The Regents of the University of California

COMMITTEE ON FINANCE
May 18, 2000

The Committee on Finance met on the above date at Covel Commons, Los Angeles campus.

Members present:	Regents Atkinson, Bagley, Connerly, Davies, Hopkinson, Montoya, Pannor, Parsky, and Preuss; Advisory member Miura
In attendance:	Regents Bustamante, Khachigian, Lansing, Moores, Sayles, Taylor, and Vining, Regents-designate Fong and Kohn, Faculty Representatives Coleman and Cowan, Secretary Trivette, General Counsel Holst, Provost King, Senior Vice Presidents Darling and Kennedy, Vice Presidents Broome, Gomes, Gurtner, Hershman, and Pister, Chancellors Bishop, Carnesale, Cicerone, Dynes, Greenwood, Orbach, Tomlinson-Keasey, and Yang, and Recording Secretary Bryan

The meeting convened at 8:25 a.m. with Committee Vice Chair Preuss presiding.

1. REPORT ON THE GOVERNOR'S MAY BUDGET REVISION

Vice President Hershman discussed the May revision to the State budget that was recently announced by the Governor and described the status of the University's budget in relation to it. He reported that the Governor estimates the State will have $12 billion added to its revenues by next year that will be spent on K-12, provide some tax relief, and give additional support to health, social services, and transportation. Next year's reserves will total $2.5 billion.

Mr. Hershman summarized the operating budget, noting that the Governor proposes to increase the University's budget for next year by 16.5 percent. His budget will provide $300 million for outreach and programs to enhance K-12. Additional funds will be provided as follows: 1 percent to the cost-of-living adjustment for nonfaculty UC employees; $1.1 million to scholarships for the teachers' scholarship program; $18.8 million to professional development institutes for K-12; $1 million to Advanced Placement courses for a total of $50 million for internet-related activity; $32 million to help K-12 provide access to the internet through statewide hubs; and $18 million to support the University's program for faculty and students to have internet access. He also directed $35 million to instructional equipment and deferred maintenance.

The budget for capital outlay began in January with $212 million to come from a bond issue. The Governor had proposed $75 million from the General Fund for the

Institutes for Science and Innovation. To that he has added $4.7 million to move to working drawings for the first two buildings of UC Merced and has indicated that construction money will follow next year. He included $45 million in funds in non-University budgets to help mitigate environmental concerns and $50 million for hospital infrastructure for the University's medical centers. He agreed also to a $600 million program to finance seismic reconstruction funded through a lease revenue bond mechanism.

Regent Taylor asked whether affirmative steps are being taken toward lowering tuition for the summer quarter. Mr. Hershman reported that the Senate has approved all of the Governor's proposals, adding one item of $12 million to reduce student fees in the summer in a move toward making summer fees the same as the fees the rest of the year. The proposal has passed through the Senate but has not been taken up by the Assembly. The University is working with California State University and the Department of Finance to come to an agreement on a phased plan for year-round operations.

Regent Connerly asked whether the University will be in a position to fund its expected growth in the next few years. Mr. Hershman responded that in this budget the Governor has provided for basic funding for salaries and other cost increases to cover the enrollment of 6,000 more students. It remains a concern as to whether there will be sufficient money available for the related capital outlay. There is also $10 million in the operating budget for development of the Merced campus. Following the 2001 budget, money will be requested from the General Fund for construction of the first two buildings. Following a further question by Regent Connerly, Mr. Hershman reported that there is money in the budget to provide for a 1.5 percent merit increase plus a 3 percent COLA for faculty.

Committee Vice Chair Preuss noted that the University has an obligation to the State to fulfill its mission according to the Master Plan and that it can fulfill that obligation only if it gets enough funds. He asked if there were some measure by which it may be determined whether that obligation will be met in the future. He stressed that early action could be necessary to keep the University on track in this regard. Mr. Hershman agreed that close attention should be paid to the issue. He noted that the campuses which are growing the fastest will suffer the most if sufficient funds are not made available.

Regent Sayles asked how many courses could be supported by the budget for on-line instruction. He asked for an analysis of what it would take to raise to the state's average those schools that are lacking in this area. Chancellor Greenwood informed him that the program already under way is completing its third semester and anticipates the participation of 800 students around the state by next fall. She was optimistic about its effect. President Atkinson noted that the program represents a first effort, the positive effects of which will need to be assessed over time.

Regent Sayles asked whether money is available to increase opportunities for transfer students. Mr. Hershman reported that the University has an agreement with the community colleges, the Governor, and the Legislature to expand the number of transfer students by 6 percent per year.

In answer to a question by Regent Davies, Mr. Hershman reported that the University will spend $300 million on outreach this year. Committee Vice Chair Preuss noted that the figure represents one-third of the budget for a campus. He believed the University's outreach effort is poised to make a significant contribution to underprivileged K-12 students around the state.

Regent Bagley recalled that thirty years ago the State General Fund provided 60 percent of the University's budget. Today that figure has shrunk to 30 percent. He stressed that that fact should be put into context and brought to the attention of legislators at every opportunity. He then asked why the School of Veterinary Medicine at the Davis campus had lost its accreditation. Mr. Hershman believed the main reason was that its facilities were below par. He reported that a plan for a major new instructional facility has been drafted and that a second building will be proposed in the next budget.

2. POLICY CONSIDERATIONS GUIDING THE DEVELOPMENT OF THE 2001-02 BUDGET

It was recalled that the University's annual budget is a statement of resources needed to maintain access and ensure the excellence of University programs. Funding requests in the budget reflect both long-term and short-term objectives that have been identified and reaffirmed in the University's ongoing planning and consultation process. Through that process, basic principles emerge that are used to develop the University's budget request each year. These principles derive from the University's needs in terms of its tripartite mission of teaching, research, and public service, the role of the University of California in the state's educational pipeline, and the role the University plays in the state's economic growth and development.

The process of developing the budget is influenced by agreements reached with the Governor and the Legislature. Primary among these is the Partnership. For each of the last six years, the University has built its budget request on the basis of agreements reached with the Governor's Office regarding funding principles. This occurred first with the Compact, an agreement negotiated with Governor Wilson covering the years 1995 through 1999. Under the Compact, the University's budget was stabilized after years of budget cuts, and the ability to plan for the future was restored.

A new Partnership Agreement with Governor Davis is being negotiated. It is the Governor's view that while K-12 and the higher education segments need adequate

State support, they also must be held accountable for specified outcomes that are in the best interests of the State. As indicated in his January budget proposal, the Governor intends to complete negotiations on the new Partnership Agreement this spring. This Agreement will provide the basis for the University's budget request for State funding each year. The funding principles in the Agreement have been widely discussed within the University community and have been used by both the University and the Department of Finance to build the University's budget for the 1999-2000 and 2000-01 fiscal years. The Partnership Agreement should be final by spring in time for development of the 2001-02 budget.

Principles for Development of the 2001-02 Regents Budget

The following outlines the major principles and funding strategies guiding the development of the 2001-02 Regents Budget. Briefly, these principles are (1) maintaining quality, (2) maintaining access, (3) maintaining affordability, and (4) developing initiatives that respond to critical state needs in research and public service. These principles are similar to those used in recent years and reflect discussions with The Regents and other internal constituents, such as chancellors, faculty, students, and staff, as well as the Governor and the legislature.

The quality of the University's academic program and the educational experience that students receive are among the highest in the nation. This quality has been achieved because the faculty and staff are committed to providing a rich academic environment in which opportunities for intellectual growth are widely available and achievement is recognized and rewarded. It is imperative that this high quality be preserved and enhanced by recruiting and retaining the best faculty, students, and staff, and by maintaining excellent programs. Resources are needed to provide the following:

Merit Increases for All Employees. Merit increases recognize and reward excellence, which is critical to the preservation of quality. Merit increases are not automatic. Academic merit increases are awarded only after extensive review of individual achievements. Staff merit salary increases are awarded to eligible individuals based on their performance.

Compensation for Faculty. Competitive salaries are needed to attract and retain the best faculty. The quality of the faculty, more than any other factor, determines the quality of the University. One of the biggest challenges facing the University as it grows over the next decade is the recruitment and retention of the best faculty. It is estimated that the University will need to hire approximately 7,000 new faculty by 2010 (4,000 associated with retirements and normal turnover, and 3,000 associated with enrollment growth). To attract those faculty, the University must pay competitive salaries. A lag in faculty salaries sends a negative message about the University across the nation. Nothing is more certain to undermine quality than an inability to offer competitive salaries.

The compensation proposal each year is based on a methodology developed by the California Postsecondary Education Commission (CPEC) for estimating the gap between the average salaries paid at eight comparison institutions and those paid by UC. Because of the budget cuts in the early 1990s, the University's average salaries fell significantly behind the average of its comparison institutions. By 1998-99, that gap had been closed. Funds are requested currently for a parity adjustment, in addition to the cost-of-living adjustment (COLA) for all employees sufficient to keep faculty salaries at the average of the comparison institutions. The calculation indicating the gap for next year will be available in the fall.

Compensation for Staff. As with the faculty, the University is competing regionally and nationally for high-quality staff needed to operate its programs. Salaries play a crucial role in attracting and retaining excellent staff. The University has been moving toward a more market-based model in setting staff compensation ranges. However, the market has become increasingly volatile, particularly in the information technology area, where demand outstrips supply and it has become increasingly difficult to recruit or retain qualified staff. In recent years, funds have been included in the budget plan for a parity increase for these employees to keep up with a highly competitive marketplace. Parity adjustments have been offered also to Cooperative Extension specialists, another employee group that has significantly fallen behind the market.

The University's budget plan usually includes a proposal for a COLA for all employees so that salaries at least keep pace with inflation. In the past, this COLA was based in large part on COLAs provided to State civil service employees. That pattern was disrupted, however, with the budget cuts in the early 1990s. In some years during that time, no increases were provided, while civil service employees' salaries were increased (in one year UC employees had a pay cut), and in other years State employees had no increases while UC employees' salaries were raised. Salary increases for State employees in 1999-00 and those proposed for 2000-01 are significantly above those provided to UC employees. Consequently, the University's salaries are lagging significantly behind those of State employees. This issue needs to be addressed in the next budget.

Price Increases for Non-salary Budgets. Programs can deteriorate without adequate funds to keep up with rising costs. The budget plan each year includes resources to offset the impact of inflation for the non-salary portion of the budget. The University generally requests an increase based on the estimated rise in inflation.

Support for Improving the Quality of Undergraduate Education. A key measure of quality and competitiveness with other research institutions is the student-faculty ratio. Until 1990-91, the University's budgeted student-faculty ratio was 17.6:1. This ratio was already higher than two of its public salary comparison institutions and significantly higher than all of its private comparison institutions. With the budget cuts of the early 1990s, the student-faculty ratio deteriorated even further, rising to 18.7:1. As the State's fiscal situation began to improve, The Regents identified restoration of the student-faculty ratio to its traditional level as one of its highest priorities. The budget for 2000-01 included the first step in a multi-year plan to reach a budgeted ratio of 17.6:1.

Funding for Core Needs. Four core budget areas that are inextricably linked to the quality of the academic program have been chronically underfunded in the past: building maintenance, instructional equipment replacement, instructional technology, and libraries. Permanent funding shortfalls in these areas were estimated to total $150 million in 1998-99. A four-year plan was undertaken to address the funding shortfall based on a component in the Partnership Agreement to provide an increase each year equivalent to 1 percent of the State-funded base budget for these four areas. With the 1999-2000 and 2000-01 budgets, over $50 million in State funds will have been directed toward these key areas; at the end of four years, the State will have contributed $100 million toward funding the gap. A portion of the shortfall will also be funded by redirecting resources within the University. The effort by both the University and the State to provide adequate funding for these core needs reflects the importance of these functions to the overall quality of the institution.

Funding for Deferred Maintenance. Adequate support for deferred maintenance has been among the most intractable funding problems in the University's budget. Chronic underfunding for ongoing maintenance has exacerbated the problem. Consequently, the deferred maintenance backlog of high-priority projects alone is estimated to be over $500 million. The funding provided through the Partnership for core needs will help address the ongoing maintenance problem and thus stop the deferred maintenance backlog from growing exponentially. With regard to deferred maintenance funding, the University has developed a program using increased income from nonresident tuition to pay for debt service on approximately $60 million to $65 million in long-term financing to begin addressing critical, high-priority projects. This program was begun in 1998-99 and is anticipated to continue at least through 2003, at which time over $300 million will have been made available for deferred maintenance projects.

One-Time Funding Needs. While the Partnership Agreement provides needed State support for the basic budget and for core unfunded areas, there continue to be extraordinary needs that small increments of funding cannot adequately address. These include additional funding for deferred maintenance, instructional equipment replacement, instructional technology, capital outlay funding, and other one-time needs. The University will continue to request funding for such one-time needs, as State resources are available.

2001-02 Budget: Funding Considerations for Maintaining Quality

As proposed in the Partnership Agreement, the State will provide basic operating budget adjustments of 4 percent per year on the State General Fund base, and an additional 1 percent on the base for the four core needs (ongoing building maintenance, instructional equipment, instructional technology, and library materials). The Partnership does acknowledge that the State may provide one-time funding for high priority needs. These funds, which would be contingent upon the State's fiscal situation, would be in addition to the funds provided to support the University's basic budget.

Each year, the University's expenditure plan for its basic budget needs takes into account both Partnership funding and an estimate of General Fund income earned by UC. Except for special one-time funding needs, any additional resources to maintain the quality of the programs must be funded from the base budget increases funded in the Partnership and from increases in UC General Fund income. This means distributing the Partnership and UC General Fund income among several high priorities, all of which play an important role in maintaining and enhancing the quality of the institution.

The Partnership Agreement also assumes increases in private and federal support to help maintain quality. Private support has grown from slightly over $100 million in 1980 to over $900 million in 1999-2000. Federal support continues to grow, although the rate of growth has varied over the last two decades. In the 1980s, federal research support rose by about 10 percent per year. In the early 1990s, the growth rate slowed dramatically to about 4 percent per year and then was flat in 1996-97. However, the federal budget situation has improved in recent years such that the rate of growth in 1999-2000 is expected to return to the 10 percent-per-year level.

Maintaining Access Under the Master Plan

The Master Plan calls for UC to accept students from among the top 12.5 percent of California public high school graduates and to provide professional and graduate academic education through the doctorate level. The University remains strongly committed to the Master Plan and to offering a place in the University to all qualified undergraduate students who wish to attend. As more students are enrolled, there must be adequate resources to fund portions of the budget that are affected by enrollment workload growth.

Annual Enrollment Growth. The University currently projects an annual enrollment growth rate of 5,000 FTE students (or about 3 percent) per year, based on assumptions presented to The Regents in October 1999 about expected growth in the number of Master Plan-eligible students, transfers from the community colleges, and graduate students needed to meet California's workforce needs.

Eligibility Under the Master Plan. Every few years, CPEC conducts a study of the proportion of California public high school graduates eligible for admission to UC and California State University. The most recent report, based on 1996 high school graduates, indicated that 11.1 percent of California high school graduates met the academic course, scholarship, and test requirements specified by UC for eligibility.

To achieve a pool of eligible students in the top 12.5 percent of California high school graduates as envisioned in the Master Plan, in March 1999 The Regents approved revised guidelines for freshman admission to the University. The guidelines provide a new "4 percent" path to eligibility for freshmen applicants entering the University in fall 2001 and beyond. Under this policy, 11th grade students who rank among the top four percent of their high school classes are eligible for admission to UC if they have completed a University-defined pattern of courses. In addition, The Regents approved a requirement that all students meet or exceed a minimum score on the eligibility index, which includes a combination of high school grade point average, Scholastic Assessment Test reasoning scores (SAT I), and subject scores (SAT II). It is anticipated that UC's eligibility requirements will yield a pool of the top 12.5 percent of California high school graduates.

The University's enrollment growth projections assume a continuing enrollment of about 7.5 percent of the California high school graduating class.

Community College Transfers. In fall 1998, the University and the California community colleges entered into a memorandum of understanding to increase the number of students who transfer from community colleges to UC from 10,150 in 1998-99 to 14,500 in 2005-06. The University's enrollment growth projections include an assumption that these numerical goals will be achieved.

Graduate Enrollment Growth. At the graduate level, student enrollment growth is planned by projecting the needs of higher education, the state, and the nation, and balancing that assessment with the ability of the State and the federal government to provide sufficient resources. The University's estimates for annual enrollment growth assume that graduate enrollments will increase at about the same rate as undergraduate enrollments.

Teacher Credential Program. In response to the significant demand for teachers in the state, the University developed a plan to more than double the number of students enrolled in UC education credential programs. Annual growth in the programs is estimated to be 450 FTE per year. This is included within the annual enrollment growth of 5,000 students.

Engineering and Computer Sciences. Technology is driving demand for more employees with degrees in engineering and computer science. The need for more highly trained workers with advanced degrees in these disciplines is especially critical. Consequently, as much as one-third of the growth in projected graduate student enrollment and significant growth in undergraduate majors will occur in engineering and computer science. With the 2001-02 budget, the University will be in its third year of an eight-year plan to increase by 50 percent the number of students in engineering and computer sciences by the year 2005-06. This plan calls for annual growth in these disciplines of about 1,000 FTE per year, included within the annual enrollment growth of 5,000 students.

2001-02 Budget: Funding Considerations Related to Maintaining Access

By agreement with the State, funding for enrollment growth is provided on the basis of the marginal cost of instruction, a calculation developed with the participation of UC, CSU, the Department of Finance, and the Legislative Analyst. Components of the calculation include salary and benefits for additional faculty; related instructional support, such as clerical and technical personnel, supplies and equipment; support for teaching assistant positions; institutional support; and support for libraries and student services. Marginal cost is provided for each additional student and is used in addition to student fee income to help support instruction. The University estimates that increases will total approximately 5,000 students per year for the next 10 years. In 2000-01, the State-funded portion of the marginal cost was $8,539 per student. This figure will be recalculated for the 2001-02 budget.

Capital Outlay. As enrollment increases, the University must provide facilities needed for growth and ensure that existing facilities are safe and are suitable for the academic program. The University estimates it will need approximately $500 million per year in capital funding for State-supportable space, about half of which would be used for projects related to enrollment growth and the other half for projects related to seismic and life-safety needs, infrastructure, and renovation of space that can no longer support the academic program. The University currently receives $210 million per year from the State in Proposition 1A bond funding through 2001-02, an amount that is insufficient to meet its needs. The State may support a larger bond issue for the four-year period beginning in 2002-03 as well as provide one-time funding for capital outlay, depending on the availability of State resources.

Maintaining Affordability

The University has a long-standing commitment to affordability. Mandatory systemwide student fees are about $1,300 below the average of its comparison institutions, and financial aid for needy students has increased dramatically in recent years. University students receive nearly $1.1 billion in financial aid from all sources, over half of which is in the form of grants. While it is important to maintain affordability, programs supported by fees must be cost-adjusted along with the State-funded portion of the budget.

For the last six years, the State has provided adequate funds to maintain student-fee-funded programs without the need for a student fee increase and since 1998-99 has actually funded a 10 percent fee reduction for undergraduate students and a 5 percent reduction for graduate students. Furthermore, a significant amount of financial aid for needy students has been added both because of increases in Cal Grant funding and because the State has maintained student financial aid funding in the University's budget at its existing levels despite fee reductions. These actions have helped keep UC affordable.

2000-01 Budget: Funding Issues Related to Affordability

The University's budget plan each year includes an assumption that funding equivalent to a student fee increase will be provided to support cost adjustments for fee-supported programs similar to those provided to State-supported programs. This funding may be derived either from a student fee increase or from a State-funded "buyout," depending on budget negotiations with the Governor and the Legislature. The Partnership Agreement proposes that any student fee increases would not exceed the increase in California per capita personal income and that at least one-third of any additional fee revenue would be used for financial aid.

Initiatives to Respond to Critical State Needs in Research and Public Service

The University's budget each year reflects an assessment of high priority needs within the state in many different areas, including the following: research, in which new knowledge discovered by the University enhances the quality of life and helps stimulate economic development and job creation in the state; public service areas, such as outreach, K-12 teacher professional development, and Cooperative Extension; and other programs that serve an identified statewide need. These are areas in which the University has a unique role to play or in which University expertise can be brought to bear on a major problem facing the state. As in past years, the annual budget request will include proposals for new initiatives that serve statewide needs in the context of the availability of State funding.

Research. The University of California plays a unique role in the state's economic development. The University attracts large amounts of federal funding into the state, its research leads to new knowledge that stimulates creation of new industries, and it acts as a magnet to business and industry seeking relationships with research institutions that can contribute to developing new products for the marketplace.

It was in this context that the Governor included funding in the 2000-01 budget to develop three major research centers on UC campuses. Funding is proposed at $75 million per year for four years for the *California Institutes for Science and Innovation.* This funding is to be used primarily for capital purposes to build the institutes, although some of the funds will be used for operating purposes as well. The funds are to be matched on a 2:1 basis by non-State funds. The University is seeking the approval of the State to apply the matching funds requirement to funds raised for both capital and operating purposes. These institutes will explore research potential in areas that show economic promise for the state, for example in agriculture, bioengineering, biotechnology, communications, digital media, information sciences, energy, environmental sciences, medicine, nanotechnology, and neuroscience.

Public Service. In 1996-97, the Outreach Task Force issued its landmark report recommending that funding for outreach be doubled over five years in order to accomplish the goals set out in the report. In recent years, the State has provided enormous increases for public service programs to help educationally disadvantaged students become eligible for UC and to help K-12 schools and community colleges improve their performance. Since 1996-97, funding for outreach and K-14 improvement programs operated by the University has quadrupled. There clearly exists in State government as well as the University a strong interest in the University's playing a lead role in assisting students and schools to greatly increase educational opportunities for those students who come from educationally disadvantaged backgrounds. Given the significant infusion of funds for outreach and K-14 improvement programs in recent years, it is important to focus on implementation and evaluation of these programs.

The Governor and the legislature have shown a growing interest in the need to increase transfers from community colleges to UC. The MOU with the California community colleges has already sparked considerable cooperative activity. Also, the Governor's January budget proposal includes funding to begin implementation of a program similar to the K-12 partnership program, in which community college partners are identified and UC and community college faculty and administrators work together to remove barriers to transfer.

2001-02 Budget: Funding Considerations Related to New Initiatives

The proposed Partnership Agreement acknowledges that State resources above the basic budget funding may be provided for new or expanded special initiatives or programs as approved by the Governor and the Legislature, including special research initiatives, and outreach and other public service programs to improve K-14 schools. Consequently, in addition to the second year of funding for the science institutes, consideration will be given to proposals for new and expanded efforts in selected areas in both research and public service (outreach and K-14 programs) for the 2001-02 budget. The University's process for developing such proposals will include both internal and external perspectives on whether the proposal is of high quality and high priority, as well as the extent to which the program would serve a statewide interest.

Vice President Hershman recalled the desire on the part of the Regents to be more involved in the budget process at an earlier point and to participate in the discussions and examination of priorities. He noted that the development of the 2000 budget has been guided by Regents' ongoing discussions.

Regent Hopkinson suggested it would be helpful if the programs within the principles were listed along with their funding allocations. She noted a concern with the significant challenges the University faces in recruiting graduate students. Some campuses may have a disproportionate increase in costs not addressed by the formula for supporting new students. She suggested listing where money is spent within the outreach program. She believed that other universities offer better student aid packages. Mr. Hershman commented that the University needs to start building its graduate programs. During the next ten years, the University will maintain the current ratio of undergraduate-to-graduate students. If a campus' growth of graduate enrollments is average, the marginal cost formula will be fair. Campuses with disproportionate increases to the systemwide average could be financially disadvantaged. This issue is being addressed in conjunction with the Academic Senate.

Regent Davies believed that the Regents should be free to express their preference for encouraging an improvement in the undergraduate-to-graduate student ratio, but he noted that individual campuses undergo complex negotiations with the Office of the President to which he doubted the Regents could add any value.

Mr. Eli Ilano, chair of the UC Student Association, shared some of the students' budget priorities for 2001-02. These include staff salaries, graduate student fellowships, student fees, and student services. He recalled that in October 1999 he had presented a student services budget proposal to the Regents based on a need that has been expressed by students to replenish services that were cut early in the decade. Student fees committees and student governments on the campuses were surveyed to put together a list of needs, and meetings were held with Vice President Hershman and individual Regents concerning budget issues.

Mr. Ilano reported that there were four areas of need within student services. The first is academic success services, which include learning resource centers, career centers, access to technology, and population-specific academic services. The second is access services, which includes child care, disabled student services, multicultural centers, women's centers, and gay, lesbian, bi-sexual, and transgender resource centers. The next category is health and psychological services, including alcohol and drug abuse counseling. The last area is facilities for student services. He noted that students get no State money to fund their facilities, many of which suffer from deferred maintenance and need seismic upgrading. He distributed a draft of student service priorities that outlines how the additional money would be spent on each campus. The financial need totals $30 million, which would be raised by shifting $200 per student from the Educational Fee to the Registration Fee. The State would need to fill the gap created in the General Fund. Mr. Ilano expressed the hope that the Regents would consider this proposal.

Mr. Ilano noted that a report was published by UCLA that emphasizes the contributions made by nonresident and international students to UC and discusses the adverse effects of nonresident tuition over the past decade. Students recommend that nonresident tuition be frozen and that full tuition and fee remissions be provided for nonresident students in teaching and research assistant positions.

Mr. Ilano reported that the prevention of hate crimes has been made a top issue by the UC Student Association, which held a joint conference with the Office of the President and is formulating some recommendations based on that discussion.

3. **REPORT ON THE FY 2001 FEDERAL BUDGET**

Vice President Hershman recalled that in past years very large cuts in federal government funding for research had been anticipated. He reported that the situation has improved each year and the cuts never materialized, due in large part to successful lobbying in Washington by representatives of higher education and research scientists. There has been bi-partisan support in many areas of importance to the University. Federal funds supporting the University total $5.7 billion. They support the Department of Energy laboratories, Medicare and Medi-Cal, research, and student loans and grants.

Vice President Darling commented about the federal fiscal year 2001 budget, noting that about two-thirds will be spent for mandatory purposes such as interest on the national debt, Social Security, Medicare, and Medicaid. That leaves only one-third for priorities set by the President and the Congress. Of that discretionary budget, nearly half is for defense programs, and the remainder is for domestic programs.

That is the segment of the budget for which the University competes. The current year budget of $273 billion was funded by adding $14 billion that cannot be spent until federal fiscal year 2001. The Congressional Budget Office devised a 2001 base line budget that was the 2000 budget incremented by the cost of inflation. The Clinton administration's proposal for 2001 represents only a 2.1 percent increase above that baseline. The Congressional budget resolution is slightly higher than the 2000 budget but is lower than inflation. That is the range within which the University seeks its funding.

Mr. Darling reported that 54¢ of every research dollar that reaches the University comes from the federal budget. Sixty percent of all of its financial aid, one-third of its hospital revenues, and nearly all of its laboratory research money come from the federal government.

President Clinton has noted a trend over the last few years of substantial increases for life sciences and medical sciences budgets and nearly flat funding for the physical sciences and engineering. In his budget he proposes to address this problem, with the support of the National Institutes of Health, to build the underpinnings for all sciences. He proposes a 17 percent increase for the National Science Foundation as well as growth above inflation for Department of Defense basic research, NASA, and the Department of Energy. Because of these proposals, the University is in a good budget situation for 2001.

Mr. Darling reported that President Clinton also had recommended substantial increases in student financial aid and education programs. Congress has met or exceeded his increases, with the exception of federal funding for outreach programs.

The President's proposed budget could have a negative impact on the University's teaching hospitals. He has proposed a prescription drug benefit which comes with a $14 billion price tag. Mr. Darling reported that the money will likely come out of Medicare funding. In order to pay for that, the President will propose that the amount of unpaid patient bills that the federal government will reimburse through Medicare be reduced. Reimbursement for prescribed drugs will be reduced also. The proportion of patient bills that must be paid by other insurers before Medicare will pay its share will be increased. Mr. Darling believed that although the University will receive more federal support than it has in decades from this budget, the University's medical programs will be affected adversely.

4. PROPOSED INCREASE IN NONRESIDENT TUITION FOR 2000-01

The President recommended that, effective with the fall term 2000, the Nonresident Tuition Fee be increased by $440 (4.5 percent), from $9,804 per nonresident student per year to $10,244 per nonresident student per year.

It was recalled that, in addition to paying nonresident tuition, out-of-state students also must pay the Educational Fee, the University Registration Fee, miscellaneous campus fees, and, if applicable, the Fee for Students in Selected Professional Schools.

The 2000-01 Regents Budget proposed an increase in the Nonresident Tuition Fee of 4.5 percent over the 1999-2000 level, and the proposed increase is incorporated into the Governor's Budget for the University. While the Assembly has not yet taken action on the University's budget, the increase is also reflected in the Senate's budget for the University. Consistent with State policy, with the proposed increase the University's 2000-01 total charges for nonresident undergraduate and graduate students will be higher than the State-funded marginal cost of instruction and less than the projected average of tuition and fees charged at other public institutions. For nonresident undergraduate students, the University's fees are expected to be about $525 less than the average of tuition and fees charged to nonresident undergraduate students at the four public institutions used for fee comparison purposes. For nonresident graduate students, the University's fees are expected to be about $330 less than the average of tuition and fees charged to nonresident graduate students at the institutions used for fee comparison purposes.

The proposed fee increase will generate about $6 million in new revenue.

The University intends to continue using increases in nonresident tuition to help fund the deferred maintenance and facilities renewal program. For 2000-01, it is anticipated that the $6 million in nonresident tuition income associated with the 4.5 percent fee increase will be used to finance approximately $60 million to $66 million of debt to help fund high-priority deferred maintenance projects.

Committee Vice Chair Preuss recalled that the State's tuition policy is one based on tradition. He believed that in order to act in the best interests of students the Regents should attempt to effect changes in that policy. He stressed the importance of attracting the best students from other countries and retaining them to develop California industry. He believed these students should not be discouraged from attending the University because of its high cost.

Regent Pannor reported that the UC Student Association had taken a strong stand against raising nonresident tuition.

Regent Hopkinson asked about a recent settlement agreement of the strike that included graduated reductions in fees for graduate student employees. Vice President Hershman explained that the agreement does not apply to out-of-state fees.

Committee Vice Chair Preuss expressed the hope that the message would be carried to the State administration that many Regents feel that State law governing nonresident tuition should be modified.

Regent Connerly noted that a California resident is paying forms of taxes that a non-resident does not pay. The politics of that circumstance must be weighed during analysis of the State fee policy.

Regent Lansing believed that the University's primary goal was to educate California residents. She noted that non-resident graduate students from within the country gain resident status relatively easily compared with students from out of the country. Regent Hopkinson observed that part of the University's educational mission requires providing teaching and research assistants, who are difficult to recruit, and the University does not provide them with as much financial assistance as other universities do.

Chairman Davies advocated reexamining the policy at a future meeting when the Regents have all the factors at hand. Faculty Representative Coleman suggested one solution could be to request more money for fellowships and other forms of financial aid. Also, the graduate student market is international. To get the very best students, the University needs to provide them with sufficient financial support.

Committee Chair Preuss moved that the President's recommendation be amended to reflect that the nonresident tuition policy will be reviewed during the next year. His motion was duly seconded. The Committee approved the President's recommendation, as amended, Regent Pannor voting "no" and Regents Preuss and Bagley abstaining.

5. **EXTERNAL FINANCING FOR THE 2000-01 UNIVERSITYWIDE DEFERRED MAINTENANCE AND FACILITIES RENEWAL PROGRAM**

The President recommended that:

A. Funding for the 2000-01 Universitywide Deferred Maintenance and Facilities Renewal Program be approved in an amount not to exceed $66 million from external financing.

B. The Treasurer be authorized to obtain external financing in an amount not to exceed $66 million to finance the Universitywide Deferred Maintenance and Facilities Renewal Program, subject to the following conditions:

(1) Average annual debt service shall not exceed $6 million (this limitation is intended solely as a limit on the amount of scheduled

debt service and not as a limitation on the extent of the pledge on nonresident tuition income).

(2) Repayment of the debt shall be from Nonresident Tuition income.

(3) The general credit of The Regents shall not be pledged.

C. The Officers of The Regents be authorized to provide certification that interest paid by The Regents is excluded from gross income for purposes of federal income taxation under existing law.

D. The Officers of The Regents be authorized to execute all documents in connection with the above.

It was recalled that in February 1998, the Regents approved the first year of a new approach to facilities renewal that will provide significant levels of funding over the next several years. The Regents authorized the Treasurer to sell bonds that provided $64.8 million for deferred maintenance and capital renewal for 1998-99, with repayment of the bonds from a portion ($6 million) of the increase over the prior year's UC general funds, specifically nonresident tuition funds. Only high priority projects with long-term benefits to the University are eligible to be funded through this mechanism. The Regents approved the second year of this program in June 1999 and again authorized the Treasurer to sell bonds that provided an additional $64 million for 1999-2000. As established in the first year, repayment of the bonds will come from $6 million in nonresident tuition funds.

Continuation of the University's Plan

The basic tenets of the University's plan, as first proposed in 1998-99, are as follows:

- University financing will be issued each year over a period of at least five years to fund "Priority 1" deferred maintenance and facilities renewal projects that have a minimum useful life of 15 years.

- The source of funds to be pledged and used for repayment of the debt will be nonresident tuition income.

- The amount of funding to be provided annually for debt service will be limited to no more than 5 percent of the annual increase in UC and State General Funds.

- The amount of funding to be provided annually for project costs will be influenced by current interest rates at the time of financing, which will determine the amount of principal which a specific debt service payment can support.

If this program is continued as planned, it is anticipated that $300 - $325 million will have been made available over a five-year period, through 2002-03, for deferred maintenance and facilities renewal projects. This will have a significant impact on reducing the highest priority deferred maintenance projects within the backlog, as well as funding many facilities renewal projects. The focus of the program in the third year will be complete system renewal.

This financing program has been and will continue to be augmented annually with State or UC general funds as temporary or permanent funding becomes available.

As described in the *2000-01 Regents' Budget for Current Operations* that was approved in November 1999, there has been no systematic funding for facilities renewal, and there are only very limited funds in the capital budget for the replacement of building systems. To make matters worse, the budget reductions of the early 1990s followed years of insufficient funding for ongoing as well as deferred maintenance. As a result, the University is faced with maintenance and facilities problems that cannot be adequately addressed with existing resources. Insufficient funding related to maintaining existing facilities falls into three major categories: ongoing maintenance, facilities renewal, and deferred maintenance.

Ongoing Maintenance. The *2000-01 Regents' Budget for Current Operations* includes an increase of $8 million to the base budget for annual building maintenance above and beyond that required to fund new space. This increase builds on the 1997-98 State funding increase of $7.5 million, the increase of $6 million that was provided in 1998-99, and an increase of $4 million in 1999-2000. These increases are consistent with the concept endorsed by the Legislature to develop a multi-year plan fully to fund ongoing building maintenance. However, based on State-recognized workload standards, building maintenance has been underfunded for some time. Even with these four increases to the base budget, building maintenance will remain underfunded by about $34 million annually in 2000-01. This deficit means that the University is being funded at approximately 75 percent of the existing need.

Facilities Renewal. Facilities renewal is a program systematically and predictably to replace or renew components of buildings and infrastructure to extend the useful life of facilities. The condition of the University's existing physical plant is a serious problem, resulting from the wear and decline associated with the age and intensive use of many buildings and infrastructure. The importance of facility renewal is obvious at a campus of the age of Berkeley or Los Angeles, but even the newest campuses of the University are now three decades old and are experiencing many of the same problems.

Normal use inevitably causes wear and tear on building systems causing them to wear out, and they must be replaced, regardless of how well they are maintained. Heating, ventilation, and air conditioning systems, elevator control systems, and roofs are a few examples of these systems. Normally, these systems would have useful lives of 25-30 years, but if funding for proper and timely annual maintenance is not available, the useful life of these systems is shortened. Infrastructure that constitutes the major support systems for the campuses include items such as electrical and water distribution systems, roads, sidewalks, and bridges. These are extensive, often complex systems that are costly to maintain or replace.

In the past, the University has not specifically budgeted annually for this category of expense. Many such projects have gone unfunded until they become emergencies. When they are funded, it can be as a part of ongoing maintenance, the deferred maintenance program, or as part of a major capital improvement project which renews building systems at the same time that programmatically-driven renovations are being made.

Two major factors contribute to creating the deferred maintenance backlog: insufficient ongoing maintenance funding and underfunded facilities renewal. Both of these problems lead to the deterioration of the University's capital assets and ultimately affect the quality of facilities provided for teaching and research. When laboratory and research space is outdated or substandard, the ability to attract and retain outstanding faculty and students is compromised.

The age of University buildings is another major factor that is contributing to the problem. There was tremendous growth and expansion throughout the University during the 1950s and 1960s. Almost one-half of the space that now houses State-supportable programs was constructed during those two decades, and almost two-thirds of all State-supportable space was built before 1970. The systems in these facilities have exceeded or will soon exceed their useful lives.

Funding History

The level of annual funding for deferred maintenance funding has been inconsistent in recent years and has varied from a low of $7 million to a high of almost $85 million. Permanent, annual State funding allocations for deferred maintenance ended in 1993 as part of State operating budget reductions that affected many areas of the budget. Prior to this, State funding of nearly $20 million per year had been provided. In 1994-95, the State authorized the University to use $25 million in long-term financing to pay for high priority deferred maintenance projects. A second authorization for $25 million was included in the 1995-96 budget. Consistent with agreements with the State, repayment of the debt is included in the University's State-funded budget.

The 1996 State Budget Act appropriated $5 million in general obligation bonds for deferred maintenance, and the University allocated another $19 million in one-time funds for deferred maintenance. The University reappropriated $7.9 million in excess general funds for deferred maintenance in 1997-98. In addition to the nearly $65 million in projects that were funded through the 1998-99 debt-financed program, the State provided the University with $20 million in one-time funds for deferred maintenance in 1998-99. In 1999-2000, $64 million was funded for the second year of the debt-financed program, and the Budget Act of 1999 included, for the first time in many years, a permanent increase of $7.1 million for deferred maintenance.

Financial Feasibility

As outlined in the University's Plan, the amount available for debt service for the Deferred Maintenance and Facilities Renewal Program will be limited to no more than 5 percent of the annual increase in the UC and State General Fund operating budget. For the 2000-01 financing, the University will use $6 million per year for debt service to be funded from the nonresident tuition income, as was done in 1998-99 and 1999-2000. Because this is the third year of the program, a total of approximately $18 million per year will be used to pay debt service for all three years.

Depending on interest rates at the time of financing, it is estimated that $56-$66 million will be available for project costs.

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

The meeting adjourned at 10:25 a.m.

Attest:

Secretary