The Regents of the University of California

COMMITTEE ON FINANCE
November 19, 2014

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

Members present:	Regents Gould, Island, Kieffer, Leong Clancy, Makarechian, Newsom, Reiss, Ruiz, and Saifuddin; Ex officio members Napolitano and Varner; Advisory members Davis, Gorman, Hare, and Oved; Staff Advisors Acker and Coyne
In attendance:	Regents Atkins, Blum, De La Peña, Engelhorn, Lansing, Ortiz Oakley, Pattiz, Pérez, Sherman, Torlakson, and Wachter, Faculty Representative Gilly, Secretary and Chief of Staff Shaw, General Counsel Robinson, Chief Compliance and Audit Officer Vacca, Provost Dorr, Executive Vice President and Chief Financial Officer Brostrom, Senior Vice Presidents Dooley and Stobo, Vice Presidents Andriola, Brown, Budil, Duckett, Lenz, and Sakaki, Chancellors Block, Blumenthal, Gillman, Hawgood, Katehi, Wilcox, and Yang, and Recording Secretary Johns

The meeting convened at 2:40 p.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 September 17, 2014 were approved.

2. **APPROVAL OF UNIVERSITY OF CALIFORNIA 2015-16 BUDGET FOR CURRENT OPERATIONS**

The President of the University recommended that the budget plan included in the document, *2015-16 Budget for Current Operations*, and shown in Attachment 1, be approved.

[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.]

Committee Chair Ruiz noted that the Board had just heard in the meeting of the Committee on Long Range Planning how the elements of the tuition and financial aid plan would fit together within UC's long-range budget outlook. While the University plans for the next five years, the Board must also approve an annual operating budget to submit to the State. The University's 2015-16 budget makes the same assumptions as the five-year plan, namely, that UC's core operating budget relies on three revenue streams:

State support, tuition, and alternative revenue sources and cost savings generated through operating efficiencies.

Committee Chair Ruiz emphasized that the tuition increases included in the budget would make it possible for UC to keep its commitment to affordability and access. UC has long had one of the strongest financial aid programs in the country. Maintaining support for low-income students and historically underrepresented minorities has always been a top priority. As a result, more than half of UC undergraduates do not pay any systemwide tuition and fees. Four UC campuses each enroll more Pell Grant recipients than all eight Ivy League universities combined.

The Board of Regents is committed to doing even more to ensure that California students are not shut out of the opportunities a UC education can provide. The University is pursuing administrative cost savings and alternative revenue streams, and actively increasing private support for scholarships and fellowships for students of all income levels.

Despite the University's best efforts to find new revenue sources and increase private support, UC cannot maintain and enhance its quality and public service without State support. In the months ahead, students, alumni, faculty, staff, and public education supporters would need to work together to make this case in Sacramento. The Board of Regents was looking forward to working with the Governor and the Legislature to secure adequate investment in the University of California.

Vice President Lenz began his discussion of the UC budget by noting that the Legislative Analyst's Office (LAO) had released projections indicating an increase of $4.2 billion in State General Fund revenue in the 2015-16 fiscal year. This was encouraging news for the State and the University.

The University's 2015-16 budget assumes almost $120 million in new revenues from the State. This would be a four percent increase, consistent with the Governor's multi-year funding plan for the University, and equivalent to a 1.7 percent increase to the University's core budget. Mr. Lenz stressed that the University had not broken any promise in its negotiations with the State about not raising tuition. He recalled that in May 2012, the Regents had a robust discussion of the University's funding needs. At that time, discussions resulted in a conclusion that UC would need a six percent increase in State General Fund support and a six percent increase in tuition. In July 2012, these matters were discussed again in conjunction with the University's support for Proposition 30, and the revenue assumptions remained the same. The University continued to indicate these assumptions, even following the Governor's budget that was released after the passage of Proposition 30. While actions taken by the University, like the Working Smarter initiative, have allowed the University to drop some of these revenue assumptions, UC cannot survive on only the four percent General Fund increase.

Regent Newsom stated than an LAO report references a commitment made by UC and California State University to keep tuition flat. He stated that the State Department of

Finance believes that there was an agreement. Mr. Lenz countered that there never was an agreement. There were discussions, but at no point were the University and the State able to come to an agreement. Regent Newsom stated that there were public pronouncements to the effect that there was an agreement. Committee Chair Ruiz requested that the Regents receive the information on this point, including information from the LAO report that Regent Newsom had referred to, and that it be clarified.

Regent Gould referred to the modest growth in UC's out-of-state enrollment and to an alternate scenario for dramatic growth, included in the three-year sustainability plan required by the State, that the University does not favor. He asked about the plan for continued growth of nonresident enrollment to help make up for budget cuts. He asked how this growth would be managed and what its implications would be for individual campuses, noting that this is a sensitive issue for legislators. Mr. Lenz responded that UC's plan considers the ability to take on 5,000 more California resident students. Campuses would continue to increase their nonresident enrollment, and this revenue is essential for those campuses that now have low percentages of nonresident enrollment. He stressed that the University needs to reflect carefully on its nonresident enrollment levels; for example, it needs to consider whether it is prudent to have a cap on this enrollment systemwide, and to examine the issue on a campus-by-campus basis. If the proposed budget does not come to fruition, this is an option for generating revenue.

Regent Gould reiterated that this is a sensitive issue and requested that it be discussed in more detail at a future meeting.

Regent Reiss referred to the proposed increase in tuition for nonresident students. She asked how much greater this cost increase could be, or how much more the University could charge without losing applications from nonresident students who meet UC standards. Chancellor Block responded that the University is reaching a point of price sensitivity. He anticipated that UC campuses would encounter difficulties as nonresident tuition becomes more expensive; private institutions offer financial aid and class sizes that are attractive to nonresident students. Chancellor Katehi drew attention to the significant differences between UC campuses in their percentages of nonresident enrollment. Nonresident enrollment is at three to four percent at some campuses, but close to 23 percent at others. Increases in nonresident tuition might benefit campuses with high percentages of nonresident students, but not other campuses.

Mr. Lenz continued with a discussion of the proposed budget. The University was assuming an increase of almost $137 million in tuition and the Student Services Fee. Almost $98 million of this amount was from the five percent tuition increase, and this would be the price to the State of buying out the increase. About $30 million would come from tuition and fee revenue from increased enrollment, and $8.7 million would be realized from Professional Degree Supplemental Tuition. Almost $73 million would be set aside for financial aid.

The budget also assumed increases in revenue through alternative revenues and cost reductions. Mr. Lenz briefly outlined UC efforts in liquidity management, procurement, and new models of philanthropy.

Enrollment would grow by one percent, or about 2,200 full-time equivalent students. The budget would fund about 1,000 California resident undergraduates, 750 graduate students, and about 400 of the 7,000 students for whom the State provides no funding. Other expenditures would include financial aid, investment in academic quality, and mandatory and high-priority costs.

Mr. Lenz briefly outlined proposed increases in expenditures in enrollment growth, financial aid, and reinvestment in quality. The category of “reinvestment in quality” included areas such as the student-faculty ratio, graduate student support, faculty hiring, course section offerings, and instructional equipment. Proposed increases in expenditures for mandatory costs included the UC Retirement Plan (UCRP), health benefits, annuitant health benefits, compensation commitments linked to collective bargaining, faculty merit increases, and non-salary price increases. The increase of $17.6 million for the UCRP represented growth in employee numbers and adjustments in compensation. Proposed increases for high-priority costs included a three percent compensation increase for non-represented employees, deferred maintenance, and capital program projects already approved that are at some stage in construction.

Regent Ortiz Oakley asked about the relationship between the need for more faculty and the number of courses they teach, and how many more students UC could educate and how many more courses it could offer by hiring more faculty. Mr. Lenz responded that this might vary depending on area, level, and course content. In its nursing programs, the University must meet an accreditation requirement regarding the ratio of students to faculty. President Napolitano observed that it would be convenient if there were an equation to answer Regent Ortiz Oakley’s question, but there is no such equation. The University envisions that chancellors will consult with faculty and students to identify course needs. The needs for additional instructors or courses vary by campus. President Napolitano emphasized that there is no formula to address this question, nor is there a formula that takes faculty research into account.

Regent Ortiz Oakley responded that while a formula might not be necessary at the moment, it would be helpful to be able to ensure that every expenditure requested in the proposed budget directly increases UC’s ability to educate Californians. Adding faculty is a significant expenditure. He referred to the numbers for projected enrollment growth in the budget, and asked how UC revenues would be affected if more of the new enrollments were transfer students. Mr. Lenz responded that there would not be a loss in revenue if UC were to take more community college transfer students rather than other groups. President Napolitano added that community college transfer students often enroll in upper division courses; those courses tend to be more expensive to offer than courses offered in the first two years. As the University takes on more transfer students, there would be some expenditure associated with that increase.

In response to another question by Regent Ortiz Oakley, President Napolitano explained that upper division courses cost more because class sizes are smaller and the courses are more specialized.

Regent Pattiz reflected that recruitment of highly talented faculty probably requires a good deal of individual negotiation regarding matters such as support for research and teaching load. Chancellor Yang responded that one of the key questions asked by top faculty who are being recruited is about the University's long-range financial stability. Mr. Lenz reminded the Committee that the University receives over $5 billion in research funding, while State funding is less than $3 billion. There would be a significant cost in assuming that faculty research could be reduced. Referring to Regent Ortiz Oakley's remarks, he stressed that a priority for the University is to protect classroom instruction. This was shown by the fact that UC has reduced the number of staff and administrative positions more than faculty positions. Chancellor Katehi commented that faculty bring in significant research funding and that 70 percent of UC Davis students have some experience in a research laboratory. She stressed that faculty research also improves the quality of teaching. The University needs more faculty for both research and teaching.

Regent Makarechian recalled that half of UC students pay no tuition; perhaps a third of them pay full tuition. He asked if there were a chart showing the family income levels of those students who graduate with debt. He recalled that UC returns almost $700 million to financial aid. He estimated that if this amount were not returned, tuition for every student would be approximately $4,600. He asked if other State universities return a similar amount or percentage of funding to financial aid. Mr. Lenz responded that UC has the richest financial aid program of any research university in the U.S.

Regent Makarechian stated that it would be helpful to present information demonstrating that the tuition level stated in the proposal was not the real tuition paid by many students. Mr. Lenz responded that the administration had presented this information at an earlier meeting, showing the actual cost of UC tuition to students, net of financial aid, compared to other institutions.

Regent Makarechian stated that UC should emphasize that its tuition, net of financial aid, is much lower than the tuition of comparator institutions. Mr. Lenz responded that this chart and information would be presented again at a future meeting.

Faculty Representative Gilly referred to earlier comments by Regent Pattiz. She stressed that faculty research informs and has an influence on teaching. Faculty are abreast of the latest information in their fields and bring this to the classroom. It was not a question of research versus teaching, but a question of how much time faculty members have to devote to each.

Committee Chair Ruiz stressed that UC must plan for future enrollment scenarios to ensure access for students who qualify, and should strive to increase enrollment of transfer students. Mr. Lenz responded that UC had been working for some time on enrollment projections. He anticipated that information on enrollment would be presented to the Regents in spring 2015. He expressed concern that UC lacks the additional revenue needed to serve the growing number of transfer students.

Student observer Christopher Kan expressed opposition to the proposed tuition increase. The proposed budget would ensure that UC students and their families would have to borrow more to finance their education. Even as UC graduates find more jobs, they are defaulting on student debt more often. Student debt delays formative life experiences, such as the purchase of a first home, marriage, and the start of a family. These burdens also have a wider effect on the economy. It would be unwise to raise tuition to allow entry of one group of students while burdening another with heavy debt. The UC system already has problems with affordability and quality. UC should reverse the budget proposal and tuition increase and continue to seek efficiency improvements to make funds available for educational quality. If the State does not provide increased funding, UC should limit additional enrollment.

Upon motion duly made and seconded, the Committee approved the President's recommendation and voted to present it to the Board, Regent Newsom (1) voting "no."

3. **UNIVERSITY OF CALIFORNIA FINANCIAL REPORTS, 2014**

The President of the University recommended that the Regents adopt the 2013-14 Annual Financial Reports for the University of California and the University of California Retirement System.

[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.]

Committee Chair Ruiz explained that the annual report for the five UC medical centers and the Children's Hospital and Research Center Oakland (CHRCO), a distinctly presented component unit of UCSF, would be provided around the end of November.

Associate Vice President and Systemwide Controller Peggy Arrivas observed that this had been the most complex year in her experience for the University's financial reports. The University implemented seven new accounting pronouncements this year, which resulted in restating the numbers presented for 2013. There was a very complex transaction this year, the acquisition of CHRCO, and UC has taken on a new external auditing firm. The adoption of the annual report for the medical centers would take place between meetings by interim action.

Regent Makarechian referred to an adjustment in the UCSF numbers discussed the previous day during the meeting of the Committee on Compliance and Audit. Ms. Arrivas confirmed that this correction had already been made to the report before it was finalized. No numbers in these two reports would change. There was no change to be made to the medical center report that would be distributed.

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

4. **CHIEF FINANCIAL OFFICER DIVISION CAMPUS BENCHMARKING REPORT**

[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.]

Director Cathy O'Sullivan explained that the Chief Financial Officer Division Campus Benchmarking Report was intended to measure objectively certain elements of UC's financial operations in a way that is meaningful to those in charge of the University's financial operations systemwide and that will facilitate changes leading to greater efficiency, time savings, and improved processes. She noted that with the new Chief Financial Officer, the University was taking a fresh look at what indicators are measured in the report and what goals are set. There had been significant progress on many goals.

5. **ANNUAL ACTUARIAL VALUATIONS FOR THE UNIVERSITY OF CALIFORNIA RETIREMENT PLAN AND ITS SEGMENTS AND FOR THE 1991 UNIVERSITY OF CALIFORNIA-PUBLIC EMPLOYEES' RETIREMENT SYSTEM VOLUNTARY EARLY RETIREMENT INCENTIVE PROGRAM**

[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 Duckett explained that each year, the actuary for the UC Retirement Plan (UCRP), Segal Consulting, produces a valuation report. He presented some highlights of the report. As of July 1, 2014 UCRP has over 120,000 active members, with about 14,000 in the new tier that was implemented in 2013. UC paid out benefits of $2.7 billion during the plan year to over 64,000 annuitants. The UCRP has an actuarial accrued liability of $60 billion, which is 80 percent funded by UCRP's assets on an actuarial value basis, after smoothing. This was an increase from 76 percent the previous year. The funded ratio on a market value basis increased from 79 percent the previous year to 87 percent in the current year, due to an investment return of nearly 18 percent during 2013-14. UCRP had $52.8 billion in assets on a market value basis as of June 30, 2014. Mr. Duckett presented a chart showing the funded ratios of the UCRP since 2005, comparing both the actuarial value of assets and the market value of assets.

For the campuses, medical centers, and Lawrence Berkeley National Laboratory, the total funding policy contribution rate for the plan year 2015-16 is approximately 29 percent of covered payroll, based on a normal cost rate of 18 percent and an amortization rate of the unfunded liability of 11 percent.

Contribution rates beginning in fiscal year 2014-15 are 14 percent for the University and eight percent for most UCRP members. In the four years since the Regents approved a series of changes to post-employment benefits, there have been intensive discussions and collective bargaining which have resulted in all employee groups making appropriate contributions; this has helped bring stability to the UCRP. At the completion of the collective bargaining process, three unions, the California Nurses Association, the University Professional and Technical Employees, and the American Federation of State, County and Municipal Employees agreed to have all their members, about 40,000, pay a contribution rate of nine percent beginning in plan year 2014-15. In return for this, 2013 Tier members in these unions would be covered under retirement plan age and payout structures similar to those of the 1976 Tier members. The cost of this is neutral to the UCRP because the union members are making an increased contribution.

6. **ANNUAL ACTUARIAL VALUATION OF THE UNIVERSITY OF CALIFORNIA RETIREE HEALTH BENEFIT PROGRAM**

[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 Duckett began the discussion by recalling that the UC retiree health benefit program is funded on a pay-as-you-go basis; it is not pre-funded. Retiree health is part of UC's overall benefits program. UC continues to manage the cost of this program, as well as of the program for active employees. UC has increased the overall level of contribution toward retiree health. The projected cash costs for the current year were $276 million, compared to actual pay-as-you-go costs of $271 million for the prior year. Future costs are expected to be managed further by continued cost containment and design adjustments to the overall benefit plan for active employees and retirees. A number of factors can affect long-term estimates of the unfunded liability. The unfunded liability as of July 1, 2014 is $14 billion, compared to $13.2 billion for the previous year. The increase in liability is primarily due to the program not being pre-funded and the interest that accrues on the existing liability as benefits eligibility accrued by active employees during the year is greater than the benefits paid for retirees. Mr. Duckett reminded the Committee that over the years, UC has communicated to active employees and retirees that retiree health benefits are not an accrued or vested benefit or entitlement, and can be changed by the University at any time.

For calendar year 2015, UC would determine its maximum contribution for retirees as a percentage of total premiums, including standard Medicare Part B premiums. Medicare-eligible retirees would receive a contribution from the University of 77 percent, while non-Medicare-eligible retirees under the age of 65 would receive a contribution of 70 percent. All new hires or rehires are eligible to receive benefits under the new health eligibility rules, which require a longer period of service with the University and a higher age.

Regent Makarechian referred to information in the executive summary of the actuarial valuation report by Deloitte, according to which projected cash contributions for 2014-15 were $276 million. He asked how this number was arrived at, when there should have been savings over previous years. Mr. Duckett responded that part of this gap was due to collective bargaining agreements that the University negotiated. The unions requested additional retiree health benefits, but were paying for them with increased contributions. As a result of these agreements, the University felt it was appropriate to equalize non-represented employees' contributions to retiree health with those of the unionized groups. In response to another question by Regent Makarechian, Mr. Duckett confirmed that these are actual cash contributions.

Regent Makarechian again referred to the executive summary in the Deloitte report, which listed an amortization cost of $1.27 billion, approximately 14 percent of UCRP covered payroll. He asked if this was a non-cash balance sheet item. Mr. Duckett responded that he believed this was also a cash item. He described it as a projected cost, not a cost that would be paid out in the course of the year.

Regent Makarechian asked about indirect cost recovery rates on federal grants. Mr. Duckett responded that the University is reimbursed at an appropriate rate for federal grants. The recovery rates had improved. In response to another question by Regent Makarechian, Mr. Duckett reported that the Department of Energy had paid an obligation it owed the University.

Regent Makarechian asked if the $276 million cash in contributions for 2014-15 included some of that obligation. Mr. Duckett responded in the affirmative.

Regent De La Peña expressed concern that the University was not billing the government for services covered under Medicare. Mr. Duckett responded that he would check with Senior Vice President Stobo to ensure that UC is being reimbursed appropriately.

Regent Ortiz Oakley asked if UC offers lifetime benefits to employees. Mr. Duckett responded that it offers lifetime pension benefits after retirement.

Regent Ortiz Oakley asked if UC does not compel employees to enroll in Medicare once they reach the age of eligibility. Mr. Duckett responded that an adjustment is made and costs decrease once an individual becomes eligible for Medicare.

Regent Ortiz Oakley asked if lifetime benefits are extended to all employee groups. Mr. Duckett responded that depending on the level of qualification, some benefits are extended to employees for retiree health. In 2013 the rules on this changed. There is not automatic eligibility after a certain number of years of service, but graduated eligibility at age 50 as opposed to full eligibility at 50, depending on years of service, which was the case in the past.

Regent Ortiz Oakley asked if the University has considered scenarios to curtail lifetime benefits in the context of the UC budget. Mr. Duckett responded that there was an extensive study of pension benefits and retiree health benefits, by the Post-Employment Benefits Task Force. The Task Force examined a number of different scenarios to reduce costs. The University has been reducing the amount of benefits it covers, year by year, to the current floor of 70 percent.

7. **GRANT OF THIRD-PARTY INDEMNITY TO OBTAIN CALIFORNIA COASTAL COMMISSION PERMIT FOR SHELLMAKER ISLAND BOATHOUSE CONCRETE DECK REPAIR PROJECT, IRVINE CAMPUS**

The President of the University recommended to the Regents that:

A. The Regents approve acceptance of risks and grant of indemnity in connection with the Irvine campus' receipt of a Coastal Development Permit from the California Coastal Commission for the replacement of a concrete slab at the campus' Rowing Facility on Shellmaker Island in Upper Newport Bay, which permit is conditioned on the Regents assuming the risk to the project of injury or damage arising from the Commission's approval of the project.

B. The President, after consultation with the General Counsel, be authorized to approve and execute any documents necessary in connection with the above.

[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.]

Committee Chair Ruiz briefly introduced the item.

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 3:45 p.m.

Attest:

Secretary and Chief of Staff

2015-16 Budget Plan for Core Funds (Dollars in Millions)

2014-15 OPERATING BUDGET

State General Funds	$2,986.7
Less General Obligation Bond Debt Service	(193.7)
State General Funds (excluding GO Bond Debt Service)	$2,793.0
Total Core Funds (State General Funds, Student Tuition and Fee Revenue, and UC General Funds)	$6,887.0

PROPOSED INCREASES IN REVENUE

State General Funds (as proposed in the Governor's multi-year plan)		
4% Base Budget Adjustment (equivalent to a 1.7% Increase in Core Funds)	$	119.5
Subtotal	$	119.5
Student Tuition and Student Services Fees		
5% Increase in Mandatory Charges (or additional State Funds)	$	97.7
Mandatory Charges from Enrollment Growth		30.2
Professional Degree Supplemental Tuition (available for program)		8.7
Revenue for Financial Aid		72.9
Subtotal	$	209.5
UC General Funds		
Nonresident Supplemental Tuition	$	50.0
Indirect Cost Recovery		-
Subtotal	$	50.0
Alternative Revenues/Cost Savings		
Liquidity Management	$	40.0
Systemwide Contracts		20.0
Philanthropy		20.0
Subtotal	$	80.0
TOTAL INCREASE IN REVENUE	**$**	**459.0**

PROPOSED INCREASES IN EXPENDITURES

Mandatory Costs		
Retirement Contributions	$	17.6
Employee Health Benefits		27.0
Annuitant Health Benefits		5.2
Contractually Committed Compensation		15.6
Faculty Merit Program		32.0
Non-Salary Prices		28.0
Subtotal	$	125.4
Investment in Academic Quality	$	60.0
California Enrollment Growth	$	22.0
High-Priority Costs		
Compensation	$	109.8
Deferred Maintenance		55.0
High-Priority Capital Needs		13.9
Subtotal	$	178.7
Financial Aid	$	72.9
TOTAL INCREASE IN EXPENDITURES	**$**	**459.0**