The Regents of the University of California

COMMITTEE ON FINANCE
January 22, 2015

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, Lozano, Makarechian, Reiss, Ruiz, and Saifuddin; Ex officio members Napolitano and Varner; Advisory members Davis, Hare, and Oved; Staff Advisors Acker and Coyne

In attendance: Regents De La Peña, Elliott, Engelhorn, Lansing, Pérez, and Zettel, Faculty Representative Gilly, Secretary and Chief of Staff Shaw, General Counsel Robinson, Chief Investment Officer Bachher, Provost Dorr, Executive Vice President and Chief Financial Officer Brostrom, Senior Vice President Stobo, Vice Presidents Duckett and Sakaki, Chancellors Block, Blumenthal, Gillman, Hawgood, Katehi, Leland, Wilcox, and Yang, and Recording Secretary Johns

The meeting convened at 9:05 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 19, 2014 were approved.

2. **AMENDMENT TO THE 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 an amendment to the allocation of the University's net share of Los Alamos National Security, LLC (LANS) and Lawrence Livermore National Security, LLC (LLNS) fee income to be expended in fiscal year (FY) 2014-15 that was previously approved pursuant to the May 2014 Regents item F5, *Allocation of Los Alamos National Security LLC and Lawrence Livermore National Security LLC Fee Income to be Expended in Fiscal Year 2014-15*.

FY2014-15 Fee Income Allocation

Estimated Funds Available	**Original**	**Amended**
Estimated Net Fee Income for CY 2014	$24.10 M	$10.50 M
Total Funds Available	**$24.10 M**	**$10.50 M**

Recommended Allocation		
Contract Non-Reimbursable Compensation (for LLC employees)[1]	$ 2.20 M	$2.20 M
UCOP oversight	$ 5.05 M	$5.05 M
Post-contract contingency	$ 1.30 M	$0.00 M
Contingency for factors affecting the final fee (maintained at $5.0M level)	$ 1.65 M	$3.25 M
Laboratory-Campus Student Fellowship Pilot Program	$0.40 M	$0.00 M
Research allocation July 2014-2015	$13.50 M	$0.00 M
Total allocation 2013-2014	**$24.10 M**	**$10.50 M**

[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 Committee on Oversight of the Department of Energy Laboratories had discussed fee income from Los Alamos National Security, LLC (LANS) and Lawrence Livermore National Security, LLC (LLNS) the previous day. The total available funds from this fee income for UC in fiscal year 2014-15 were estimated to be $10.5 million, a reduction of $13.6 million. The President was recommending that only essential allocations be made. Executive Vice President Brostrom added that the University had originally projected $24 million in fee income from LANS and LLNS. Due to the reduction in actual fee earned, the amount was now projected at $10.5 million. The University would accommodate this reduction by eliminating funding for the post-contract contingency fund, the Laboratory-campus student fellowship, and the UC Laboratory Fees Research Program.

Regent Reiss described the proposed action as a prudent measure.

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

3. **UPDATE ON THE PROPOSED GOVERNOR'S BUDGET FOR 2015-16**

[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 Brostrom began the discussion by stating that the Governor's proposed budget for 2015-16, introduced earlier that month, reflected a strengthening State economy and revenue increases attributable to Proposition 30. The State General Fund for 2015-16 was projected to be $113.3 billion, a 6.1 percent increase over the 2014-15 budget year. A large part of the General Fund expenditures would be directed to the K-12 system and to community colleges. Of the $3 billion in new funding for education, more than 80 percent would flow to the K-12 system. UC would receive $119 million. The community college system would receive $600 million, much of this to

[1] Previously referred to as "Supplemental Compensation." Contract non-reimbursable (NR) compensation funds the University's contract-required share of NR compensation for LLC employees in Key Personnel positions.

fund enrollment growth and new programs. Many of these community college students would be looking for opportunities to transfer in a few years, yet UC and the California State University (CSU) were not being adequately funded to allow for enrollment growth. This would present a budget challenge.

The Governor's budget proposes a four percent increase in State appropriations for the University, which equates to a 1.7 percent increase in UC's overall core funds budget, on condition that there be no increase in in-state tuition, nonresident tuition, or Professional Degree Supplemental Tuition (PDST), and no increase in the number of nonresident students. Nonresident enrollment would remain at the 2014-15 level. These conditions would have a negative impact on the UC budget, amounting to approximately $165 million, or about 43 percent of the revenues identified in the UC budget plan. This would eliminate nearly half the revenues UC had originally proposed; half of UC's budget would have no identified source of funds to support mandatory and high-priority cost increases.

UC's budget plan assumes three revenue sources in three roughly equal amounts: State funding, tuition and fees, a large proportion of which would be used for financial aid, and UC general funds and alternative revenues. Alternative revenues would include the University's efficiency measures. Expenditure assumptions include $125 million in mandatory costs, including pension contributions, health benefits, union contracts, and faculty merit increases. High-priority costs include deferred maintenance needs, capital needs, and a compensation increase for non-represented employees. Another expenditure category is reinvestment in academic quality: new faculty, increases in graduate student support, classroom technology, and addressing faculty salary gaps. The plan also includes an expenditure category for increasing California student enrollment by 5,000 students over five years. This year would be the first year of funding for that increase.

Actions taken by the Regents in November 2014 spurred responses from the Legislature. State Senator Marty Block and Senate President pro Tempore Kevin de Leon introduced SB 15, which would increase funding to UC and CSU by $340 million in 2015-16. The University's share of this funding would be $125 million. SB 15 would hold in-state tuition and PDST at current levels, but would call for a nearly 20 percent increase in nonresident supplemental tuition, or $4,000. SB 15 would also call for a marked increase in enrollment, by 5,000 students in one year. The bill would also prescribe how money is spent: $50 million for new enrollment, $25 million for additional class offerings, and $50 million for increased student services, with a primary goal of improving graduation rates and reducing time to degree. SB 15 would eliminate the Middle Class Scholarship Program; this would represent a cost of $100 million to UC students by 2017-18, when the Program would be fully phased in.

Regent and Speaker Atkins also introduced a plan, so far not codified in legislation. It would hold tuition at current levels and call for a 22 percent increase in nonresident supplemental tuition, or about $5,000. It would provide $50 million in State General Funds above the four percent base budget increase proposed by Governor Brown. Regent Atkins' proposal would increase California student enrollment by 2,000 a year, or

10,000 over five years, with growth at all nine undergraduate campuses. New funding would be used for enrollment growth and expanding student services. The proposal would cap nonresident enrollment, call for pension reforms for new UC employees contained in the Public Employees' Pension Reform Act of 2013, and increase financial aid, with Cal Grants for low-income students and accelerated implementation of the Middle Class Scholarship Program.

Mr. Brostrom then outlined three other opportunities for State funding. He recalled President Napolitano's ambitious goal of achieving climate neutrality by 2025 and current UC sustainability and energy efficiency programs, which require investment money. One opportunity was funding through Proposition 39. Half of Proposition 39 funds are allocated to energy efficiency programs, and they have been allocated to the K-12 system to meet Proposition 98 requirements. The University hopes that some of these monies could be released for UC energy efficiency projects.

Another opportunity might be revenues from the State's AB 32 cap-and-trade program. The Governor's budget projects a doubling of cap-and-trade auction revenue, but some experts suggest that this amount might be even higher, since this is the first year the program will be applied to fuel suppliers. Forty percent of AB 32 funds would be distributed through a legislative appropriation. This could be a source of funding for UC energy efficiency projects and other capital investments.

Another new item in the State budget is Proposition 2, championed by the Governor and approved by the voters. It augments the State's "rainy day" fund, which is projected to end the year at nearly $3 billion, and provides $1.2 billion to pay back previous borrowings and unfunded liabilities. The State has projected that it can pay off economic recovery bonds, loans from special funds, and settle up Proposition 98 requirements. The UCRP and UC retiree health liabilities are listed in Proposition 2 and in the Governor's budget as liabilities and Proposition 2 monies could be applied to them.

Regent Island asked about the expenditure figure of $22 million for California student enrollment growth, displayed in a slide shown earlier, for 1,000 new students in one year. He asked if this was an annual amount, projected for five years, and thus five times $22 million. Mr. Brostrom confirmed that this was correct. Regent Island asked how much of the increase in financial aid was related to enrollment growth. Mr. Brostrom responded that one-third of undergraduate tuition and 50 percent of graduate student tuition and PDST are set aside for financial aid. The increase in financial aid derived from both tuition increases on existing students and from enrollment growth.

Regent Leong Clancy asked if savings in capital investments are restricted dollars, applicable only to capital projects, or if these are general fund monies that can be used for other purposes. Mr. Brostrom responded that capital investment savings in the proposed budget could be used for other purposes. State funding was currently in the form of a "block grant." The amount proposed in the budget was money that UC chooses to allocate to capital projects, a very small portion of UC's overall need. These are projects UC has chosen to fund centrally rather than allocate to the campuses.

Regent Lozano referred to the legislative proposals just discussed and asked what the University's position would be on capping or eliminating nonresident enrollment or on eliminating the Middle Class Scholarship Program. She expressed the Regents' concern about UC's financial aid commitment to middle class families and also asked how the Regents' guiding principles would be incorporated in discussions with the State. Mr. Brostrom responded that these proposals represented promising beginnings in the State Senate and Assembly. The University's overall target amount for in-state tuition is about $100 million. If UC were to freeze in-state tuition there would be a gap in the budget. Both the Senate and Assembly have new General Fund monies that would cover part of that amount. Mr. Brostrom stated that a combination would be possible in which, for example, UC would raise nonresident tuition more than five percent, cap in-state tuition, and receive more monies from the General Fund. President Napolitano has asked the administration to examine funding deferred maintenance and other needs with assets or with one-time funds, reducing expenditures, and receiving more support from the State without raising in-state tuition. He emphasized the vulnerability of UC's middle-income students; UC does a good job of providing for low-income students, while middle-income students receive little State or federal aid. If the Middle Class Scholarship Program were eliminated, UC would have to find some institutional way to support these students.

Regent Makarechian asked about the status of Proposition 2. Mr. Brostrom responded that Proposition 2 was an attempt by the Governor to buffer the State from volatility in revenue sources. This "rainy day" fund was a good proposal that would help the State and the University avoid severe ups and downs in funding levels. Another purpose of Proposition 2 is to pay down unfunded liabilities and previous borrowings. A deficit borrowing that took place in 2004-05 was now being paid off. The University maintains that it should be considered for some of this funding as well.

Regent Makarechian asked about the status of State payment to UC for these liabilities. Mr. Brostrom responded that UC is listed in the current-year budget as a liability, but with an amount of zero. He stated his view that paying the UCRP obligations should be a higher priority for the State than paying off loans from special funds.

Regent Makarechian asked if in fact the University could expect UCRP funding from the State this year. Mr. Brostrom responded that the University would bring its argument to the Legislature and the Governor.

Regent Gould stated that Proposition 2 represented an excellent opportunity. The cap-and-trade program was another option for UC funding that the Legislature and the Governor should consider; UC has many projects that fall within the purview of this program. The California Legislative Analyst's Office (LAO) recently issued a revised estimate of revenues for this year. California is experiencing economic growth, and the LAO projected that the State might have additional revenues in May. Mr. Brostrom recalled LAO estimates for a period of three years. More revenues were available than projected in 2013-14 as well as in 2014-15, the current budget year, and the projection for 2015-16 would be for more revenue as well. The Governor has exercised appropriate caution in revenue projections. Trends have been positive. Some revenue has come from capital gains taxes, strong employment rates, and higher personal income tax. Regent Gould observed that Proposition 39, the cap-and-trade program, and Proposition 2 were all credible avenues and outstanding opportunities for the University to seek permanent funding. He asked that Mr. Brostrom keep the Regents apprised of these options.

Regent Pérez stated that Governor Brown played no role in putting Proposition 2 on the ballot. Potential revenues projected by the LAO this year might provide an opportunity for UC to take advantage of the debt repayment portion of the measure. This is not regular ongoing funding, but might relieve some economic pressure on UC.

Regent Saifuddin asked about the long-term implications of SB 15 and emphasized student concerns about sources of scholarships, financial aid, and possible elimination of the Middle Class Scholarship Program. Mr. Brostrom responded that SB 15 was a budget proposal for 2015-16, with no long-term aspects. The University wishes to work with the Legislature to establish long-term funding plans.

Regent Island referred to information in a slide displayed earlier, according to which Regent and Speaker Atkins' plan "proposes increases in amount of teaching required of faculty." He expressed alarm at this proposal, which he described as an inappropriate intrusion into an area that is the prerogative of the Board and of UC faculty. Mr. Brostrom responded that this proposal was not in a legislative bill, only a phrase in a document, and that no more details were available. SB 15 and Regent Atkins' plan prescribe uses of expenditures, which historically have been within the jurisdiction of the Board. The University could not comment on this proposal until it appeared the form of a legislative bill. He acknowledged that this proposal was more prescriptive than legislative language in the past.

Regent Island asked if the intention of this proposal to require more teaching by faculty was to move the University away from being a research institution. Mr. Brostrom responded that the Governor and his staff, in discussions with the University, have raised the issue of faculty teaching more. The University has consistently responded that this would result in less research; research is not only an important part of UC's educational mission, but also brings in $5 billion in external funding, some of which goes to UC's core budget. The University has been examining faculty workloads and student credit hours. UC faculty compare favorably in this area; they have a high rank among research universities in teaching workloads and student credit hours. Mr. Brostrom acknowledged that UC is different from the CSU system in that CSU faculty teach more courses.

Faculty Representative Gilly expressed concern about the proposal to require more teaching by faculty. Increased teaching would mean a decrease in research and a weakening of the research University, a diminution of an element of the California Master Plan for Higher Education.

Regent-designate Oved noted that these legislative proposals place a significant burden on nonresident students. He asked about the dollar amount of the tuition increases in these proposals for nonresident students. Mr. Brostrom responded that nonresident tuition would be about $26,000, bringing total charges to roughly $38,000 for out-of-state students, similar to nonresident tuition at the Universities of Michigan and Virginia.

Chancellor Katehi commented that nonresident tuition at UC was already very high, and that any increase above the five percent already proposed would harm graduate programs and the ability of campuses to recruit international students. UC faculty currently complain that nonresident tuition for first-year graduate students is prohibitive. A further increase would make it even more difficult to recruit graduate students and would be devastating.

Committee Chair Ruiz stressed the Regents' goal of accommodating the demand for a UC education. He asked about the scenario and impact on students if UC were to have only the funds the State was offering. Mr. Brostrom responded that UC's long-term stability plan for tuition and financial aid included such a scenario – the effect on enrollment if UC were not to raise tuition for five years, but to rely only on the Governor's increase in State funding. The effect would be drastic. The University would reduce in-state enrollment and replace it with nonresident enrollment. In the current year, California student enrollment growth would be reduced to zero, as would deferred maintenance, and there would be no increases to financial aid. UC would still have a $100 million budget shortfall to be absorbed by the campuses. It would be a year of cuts, if UC were to meet the other goals in its expenditure plan. The University would cut the planned $22 million for California student enrollment growth, $72.9 million for financial aid, the amount budgeted for academic quality initiatives, and some of the planned high-priority needs, but there would still be a $100 million shortfall. The Governor's budget proposal affects not only the $100 million of in-state tuition revenue mentioned earlier. An additional $67 million in revenue that UC was counting on in its original revenue estimates would be forfeited if UC were to not raise nonresident tuition and PDST and were to cap nonresident enrollment growth.

Committee Chair Ruiz asked if this meant that UC might have to consider not accepting a number of students it would otherwise admit for this year. Mr. Brostrom responded in the affirmative. Under this scenario, UC's budget plan would have no growth in California resident students.

Committee Chair Ruiz expressed disagreement with Governor Brown, who had made a statement the previous day to the effect that the size of the K-12 student population would remain level. This statement did not take into account outreach efforts and efforts to help prepare K-12 students for UC and CSU eligibility. If the K-12 system improves student preparation, the number of UC-eligible students would increase. Committee Chair Ruiz stressed that UC and CSU are a key to social mobility for underrepresented minorities, and a key for them to participate in the American dream. He raised the question of how one could calculate the dollar value of the social mobility UC provides for first-generation college students; it has a tremendous impact on California, including the California economy.

Student observer Christopher Kan urged UC to prioritize affordability and quality. Default rates on student loans for UC graduates were increasing. UC alumni were defaulting on student debt more often, even though the economy was growing. UC should refrain from raising tuition over the next five years. The quality of a UC education has suffered, as seen in crowded classrooms and the fact that students receive less feedback in class and on their assignments. It is imperative that the University reinvest in quality. UC should publish its expense report as required by AB 94. Transparency would allow all stakeholders, students included, to work toward a more efficient University. Campuses have problems stemming from mismanagement of facilities that needlessly increases the cost of a UC education.

President Napolitano responded to the issue of AB 94. The previous day, Governor Brown pointed out that for years, UC did not use a cost-per-student calculation and did not accumulate data on that basis. This was in part because there are students with double majors, graduate and undergraduate students, and many variations among the student population. The AB 94 criteria are prescriptive and do not match up with 20 to 30 years of UC accounting practice. This has required the University to perform a significant amount of work. President Napolitano stressed that UC would file its AB 94 report, but also stressed that this report does not reflect the true cost of providing a UC education. It has taken time for UC to meet the AB 94 requirements, but this is not due to lack of effort. The University must revisit decades of records and cost accounting. The University has the necessary information, but not in the format required by AB 94.

The UC administration recognizes that it must keep costs as low as possible. President Napolitano referred to Mr. Brostrom’s presentation and the fact that UC planned to address one-third of its revenue needs through its own sources and efficiencies. President Napolitano stated that she knew of no other State agency that could accomplish this.

The meeting adjourned at 9:50 a.m.

Attest:

Secretary and Chief of Staff