The Regents of the University of California

COMMITTEE ON FINANCE
May 15, 2014

The Committee on Finance met on the above date at the Sacramento Convention Center, 1400 J Street, Sacramento.

Members present:	Regents Blum, Flores, Island, Kieffer, and Reiss; Ex officio members Brown, Napolitano, and Varner; Advisory members Jacob and Leong Clancy
In attendance:	Regents De La Peña, Lozano, Pattiz, Schultz, Sherman, and Zettel, Regent-designate Engelhorn, Faculty Representative Gilly, Interim Secretary and Chief of Staff Shaw, General Counsel Robinson, Chief Compliance and Audit Officer Vacca, Chief Investment Officer Bachher, Provost Dorr, Executive Vice President and Interim Chief Financial Officer Brostrom, Senior Vice Presidents Dooley and Stobo, Vice Presidents Allen-Diaz, Budil, Duckett, Lenz, and Sakaki, Chancellors Blumenthal, Drake, Katehi, Leland, and Yang, Interim Chancellor Hawgood, and Recording Secretary Johns

The meeting convened at 10:20 a.m. with Committee Vice Chair Kieffer presiding.

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

Upon motion duly made and seconded, the minutes of the meeting of March 19, 2014 were approved.

Student observer Tony Milgram, a third-year undergraduate at UC Santa Cruz, stressed the importance of cooperation between Regents and students in advocating for UC with the Legislature. He expressed the students' appreciation for the progressive steps taken by the Office of the President to save money; students would like to see these cost-saving measures on all UC campuses. He asked the ex officio members of the Board in particular to consider the consequences to UC of State disinvestment.

Mr. Milgram expressed students' concern about the fact that the May Revision to the 2014-15 budget included no additional funding for the University. This would lead to reductions and continued disinvestment in UC programs, students, and student support. Insufficient State funding for UC could cause a decline in excellence, academic quality, and integrity. Referring to the rainy day fund included in the State budget, Mr. Milgram recalled that the University has struggled to maintain the status quo at a huge cost to students and argued that the current moment is a "rainy day" and that UC needs to be funded appropriately or else lose its status as one of the outstanding universities of the world.

2. **FISCAL YEAR 2014-15 BUDGET FOR THE OFFICE OF THE PRESIDENT**

The President of the University recommended that the University of California Office of the President fiscal year 2014-15 budget, as shown in the table below, be approved.

FY 2014-15 BUDGET SUMMARY OFFICE OF THE PRESIDENT	TOTAL BUDGET			UNRESTRICTED BUDGET			
	TOTAL FY 2013-14	CHANGE	TOTAL FY 2014-15	TOTAL FY 2013-14	CHANGE	% CHANGE	TOTAL FY 2014-15
GENERAL ADMINISTRATION AND CENTRAL SERVICES							
Provost Office	163,530,719	36,794,849 *	200,325,568	90,553,401	(893,906)	-1%	89,659,495
Finance	68,623,749	(729,002)	67,894,747	32,720,609	601,921	2%	33,322,530
Business Operations	91,149,449	(2,281,461)	88,867,988	43,778,721	562,181	1%	44,340,902
President's Executive Office	2,592,048	417,798	3,009,846	2,297,204	480,053	21%	2,777,257
Health Sciences	9,079,898	(3,694,074)	5,385,824	3,258,102	127,722	4%	3,385,824
External Relations	16,257,057	206,967	16,464,024	11,087,126	219,252	2%	11,306,378
Lab Management	4,040,647	-	4,040,647		-		
Academic Senate	1,873,696	(6,259)	1,867,437	1,843,794	48,113	3%	1,891,907
Regents Officers	-	-	-		-		
General Counsel	12,802,504	64,562	12,867,066	10,998,303	(43,064)	0%	10,955,239
Secretary/COS	3,393,068	(199,286)	3,193,782	3,388,068	(199,286)	-6%	3,188,782
Ethics and Compliance	5,634,522	(53,136)	5,581,386	5,625,287	(48,944)	-1%	5,576,343
Centrally Funded	16,660,751	(2,456,315)	14,204,436	13,690,223	(363,045)	-3%	13,327,178
SYSTEMWIDE PROGRAMS AND INITIATIVES		-	-		-		
Agriculture and Natural Resources	90,111,199	518,053	90,629,252	66,083,120	-	0%	66,083,120
President's Initiative	10,000,000	(153,000)	9,847,000	10,000,000	(153,000)	-2%	9,847,000
Public Service, Research & Other	91,515,270	2,916,714	94,431,984	32,202,261	(337,997)	-1%	31,864,264
TOTALS	$ 587,264,577	$ 31,346,410	$ 618,610,987	$ 327,526,219	-	0%	$ 327,526,219

* This increase is attributable to the inclusion of the Education Abroad Program budget, which was inadvertently omitted from the 2013-14 submission.

[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.]

Executive Vice President and Interim Chief Financial Officer Brostrom began his presentation by noting that the proposed budget for the Office of the President (UCOP) for fiscal year 2014-15 would increase by 5.3 percent over the previous year. This increase was due to the fact that the Education Abroad Program was included in the UCOP budget this year. This program is almost entirely supported by student tuition and fees. The unrestricted portion of the UCOP budget, funded by an assessment to the campuses, had remained flat. Mandatory cost increases, including compensation, health and welfare benefits, and an increased pension contribution had been absorbed to maintain a flat, unrestricted funds budget. A number of measures proposed by President Napolitano are being enacted. UCOP is aiming to reduce travel by more than ten percent. A rigorous approval process is being used to reduce the amount spent on outside consultants. There is a freeze on UCOP staff positions through 2014-15.

Mr. Brostrom recalled that in the past, UCOP had been funded with State funds and a myriad of taxes on the campuses. About three years earlier, the University instituted a new way of funding UCOP, returning all funds to the campuses – indirect cost recovery, patent recovery, and nonresident tuition – and assessing a low, broad-based tax on all campus expenditures, about 1.5 percent, to fund UCOP. There was criticism of this approach because it overcharged certain units or programs, like the medical centers, that did not derive as much benefit from UCOP. UCOP, working with the campuses, has developed a new approach. The assessment would now, effective in 2014-15, be based one-third on total expenditures, one-third on total number of employees, and one-third on the total number of students.

Mr. Brostrom noted that the effort this year to maintain the UCOP unrestricted fund budget at a flat level was a springboard for a broader assessment of UCOP, for considering which functions should be centralized and which left on the campuses. Following the departure of former Chief Financial Officer Taylor, UCOP is considering realignment and possible consolidation of certain offices.

In response to questions by Committee Vice Chair Kieffer, Mr. Brostrom responded that the Education Abroad Program budget amounts to approximately $36 million, and confirmed that without inclusion of this element in the UCOP budget, there would in fact be a decrease in UCOP expenditures in general. He noted that the expenditure for the Education Abroad Program had not increased. From an administrative standpoint, the Program is located at UC Santa Barbara, but the University has decided to keep its budget at UCOP.

Regent-designate Leong Clancy asked about the difference between the old and new approach in the amount of the assessment from the campuses. Mr. Brostrom responded that the amount of money is the same, but campuses are affected differently. It benefits campuses with large medical centers. A major criticism of the old approach came from UCSF, which was paying the second-highest assessment due to the size of its enterprise, while it derived no benefit from many UCOP programs. UCOP is trying to keep this new approach revenue-neutral for the campuses; as an example, UCSF is now returning a portion of State funds which UCOP will allocate to campuses that now have to pay more. In general, undergraduate campuses will have to pay somewhat more under the new approach, while campuses with large medical centers will pay less.

Regent-designate Engelhorn asked about funding for UCPath, the systemwide payroll and human resources enterprise, not listed in the current item. Mr. Brostrom responded that the University was developing an integrated work plan for UCPath. This new payroll program would have its first implementation on January 1, 2015 at UCOP, followed by other locations. UCPath was not listed in this proposed budget because all its costs to date were being capitalized, part of the implementation cost. Once the UCPath system is implemented, those costs would be amortized over a period of seven to 10 years. There was a delay in UCPath implementation, which accounted for the fact that the previous year's budget included some ongoing UCPath operating costs; these costs would not be part of the current budget, but would appear in the UCOP budget in 2015-16.

Governor Brown requested a document analyzing all elements of UCOP, both historically and at present. The total budget of approximately $600 million was significant, equivalent to two UC campuses in terms of State funding. He asked about the functions of this central office, noting his own efforts in the State government to transfer more authority to local school districts and counties. Mr. Brostrom responded that many documents on UCOP are available, and explained that a great deal of the UCOP budget flows through to the campuses. The budget for the division of Agriculture and Natural

Resources is included in the UCOP budget. Actual UCOP administrative functions account for about $90 million of the budget, and Mr. Brostrom expressed his conviction that this is money well spent on operating a single pension system, a single benefits program, and all asset and debt management. These are functions that should be centralized. President Napolitano has asked the administration to review these functions to determine if some should be moved to the campuses.

Governor Brown remarked on the dangers of both bureaucratic over-centralization and a lack of sufficient central organization. He reiterated his wish to understand the functions of UCOP and invited the chancellors to share their views, noting the importance of dialogue on this issue.

Regent Blum recalled that ten years earlier the UCOP budget had been twice as large. Efforts for greater efficiency made during the tenure of former President Yudof had led to significant improvements.

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

3. **ALLOCATION OF LOS ALAMOS NATIONAL SECURITY LLC AND LAWRENCE LIVERMORE NATIONAL SECURITY LLC FEE INCOME TO BE EXPENDED IN FISCAL YEAR 2014-15**

The President of the University recommended that the President be authorized to expend, for the following purposes and in the following amounts, from the University's net share of Los Alamos National Security, LLC (LANS) and Lawrence Livermore National Security, LLC (LLNS) income earned between January 1, 2014 and December 31, 2014, the following amounts:

A. Unreimbursable compensation for UC-designated key staff at LANS and LLNS (formerly referred to as "Supplemental Compensation") from July 1, 2014 through June 30, 2015 in the amount of $2.2 million ($1.2 million in 2013-14). The increase is primarily due to a new requirement by the Department of Energy (DOE) to apply full overhead burdens on all compensation, including the unreimbursable amount, consistent with Cost Accounting Standards under the prime contracts for the management and operations of Los Alamos National Laboratory (LANL) and Lawrence Livermore National Laboratory (LLNL).

B. An appropriation to the Office of the President budget for federally unreimbursed costs of University oversight of its interest in LANS and LLNS, paid or accrued July 1, 2014 through June 30, 2015, including but not limited to an allocable share of the costs of the President's Executive Office, the Provost, the Academic Senate, Human Resources, Financial Management, Compliance and Audit, Laboratory Management Office, Research Security Office, Federal Government Relations, Office of Research, Office of the General Counsel, Office of the Secretary and Chief of Staff to The Regents, and the University-appointed

Governors on the Boards of the LLCs in the amount of $5.05 million ($4.9 million in 2013-14). The increase in costs from fiscal year 2013-14 is due primarily to increasing labor and benefits costs as well as changes to the University-appointed Governors.

C. An appropriation in 2014-15 to a post-contract contingency fund in the amount of $1.3 million (no change from 2013-14).

D. An appropriation for contingency for factors affecting the final fee in the amount of $1.65 million ($1.39 million in 2013-14).

E. An appropriation in 2014-15 for the Laboratory-Campus Student Fellowship Pilot Program in the amount of $400,000. This is a new appropriation.

F. An appropriation in 2014-15 for research projects, to include National Laboratory research projects as well as other research projects in the amount of $13.5 million. ($15.28 million in 2013-14).

[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.]

Executive Vice President and Interim Chief Financial Officer Brostrom briefly explained the item. The fee income for Los Alamos National Security, LLC and Lawrence Livermore National Security, LLC for 2014-15 was projected to be $24.1 million. Most of this budget, $13.5 million, would be expended for research. About $5 million would meet Office of the President expenses for Laboratory Management. A new budget appropriation of $400,000, for the Laboratory-Campus Student Fellowship Pilot Program, would enhance collaboration between the campuses and National Laboratories.

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

4. **ADOPTION OF EXPENDITURE RATE FOR THE GENERAL ENDOWMENT POOL**

The President of the University recommended that the expenditure rate per unit of the General Endowment Pool (GEP) for expenditure in the 2014-15 fiscal year shall remain at a rate of 4.75 percent of a 60-month moving average of the market value of a unit invested in the GEP.

[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.]

Executive Vice President and Interim Chief Financial Officer Brostrom briefly introduced the item. Assuming investment returns of 12.5 percent on the General Endowment Pool in the current fiscal year, the payout rate of 4.75 percent would result in a total estimated payout of $270 million, an eight percent increase over the previous year on a per-share basis.

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

5. **ADOPTION OF ENDOWMENT ADMINISTRATION COST RECOVERY RATE**

The President of the University recommended that the endowment administration cost recovery rate remain at 55 basis points (0.55 percent)[1]and apply to the distributions from the General Endowment Pool (GEP) to be made after July 1, 2014, from the eligible assets invested in the GEP. The funds recovered shall be used to defray, in part, the cost of administering and carrying out the terms of endowments on the campuses and at the Office of the President.

[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.]

Executive Vice President and Interim Chief Financial Officer Brostrom briefly introduced the item, explaining that this action would virtually eliminate costs for the campuses for supporting endowment activities.

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

6. **APPROVAL OF FISCAL YEAR 2014-15 CapEquip FINANCING AUTHORIZATIONS**

The President of the University recommended that:

A. The fiscal year 2014-15 CapEquip authorizations delineated in Attachment 1 be approved as one-year authorizations expiring June 30, 2015.

B. The President be authorized to approve and obtain external financing for the CapEquip program in an amount not to exceed $71 million.

C. The general credit of the Regents shall not be pledged.

D. The President be authorized to execute all 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.]

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[1] One basis point is 0.01 percent of yield (i.e., one hundred basis points equals one percent); 55 basis points are the equivalent of $55 on endowment assets with a 60-month average market value of $10,000.

Executive Vice President and Interim Chief Financial Officer Brostrom recalled that the CapEquip program was developed by former Chief Financial Officer Taylor. Before the program was instituted, campuses paid rates of eight to 12 percent on capital leases with vendors. The program is funded through UC's commercial paper program and allows campuses to purchase capital equipment with loan terms of three to seven years, at a loan rate of 2.29 percent for the coming year. CapEquip generates significant savings on interest costs.

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

6. **APPROVAL TO JOIN THE FORT ORD REGIONAL HABITAT COOPERATIVE AND TO PARTICIPATE IN A LANDSCAPING AND LIGHTING DISTRICT, UC MONTEREY BAY EDUCATION, SCIENCE AND TECHNOLOGY CENTER, SANTA CRUZ CAMPUS**

The President of the University recommended that:

A. The University's participation in the Joint Exercise of Powers Agreement (JEP Agreement) establishing the Fort Ord Regional Habitat Cooperative Membership (Cooperative), for purposes of holding and managing base-wide endangered species incidental take permits on the former Fort Ord lands, which include land owned by the University, be approved.

B. The President, after consultation with the Office of the General Counsel, be authorized to execute all documents necessary for the University to become a member of the Cooperative, without limitation, via a JEP Agreement, to include the following provisions:

(1) The Santa Cruz campus shall manage and administer the Fort Ord Natural Reserve (FONR) lands consistent with an Installation-Wide Multispecies Habitat Conservation Plan (HCP) and its related oversight documents. All monitoring and reporting responsibilities will be performed by the Cooperative.

(2) The Fort Ord Reuse Authority (FORA) will have the following financial obligations until it sunsets (anticipated in 2020), after which the Cooperative will have the same obligations for the remainder of the 50-year life of the endangered species incidental take permit, with those financial obligations to be met by development fees charged and collected by the FORA:

a. Provide approximately $84,000 annually, indexed to inflation, to the campus for management and operational costs at FONR. After the FORA terminates, the Cooperative will take on this responsibility until such time as the habitat endowments, including the FONR endowment, are fully funded.

b. Contribute 25 percent of all development fees collected to fund habitat endowments, including the FONR Endowment, until all endowments are fully funded.

(3) Any party may withdraw from the Cooperative upon 90 days' written notice to the other parties. The withdrawing party shall remain obligated to the same extent, if any, as the remaining parties, including but not limited to debt, liabilities, and obligations arising from or related to any Cooperative actions taken during the period that the withdrawing party was a member of the Cooperative.

(4) The President be authorized to approve and execute a HCP Implementation Agreement with the California Department of Fish and Wildlife, and sign an endangered species incidental take permit issued by the U.S. Fish and Wildlife Service in conjunction with the other members of the Cooperative, and jointly hold a State endangered species incidental take permit applicable to the former Fort Ord land, such agreement to include the following provisions:

a. The University will be solely responsible for managing the University's lands at FONR.

b. The University will establish and manage an endowment to provide and receive funding in perpetuity for HCP-required management activities on FONR.

c. The President of the University will adopt a policy to collect funds associated with development of UC-owned lands at the former Fort Ord to be used to mitigate impacts to endangered species.

(5) The President be authorized to negotiate, approve, and execute any other agreements, amendments, or modifications concerning the Cooperative or the JEP Agreement that are reasonably related to the above, provided such agreements, amendments, or other modifications do not materially change the obligations or reduce the consideration to the Regents.

(6) The President of the University be authorized to appoint the University's representative to the board of the Cooperative.

(7) The President of the University be authorized to approve and execute any other agreements, amendments, or modifications concerning the University's joining a Landscaping and Lighting District for the Central North Campus of the UC Monterey Bay Education, Science and

Technology Center to be established by the City of Marina, and to appoint the University's representative to the board of such a District.

[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.]

Executive Vice President and Interim Chief Financial Officer Brostrom briefly summarized the item, which was related to an item discussed the previous day by the Committee on Grounds and Buildings.

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

7. **UPDATE ON THE 2014-15 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 his discussion by recalling that a week earlier, the Governor and the Speaker had introduced the Governor's rainy day fund proposal. This bill would replace the rainy day fund passed by the Legislature and signed by former Governor Schwarzenegger in 2010 and increase the size of the fund to up to ten percent of the amount of the General Fund. One-half of the new rainy day fund would be used to pay off the State's debt obligations, the other half for reducing retirement liability. The bill creates a Proposition 98 reserve and requires the Department of Finance to submit five-year General Fund revenue and expenditure projections. Mr. Lenz anticipated that the bill would allow the State to achieve fiscal stabilization in future years and that State reductions to programs would not be as significant as they have been in the past.

The Governor's May Revision to the budget proposal reflected an increase in revenue of about $2.4 billion from 2012-13 to 2014-15, and was focused on addressing State mandatory costs. The most notable cost was the increase in Medi-Cal enrollment, about 60 percent, as a result of the Patient Protection and Affordable Care Act, and would require setting aside $1.2 billion in 2014-15 and another $1.2 billion the following year. The Governor also proposed using the increased revenue to address $430 million in obligations to the California Public Employees' Retirement System, $142 million for drought-related expenditures, $659 million as an increase in the Proposition 98 guarantee, and $100 million to repay cities and counties for ten-year-old mandate claims. This left a reserve of approximately $528 million, which Mr. Lenz described as not significant compared to the size of the General Fund, $105.3 billion.

Mr. Lenz observed that although the Governor had not addressed the University's request for funding of approximately $125 million, this still remained a priority for the Governor and Legislature. A major concern for the Legislature is that UC take on eligible California resident freshmen and community college transfer students. The University is prepared to do this, but Mr. Lenz recalled that the State has not increased its investment in student enrollment since 2007; UC is funding about 7,500 students for whom it receives no State support, at a cost of about $75 million. Concerns have been raised about increasing the number of nonresident and international students, but Mr. Lenz stated that increased revenue from these students had helped campuses support California students without State funding.

Mr. Lenz reported that he had also had discussions with State policymakers regarding the diversity of UC's student population. Senate Constitutional Amendment 5, an effort to mitigate restrictions on affirmative action of Proposition 209, had recently received attention in the news media. This effort was put on hold, but the University's discussions had focused on the prudence of State investment in UC's outreach programs to the K-12 system and the community colleges. At one time the State provided UC with more than $82 million for outreach programs; currently it provides only $12.5 million. The University believes that State reinvestment in UC outreach programs would lead to increased student diversity.

Another priority for the University is academic quality. If enrollment is to increase, UC must have the ability to hire more faculty and create the academic infrastructure necessary for students to progress. Other pressing needs are graduate student support, deferred maintenance, instructional equipment, and library materials. Budget cuts have prevented progress on these quality initiatives.

Mr. Lenz anticipated that the California Legislative Analyst's Office (LAO) would issue an analysis of the May Revision the following day. He recalled that the previous year, the LAO projections on General Fund revenue were approximately $3.2 billion higher than projections by the Governor's administration. If the LAO projection were higher again this year, this might provide flexibility to the Legislature to address budget priorities for UC and the California State University. Mr. Lenz briefly outlined the further course of the budget deliberation process before passage by the Legislature.

Executive Vice President and Interim Chief Financial Officer Brostrom noted that UC's budget request can entertain both permanent budget augmentations and one-time increases. While UC is seeking ongoing funding, it can accomplish much with one-time funding as well.

The meeting adjourned at 10:55 a.m.

Attest:

Interim Secretary and Chief of Staff

Table A: Approval of FY2014-15 CapEquip Authorization

UC Location	FY 2014-15	Description of Expected Equipment Purchases
Berkeley	$ 5,000,000	Research equipment, telecommunications equipment, other equipment, software, and refinancing of certain existing capital equipment leases and other eligible capital investments
Davis	10,000,000	Science and laboratory equipment, animal caging, facilities maintenance equipment, computer software
Irvine	2,000,000	Research equipment, medical equipment, IT equipment
Irvine - Medical Center	5,000,000	Medical equipment, diagnostic equipment, budget software, and refinancing of certain existing capital equipment leases.
UCLA	5,000,000	Computer hardware, copying equipment, office equipment, musical instruments, medical equipment, diagnostic equipment, research equipment, laboratory instrumentation and equipment, theatrical equipment, shop equipment, communications and networking equipment, vehicles, computer software, fabricated items, and refinancing of existing capital equipment leases.
UCLA - Medical Center	20,000,000	Computer hardware, copying equipment, office equipment, furniture & fixtures, musical instruments, medical equipment, diagnostic equipment, research equipment, laboratory instrumentation and equipment, theatrical equipment, shop equipment, communications and networking equipment, vehicles, computer software, fabricated items, and refinancing of existing capital equipment leases.
Merced	2,000,000	Housing Furniture and Equipment, Fleet Vehicles, Office Furniture, Portable Trailers
San Diego	5,000,000	Research, medical and diagnostic equipment; budget software and refiancing of certain existing capital equipment leases.
San Francisco	15,000,000	Scientific equipment, information technology/network, office equipment and transportation/fleet vehicles
Santa Barbara	2,000,000	Diagnostic equipment and instruments, other equipment, vehicles, and refinancing of certain existing capital leases.
Total Authorization:	**$ 71,000,000**	