The Regents of the University of California

COMMITTEE ON FINANCE
January 22, 2014

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

Members present:	Regents Blum, Flores, Gould, Island, Kieffer, Reiss, Ruiz, and Wachter; Ex officio members Lansing, Napolitano, and Varner; Advisory members Jacob, Leong Clancy, and Saifuddin; Staff Advisors Barton and Coyne
In attendance:	Regents De La Peña, Feingold, Makarechian, Pattiz, Schultz, Sherman, and Zettel, Regent-designate Engelhorn, Faculty Representative Gilly, Secretary and Chief of Staff Kelman, Associate Secretary Shaw, General Counsel Robinson, Chief Compliance and Audit Officer Vacca, Provost Dorr, Executive Vice President Brostrom, Chief Financial Officer Taylor, Senior Vice Presidents Dooley and Stobo, Vice Presidents Allen-Diaz, Brown, Duckett, and Lenz, Chancellors Block, Blumenthal, Drake, Katehi, Khosla, Leland, Wilcox, and Yang, and Recording Secretary Johns

The meeting convened at 9:50 a.m. with Committee Chair Ruiz presiding.

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

Upon motion duly made and seconded, the minutes of the meeting of November 14, 2013 were approved.

2. **UPDATE ON THE FEDERAL BUDGETS FOR FEDERAL FISCAL YEAR 2014 AND FEDERAL FISCAL YEAR 2015 AND THE IMPACT ON THE UNIVERSITY OF CALIFORNIA**

[Background material was provided to Regents in advance of the meeting, and a copy is on file in the Office of the Secretary and Chief of Staff.]

Senior Vice President Dooley recalled that federal budgets for the past several years had been adopted by continuing resolutions, not by regular order. Subject to the agreements reached the previous fall and implemented the previous week by the U.S. House of Representatives and Senate, and signed by President Obama, the federal government appeared to be back on a regular track for proceeding with appropriations bills. At this moment it would be appropriate to provide an update on the implications of these developments for the University.

Associate Vice President Gary Falle described highlights of the federal fiscal year 2014 budget. The omnibus appropriations bill, a voluminous document of about 1,600 pages, had been passed the previous Friday. UC staff had carried out some preliminary analysis of the bill. Federal funding for UC in 2012-13 is estimated at more than $8 billion in research grants, student aid, Medicaid and Medicare payments for patient care, as well as management fees for operational costs associated with Lawrence Berkeley National Laboratory (LBNL). Approximately 68 percent of the federal budget is made up of mandatory programs, such as Social Security, Medicare, Medicaid and interest on the national debt. The rest of the federal budget is considered discretionary, with about half of discretionary funds used for defense spending. The efforts of Congress and the federal government over the past several years to reduce the federal deficit have focused on the discretionary portion of the budget. In 2011, as part of deficit reduction efforts, Congress passed legislation requiring sequestration, including automatic, across-the-board spending cuts if certain spending targets are not met by Congress. Unless repealed or delayed, sequestration could reduce the federal deficit by $109.3 billion every year for ten years. Congress did not achieve these targets the previous year. Across-the-board cuts to discretionary programs, totaling five to six percent were implemented directly on the previous year's funding. For the University, these cuts were most noticeable in UC's research funding. Preliminary data for 2013 indicate that the UC system has experienced an approximately 12 percent drop in federal awards compared to 2011-12. This includes about four percent fewer National Institutes of Health (NIH) awards and nine percent fewer National Science Foundation (NSF) awards. There were similar reductions in other federal programs. The fiscal year 2013 budget impact is important; it provides a context for understanding Congress' actions in the 2014 budget just passed. While the University actively opposed sequestration from the beginning, Mr. Falle stressed that this law is still on the books until repealed or delayed. The current omnibus budget has repealed sequestration for the current and the next year, and partially restored some discretionary program funding. There is a slight increase in some domestic program funding from the 2013 level. While the broad range of programs would see increases above the levels of the previous year, when sequestration was in effect, a preliminary examination of the numbers indicates that nevertheless, the funding levels of many accounts remain below what they were two years ago.

Mr. Falle underscored the significant ground the University has lost due to sequestration and inflation. Funding has not returned to the levels of the 2007 domestic appropriations. In December 2007, the NIH received approximately $29.2 billion or about $32.8 billion in current-year dollars. The fiscal year 2014 budget provides $29.9 billion, a nearly $3 billion decrease in inflation-adjusted dollars compared to fiscal year 2007.

For most programs that are important to UC, the fiscal year 2014 budget is a flat budget. It restores some funding cuts from the previous year's sequestration, but, because of inflation, provides no growth. The Pell Grant program is the largest discretionary program in the Department of Education, and approximately 40 percent of UC's students are eligible for Pell Grants. The 2014 budget provides the same level of funding for the Pell Grant program as provided during the previous four years. The maximum award would be $5,730 in the next academic year, an increase of only $85 above the current year. The funding for campus-based programs such as the Federal Work-Study program, international education, graduate education, and many academic preparation programs is flat, or with small increases in fiscal year 2014. But overall, this funding is below the levels of two years earlier.

The federal government is the University's single largest source of research funding. In 2011-12, UC received nearly $3 billion in federal research funding, accounting for about 65 percent of UC's research awards. It is estimated that annually, the University of California receives about eight to ten percent of all federal funding for basic research grants awarded to universities. Increases in funding for research-sponsoring agencies usually result in higher funding for UC in subsequent years. The NIH, NSF, and the Departments of Energy, Defense, and Agriculture are the five largest sources of federal funding to UC. The NIH received a $1 billion increase for fiscal year 2014 above fiscal year 2013. However, the fiscal year 2014 level is nearly $1 billion short of the enacted fiscal year 2012 funding level. Language in the bill highlighted a budget initiative for NIH and its commitment to the BRAIN (Brain Research through Advancing Innovative Neurotechnologies) Initiative. Several UC campuses are expected to be engaged in this initiative. The NSF fared well, with an approximately $280 million increase over the previous year. Basic and applied research programs of the Department of Defense remained relatively protected. The Department of Energy received an increase, and UC campuses and LBNL are significant research partners with that Department's Office of Science and Office of Energy Efficiency and Renewable Energy. The Los Alamos and Lawrence Livermore National Laboratories fared well, with a continuation of funding for weapons modernization efforts. The Department of Agriculture also fared better in this budget than in 2013. UC Health receives over $2 billion annually for provision of patient care services under Medicaid and Medicare. The 2014 budget has no real impact on these funds, which are part of the government's mandatory spending.

Mr. Falle concluded that while the University had hoped for more federal investment in education, research, and health care, the fiscal year 2014 budget could have been much worse for the University if the lower funding targets in sequestration had not been repealed; instead of a flat budget there could have been significant reductions. The federal budget process was now on a regular order. The budget agreement passed in December set targets for 2014 and 2015. The University had already begun to work with the California congressional delegation about funding for 2015. Priorities would be determined in consultation with the Office of the President and the campuses.

Regent Pattiz noted that the category of "Laboratory-directed research and development" at the National Laboratories, which often includes projects involving collaboration with the campuses, had been affected by the budget reductions being discussed. The Laboratories were feeling the same effects as the University, although not to the same degree.

In response to a question by Regent Makarechian, Mr. Dooley explained that federal fiscal year 2013, which began on October 1, 2012, was the year when the impact of sequestration first hit. The budget just passed is for the current fiscal year, which began October 1, 2013. Mr. Falle added that for last year's funding levels, UC received approximately $8 billion in federal funds, including funds for research, student aid, and Medicare and Medicaid.

Regent Makarechian asked if indirect cost recovery is based on previous contracts, with the University billing for the previous year's work, and if the University was being reimbursed for what it had already spent. Mr. Falle responded that UC researchers apply and compete for contracts within a given year, and receive funds based on the appropriations bill for that year, not on future appropriations. Indirect cost recovery is built into research grants and is paid from the previous year's budget.

Regent Makarechian asked if, when a reduction is going to be made in a coming year, the government might not pay the indirect cost recovery for the previous year. Mr. Dooley reiterated that indirect cost recovery is included in the research grant. The University does not bill in arrears for this. The reduction would be in the amount of grant awards the government might make in a future year.

Regent Gould stressed the importance of the Pell Grant program for UC and the magnitude of student demand. He asked about the implications for the University of flat funding for this program over a period of four years. Mr. Falle responded that the Pell Grant program is unique in that it is supported by both discretionary and mandatory funding. The flat funding for Pell Grants over the past four years was on the discretionary side. The law provides for mandatory monies for the Pell Grant for the maximum award, based on inflation. This mandatory funding would continue. The discretionary funding for the Pell Grant program is contained in an appropriations bill and competes with the Departments of Labor and Health and Human Services. It appears that the funding for the Pell Grant program in future years might not be sustainable if criteria for eligibility are not reviewed. Congress was currently working through reauthorization of the Higher Education Act, and part of this process was an examination of the sustainability of the Pell Grant program. The University is very actively working to protect its interests, should there be any changes to the program.

Regent Flores noted that students have been especially attentive to the University's presence in Washington, D.C. for the previous year-and-a-half. Students would be meeting with members of the California congressional delegation in March. Students are eager to take part in UC advocacy efforts.

Regent Kieffer referred to Mr. Falle's earlier statement that UC receives about eight to ten percent of all federal funding for basic research grants to universities. He asked how this figure compared to percentages for UC over the past 20 years. Mr. Falle responded that he could provide this information. The eight to ten percent funding has been average for the past few years. When federal funding for research grows for the NSF and NIH, it grows for UC as well. He recalled a major effort by Congress, the America COMPETES Act, to put research funding on an upward trajectory. Research funding also increased in the American Recovery and Reinvestment Act. It is only since 2010-11 and 2011-12 that the trend has gone down.

Regent Kieffer reiterated his request for information on UC's federal research funding as a percentage of the whole, as well as on the research funding for private universities in California, and on funding levels over time. Mr. Dooley responded that California institutions of higher learning, both UC and private universities, compete very well for federal research funding. Percentages also vary by funding source or agency; the University is close to garnering 15 percent of total competitive federal research funding granted by the Department of Agriculture.

Regent Kieffer stated that it is important for the California public to understand how much research funding UC and private universities bring into the state, and how that money is used. This understanding would lead to a greater appreciation of the research carried on at UC.

Committee Chair Ruiz referred to Mr. Falle's observation that UC has lost ground in federal funding. He asked if the University has the necessary resources to manage in this new environment and to improve its ability to generate funds. Mr. Dooley responded that UC had not lost ground in relation to other universities. The sequestration cuts, made across the board, reduced the available research dollars that all universities compete for. The fact that the University still competes well indicates its high standing. Mr. Dooley stated his view that UC advocacy has been effective under difficult circumstances, with strong support by the California delegation in the U.S. House of Representatives and Senate. Senators Boxer and Feinstein have been strong advocates for UC. Research funding is affected by a much broader dialogue about the overall level of federal funding. Mr. Falle added that the University's advocacy at the federal level works in concert with the campuses, with other educational institutions with representation in Washington, and with major associations pursuing the same goals.

Committee Chair Ruiz asked about long-term expectations. Mr. Falle responded that sequestration is still the law. Although it had been repealed for the past two years, it would go back into effect in 2016 if not repealed or delayed. The repeal of sequestration and the return to a regular appropriations process would be positive developments for the University. Committee Chair Ruiz stressed the Regents' wish to assist with UC advocacy.

Staff Advisor Barton noted that UC's Working Smarter initiative includes efforts to enhance indirect cost recovery. She asked about the effectiveness of these efforts. Mr. Falle responded that UC has been effective in focusing the federal government's attention on indirect costs and the difference in recovery rates for UC and private institutions. Executive Vice President Brostrom stated that these efforts have been very successful. UC's indirect cost recovery rates are 12 to 15 points below the rates of private comparator institutions. The recovery rates for Harvard University and the Massachusetts Institute of Technology are 68 percent; before UC began its current efforts, its recovery rates were between 51 and 54 percent. This effort has been both technical, with all campuses conducting better space inventories and seeking reimbursements for energy costs, and political, with UC representatives discussing the disparity in indirect cost rates during meetings with the California delegation in Washington. Several campuses have seen meaningful increases. UCSF experienced a four-point increase over three years while Berkeley had a 3.5 percent increase. The indirect cost recovery rates for these campuses were still not at an appropriate level but were increasing. In spite of this upward trend, the amount of recovery has remained flat in the UC budget because of cuts to research funding and subsequent reductions in reimbursements. If NIH research funding is reduced by $2 billion, there is a significant reduction in UC's share of that funding.

3. **UPDATE ON THE 2014-15 GOVERNOR'S PROPOSED BUDGET**

[Background material was provided to Regents in advance of the meeting, and a copy is on file in the Office of the Secretary and Chief of Staff.]

Vice President Lenz began the presentation by stating that total State expenditures in the Governor's 2014-15 proposed budget were almost $155 billion, including almost $107 billion in State General Funds, an increase of 8.5 percent over the 2013-14 State General Fund budget. Expenditures also included $44 billion in special funds, and $4.2 billion in bond funds. Executive Vice President Brostrom noted that the State appropriation to the UC budget increased by five percent, while the overall State General Fund budget increased by 8.5 percent. While the University is happy about this increase, it is still receiving fewer resources relative to other parts of the State budget.

Mr. Lenz explained that the largest revenue source for State General Funds in the 2014-15 budget was personal income tax, approximately $70 billion or about 66 percent of overall funding. The next-largest source was the sales and use tax, about $24 billion or 23 percent. The corporation tax would provide about $8.7 billion or 8.2 percent of revenue. Of the proposed General Fund expenditures, about 42 percent or $45 billion would be spent for K-12 education. Spending on the higher education sector would be 11.6 percent or about $12.4 billion, for UC, the California State University (CSU), the California Community Colleges, and the California Student Aid Commission. Health services programs would receive 20.4 percent or almost $22 billion, corrections and rehabilitation nine percent or $9.5 billion, and human services programs 6.5 percent or almost $7 billion.

In State General Fund expenditures for higher education, the California Community Colleges would receive nearly 50 percent of funding, or about $7.2 billion. This is mostly due to the inclusion of the community colleges, with K-12 education, in the Proposition 98 minimum funding guarantee. UC and CSU would receive nearly the same percentage, or about $3 billion each. Another area of higher education to receive funding is the California Student Aid Commission, which funds Cal Grants and the new Middle Class Scholarship program. Mr. Brostrom called attention to the fact that UC and CSU are in fact not treated equally in the State budget; the State contributes directly to CSU pension costs, while UC is asked to address this cost out of its overall General Fund appropriation.

Mr. Lenz noted that Governor Brown's budget priorities were focused on California's overall fiscal condition. The proposed budget would establish a healthy State budget reserve, pay down many K-12 and community college budget deferrals, and retire the State's economic recovery bonds, which were used to keep the State afloat during the budget deficit of over $20 billion. The budget would further repay special fund loans that had been used to assist with General Fund cash flow. In addition, Governor Brown proposed investment of cap and trade revenue in sustainability, clean transportation, clean energy, and energy efficiency programs, one-time funding for statewide deferred maintenance, and the use of special funds to address critical water-related issues.

As mentioned earlier, the proposed budget included investment of State General Funds in education, with the K-12 system and community colleges receiving the largest share under the minimum funding guarantee mandated by Proposition 98. UC and CSU would receive the same $142 million base funding increase. CSU was currently adopting the same debt restructuring proposal that was provided to UC in the 2013-14 budget. For UC, this was a $100 million benefit. The California Student Aid Commission would receive significant funding, including an increase of $107 million as the first-year investment in the Middle Class Scholarship program.

In its initial review of the proposed budget, the Legislative Analyst's Office indicated that the State revenue assumptions could rise by a few million dollars by the time of the May Revision. The Legislative Analyst's Office recommended to the Legislature that it increase the size of the budget reserve and begin to address important retirement liabilities, including the UC Retirement Plan (UCRP).

The proposed budget would provide a five percent base budget increase to UC, or $142.2 million. It would also provide $50 million for competitive incentive awards to UC, CSU, and the community colleges to increase degree completion, reduce time to degree, and ease and improve the transfer experience of community college students. The proposed budget contains no other funding adjustments for UC, and the University anticipates no general tuition increase in 2014-15. Mr. Lenz cautioned that with no tuition increase and no increase beyond the five percent base budget adjustment, fully one-half of UC's core budget had no identified source of additional funds to support mandatory cost increases. After years of severe budget cuts, the University was essentially being asked to make further cutbacks in order to meet basic budget obligations. Mr. Brostrom observed that if State funds represented about 40 percent of UC core funding and State General Fund support was growing at five percent, while all other funding remained flat, this meant that UC's overall budget would grow by only two percent. This would not permit UC to meet its mandatory costs, let alone high-priority costs.

Mr. Lenz then briefly reviewed the University's revenue and expenditure assumptions, part of the UC operating budget plan approved by the Regents in November 2013. The University had assumed a five percent State General Fund increase and $4 million for retired annuitant health care costs, which the State has traditionally funded, for a total of $146.2 million. UC requested additional revenue from the State of almost $121 million. UC made a commitment to secure on its own about one-third of its revenue assumptions, either from nonresident tuition or from alternative revenue sources. Turning to expenditures, Mr. Lenz noted that the University faces approximately $168 million in mandatory costs, including retirement obligations, employee health benefits, current contractual agreements, academic merit increases, and non-salary increases. High-priority costs of $165 million include additional funding for enrollment growth, a three-percent increase in compensation for all UC employees, deferred maintenance, and debt service on critical capital facilities projects. The University also identified an expenditure of $50 million for reinvestment in academic quality, such as increased graduate student support, more faculty hiring, start-up funding for faculty, and addressing faculty and staff salary gaps.

If the Legislative Analyst's Office's assumptions were correct, and additional State revenue would be available by the time of the May Revision, the University has suggestions for how the State could address ongoing and one-time UC funding needs. The University understands the many demands on the State budget, and these suggestions represent a compromise that Mr. Lenz stated would be attractive to policymakers in Sacramento. Additional ongoing funding could be used for the State's obligation to the UCRP and for one percent enrollment growth. These two concerns cannot be addressed with one-time funding.

Mr. Lenz expressed his concern about the State's approach to higher education enrollment. The proposed budget would provide for three percent in enrollment growth at the community colleges, $155 million to add 55,000 students in the 2014-15 academic year. This increase in the pipeline of transfer students had funding implications for CSU and UC. The proposed budget included $163.8 million for a five percent enrollment growth at CSU, or 20,000 new students. Mr. Lenz explained that in fact there was no additional funding in the proposed budget specifically for CSU enrollment growth, but because the UC and CSU budgets are treated differently with regard to pension funding, there is some room within the CSU budget to address enrollment needs, as had been the case in 2013-14.

Mr. Lenz noted that UC's suggestions to the State regarding additional revenue also included a number of suggestions for one-time funding. He thanked Assembly Speaker and Regent Pérez for early action by Assembly Democrats in producing the 2014 Blueprint for a Responsible Budget. The priorities outlined in this document were encouraging. While there was not a specific dollar amount set aside for UC, there was clearly an assumption that a five percent base budget adjustment is not sufficient to address increased enrollment at UC and to reinvest in UC's quality. The University was encouraged by the 2014 Blueprint, but during the budget process UC would remain mindful of the State's fiscal condition and the Regents' priorities.

Tony Milgram, an undergraduate student at UC Santa Cruz and student observer to the Committee, emphasized the importance to students of not raising tuition. Increases in tuition over the previous ten years have meant that few students were able to graduate without debt. The current increase in State funding was very much appreciated, but the University needed a better long-term plan. Quality of education is most important to a UC degree and has real meaning for students in class sizes, research opportunities for undergraduates, and student support services. All these elements contribute to students' overall experience and to better graduation rates and influence how alumni will interact with the University after graduation. Mr. Milgram also stressed the importance of support for UC graduate students and graduate programs. Graduate students struggle to secure direct funding and face a lack of career resources on campus. He urged reform of graduate education at UC rather than an increase in the number of graduate students when there are not sufficient resources to support the existing numbers. He concluded by reiterating students' concerns that tuition be kept steady, that UC examine all options for tuition before moving to a tuition increase, and that the affordability of a UC education be a priority.

Regent Makarechian referred to a chart showing the State General Fund expenditures for higher education in the proposed budget, with about 20 percent for CSU and about 20 percent for UC. He asked if these percentages included contributions to pension plans. Mr. Brostrom responded that the pension contribution for CSU was above and beyond these percentages. The proposed budget included a separate line item for a contribution to the California Public Employees' Retirement System (CalPERS); the CSU pension contribution is made from that.

Regent Makarechian stated that the University's pension contribution should be indicated in the presentation materials, as funds UC is paying out of its own pocket. In real dollar terms, the University is receiving much less than CSU. He asked about the State's legal justification for not paying its obligation to the UCRP, and if the University had responded to this situation in legal terms. Mr. Robinson responded that he could address this matter in closed session. Mr. Lenz responded that the University has made progress in this matter, and the State has made payments to the UCRP. A few years previously, there was legislation that precluded the State from using any future General Funds to address its UCRP obligation. This was overturned by subsequent legislation. The State had provided $89 million in the 2012-13 budget. As part of budget deliberations for the current year, this obligation was met by $100 million in debt service restructuring. He emphasized that the State had recognized this obligation. In addition, UC was included in the budget summary in a list of the State's pension and health benefit liabilities. Mr. Brostrom added that even though the State has included the UCRP obligation in previous budgets, in 2014-15, the University's or employer contribution to the UCRP would be $1.2 billion. State General Funds would cover roughly a third, or $400 million of this amount, and they would be drawn from the 20 percent or roughly $3 billion allocation to UC referred to by Regent Makarechian earlier. For CSU, the corresponding amount was free to be spent on faculty, graduate student support, and other needs. Committee Chair Ruiz asked Mr. Robinson to discuss the legal question raised by Regent Makarechian in a closed session meeting.

Regent Zettel referred to the fact that the State budget would provide funding for enrollment growth for the community colleges, but not for CSU or UC. She observed that this was one cause of UC budget deficits and asked if the University was aware that State Senator Marty Block had introduced legislation to allow community colleges to issue baccalaureate degrees. Mr. Lenz responded that the University has discussed this matter with Senator Block, who expressed willingness to cooperate with the three higher education segments. California Community Colleges Chancellor Brice Harris had expressed caution about moving in this direction. Mr. Lenz recalled that, like UC, the community colleges had experienced significant budget reductions. The community colleges had lost half a million students and were still trying to return to earlier enrollment levels. They were cautious about expanding their mission at this time in a way that would result in future costs.

Regent Lansing asked about UC lobbying events in Sacramento in May. She recalled that this event had been very effective the previous year. She asked that the University identify and prepare relevant discussion points and schedule meetings in advance so that the University's advocacy is as effective as possible. Mr. Brostrom responded that there would be a day of joint advocacy for all California higher education segments, as well as specific lobbying days for UC before and during the Regents meeting. Regent Lansing emphasized that the Regents could be effective in communicating with members of the Legislature.

Regent Gould expressed appreciation for the Governor's support for higher education in the proposed budget and for the five percent base budget increase, but stressed that UC's core funding would grow by only two percent. This limits the University's capacity to act on UC salaries, retirement benefits, and enrichment of academic programs. One remedy for this situation would be to address the State's obligation to the UCRP. This contribution, like the contribution to CalPERS, should be a separate line item in the State budget. This would allow for an easy comparison of UC and CSU and determination of parity in how the State treats these two institutions, and it would be an easy step for the Legislature to take. Regent Gould asked about the Governor's long-term constitutional initiative for a rainy day fund, which might help prevent the cycle of boom and bust experienced by the State and the University. Mr. Brostrom responded that even after the passage of Proposition 30, two-thirds of California revenue comes from personal income tax. In most states, a third of revenue is from property tax, a third from income tax, and a third from sales tax. A large share of the California personal income tax comes from capital gains and other volatile sources. State revenues from capital gains were $11 billion in 2007 but dropped to $2 billion in 2009. Mr. Brostrom suggested that the State should seek to make its revenue base more stable and less volatile; beyond that, a rainy day fund made sense. Mr. Lenz expressed concern about decreasing flexibility of future California Governors and Legislatures to allocate funding. He estimated that in 1993 to 1996, when Regent Gould served as the Director of the State Department of Finance, approximately 85 percent of the State budget was either federally mandated, court-mandated, statutorily required, or part of the Proposition 98 funding guarantee. This percentage was currently probably closer to 92 percent. UC and CSU compete with other State agencies and services for the remaining discretionary eight percent of the budget. He stated his view that the objectives of the rainy day fund initiative could be achieved without putting an initiative on the ballot.

Regent Gould emphasized that the University could achieve a long-term tuition plan and stabilized funding only if it had a stable partner to work with. The University should follow closely how the rainy day fund initiative takes shape and how the Governor directs it. It could have a significant impact on the University's long-term financial capacity.

Regent Flores noted that the UC budget plan called for $90 million from alternative revenue sources and recalled that nonresident, out-of-state enrollment was part of that strategy. She urged the University to proceed with caution on this strategy and to have an informed discussion about other alternative revenue sources besides nonresident enrollment. Mr. Brostrom asked if Regent Flores was concerned specifically about the number of nonresident students or about this and tuition levels. Regent Flores responded that she was concerned about the number of nonresident students.

Regent Pattiz expressed support for a stable tuition plan. He stated his view that community colleges were not likely to be in a position to offer bachelor's degrees. Nevertheless, it was an interesting idea that should be examined even if it was not likely to be realized.

Faculty Representative Jacob observed that the University works closely in partnership with the community colleges. The proposals for community college bachelor's degrees were limited and workforce-based, for career and technical education degrees that neither UC nor CSU would offer. The one area that might provoke debate would be nursing, but Mr. Jacob doubted that these proposals represented competition for UC or CSU. The University would examine the matter carefully.

Regent Lansing stated that the University should continually review the California Master Plan for Higher Education, which provides a helpful model of student transfer from community colleges to CSU and UC. She stated that she was opposed to anything that would undermine this structure.

Chairman Varner emphasized that the University currently enjoyed a better budget situation than it had for a long time and stated that UC might fare even better than in the proposed budget. Budget planning with the State would include plans for predictable tuition over the long term and the avoidance of sharp increases. Chairman Varner expressed the University's wish to be able to offer to any undergraduate student the ability to graduate in four years. He observed that the three higher education segments of California were now cooperating rather than competing in efforts to save money and improve student transfer. The University was actively preparing for discussions with legislative leaders in May.

Regent Feingold referred to the $50 million in the proposed budget for competitive incentive awards to UC, CSU, and the community colleges. He asked if this was one-time or ongoing funding. Mr. Lenz responded that this was one-time funding and briefly described the board that would review proposals and oversee the funding. It would include representatives of the California Community Colleges, CSU, and the Board of Regents. The deadline for proposals was January 9, 2015, and funding could be allocated in the 2014-15 academic year.

Regent-designate Saifuddin observed that the state's community colleges were struggling with high student attrition. Community colleges serve a different market and the proposal for community college degrees was not a threat to the quality of UC.

Staff Advisor Coyne asked about UC advocacy for one percent enrollment growth in case additional State revenue becomes available, and if there were data to support one percent as the appropriate number. Mr. Lenz responded that the University felt this was the appropriate percentage in November 2013, when the UC budget was presented to the Regents. Because enrollment numbers are tied to the budget, they are sometimes not finalized until June, long after the University has admitted students for the following academic year. The University felt that one percent growth was a sufficiently conservative estimate so that if the decision on enrollment was made late in the process, UC could meet this target during the year. If the enrollment decision occurred earlier in the process, Mr. Lenz anticipated that the University could accommodate enrollment growth greater than one percent. Mr. Brostrom added that enrollment growth depends not only on the operating budget but also on the capital budget. The ability of some campuses to absorb more students, in particular the Merced campus, are constrained by this factor. The University would have to find ways to fund additional classroom and laboratory space.

Committee Chair Ruiz asked that the Regents receive a copy of the 2014 Blueprint for a Responsible Budget mentioned earlier. He drew attention to the fact that the Governor's budget included a significant increase in funding for the K-12 system, and this would likely result in more high school graduates eligible for UC and CSU. The number of UC-eligible graduates might well be greater than the one percent growth the University provides for in its budget. The impact on UC enrollment, affordability, and quality could be significant if the University does not plan in advance and anticipate future demand. It would be regrettable if UC were not prepared to address this situation and had to turn away more students than at present.

4. **FORMATION OF A NONPROFIT CORPORATION AND TRANSFER OF THE RESIDENTIAL LENDING ACTIVITIES OF THE OFFICE OF LOAN PROGRAMS TO THE NONPROFIT CORPORATION**

The President recommended that the Regents:

A. Approve the University's formation of a California nonprofit public benefit corporation to be known as the University of California Home Loan Program Corporation (the Nonprofit) to undertake the future residential lending activities of the University of California (the Program), subject to the following conditions:

(1) The purpose of the Nonprofit shall be to operate the Program as it is currently operated or is modified in the future.

(2) The Nonprofit shall be governed by a five-person Board of Directors (Board) which will consist of five officers of the Regents or their

designees: the President, Chief Operating Officer, Chief Financial Officer, Chief Investment Officer, and General Counsel, sitting ex-officio. Initially, the Chief Financial Officer, or designee, shall serve as the Chair of the Board; provided, however, that the President shall have the authority to remove the Chief Financial Officer as Chair of the Board at any time and appoint another member of the Board as Chair.

B. Approve the transfer of the future operation of the Program to the Nonprofit, excluding loans previously extended by the Office of Loan Programs and current cash reserves.

(1) The Nonprofit will be staffed entirely by employees of the University of California assigned to the Nonprofit pursuant to a services agreement to be executed between the Regents and the Nonprofit. As consideration for these services, the Nonprofit will transfer to the Regents the administrative fees collected under the Program.

(2) The Nonprofit will execute a master note agreement (Master Note) in favor of the Regents. Pursuant to the Master Note, the Regents will provide the Nonprofit with funding sufficient to enable the Nonprofit to extend future loans pursuant to the terms and policies of the Program. Loan payments received by the Nonprofit will be transferred to the Regents on a monthly basis, according to the terms set forth in the Master Note.

(3) The Nonprofit will apply for and expects to obtain tax-exempt status as an organization described in Section 501(c)(3) of the Internal Revenue Code of 1986 and the corresponding provisions under California law.

(4) Notwithstanding the transfer of the Program to the Nonprofit, the participation in the Program by any member of the Board shall be approved by the Regents.

C. Authorize the President, after consultation with the General Counsel, to approve and to execute (a) any documents reasonably required to accomplish the above; and (b) any modifications thereto, provided that such modifications do not materially increase the obligations of the Regents.

[Background material was provided to Regents in advance of the meeting, and a copy is on file in the Office of the Secretary and Chief of Staff.]

Chief Financial Officer Taylor explained that this item called for the formation of a nonprofit public benefit corporation to undertake the activities that the Mortgage Origination Program (MOP) currently offered to faculty for recruitment and retention purposes.

Regent Makarechian asked about how rates would be set by the board of the nonprofit and about the loan process. Mr. Taylor responded that the loans are funded from the Short Term Investment Pool (STIP). The basic rate that the University charges borrowers is closely tied to STIP, with a floor of three percent for variable rate loans. The basis used to determine the rate is the performance of STIP over the previous four quarters. As discussed at the November 2013 meeting, UC would now offer a 5/1 adjustable rate mortgage loan product, with a fixed rate for five years and floating thereafter. Mr. Taylor stated that his office was working with staff in the Office of the Chief Investment Officer to ensure that this product would be funded appropriately and anticipated that younger faculty would be interested in it. In the future, the University's home loan program would be managed much as it was at present, under current guidelines. The Regents would keep ultimate fiduciary authority for making decisions about the type of products and the amounts UC can offer. Exceptions to the guidelines would be brought for approval to the President and the Chair of the Committee.

Regent Makarechian asked how the Regents would receive reports on the activities of the nonprofit, and how much money would be managed by the nonprofit. Mr. Taylor responded that the Regents receive an annual report on the portfolio, at the end of each calendar year. UC sells its loans in the secondary market whenever possible and has enjoyed success in the past several years. UC does not try to hold loans for a long time because it wishes to replenish liquidity in STIP. Director Ruth Assily reported that the annual volume for the loan program was approximately $120 million. In the current year the volume might reach $150 million.

Regent Makarechian asked how much money would be put into the corporation. Ms. Assily responded that the allocation would be approved by the President. The program currently had an allocation of $350 million. The corporation would be drawing down those funds, rather than the Office of Loan Programs. Mr. Taylor added that the staff of the nonprofit corporation would be the same individuals who were currently staffing the program. Their positions were funded by the MOP proceeds. This is a self-supporting program; it uses no taxpayer or tuition monies. UC charges 25 basis points in addition to the set borrowing rate; the borrowers contribute to a fund that pays administrative expenses and replenishes the mortgage loan loss reserve.

Regent Makarechian asked about the rationale for the current action, if the MOP had been running smoothly and if it would continue to be managed by the same people. Mr. Taylor responded that the existing program does not comply with new lending standards developed by the Consumer Financial Protection Bureau. This is a new federal agency and as yet there is no process to appeal for an exemption from its rules. UC must comply with the Bureau's regulations in order to make conforming loans that can be sold in the secondary market. Mr. Taylor expressed the University's wish for greater flexibility and its intention to pursue an exemption in the future, but for the moment, the University must comply.

Committee Chair Ruiz observed that the University's home loan program is very important for faculty recruitment.

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 11:10 a.m.

Attest:

Secretary and Chief of Staff