The Regents of the University of California

COMMITTEE ON FINANCE
September 21, 2005

The Committee on Finance met on the above date at UCSF–Laurel Heights, San Francisco.

Members present: Regents Blum, Bustamante, Dynes, Hopkinson, Juline, Parsky, and Wachter; Advisory members Ledesma, Schreiner, and Oakley

In attendance: Regents Island, Johnson, Kozberg, Lozano, Marcus, Moores, Pattiz, Rominger, Rosenthal, Ruiz, and Schilling, Regent-designate Coombs, Faculty Representative Brunk, Secretary Trivette, General Counsel Holst, Interim Treasurer Berggren, Provost Greenwood, Senior Vice Presidents Darling and Mullinix, Vice Presidents Broome, Doby, Foley, Gomes, Gurtner, Hershman, and Hume, Chancellors Birgeneau, Bishop, Carnesale, Córdova, Denton, Drake, Fox, Tomlinson-Keasey, Vanderhoef, and Yang, Laboratory Director Anastasio, and Recording Secretary Bryan

The meeting convened at 10:15 a.m. with Committee Chair Blum presiding.

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

Upon motion duly made and seconded, the minutes of the meeting of July 21, 2005 were approved.

2. **UPDATE OF THE LONG RANGE PLANNING INDICATORS**

Senior Vice President Darling and Vice President Hershman discussed long range planning issues and provided an update on the quality indicators established when this series of presentations began in September 2002. The indicators were requested by The Regents to emphasize the importance of protecting and enhancing the quality of the University's teaching and research programs while addressing the challenges of enrollment growth and constrained resources.

Senior Vice President Darling recalled that in 2002 an environmental scan was conducted to identify external factors that could affect the University. Benchmarks were developed to monitor progress in maintaining educational quality, securing the necessary financial resources, and achieving the University's institutional goals. This effort was encouraged by Regents Preuss, Hopkinson, Davies, and Kozberg, who were concerned about maintaining the excellence of the University during this decade of exceptional enrollment growth. Their concerns at the time were compounded by the collapse in State revenue, which resulted in dramatic reductions in State funding for the University. This effort continues in conjunction with the Long Range Guidance Team that was appointed by President Dynes that includes Regents Parsky, Hopkinson, Kozberg, Rominger, and Rosenthal as well as chancellors, Academic Council leaders, and other colleagues. At the very least, quality means offering an excellent undergraduate education, nationally ranked graduate programs, and outstanding research. The quality indicators that are monitored move slowly and are not likely to change very much from year to year. The enabling factors, which can change quickly, are monitored as early warning indicators. Academic excellence requires outstanding faculty and support resources, but California's fiscal crisis has already taken its toll on the factors that enable quality in the University.

In 2002, complex variables were reduced to a traffic signal system. The slow-moving indicators were green but several of the early warning indicators were yellow, signifying caution and constant monitoring. Since then, faculty and staff salaries and graduate student support have deteriorated badly. Action must be taken, in addition, to address academic and support services before the effects become irreversible.

Mr. Darling commented on some trends in the State's economy and demographics. The economy and demographics of California are changing, making higher education more important than ever. More of California's future jobs will require a university education. The University must maintain and enhance its quality if it is to continue to be an engine of California's economic growth. Financial resources are essential to maintain quality; early warning signs, however, are pointing in the wrong direction. The compact with the Governor, combined with a recovering State economy, offer hope for the future, but other State spending priorities could diminish funding for higher education.

Mr. Darling noted that the shift to a knowledge-based economy has caused employers to pay an "education premium" for highly educated citizens. Census Bureau data indicate that earnings and unemployment are closely correlated with educational attainment. More broadly, there is mounting evidence that health, civic participation, and opportunities for one's children are also closely linked to a person's level of education. California's professional and managerial jobs are growing much faster than the average rate of growth for all other occupations, yet only one-half of the college graduates taking professional and managerial jobs in California received their college education in California. California's population is also changing. It increased by 50 percent between 1980 and 2005 and is expected to increase by another 50 percent by 2040. The state is quickly becoming a multi-national, multi-lingual, multi-ethnic, and multi-racial society. The impact of international immigration is having a profound effect on California's demographics. From 1940 to 1970, less than 10 percent of California's population growth was due to immigration. Since 1970, however, nearly 50 percent of the state's population growth has been due to immigration, primarily from Latin America and Asia. As a result, 25 percent of California's residents were born outside the United States, and another 25 percent are the children of parents born outside the United States. The generation born after World War II has had an important effect on the nation. In 1960 they were concentrated in the public schools. By 1980, they were in college or beginning careers, having driven up college enrollments in the 1960s and 1970s. The California Master Plan was a product of that generation. By 2000, they were in mid-career. By 2020 they will be retiring or retired. At that point, California could face the prospect of a very large dependent population at both the very young ages and the very old ages, a large retirement population that has twice as many senior citizens as currently, and a slightly larger number of school children, with the combined impact that the State's resources could be overwhelmed, as pressures on social and medical services, combined with pressures on the schools, drain State coffers. The only way to stay ahead of this is to have a highly educated, highly productive workforce that is supporting the very young and the elderly who are drawing on State resources.

Mr. Darling continued that the complexion of California's population is also changing. Projections for 2040 indicate an almost complete reversal of the percentages of the non-Hispanic white population and the Hispanic population. Whites will have decreased from 67 percent of the population to 26 percent, Hispanics will increase from 19 percent to 50 percent, Asian Americans will increase from 5 percent to 13 percent, African Americans will decline from 8 percent to 7 percent, and Native Americans will remain about 1 percent of the population. For the University's undergraduate student population between 1975 and 2005, whites declined from 81 percent to 43 percent, Hispanics increased from 5 percent to 16 percent, Asian Americans increased from 10 percent to 35 percent, and African Americans declined slightly. Given that many of California's most disadvantaged residents are educated in the state's lowest performing schools, the University's student academic preparation programs may be the beacon of hope to fulfill the educational aspirations of these students. Higher education is a more important pathway for upward social mobility than ever before. The University has successfully accommodated a growing college-age population but has not met the growing need for graduate and professional education.

Mr. Darling reported that California's fiscal crisis has hindered the University's progress on many measures. On the positive side, the persistence rates for freshman have increased; similarly, five-year graduation rates show improvement. Four-year graduation rates show greater improvement. There has been a positive trend in federal research support during the past decade, but more recently it has tailed off. Given the pressures on the federal budget both in terms of limiting discretionary federal spending and paying for the aftermath of Hurricane Katrina, further large increases in federal funding are unlikely.

Mr. Darling noted there are several indicators of strong graduate programs. UC is the only university with six campuses admitted to the Association of American Universities. Other rankings show that fewer public universities are among the nation's best, underscoring the widening gap between the best private universities and the best public universities, in large measure because of declining State spending in higher education as a percentage of state budgets.

Vice President Hershman focused his remarks on short-term indicators and problems. He observed that the University may not be able to count on federal funding in the long run to help solve its fiscal problems. Turning to State funding, he noted that the University had a $1.5 billion shortfall in its normal workload budget, despite the fact that enrollment continued to grow. With the Compact with the Governor, there was no further deterioration in 2005-06, and that will hold for 2006-07. The State funding in the first few years of the Compact does not provide funds to restore the previous cuts. It will only keep things even. It has been necessary to raise student fees to make up for some of the loss in State funds of about $2,500 per student, or $500 million. He reported that a set of priorities based on the Regents' priorities will be laid out in the next budget presentation for using that $500 million, if it can be restored over time.

Mr. Hershman recalled that there is a commitment in the Compact with the Governor to fund enrollment growth of about 5,000 students per year. Community college transfer rates, which have declined, are expected to return to an appropriate level during this decade. He recalled that at the beginning of the past few decades, the State has had economic problems which resulted in increases in student fees. The State decided to cut the University's budget and replace State funds with student fee revenue. The University has gone from very low fees to having fee levels more like the average of other public institutions. An important feature of the Compact is that the University has been able to keep the increased student fee revenue rather than losing it to the State.

Mr. Hershman dispelled the notion that not a lot of money is being put into financial aid. He reported that from 1990 to 2005, grant financial aid has increased from $200 million to over $1.1 billion. The increase has come from UC funds, Cal Grants, federal funds, and private donations. The University educates far more low income students than any other major research university. In spite of the recession and fee increases, the percentage of low income students has increased since 2000. About one-quarter of California families earn $60,000 to $100,000. Students entering the University are keeping pace with that percentage of middle income students. Graduate enrollments are expected to grow by about 1,000 per year and are projected to continue growing to 2010, including in the health sciences.

Mr. Hershman reported that salary levels have become an important issue. There is a national shift in the differential between salaries at public versus private institutions. The gap has increased from 10 percent in 1980 to 35 percent. The State policy has been that the University's average salaries should be comparable to the average of the best public and private institutions. During the 1980s, UC was in line with this policy. It fell behind in the early 1990s and then regained strength during that decade, but its salary levels now are 22 percent lower than the best of the private universities. Salaries must be brought back to competitive levels particularly as employees will soon be asked to begin contributing to the retirement system. A multi-year plan will be required to keep salaries from falling further behind. It will be necessary to strive to return the student-faculty ratio to 17.6:1. Academic support, including libraries and equipment, is seriously inadequate. It will be necessary also for the State to recognize maintenance of University facilities in the marginal cost formula, so that additional funds are provided as students are added. The University's high priority deferred maintenance projects amount to at least $500 million, and capital renewal needs have reached at least $200 million per year. Private funds, although not a substitute for State support, are becoming more critical.

Mr. Hershman reiterated that the University has suffered a 40 percent decline in State subsidy amounting to $500 million. He noted that student fees have increased dramatically, while the quality of the education provided by the University has suffered.

Mr. Hershman recalled that the Compact with the Governor provided a 3 percent increase for salaries in 2005-06, which will be insufficient to keep salary levels even; it will be increased to 4 percent for 2007-2010. Capital outlay is set at $345 million per year. The University will need to commit general funds of 3 percent to 4 percent to cover inflation. Student fees will be increased 8 percent for undergraduates and 10 percent for graduate students. For professional schools students, a three-year plan will be developed.

In summary Mr. Hershman observed that, as measured against The Regents' budget priorities, graduation rates for undergraduates had improved slightly, research funding had achieved an increase of less than half the goal, the rankings of graduate and professional programs were being maintained, undergraduate enrollment was returning to plan, graduate enrollment was near plan, faculty and staff salaries remained below market, academic support services had suffered large budget cuts, financial aid had been increased, graduate student support had fallen behind, and facilities were being maintained at only 84 percent of the CPEC standard. The Compact with the Governor provides a minimum level of funding. When the economy improves, the University will be seeking more money.

Committee Chair Blum raised the issue of productivity. To get salaries and class size in line will require about $380 million. He was skeptical that savings during the next three or four years generated in purchasing and information technology could amount to a significant contribution.

Regent Hopkinson acknowledged the scope of the University's financial problems. She commented that one of the Regents' priorities was not to let the student-faculty ratio goal exceed 17.6:1. She noted also that, although the dollars provided for student aid had increased dramatically, the percentage of return to aid remained below previous rates. Mr. Hershman responded that the combination of Cal Grants and UC return to aid, which had remained stable at 50 percent, actually represented one of the few positive areas in the budget.

Regent Marcus believed that public research universities were at risk. He believed the Regents should be spending less time reviewing the problems and more time finding solutions to them. He asked for the presentation to be broken down into segments over a period of time that are manageable, with solutions presented.

Chairman Parsky mentioned that a process had begun of having small groups of Regents review long range planning, student fees, and compensation. The budget presentation at the November meeting will reflect some of their conclusions, and those matters will continue to be addressed during the coming year. He believed it was important to see each issue in the context of the overall series of problems.

Regent Blum reported that at the November presentation the Regents would be informed about specific vulnerabilities on which they should focus. Senior Vice President Darling indicated that the November presentation would contain a further analysis of each problem and a plan of action that may be adopted or modified to address each vulnerable area.

Regent Pattiz agreed with Regent Hopkinson concerning return to aid levels. Mr. Hershman indicated that the cost of returning the level to 33 percent would be about $6 million. Regent Pattiz believed that return to aid, the graduate student situation, and professional fees were huge problems for the University. He was hopeful that finding ways to run the University more efficiently would result in making more money available for student aid.

Regent Moores was disappointed that the same problems had been discussed for the past several years and no innovative solutions were being presented. He believed that the responsibility for suggesting fundamental change rested with the University administration. He noted that there were many possible solutions that had never been suggested. Chairman Parsky agreed that every suggestion should be considered. President Dynes believed that the Regents would have to face making some fundamental changes.

Regent Rominger mentioned an issue that could be an indicator of quality – the international experience of the University's students. He observed that the University was losing students to overseas universities that will provide them with the experience necessary in a global economy.

Regent Juline believed that the presentation had been too subjective and that other indicators would provide more clarity in understanding the progress or lack thereof in each of the major categories. He noted that the student-faculty ratios were provided only on a budgeted basis and that the cost of instruction that was provided was not fully inclusive. He suggested presenting in November a quantitative analysis in terms of budget allocations to major categories that would show where things stand, what the goals are for improvement, and the magnitude and relative size of the gaps. Committee Chair Blum suggested also breaking down the categories to show, for instance, whether the ratios were acceptable in terms of salary and class size in the law schools versus the competition. Senior Vice President Darling agreed that some elements of the presentation had been subjective and should become more quantitative, but he emphasized that the indicators that were used were the ones that had been adopted by The Regents.

Regent Rosenthal asked that the November presentation address the issue of reestablishing return to aid levels to 33 percent. He asked the chancellors of campuses with professional schools to impress on their deans, as they determine those fees, not to lose sight of the fact that the University serves a public mission. He believed that, as the prestige of the University will always draw abundant applicants for faculty positions, it would be most appropriate to direct all available funds toward enhancing affordability for students rather than increasing faculty salaries.

Faculty Representative Oakley noted that the administration and the faculty would likely have some divisions of opinion as to what route should be taken with respect to the budget crisis. In moving to the stage of formulating policy to meet these challenges, the faculty perspective will be valuable. He advocated representing the faculty voice adequately when contemplating solutions.

Regent Lozano suggested working closely with the California State University on possible collaborations in areas such as support services and program offerings.

Regent Ruiz observed that two projects had been on the table for some time. One is the efficiency report; the other is the construction cost reduction plan. He was concerned that little progress was being made on these issues. Regent Kozberg noted that the cost of initiating changes can be significant. She believed the continuation of even minor changes would be helpful in creating the necessary culture shift that can foster more significant savings.

President Dynes invited Ms. Anu Joshi, President of the University of California Student Association, to present her comments. Ms. Joshi displayed slides illustrating the total cost of attendance for first-year students as compared to other public institutions, noting that increases in fees have changed the way in which students view their ability to attend. She noted that the number of hours a student must work has increased dramatically over the last 20 years. She advocated not raising student fees and restoring return to aid to 33 percent.

Provost Greenwood recalled that the issue of return to aid is complex. She noted that talking about return to aid on fees is not the equivalent of talking about the money that the University puts into financial aid. The 33.3 percent return to aid to which Ms. Joshi referred is on the incremental change on the fees. It has been as low as 16 percent and as high as 33.3 percent. Last year it was about 26.5 percent. If adjustments are made to help middle class students, it may be 28 percent in next year's budget. She pointed out that other universities may accept fewer low income students, who require additional support, than the University accepts. Access for needy students has always been important to UC.

> [For speakers' remarks, refer to the minutes of the September 22, 2005 meeting of the Committee of the Whole.]

3. **UNIVERSITY DEBT STRUCTURE**

Committee Chair Blum commented that the capital expenditures that the University needs to make are substantial, but they are offset by the fact that interest rates and the University's ability to finance debt in the public markets have never been better. The University has more debt capacity that was believed previously.

Senior Vice President Mullinix invited Assistant Treasurer Young and Mr. John Augustine, of Lehman Brothers, to review the University's debt structure, goals for restructuring University debt and how several of them were accomplished, a market update, financing opportunities, and the next phase of restructuring.

Assistant Treasurer Young reported that, as of September 1, the University has outstanding bonds totaling $5.7 billion. This does not include campus-originated leases or $1.7 billion in State lease revenue bonds for UC projects. Long-term, fixed-rate bonds are issued for the permanent financing of construction. Tax-exempt, variable rate commercial paper is used to provide for the construction financing for projects prior to permanent financing. Taxable commercial paper is used to provide a lower cost alternative to the Short-Term Investment Pool for intergovernmental transfers under the Medi-Cal 1255 and 855 programs. Bank debt is used primarily for gift-funded projects. The University's weighted average interest rate is 4.46 percent for all debt, which compares very favorably with its public and private peer institutions.

Outstanding UC debt has been accelerated since 1990, representing a compound growth rate of approximately 8.4 percent. The State has issued $1.7 billion from the State Public Works Board (SPWB) for University projects. The State budgets the debt service for SPWB bonds, but these are considered a "double-barreled credit" by rating agencies and are reflected on the University's balance sheet as a liability. As such, these count against UC's debt capacity, although perhaps not dollar for dollar. The State has never failed to appropriate the debt service. The University's bond rating generally is Aa/AA category, while the State's is A.

In addition to the University's $5.7 billion in outstanding bonds, there is another $1.67 billion in projects approved but not yet permanently financed, of which approximately $1 billion is in various phases of construction and approximately $670 million is in the design, bidding, or rebidding process.

Total projected debt to 2007 is $7 billion, allowing for scheduled principal amortization.

In addition to the SPWB outstanding of $1.7 billion, there is another $650 million of debt authorized by the State Budget Act to be issued by the State for University projects, including the California Institutes for Science and Innovation, seismic bonds for UC's hospitals, the Merced campus, and various other classroom projects on the campuses. With principal amortization, SPWB debt will total $2.2 billion in 2007.

Long-term debt by campus in June 2007, when the $1.67 billion of approved projects will have been financed, is projected to be $6.4 billion, which reflects amortization of principal over two years and does not include commercial paper and bank loans. Because campuses with medical centers count that debt as part of the campus total, the totals for those campuses will be higher.

That same debt by repayment source has been projected by campus source. At approximately 38 percent, housing is the largest component of debt by repayment. The Opportunity Fund category of 22 percent is the second largest fund source and represents indirect cost recovery from federal contracts and grants. As an institution, the University of California has financed more debt for research facilities backstopped by federal indirect cost recovery than any other research institution.

A goal in debt restructuring is to rethink the strategy for financing for core projects such as research and infrastructure, auxiliaries such as housing and parking, and health care. An effort will be made to increase debt capacity by considering structures which involve UC financing as well as financing by others on UC groundleases. It is hoped that the cost of financing can be reduced by modernizing indentures and that there will be additional flexibility to take advantage of state-of-the-art financial instruments when appropriate. Private ownership of housing and office buildings will continue to be explored, as will expanding the source of capital by looking for opportunities overseas.

In Sept 2003, the University inaugurated its first phase of debt restructuring by issuing under a new General Revenue Bond (GRB) structure to finance core projects, provide financing flexibility, and reduce the cost of borrowing. GRB structure no longer links projects by revenue streams in terms of the revenue pledge. It expands the pledged fund source from approximately $800 million net revenues tied to projects financed to $3.8 billion of defined revenues, including student fees, non-resident tuition, auxiliary income, and indirect cost recovery. The indenture was modernized, and the cost of borrowing was reduced by eliminating the reserve fund requirement. GRB structure increased debt capacity for core projects, including research, infrastructure, classrooms, and libraries, to $2 billion rated at the AA level.

The Limited Project Revenue Bond (LPRB) structure was introduced to preserve debt capacity in General Revenue Bonds at the Aa2/AA level for core projects related to instruction, research, infrastructure. The LPRB structure finances auxiliary projects including housing and parking and is supported by the gross revenue of projects financed – a departure from the General Revenue Bonds, which is not project specific, but an improvement over the Multiple Purpose Pool structure used up to 2003 which pledged Net Revenues. LPRB gross revenue pledge indicates to the market that debt service comes first, which is part of the University's commitment always to pay debt service on its bonds. This structure has the same covenants as General Revenue Bonds but subordinates the lien; payments come after those to General Revenue Bonds. It is a tribute to the strength of the UC system that there was only a slight rating differential. This subordinate structure adds $1.5 billion to debt capacity if expanded to the A level, which makes the University's total debt capacity about $3.5 billion.

To preserve UC's debt capacity at all levels, an alternative to UC ownership for student housing has been developed. These structures enable third-party ownership of student housing on campuses, subject to a controlling ground lease. The projects are rated on a stand-alone basis and must be self supporting. Beds are added to the inventory of on-campus housing without the need for other beds on that campus to subsidize the new bed rate. The University does not manage or become involved in the income stream; it does not guarantee occupancy or net income. It receives market -rate ground rent, subject to the terms of the ground lease, and attempts to moderate increases in student bed rents by linking increases to the Consumers' Price Index (up to 3 percent and 50 percent of CPI above 3 percent). The availability of inclusion area land with appropriate access limits this option somewhat. The Davis, Riverside, and Irvine campuses have used the option, and it is being explored for Phase 3 of Merced campus housing.

Working with Mr. Augustine and his team at Lehman Brothers, the University developed an innovation called Financing Trust Structure which follows the example of UC's own bonds by allowing the pooling of revenues and reserve funds from different projects and project owners. This pooling ability will reduce the borrowing costs for projects; for example, East Campus Phase 2, the first project financed under this indenture (which is not a UC indenture), borrowed 75 percent of Debt Service Reserve fund rather than the 100 percent typically borrowed, saving approximately $2 million in bond costs. This structure works for projects which need lower cost, tax-exempt financing to "pencil out." For accounting reasons related to the structure, this debt is reflected on UC's balance sheet, although it is not responsible in any way for the costs of operation or debt service.

The True Non-Recourse Structure for housing keeps the project off the balance sheet and mirrors the commercial housing market structure. The developer-owner must receive the type of return reflective of the risk it has for the transaction. UC receives market rate ground rent, adjusted for the terms of the ground lease developed through an appraisal. Bed rent increases can be tied to an objective index such as CPI. The True Non-Recourse model requires developer or owner equity and conventional financing. The Davis campus is employing the True Non-Recourse model to develop Phase 1 of the West Village project. The True Non Recourse model will continue to be explored with the campuses, and new sources of capital for equity and financing, including overseas markets, will be sought.

The University keeps abreast of interest rate markets for opportunities to reduce the interest cost for projects. In 2003, two major refinancings were issued which resulted in savings of $40 million present value over the 35-year life of the bonds. This was followed by another refinancing this past June to reduce debt service costs by $25.8 million for a variety of projects, including housing, research, and deferred maintenance, and a refinancing in early 2004 saved UCLA Medical Center approximately $4.3 million present value for its bonds.

Assistant Treasurer Young turned to Mr. Augustine to provide a brief overview of the market. Mr. Augustine displayed a chart showing interest rates from 1985 to present, both tax-exempt and taxable, short and long. As the Federal Reserve has increased short-term rates eleven consecutive times, long-term rates have continued to decrease. The University is within 30 basis points of a 30-year low. Cost to capital is at an attractive point. He noted that the yield curve has flattened because the short end has risen and the long end has fallen. When debt is issued, the cost of paying for that debt service during a construction period is much less. This offers an opportunity to capture a low cost of capital. Senior Vice President Mullinix noted that when the University can lock in long-term rates, it has more long-term flexibility to be able to have a variable rate on this part of its debt structure as interest rates rise.

Assistant Treasurer Young explained that to take advantage of these low fixed interest rates, the University is planning two bond sales, one for General Revenue Bonds, the second for Limited Project Revenue bonds. The sale of General Revenue Bonds has been scheduled first because that bond sale includes a refinancing which is very sensitive to the level of interest rates. The second sale for the subordinated Limited Project Revenue bond structure has been scheduled for the end of the month.

The next phase for debt restructuring will result in portfolio management of all UC debt, which is the way in which corporations manage debt. Although General Revenue bonds look to general revenues for financing pledge, the financings are aimed at individual projects. In this sense, projects assume the risks of market timing and interest rate volatility.

The goal in treating debt as a portfolio rather than as discrete series of bonds is to simplify bond management between the Office of the President and campuses, reduce the overall interest cost, and retain the interest risk at systemwide. This will be implemented with a series of variable rate bonds, which will be managed centrally at the Office of the President – the "Central Bank" – and will charge projects at a lower interest rate than would be available in the fixed rate market. The Central Bank will allow assigning the same lower interest rate to all projects financed for 30 years.

Assistant Treasurer Young concluded the presentation by noting that there are significant savings to be realized for each campus in proportion to the amount of 30-year project financing it has. Swaps will be employed for the portfolio as well, rather than for groups of projects, as if using individual bond series.

Senior Vice President Mullinix commented that the University will issue a substantial amount of bonds in October. The University typically finances projects after construction is complete.

Committee Chair Blum noted that tax-exempt securities have to fund specific projects. Mr. Mullinix reported that the University has several hundred million dollars worth of projects that have been approved but are not being financed. Because of the market conditions, it is uncertain how those projects will proceed.

Regent Hopkinson asked about privatized housing on University campuses. Assistant Treasurer Young reported that all the housing is under 501(c)(3) ownership that qualifies for tax-exempt financing, although taxable structures are being considered. Regent Hopkinson was concerned that taxable structures could result in higher costs and about the lack of control that the University has over the activities in those housing units. She asked whether there were a structure that would maintain control and give students the same legal position as in University-owned housing. Senior Vice President Mullinix responded that there is a continuum; the University may give up some control but may be able to provide more housing. Although he believed that most third-party housing projects have worked out very well, Regent Hopkinson recalled one instance where the University bought a private sector housing development because of the lack of control.

Regent Hopkinson was concerned also about the costs to housing occupants. Mr. Mullinix acknowledged that equity financing increases costs. That is why the

University is seeking additional sources of capital equity. Regent Hopkinson suggested that the potential impact on students needed to be assessed as the structure is developed.

Committee Chair Blum offered a summary of the situation. He believed that by the end of the year all the activities under discussion would be pulled together in a clear-cut forecast that focuses on six issues. These include increasing productivity; obtaining unrestricted alumni support; building grass roots among alumni to secure good relationships with key government officials; addressing student fee issues; catching up on deferred maintenance; and determining specific capital funding needs for the next two years. The focus needs to be on the specifics so as to reveal vulnerabilities campus by campus and possibly even school by school, making it possible to form the information into a plan and move forward expeditiously.

4. **REPORT ON NEW LITIGATION**

General Counsel Holst presented his **Report on New Litigation**. By this reference, the report is made a part of the official record of the meeting.

The Committee recessed at 12:35 p.m.

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The Committee reconvened on September 22, 2005 at 10:25 a.m. with Committee Chair Blum presiding.

Members present: Regents Blum, Dynes, Hopkinson, Juline, and Parsky; Advisory members Ledesma, Schreiner, and Oakley

In attendance: Regents Gould, Island, Johnson, Kozberg, Lozano, Marcus, Moores, Rominger, Rosenthal, Ruiz, Sayles, and Schilling, Regent-designate Coombs, Faculty Representative Brunk, Secretary Trivette, General Counsel Holst, Interim Treasurer Berggren, Provost Greenwood, Senior Vice Presidents Darling and Mullinix, Vice Presidents Broome, Gomes, Hershman, and Hume, Chancellors Birgeneau, Bishop, Carnesale, Córdova, Denton, Drake, Fox, Tomlinson-Keasey, Vanderhoef, and Yang, and Recording Secretary Bryan

5. **AUTHORITY TO AGREE TO DEFEND AND INDEMNIFY THE CITY OF BERKELEY AGAINST ANY LITIGATION ARISING FROM APPROVAL OF AN ENCROACHMENT PERMIT FOR THE FOOTHILL PEDESTRIAN SAFETY BRIDGE, BERKELEY CAMPUS**

The President recommended that he or his designee be authorized to execute an agreement with the City of Berkeley pursuant to which the University would defend and indemnify the City of Berkeley against any future litigation and court costs arising from the issuance and approval by the City of Berkeley of a major encroachment permit above Hearst Avenue that permits the University to construct a pedestrian crossing for the Foothill Student Housing.

It was recalled that the Foothill Housing Complex, 2700 Hearst Avenue, Berkeley campus, includes housing for 345 students in 38 units north of Hearst Avenue, and 429 students in 43 units south of Hearst Avenue. Dining commons, a study lounge, and mail facilities are located south of Hearst Avenue. The Foothill Pedestrian Safety Bridge, part of the Foothill Housing Complex as originally designed and approved by The Regents in 1988, would connect these two sections of the complex, providing all-weather, ADA-compliant access between living units and to amenities across Hearst Avenue.

The Berkeley campus first filed an encroachment permit application with the City of Berkeley in 1988. At that time, the city manager wrote to the campus indicating that the bridge concept was acceptable to the City. Construction documents were completed, but the City requested that the campus retract the application because of community controversy over the design. The campus filed a second application in October 1992 and withdrew it in May 1993. The campus engaged in further design work and obtained additional community input in 1998 and 1999.

The campus redesigned the bridge to address community concerns regarding seismic safety, bulk, opacity, and risks due to thrown objects, and filed a third encroachment permit application in February 2003. In 2003 and 2004, the re-designed bridge and encroachment permit were supported by the City of Berkeley Commission on Disability and the Planning Commission. The Landmarks Commission, Public Works Commission, and Design Review committee (a sub-committee of the Zoning Adjustments Board) were opposed to them.

The Berkeley City Council scheduled the encroachment permit for a hearing in July 2004 after commission review and community meetings on the project. In April 2005, the City Council met at the Foothill Complex for a site tour and a public hearing. The council approved the encroachment permit by a 6 to 3 vote on April 26, 2005, conditioned upon design modifications to be approved by the Public Works Director in consultation with the Design Review Committee and on an agreement by the University to defend and indemnify the City from and against litigation arising from the City's approval of the permit.

The City has since received communication regarding the permit approval from an attorney representing New Education Development Systems Inc., owner of 2717 Hearst Avenue. The communication seeks repeal of the City's approval because of a prejudicial abuse of discretion in making the decision. If litigation ensues, the University will bear the cost of defending the City's action.

Project cost is estimated at $2 million, to be paid from student housing reserves. The current design does not deviate sufficiently from the previous design to change the environmental conclusions made in the Addendum to the Foothill Student Housing EIR.

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

6. **POLICIES ON UNIVERSITYWIDE AND SENIOR LEADERSHIP COMPENSATION, AND PROCEDURES FOR SENIOR LEADERSHIP COMPENSATION**

The Advisory Group on University Compensation recommended that at the November 17, 2005 meeting, The Regents approve the following:

A. To adopt the goals of obtaining, prioritizing, and directing funds, to the extent they are available, to increase salaries to achieve market comparability for all groups of employees over the ten year period from 2006-2007 through 2015-2016.

B. To adopt procedures for determining and setting compensation levels for senior leadership that are clear, comprehensive, and accountable, as described in Appendix 1.

C. To augment funding of salaries for amounts in excess of $350,000 with private funds for 42 senior leadership positions so that market parity is achieved over the next ten years, as described in Appendix 2.

The Committee was informed that the overall goal of adopting the policies and procedures is to align the compensation of University of California faculty and staff with their market comparators. These actions will modify current Regents' policies and procedures on compensation.

University of California salaries are below comparable market salaries by an average of 15 percent, as of July 1, 2005, with variances by category ranging from 10 percent to -20 percent. Salaries were below the market prior to the recent budget difficulties; the lack of funds for annual salary adjustments in the last two years has exacerbated the lag of University salaries behind the market. The Advisory Group on University Compensation was formed to consider alternative strategies to address these compensation issues and to consider more efficient and responsive policies and procedures.

At the request of the Advisory Group, the University engaged Mercer Human Resource Consulting to assess the competitiveness of the total remuneration offered by the University, to report on the UC total remuneration with relation to the labor markets in which the University competes for talent, and to provide information in a context for use by the Regents in determining short-term actions, longer-term strategies, and policies and procedures for determining comparability and setting salaries.

University of California Health and Welfare Benefits

UC benefits currently exceed the comparator group significantly. The Retirement portion of these benefits is measured in future dollars and therefore is not of immediate value to employees. Younger employees do not place a high value on these benefits. For employees who do not remain with the University over the long term and who leave University employment relatively early in their careers or for senior personnel who join the University late in their careers, the Retirement benefit is of significantly less or, in some instances, no value. Additionally, it is anticipated that the value of both the Health and Welfare benefits and the Retirement and Retiree Medical benefits will be reduced significantly over the next few years, as discussed below.

Active Health & Welfare Benefits

The Mercer study reported that UC's active health and welfare benefits exceed the market median value by 10 percent overall; this is well within a competitive range. For the Management and Senior Professional category of employees, the lead over the median is small (approximately 2 percent); for members of the Senior Management Group, the lead over the median rises to 33 percent as a result of differences in benefits provided, such as the employer-paid senior management group life insurance and the disability provision for senior managers who have served five consecutive years.

Healthcare costs have continued to rise in recent years while University salaries have remained flat. To help mitigate the impact of rapidly increasing healthcare costs and keep participation levels high in the University's healthcare benefit programs, the University adopted a salary-based approach for medical plan premiums so that lower-paid staff members contribute less toward the costs of their medical coverage. Because it is anticipated that the percent of increase in healthcare costs will exceed the percent of increase in salaries in the coming years, it appears that even if gross salaries improve, University employees may perceive that their net pay is not increasing commensurately.

The University will not be able to provide sufficient healthcare contributions to offset the increase in healthcare costs; therefore, the relative advantage to market will be reduced.

Retirement and Retiree Medical

The Mercer study reported that UC's retirement and retiree medical benefits exceed the market median value by 63 percent overall; the leads of the various employment categories range from 15 percent over the market median for non-ladder-rank faculty and other academics to over double the market median for service workers.

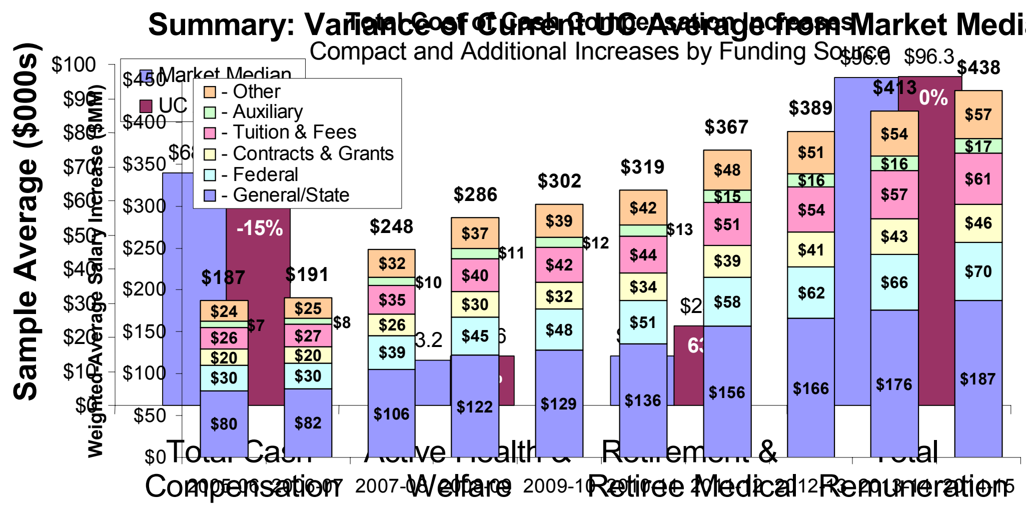
The University of California is among the few institutions continuing to offer a robust retirement plan and the full continuation of the health insurances into retirement. No contributions have been made to the retirement plan by employees since November 1990. Employer and employees are expected to contribute within two to three years, which will reduce the relative value of this benefit to market.

As of January 1, 1990, the University instituted a graduated schedule of eligibility, with the result that employees hired on or after that date must have ten years of service to be eligible for the continuation of healthcare benefits into retirement and must have 20 years of service to be eligible for the full University contribution; however, this has become a very expensive benefit. Given the cost, the University is reviewing this benefit level. Expected adjustments in the next two to three years also may reduce the relative value of this benefit to market.

Total Compensation

The Mercer study reported that overall the total remuneration package provided by the University of California is close to the market median value when benefits are factored into the equation; however, as noted above, the value of these benefits is expected to be reduced over the next five years as employee retirement contributions are phased in and the relative value of health insurance coverage declines. Additionally, retiree and retiree health benefits are not recognized as beneficial to many employees for many reasons (the benefit may be far in the future or may not be realized by employees who leave University service). Also, the value of the benefit offerings varies significantly based upon individual and group demographics, which may seriously hinder recruitment efforts.

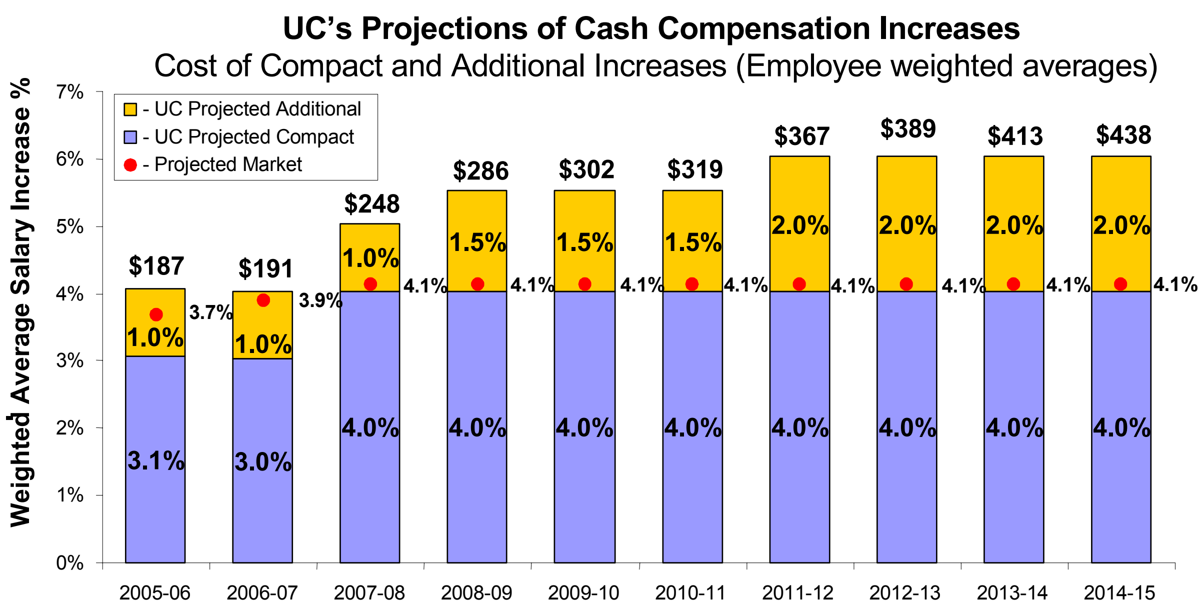
TABLE 1 - Total Remuneration Study Findings



NOTE: Percent breakdown of funding sources provided by UCOP and remain constant over time

NOTES: Averages reflect the total remuneration study population only and not UC system-wide figures -study did not include labs or medical centers; individual employees fall significantly above and below the UC averages; totals are not additive due to market median variations and rounding

RECOMMENDATION A: TO ESTABLISH GOALS TO OBTAIN, PRIORITIZE, AND ALLOCATE FUNDS, TO THE EXTENT THEY ARE AVAILABLE, TO INCREASE SALARIES TO ACHIEVE MARKET COMPARABILITY FOR ALL GROUPS OF EMPLOYEES OVER THE TEN-YEAR PERIOD FROM 2006-2007 THROUGH 2015-2016.



NOTE: Salary increase percentages provided by UCOP; total cost based on payroll at Campuses and UCOP as of March, 2005

The tables above show the proposed goals for *cash* compensation and sources of funds over the next ten years to achieve market comparability. The *total* cost of achieving comparability (in current dollars) is $2.5 billion using a 4.0 percent growth rate.

In summary, the recommendations will result in the following actions, which are described in more detail in the policies, priorities, and process for senior leadership discussed in Recommendation B below and Appendix 1.

The University will actively pursue obtaining additional funds from State and all other resources.

The Regents will determine annually the amount of funds available for this purpose to be allocated to each campus and to the Office of the President.

The Regents will set annually Universitywide and campus-specific funding levels and priorities for the use of funds, as recommended by the President, for all groups of employees, considering such factors as total compensation discrepancies, retention, recruitment, performance, and other matters.

RECOMMENDATION B: TO ADOPT PROCEDURES FOR DETERMINING AND SETTING COMPENSATION LEVELS FOR SENIOR LEADERSHIP THAT ARE CLEAR, COMPREHENSIVE, AND ACCOUNTABLE IN ACCORDANCE WITH THE PRINCIPLES IN APPENDIX 1.

The Regents and Senior Management have recognized for some time that the salary review process is ineffective.

- The current process of individual salary review does not provide for a systematic framework in which The Regents can assess Senior Leadership salaries.
- The comparability data currently provided to The Regents do not provide sufficient information to judge the individual positions and appropriate placement within the comparability range.
- An individual approval of salaries does not provide an effective process for assessing overall compensation.
- Failure to adjust the approval levels to reflect the effects of inflation has resulted in an excessive number of individual actions that require Board approval.
- While the Board has benefited from ad hoc compensation studies, routine external salary survey data, and CPEC analyses, there has not been a systemic, continuous external review procedure for individual positions.

Therefore, the Advisory Group on University Compensation recommended that:

- A salary range structure shall be approved by the Board of Regents for all campus and OP positions and shall be established based on recommendations of an external consultant.
- The Board of Regents will approve annual adjustments to the salary ranges based on an external consultant review and recommendations of the ranges and the placement of all targeted positions within this grade structure.
- For all positions of the Senior Leadership Compensation Group whose compensation exceeds the Indexed Compensation Level (ICL), the procedures described in Appendix 1 shall be used. Briefly, these procedures are:

The Indexed Compensation Level (ICL) that was used for 2004-2005 was $168,000. The ICL shall be adjusted annually based on the CPI and shall be reported annually to the Regents in accordance with Regental Bylaw 12.3(m)(2).

(1) The salaries for 32 positions specifically listed on Appendix 1 shall be directly approved by The Regents, with advice and recommendations as detailed in Appendix 1.

(2) The President, for all positions in the Senior Leadership Compensation Group except for the 32 directly approved by The Regents, will, with the advice of the Senior Management Advisory Committee, determine specific salaries for each position within the grade structure approved by The Regents and consistent with the budget funding levels approved for each campus and for the Office of the President, by The Regents.

(3) All salary increases in any one year that result in any salary over the maximum of the salary range for the position or any increase in excess of 15 percent that places the salary above the midpoint of the salary range for the position shall be individually approved by The Regents.

(4) An annual report shall be made to The Regents on all positions and salaries for all whose compensation is in the Senior Leadership Compensation Group (i.e., in excess of the Indexed Compensation Level).

RECOMMENDATION C: TO AUGMENT FUNDING OF SALARIES FOR AMOUNTS IN EXCESS OF $350,000 WITH PRIVATE FUNDS FOR 42 SENIOR LEADERSHIP POSITIONS SO THAT MARKET PARITY IS ACHIEVED OVER TEN YEARS IN ACCORDANCE WITH APPENDIX 2.

State funding for the overall University Compensation program is limited, and the University will be challenged to achieve its long-term compensation goals. Salaries for senior positions at the University of California have one of the highest percentage gaps to market, creating significant challenges in recruitment and retention.

- The University must attract the finest leaders if it is to retain its truly excellent position, and it faces significant competition from other institutions in attracting and retaining key leaders.
- Some friends of the University have expressed an interest in assisting the University by providing funding to assure competitive salaries for select leadership positions.
- As is done at a number of other elite publicly funded universities, the experience of others indicates that strict controls must be established to assure the integrity of any process for supplementing compensation.

Therefore, the Advisory Group on University Compensation recommended that:

Funding for 42 positions be sought from private sources for the salary amounts in excess of $350,000 annually. There are eight of these positions whose salary is in excess of $350,000, although this number will increase as salaries reach comparability over the next ten years. The use of private funding would be in accordance with Appendix 2 for portions of certain leadership salaries in excess of $350,000. The positions that would be eligible for private funding are:

- The President
- Chancellors
- Deans of Business-Management
- Deans of Engineering
- Deans of Law

This group could be expanded to include Senior Vice Presidents and Executive/Senior Vice Chancellors in future years.

Briefly, policy restrictions include:

(1) No University official could solicit funds for his or her own salary.

(2) Only select donors could be approached for these contributions, in a manner approved by The Regents.

(3) All funds raised through this process would be held by the President and used at his discretion and within the guidelines established by The Regents to augment salaries.

(4) Donors could designate selected campuses or positions as potential beneficiaries of their contributions, but the donor could not control the salary levels or the timing of the use of these funds.

(5) These funds would be used to augment salaries of certain Senior Leadership group positions for which the annual salaries exceed $350,000 for the fiscal year 2006-2007, which amount will be adjusted annually in accordance with Bylaw 12.3(m)(2) based on the CPI and reported to The Regents annually.

(6) The President has the authority to use the augmentation funds within the salary levels approved by The Regents in accordance with Appendix 1, except for those positions as specified in Appendix I - Senior Leadership Compensation Policy that require direct Regental approval.

(7) Until private funding is obtained for the augmented portion of the salaries for these positions, current fund sources will continue to be used to provide for the

total compensation in accordance with procedures specified in Appendix 1 - Senior Leadership Compensation Policy.

Regent Hopkinson recalled that the Advisory Group on University Compensation which had evaluated Universitywide compensation programs consisted of Chairman Parsky, herself, Regents Kozberg and Marcus, President Dynes, Senior Vice President Darling, and Senior Vice President Mullinix and his staff. She emphasized the challenge to maintaining quality that the University is facing. Sources must be identified and used to fund salaries over the next ten years. She noted that, although the Committee on Finance will discuss the advisory committee's recommendations, final action would be delayed until the November meeting.

Regent Hopkinson commented that Recommendation A sets the goal to increase University salaries to market levels over the next ten years through a variety of resources. Recommendation B is a proposal to implement a new, logical, reasoned process for establishing salaries for approximately 800 leadership positions throughout the University, similar to the process used for the rest of the positions at the University. Based on the independent consultant's study and recommendations, it will establish 16 ranges for employees. Appendix 1 summarizes those recommendations. First, there are 32 positions that will report for salary setting purposes directly to The Regents. For the remaining positions, a baseline salary of $168,000 in 2004-05 dollars is set. All salaries for all positions over that will be established based on the procedure outlined in Appendix 1. An annual independent study will be conducted, and recommendations made. The Regents will establish the 16 ranges based on that study as presented in November. Year one, which will be in November, every salary within the group of 800 will be set within those ranges. The Regents will no longer approve individual salaries, but adjustments to the ranges must be approved by The Regents. Annually, The Regents will set priorities for the use of funds for increases and will determine funding allocations for increases by campus. Increases above the range must be approved by The Regents; movement of a person from one range to another must be approved by The Regents; any individual increase in excess of 15 percent that places that person above the median will come to The Regents; and any salary for that person beyond the range will come to The Regents. There are three categories which will be handled slightly differently. The salaries for personnel in the Offices of the Treasurer, General Counsel, and Secretary, the chief executive for each of which reports to The Regents, will be determined by the President, the Chairman of the Board, and the Chair of the Committee on Finance. If there is not agreement among those parties, they will appeal to The Regents to establish the salaries.

Regent Hopkinson commented that Item C is a proposal for funding 42 of the 800 positions that exceed the $168,000 level – to fund with private funds the portion of the compensation for those 42 positions over $350,000. The criteria and procedures for that are outlined in Appendix 2. She noted that Appendix 2, paragraph (3), second bullet should read, "Donations may be made to an individual campus, but the funds shall be held by, allocated by, and distributed by the President, except for those held by the President, which shall be administered by the Chairman of the Board of Regents and the Chair of the Committee on Finance."

Regent Hopkinson stated that this is a proposal to bring to comparability over ten years and supplement with State funding that portion over $350,000, relieving the State of this burden and allowing that money to be used for other positions. This will be done consistent with the proposal for all employees, across all positions, for the whole University. To put this in perspective, the endowed professorship programs currently used for research, salaries, and graduate students throughout the University use $40 million annually, derived from a $1 billion endowment fund. If these 42 positions were being paid comparable salaries, the portion in excess of $350,000 would be $446,000 annually. That would require approximately a $10 million endowment. There are only three positions in this category in excess of $350,000, for total funding of $97,000. It is also proposed that these positions would continue to use State funds until private money is raised. The process for setting the salaries for these 42 positions would be no different than the process proposed for Item B.

Mr. Bob Miller, of Mercer Human Resource Consulting, recalled that in his presentation at the July 2005 meeting, he had discussed the results from a study of total remuneration at UC. That study examined cash compensation, the value of the health and welfare benefits for active employees, and the value of retirement and retiree health for those employees. Subsequent to that presentation, the Advisory Committee requested the consultant to analyze what might happen to the University's competitive position over the next ten years assuming that there were changes that affected the value of these benefits; that there would be a resumption of contributions to the retirement plan; and that, even though medical cost inflation is running at rates in the low double digits, UC's subsidy for medical coverage would continue to be at its current budgeted level. With the aid of slides, he illustrated the outcome of the study, using aggregated data that looks at averages. He reported that there are likely to be changes that will reduce the value of benefits over time, which will further erode the University's position. The Mercer study found that even though cash compensation was about 15 percent low, total remuneration including benefits and retirement was very close to competitive levels; however, with the coming changes in the value of benefits, the position could erode. The question is how to address the overall compensation strategy in light of these potential changes and to quantify what it will cost the University to maintain its competitive position. To do that, ten-year estimates were prepared, and sources of funding for compensation were reviewed.

Regent Hopkinson emphasized that the proposal does not recommend salary increases. She recalled that the proposal to use private funding is not new either at UC or at other comparable public institutions. Appendix 2 shows the kinds of criteria and controls that are recommended.

Regent Rosenthal asked what the process was for obtaining feedback and input for the 800-employee class in developing the recommendations. Senior Vice President Mullinix responded that there was a discussion with the Senior Management Advisory Committee and the Council of Chancellors on the process that was being recommended.

Faculty Representative Brunk noted that the Academic Senate is quite interested in the issue. He reported that, although Senior Vice President Mullinix and Mr. Miller had briefed Academic Senate leadership on the issues, the Senate's Academic Council had not yet discussed the issues. Neither the Senate nor the faculty has taken a position on the recommendations.

Regent Moores was troubled by the recommendations, which he noted had been distributed only a few days before the meeting. He believed that the material was too complex to vote on. He asked whether there were an adjustment for a local cost of living. Mr. Miller responded that in the survey work and the competitive analysis done by Mercer for both the initial total remuneration study and the projections that were discussed, where national data were used to price a job a wage differential was applied to bring the national average median wage up to estimated California levels in the cities in which the University has employees. For instance, on average, a clerical job at a national level would be paid 19 percent more in San Francisco. Where California data was used, no differential was applied. For ladder rank faculty, under the CPEC methodology using eight comparison universities, no differential was applied, given the nature of the universities and their locations. Regent Moores believed that adjustments would be necessary in order to achieve the goal of attracting and retaining faculty in the University's expensive locations.

Regent Hopkinson responded that the presentation had been made at this meeting in order to give the Regents two months before being asked to vote on the recommendation. Chairman Parsky commented that because it deals with executive compensation, there is a policy that requires an action taken by the Committee on Finance to sit for 20 days before it might be taken to The Regents. He observed that there were two procedural choices; the policy could be amended, in which case the Committee on Finance could take the issue up for action at the November meeting and recommend it to The Regents, or the Committee could refrain from acting on it at this meeting and subsequently act on it in November, after which the 20-day requirement would begin and the item would be taken to the Board at its January meeting. The Office of the President would prefer that if the Regents were to act positively on the recommendation, it would be done in the context of the November budget presentation. Members of the Committee on Finance who decided to vote for the recommendation at this meeting would have the option of voting against it when it came to the full Board in November.

Regent Moores asked about the basis for the $350,000 salary cutoff. Regent Hopkinson responded that it was a consensus of the Office of the President and the advisory committee based on an examination of the positions that would and would not be included. Regent Moores asked whether there were a rationale for asking the State of California to pay market wages for everybody except the chancellors. Regent Hopkinson reiterated that the justification for the choice of $350,000 related to the number of people who would be paid over $350,000 over a period of time and the positions that were felt to be ones that would attract donors. Chairman Parsky added that in recruiting chancellors for the various campuses over the last several years, it has become clear that the competition was paying higher salaries than the University could offer; therefore, at a time when State funding was restricted, the committee was asked to consider whether there were a level above which if private funding were available and designated it could supplement the State level of funding. The assessment was that up to the $350,000 level the University was able to recruit effectively. In the coming year, the University will need to recruit a chancellor for UCLA. The competition for that position is significantly above $350,000; therefore, it may be possible to secure donor support in order to compete for that position. Chairman Moores restated his question, asking why it has been determined that it would be inappropriate to ask the State to pay a market rate for a chancellor. He believed that market rates should be paid for all University positions. He commented that the notion that the Regents may not approve any salary item that is promoted by UCOP is not supported by evidence; therefore, providing Regental oversight seemed superfluous. He suggested contemplating the benefit of disclosure. He believed the chancellors were capable of making the appropriate decisions and disclosing them. Regent Hopkinson noted that that is what is being proposed, except for 32 positions.

Regent Marcus asked that those who will be involved in implementing and using this new delegation, including the Office of the President, the chancellors, and the faculty, confirm that it will not encumber them and have unintended consequences in terms of hiring and retaining the best and brightest. He believed that implementation would give the Regents more time to consider more important matters. He was adamantly opposed to the recommendation in Item C, which segregates a class and divides the system. He was concerned that the State could use it to set a level at which it could begin to reduce support. He believed that the Regents needed the courage to pay comparable salaries, despite the political ramifications. He asked for a report on how often the University loses ladder rank faculty and why, which he believed was the critical issue.

Faculty Representative Oakley reported that, as chair of a subcommittee of the Academic Council on senior and executive compensation, he believed he should alert the Committee concerning the issues that were likely to arise. He noted that policy speaks of the invitation to the Faculty Representatives to attend all meetings of the Board and of its Committees and, in addition, to serve on advisory committees of standing and special committees of The Regents. He was concerned that the policy of shared governance that

Chairman Parsky had reaffirmed recently be observed in the fact. He noted that he had heard the compensation advisory group referred to in several ways. The policy declaring that faculty representatives should be on all committees is subject to evasion by having committees of committees to deal with sensitive issues. He was concerned that the recommendation had not gone through the usual process of active faculty input. There are also issues that will arise in terms of process at the execution stage. Faculty salaries are subject to peer review, which is difficult for management salaries, but there needs to be some effective performance review. That is undertaken by the Office of the President, but he believed the review was pro forma. He asked whether it was appropriate to hope to protect the market salary and retain management first, having the faculty acknowledged as part of a ten-year plan but with no information as to how that ten-year plan would be funded. Finally, he believed the issue of principle would be raised – whether private funds should be used to pay public salaries. One possibility would be to establish an endowment, although he estimated that the size of an endowment to fund the contemplated support would require a $5 million to $10 million corpus. If that were possible, the final principle problem would be answered; that is, if management salaries are to be modeled on football coach salaries, it must be acknowledged that football coaches are subject to popular referendum. They get fired when they do not please the people. He did not believe that senior management should be looking to the *vox populi* as opposed to a much more sophisticated form of performance evaluation.

Regent Kozberg noted that all segments, including the public, the faculty, the students, and the employees, have a stake in the University. She emphasized that the committee work had taken two years to create the fabric to contain the entire issue and had attempted to design strong business practices to provide a basis for a dialogue on compensation. The recommendations have not been presented capriciously; they have received thoughtful input from many sides.

Regent Parsky commented that the overall direction to Regent Hopkinson had been not to create more complication or micromanagement but to do the exact opposite while simultaneously taking into account the Regents' overall responsibilities. Parts A and B of the recommendation are a serious attempt to do that; however, it was not an effort to avoid input from all Regents and the faculty. Part C was introduced after the initial direction. The use of private funds to help salaries for certain parts of the University in order to maintain competitiveness is not new. Faculty and other elements of the University have been supported with private funding. He suggested that it may be difficult to reconsider the recommendations as soon as November. He believed more time would be needed to understand all elements of the recommendation. He believed that the process should not be rushed.

Regent Hopkinson believed the Committee on Finance should vote on it, and whether it comes back in November of January should be subject to further coordination among various parties. She moved Items A and B, which were seconded, and C, which was not seconded.

Committee Chair Blum agreed with her proposal and with Regents Moores and Marcus that the University should pay whatever it must in order to be competitive and suffer the consequences. At the suggestion of Regent Marcus, Regent Hopkinson amended her motion to include only Items A and B. The amended motion was duly seconded.

President Dynes stressed that these recommendations were not being made by the President but by the advisory committee. He believed salaries of all employees should be brought up to market. While the plan addresses senior management, it is the intention to try to bring compensation for all employees up to market. It was his opinion that the recommendation provides the chancellors with the flexibility to administer salary policy so as to reward good performance and comment on less than best performance. In that sense he favored that delegation. The campuses would be able to choose their direction. He agreed that the plan needs consideration by the Academic Senate and the chancellors and favored putting it on the table for open discussion by everyone.

Regent Rosenthal believed that the only funds evident for supporting the proposal were student fees and that, unless there is effective long-term planning for student fees, the conversation was an academic exercise. A funding source must be secured first.

Committee Chair Blum disagreed. He explained that the intention is to put a new process in place for deciding how to compensate employees that will provide more flexibility. History indicates that the State's portion of the University's budget will continue to decline. This is an attempt to find a better way to decide compensation and be competitive. He viewed it as an interesting proposal that needs further discussion.

[For speakers' comments, refer to the minutes of the September 21, 2005 meeting of the Committee of the Whole.]

The Committee voted to approve Items A and B, with the understanding that all three recommendations could be reconsidered at the November meeting. The motion carried.

The meeting adjourned at 12:15 p.m.

Attest:

Secretary

Appendix 1

SENIOR LEADERSHIP COMPENSATION POLICY

1. POSITIONS INCLUDED UNDER THIS POLICY SHALL INCLUDE all positions of the University whose compensation is in excess of the Indexed Compensation Level (ICL), and this group of positions shall be called the Senior Leadership Compensation Group, or SLCG.

2. APPROVAL OF COMPENSATION shall be as follows:

   a) Compensation of the President and Secretary of The Regents shall be determined by the Board of Regents upon recommendation of the Committee on Finance.
   b) Compensation of the General Counsel shall be determined by the Board of Regents upon recommendation of the Committee on Finance after consultation with the Office of the President.
   c) Compensation of the Treasurer shall be determined by the Board of Regents upon recommendation of the Committee on Finance after consultation with the Office of the President, the Committee on Investments, and the Investment Advisory Committee.
   d) Compensation of the Chancellors, Senior Vice Presidents and Vice Presidents, Medical Center Heads, and the Laboratory Directors, including compensation upon appointment and subsequent changes in compensation, shall be determined by the Board of Regents upon recommendation of the President through the Committee on Finance.
   e) Compensation of other Officers of the University with annual rates above the Indexed Compensation Level shall be established within the ranges set by the Board of Regents and determined by the President and shall be reported annually to the Board of Regents.
   f) Compensation of all other Officers of the University with annual rates below the Indexed Compensation Level shall be determined by the President and reported annually to the Board.

3. As provided in The Regents' Bylaws, the Indexed Compensation Level (ICL) shall be adjusted annually in accordance with changes in the Consumer Price Index and shall be reported annually to the Board. The base ICL used for 2004-2005 was $168,000.

4. For all positions in the Senior Leadership Compensation Group, The Regents shall approve salary ranges annually upon recommendation of the President and/or in accordance with the process specified in item 2a through 2e above. Such recommendations shall be based on comparisons to the Full Comparison Group, the New Comparison Group, the Comparison Eight, the Private Peers, and the Public Peers, and on equity within the University of California. A cash compensation study shall be conducted annually and shall provide the basis for setting the salary ranges.

5. The methodology for setting the Salary Ranges shall reflect the relationship of the UC campuses to the comparison institutions and to other UC campuses.

6. All salaries for the SLCG except for those 32 requiring direct Regental approval (2a through 2d above) shall be determined by the President within the Salary Ranges and budget levels approved by The Board of Regents and funding levels available from State funds and other University sources, including private funds available, in accordance with Appendix 2. The Board of Regents shall set priorities annually for the use of available funds as recommended by the President, considering factors such as total compensation discrepancies, retention, recruitment, performance, and other matters.

7. Any salary for a member of the SLCG above the approved Salary Range shall be presented to The Board of Regents for approval through the Committee on Finance.

8. Any salary increase in excess of 15 percent of base salary for a member of the SLCG that will result in a salary above the salary grade midpoint for the position must be approved by The Board of Regents.

9. The President may establish procedures and delegate to each of the Chancellors the ability to set salaries for the SLCG within approved ranges for:

   - Non-represented Professional and Support Staff;
   - Management and Senior Professional Staff whose salaries are under the Indexed Compensation Level.

10. The President may establish procedures and delegate to each of the Chancellors the ability to set salaries in accordance with Universitywide guidelines established by the President for certain other non-SLCG employees.

11. All salaries for each position in the SLCG shall be reported to The Regents annually, following the annual merit process. The report shall include the methodology used to set salaries within the ranges and shall provide comparisons within campus and Universitywide for the positions and salaries reported.

12. On recommendation of the respective Principal Officer of The Regents, compensation for the Office of the Treasurer, the Office of the General Counsel, and the Office of the Secretary (excluding the Treasurer, the General Counsel, and the Secretary, whose compensation shall be approved by the Board of Regents in accordance with paragraph 2 above) shall be determined by the President, the Chair of the Board of Regents, and the respective Committee Chair of The Regents. In the event that the parties do not concur, compensation shall be determined by the Board of Regents. If such salaries are in excess of the current Regental ICL threshold, then the Board of Regents shall determine the ranges for such salaries in accordance with item 3 above.

Appendix 2

POLICY ON PRIVATE FUNDING FOR PORTIONS OF CERTAIN LEADERSHIP SALARIES

With the goal of using private funding to augment the salaries of certain Senior Leadership Compensation Group administrative positions designated by The Regents for which the market salary requirements exceed $350,000, annually adjusted, as of July 1, 2005, The Regents:

1. Authorize the President to raise private funds and allocate such private funds for specific positions as approved and designated by The Regents.

2. Designate the following positions eligible to use private funding for the portion of the salary in excess of $350,000:

   - The President
   - The Chancellors
   - Deans of Business-Management
   - Deans of Engineering
   - Deans of Law

   This group could be expanded to include Senior Vice Presidents and Executive-Senior Vice Chancellors in future years.

3. Establish a process to review and approve the donors to be solicited for the salary augmentation program using these guidelines:

   - Donors may designate the position or positions whose salary/salaries may be augmented with their funds.
   - Donations may be made to an individual campus, but the funds shall be held by, allocated by, and distributed by the President, <u>except for those held by the President, which shall be administered by the Chairman of the Board of Regents and the Chair of the Committee on Finance.</u>
   - No donor contribution may augment a salary beyond ranges or levels approved by The Regents.
   - Fundraising efforts shall be focused on providing sufficient resources for multi-year salary augmentation.
   - The President shall submit an annual report to The Regents on private funds obtained for this program and on the use of these private funds for salary augmentation.
   - University officials shall be prohibited from soliciting funds for their own salaries.

4. The University will continue to support salaries for such positions with all applicable funds until private funds become available.

5. The University may support salary augmentation with both current and endowment funds.