan includes $25 million in one-time funds requested from the State and an additional $25 million in permanent funding from resources included in the budget plan to build up the permanent base of funding for deferred maintenance. This is the second increment in a multi-year increase of funding for deferred maintenance.

- **Capital Improvements.** The process for funding State-eligible capital projects changed in 2013-14. The State's General Obligation bond debt has been shifted to the University's base budget, and it is now included as part of the base budget for the purpose of calculating the State-funded base budget adjustment each year. Under the new process, a portion of UC's State funding can be used to fund or finance State-eligible capital projects.

The University faces a growing backlog of capital projects over the coming years. The projected need for capital improvements for State-eligible projects for the five-year period from 2015-16 through 2019-20 is $2.9 billion. The new State process allows the University to continue to address its highest-priority capital needs until a new General Obligation bond can be brought before California voters. The new process requires the University to submit a list of projects proposed for funding by September 1 of each year, with the Department of Finance providing the University a final list of approved projects no earlier than April 1.

Under the new process, the State has approved 26 projects, from fiscal years 2013-14 to 2015-16, totaling more than $706 million. The approved projects include seismic/life safety projects, infrastructure renewal, additional classroom and laboratory space to accommodate past enrollment growth, and continuing projects that require funding for completion.

For 2016-17, the University is proposing one capital outlay project, the State-funded portion of the Merced 2020 Project (also being presented for approval to the Board at the November meeting). This project requests $400 million in State capital outlay funds to construct 414,400 Assignable Square Feet in academic and student support space. The Department of Finance will notify the University of approval of this 2016-17 capital outlay project no earlier than April 1, 2016. This proposal represents only a small portion of the University's total funding need for State-eligible capital improvement projects.

Funds set aside in the 2016-17 budget plan will be used to support debt service for previously approved projects coming on line in 2016-17.

- **Dream Loan.** SB 1210 (Lara) was adopted during the 2014 legislative session under the University's sponsorship. It called for UC (and CSU) to establish a revolving loan program for undocumented students which was to be funded from a combination of additional State funds and matching funds from University sources. While the State has not provided additional funds for this purpose, the University believes it is an important program and must be implemented. The University will phase in the program, starting in 2015-16, with temporary resources. In addition to increases in financial aid associated with new enrollment growth, the 2016-17 budget plan includes $5 million, half from State General Funds and half from internal University sources, for this purpose.

Other Budget Requests Not in the Core Funds Budget Plan

Proposition 2 Funds for UC's Retirement Plan. The budget framework agreed to with the Governor includes a provision for $436 million in Proposition 2 funds to help address the unfunded liability of the University's retirement program, provided the University adopts a cap on pensionable salary similar to the State's Public Employees' Pension Reform Act of 2013, as described earlier. The University will enact this change by July 1, 2016 and thus will expect to receive the 2015-16 and 2016-17 increments of Proposition 2 funds, $96 million and

$170 million respectively.

Cap and Trade Funds for Energy Projects. As part of the agreement on the 2015-16 budget, the Governor agreed to support $25 million in one-time funds from Cap and Trade revenue to support energy projects that can help the University increase energy efficiency and meet its carbon neutrality goals. The University is requesting a second increment of $69.1 million in one-time Cap and Trade (Proposition 39) funds in 2016-17 for this purpose.

Institute for Transportation Studies. A total of $9 million, to be phased in over three years in $3 million increments, is requested from the Public Transportation Account to augment State funding for the Institute for Transportation Studies, created by the State in 1947 to address the State's transportation needs in a research-based environment. With branches on four UC campuses, the Institute is recognized as the world's premier center of transportation research, bringing together UC researchers from more than 30 disciplines and annually hosting more than 250 graduate students, with about 100 master's and Ph.D. students graduating each year. The Institute plays a major role in addressing the state's congestion, land use, energy, air quality, freight, travel behavior, planning, and engineering challenges. Funds would be used to bolster the infrastructure of the Institute to accept more research opportunities (many of which are now turned away because of inadequate staffing); improve dissemination of research results so experts in the field have access to the most up-to-date information in five areas the State has identified as critical: climate change, urban sustainability and air quality, infrastructure and energy, transportation system performance/optimization, and taxation and finance; and increase research in emerging areas within the transportation field.

Innovation and Entrepreneurship Initiative. This initiative aims to leverage the scale and diversity of the University of California's ten campuses, five medical centers, and three affiliated National Laboratories to build a vibrant and innovative entrepreneurial culture across the system that will create direct benefits for the state and nation. The University has developed a highly competitive research environment to further stimulate creativity and innovation at all campus locations. UC has also developed an investment program to support UC entrepreneurs and increase opportunities to grow California's economy. The opportunity is now ripe for California to capitalize on UC's unique combination of world-class research and vibrant entrepreneurial culture and solve some of the state's most pressing problems while significantly stimulating its economy. The University of California will work with the Legislature to develop jointly a statewide innovation and entrepreneurship program that addresses areas of strategic importance to the State.

Attachment 1: 2016-17 Budget Plan for Core Funds (Dollars in Millions)
Attachment 2: UC Budget for Current Operations – Summary of the Budget Request, 2016-17