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Office of the President

TO MEMBERS OF THE FINANCE AND CAPITAL STRATEGIES COMMITTEE:

ACTION ITEM

For Meeting of January 24, 2018

APPROVAL OF THE UNIVERSITY OF CALIFORNIA 2018-19 BUDGET FOR CURRENT OPERATIONS, TUITION, AND FINANCIAL AID, AND ADJUSTMENT OF THE EMPLOYER CONTRIBUTION TO THE UNIVERSITY OF CALIFORNIA RETIREMENT PLAN

EXECUTIVE SUMMARY

The Regents are being asked to approve the University of California operating budget plan for 2018-19 and proposed adjustments to tuition, the Student Services Fee, undergraduate Nonresident Supplemental Tuition, and the employer contribution rate to the University of California Retirement Plan (UCRP).

The 2018-19 budget plan represents a balanced funding proposal that supports expanded access for California resident students, enhances UC affordability for students with financial need, and allows for investments in student success such as improving the student-faculty ratio, increasing course availability, expanding access to student mental health services, and addressing the University's most critical capital needs. The plan also addresses funding needs associated with employee and retiree health benefits, faculty and staff compensation, and employer contributions to the UCRP, among other important areas.

Revenue components of the plan include a three percent base budget adjustment from the State; enrollment growth funding for an additional 2,000 California undergraduate students and 500 graduate students; net adjustments to tuition and the Student Services Fee of $288 and $54, respectively; an increase of $978 in undergraduate Nonresident Supplemental Tuition; and internal solutions, including alternative revenues and cost savings, to address budget needs.

Increases in student financial aid from University and State financial aid programs are collectively expected to exceed the proposed adjustments to student charges for over one-half of all California resident undergraduates under the current terms of those programs, resulting in no additional expenses for mandatory charges for these students and additional resources that students can use to cover housing, food, books, and other expenses that they face. Last year, UC undergraduates received more than $740 million in University, federal, and State grants to help cover these other components of students' total cost of attendance.

To address lower-than-expected State support in 2018-19 and the resultant impact on campus operating budgets, this item also recommends that the Regents rescind the planned increase to 15 percent in the University contribution rate to the Campus and Medical Centers segment of the UCRP effective July 1, 2018, as approved at the July 2017 Regents meeting, in addition to rescinding the planned increase to seven percent in the employer assessment for Savings Choice Participants. Updated actuarial projections that include recent investment performance indicate that when combining the current level of active member and employer contributions and the approved Short Term Investment Pool transfer amount of $500 million, the total annual contribution will be within 1.5 percent (approximately $44 million) of the total Annual Required Contribution (ARC)[1] for 2018-19, approximately fully funding the ARC. It is projected that for the remaining years of the approved transfers, the ARC will be fully met based on the contributions and previously approved transfer amounts, without the increase in the employer rate to 15 percent.

RECOMMENDATION

The President of the University recommends that the Regents:

1. Approve the budget plan included in the document *2018-19 Budget for Current Operations* and shown in Attachment 1.

2. Approve the adjustments in student charges shown in Display 1, to be effective with the 2018-19 academic year.

3. Authorize the President to assess mandatory systemwide charges below the amounts shown in Display 1 if the State provides additional permanent funding to buy out some or all of the proposed increase in student tuition and fees.

4. Rescind the prior Regents' approval in the July 2017 action, *Authorization to Increase the University Employer Contribution Rate and Make Additional Contributions to the University of California Retirement Plan*, to increase the University's contribution rate for the Campus and Medical Centers segment of the University of California Retirement Plan ("UCRP" or "Plan"), effective July 1, 2018, to 15 percent (from 14 percent) for all member classes and tiers, other than Tier Two and 7.5 percent (from seven percent) for Tier Two members.[2]

5. Rescind an increase in the employer assessment to seven percent (from six percent) for Savings Choice Participants in the Defined Contribution Plan, also approved by the Regents in the July 2017 action.

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[1] ARC is the total funding policy contribution defined in Regents Policy 5601.
[2] The UCRP member class known as "Tier Two" is a frozen group. As of July 1, 2017, it had three active members.

DISPLAY 1: Proposed Maximum Increases to Student Charges[1]

	2017-18 Charges	*Proposed Adjustment*	*Proposed % Change*	Charges Effective 2018-19
Tuition (Undergraduate and Graduate)				
Tuition Base Rate	$11,442	*$348*	*3.0%*	$11,790
Tuition Surcharge[2]	$60	*- $60*	*- 100%*	$0
Total	$11,502	*$288*	*2.5%*	$11,790
Student Services Fee				
Undergraduate and Graduate	$1,128	*$54*	4.8%	$1,182
Total Mandatory Systemwide Charges (Tuition and Student Services Fee)				
Undergraduate and Graduate	$12,630	*$342*	2.7%	$12,972
Nonresident Supplementation Tuition				
Undergraduate	$28,014	*$978*	3.5%	$28,992

[1] Charges are effective the summer term preceding the academic year indicated – e.g., summer 2018 for 2018-19.
[2] Surcharge to cover costs associated with the *Luquetta v. Regents* class action lawsuit.

BACKGROUND

The University's core funds budget – the funds used to support its basic educational mission – consists of State General Funds, revenue from mandatory systemwide tuition and fees, and UC General Funds (which include Nonresident Supplemental Tuition, portions of indirect cost recovery, application fee revenue, and a variety of other revenue sources). Totaling over $8 billion in 2017-18, core funds comprise only about one-fourth of the University's overall expenditures; however, they support the operational infrastructure needed for the success of other programs in the $34 billion enterprise, such as medical centers and organized research.

The proposed 2018-19 budget plan would enable the University to continue to provide extraordinary levels of access, affordability, and excellence to current and future generations of UC students amid a complex set of budgetary circumstances. Specifically, the plan reflects elements of the long-term funding framework agreed upon by the Governor and the University; the opportunities and challenges created by the rapid growth in California resident undergraduate enrollment over the past two years, resulting in the all-time high enrollment of California undergraduates; key provisions of the Budget Act of 2017; and anticipated levels of State support for the University in 2018-19. Each consideration is described in greater detail below.

The Long-Term Funding Framework between the Governor and UC

The long-term funding framework established between the Governor and the University, which was endorsed by the Regents in May 2015, has provided welcome stability in State support for UC students. Key elements of the framework include the following:

- State support for the University's permanent base budget would increase by four percent annually over the term of the agreement through 2018-19.

- The University would receive Proposition 2 debt repayment funds of $436 million in one-time funding over three years to help address the unfunded liability associated with the University of California Retirement Plan (UCRP).

- The Student Services Fee may increase by five percent annually, with one-half of the new revenue (net of financial aid) to be used to enhance student mental health services.

- The framework permits moderate increases in Nonresident Supplemental Tuition.

- Any tuition adjustment proposed for 2017-18 or later years would be generally pegged to economic indicators that reflect cost increases in the broader economy.

Under the framework, the University committed to a number of reforms that have the potential, over time, to improve student success, expand the University's capacity to serve students, and reduce elements of the University's cost structure. As shown in Display 2, *every reform but one will have been completed by the end of the 2017-18 academic year.*

DISPLAY 2: University Reforms Included in the Funding Framework with the Governor

Completed Actions

- Approve pension options for new hires that incorporate a pensionable salary cap consistent with the State's Public Employee Pension Reform Act (PEPRA)
- Expand transfer pathways to include the 21 most popular majors for transfer applicants across the system
- Explore adoption of the State's Common Identification Numbering (C-ID) system to identify similar courses across the University's undergraduate campuses and transferable courses at the California Community Colleges.
- Identify and promote three-year degree pathways
- Pilot alternative pricing models for summer session
- Prioritize funding for online instruction to address bottleneck courses
- Reexamine the use of alternative credits to satisfy graduation requirements
- Promote best practices in academic advising that support the timely graduation of students
- Foster the innovative use of data analytics to identify and support at-risk students
- Pilot adaptive learning technologies to help focus instruction and increase the number of students who master content in particularly difficult courses and persist to completion
- Convene industry and academic leaders to identify how UC can help meet current and future workforce needs

Actions To Be Completed in the Current Academic Year

- Streamline upper-division major requirements to reduce time-to-degree (requirements have been streamlined; final report to be issued by Spring 2018)
- Explore the use of activity-based costing (ABC) at three campuses (pilot programs completed; final report to be issued by Spring 2018)

Actions With Remaining Deliverables

- Enroll a 2:1 ratio of freshman-to-transfer students systemwide and at every campus except Merced (achieved systemwide and at most campuses; strategies in place to achieve 2:1 at remaining campuses)

Several reforms called for under the framework will improve students' educational opportunities and improve student success. In addition, the stable funding provided by the framework agreement has allowed UC to meet its most pressing budgetary needs and has provided campuses with greater predictability in their funding projections.

While much appreciated, however, this stability has not reversed the substantial decline in available funds per student that has occurred in recent decades. Available funding from the University's core fund sources – State General Funds, Tuition and fees, and UC General Funds – declined by 31.2 percent on a per-student basis between 2000-01 and 2016-17 in constant dollars, as illustrated in Display 3. While the amount of *gross* revenue from these sources increased over time, the *net available resources per student* declined by $11,068 per student due to several factors.

- First, UC expenditures on financial aid increased from $337 million to $996 million in constant dollars between 2007-08 and 2016-17. This investment shielded many UC students from the impact of tuition increases that occurred in the late 2000s and provided additional aid to help students cover costs such as housing, food, and books. But it also resulted in less revenue available to meet other critical parts of the University's operating budget such as faculty hiring, academic advising, and addressing an aging infrastructure.

DISPLAY 3: Change in Available Resources from State General Funds and Student Tuition/Fees

		2000-01	
	2016-17	Adj. for Inflation	Not Adj. for Inflation
State General Funds - Permanent ($M)	$3,306	$5,000	$3,192
Tuition/Student Services Fee	$3,151	$940	$600
Professional Degree Fees	$315	$68	$44
UC General Funds	$1,418	$581	$371
	$8,190	$6,590	$4,206
Resources Unavailable for Current Operations ($M)			
Financial Aid	($966)	($337)	($215)
Lease revenue / GO Bond payments	($344)	($168)	($107)
UCRP Contributions	($424)		
	($1,735)	($505)	($323)
Available Resources ($M)	$6,455	$6,084	$3,883
Number of Students Enrolled (FTE)	263,957	171,270	171,270
Available Resources per Student ($)	**$24,456**	**$35,524**	**$22,674**
$ Change since 2000-01	***($11,068)***		
% Change	***-31.2%***		

- In addition, a significant portion of the University's State General Fund appropriation is dedicated to debt service for outstanding General Obligation and former State lease revenue bonds. This amount grew substantially in 2013-14 when $200.4 million was added to the University's base budget for debt service on outstanding General Obligation bonds that had previously been paid directly by the State outside of the University's annual State General Fund appropriation. Although this increased the University's General Fund appropriation, it also shifted the responsibility to repay those bonds to the University's operating budget.

- Employer contributions to the UCRP also increased during this period. UC restarted employer contributions to UCRP in April, 2010. In order to secure the financial viability of the plan, the rate of employer contributions rose quickly over a six-year period until it reached 14 percent of compensation in 2014-15. This put an enormous strain on campus budgets, particularly because the restart of contributions occurred at the same time as dramatic cuts were made to the University's State appropriation due to the Great Recession.

- Lastly – and most important – UC served over 90,000 more students in its State-supported programs in 2016-17 than it did in 2000-01 – an increase of 54 percent. This increase far outpaced growth in total available resources from core funds.

The resulting decline of $11,068 in available resources per student underlies many of the challenges related to the student-faculty ratio, demand for student advising and other services, and critical infrastructure needs that UC campuses face today.

Two aspects of the framework with the Governor have a direct bearing on the University's budget plan for 2018-19.

- *Adjustment to the University's base budget.* The Governor's May Revise budget proposal suggested that the University of California and the California State University should anticipate base budget adjustments of three percent in 2018-19 – considerably less than the adjustment of four percent envisioned under the framework between the Governor and the University. The University expects that the Governor's January budget proposal will reflect this lower level of support, which is reflected in the 2018-19 budget plan. For UC, the difference between a three percent adjustment and a four percent adjustment for 2018-19 is approximately $34 million.

- *Progress on programmatic aspects of the framework.* As noted above, the University has fully implemented nearly all of the programmatic reforms specified by the framework. The State's desire for greater progress in some areas is reflected in a provision of the Budget Act of 2017 that makes $50 million of the University's 2017-18 State appropriation contingent on certain outcomes. These are discussed more completely under *The Budget Act of 2017*, below.

Recent California Resident Enrollment Growth

The University, with the support of the State, has achieved an extraordinary level of enrollment growth in recent years. The growth in total enrollment of California resident undergraduates between fall 2015 and fall 2016, for example, was the largest one-year increase since the end of the Second World War. This expanded access has benefited both California high school graduates and California Community College students, who applied to – and enrolled at – the University in record numbers.

This growth, while a boon to California students seeking to enroll at UC, has created challenges for campuses. The challenges have resulted in part because actual enrollment growth far exceeded the funded enrollment growth targets specified in the Budget Acts of 2015 and 2016. Respectively, those acts provided State support for enrollment growth of 5,000 students in 2016-17 over 2014-15 levels, and enrollment growth of 2,500 additional students in 2017-18 compared to 2016-17.

Both Budget Acts provided funding on an all-or-nothing basis: UC would receive no enrollment growth funding if it fell short of the specified goal. In order to avoid the prospect of receiving no State funds for enrollment growth, campuses made the rational decision to err high when trying to achieve their enrollment targets. This tendency, combined with the inherently unpredictable nature of enrollment management, resulted in estimated growth of nearly 10,100 California undergraduates between 2014-15 and 2017-18, or 2,600 more than the 7,500 students for which funding was provided in the Budget Acts of 2015 and 2016. Absent State support for educating these students, campuses must instead divert funds from other pressing budgetary needs – e.g., reducing the student-faculty ratio or meeting student demand for academic advising – to accommodate the larger-than-expected enrollment of California undergraduates.

The Budget Act of 2017

Funding provided to the University under the Budget Act of 2017 was generally consistent with the long-term funding framework between the Governor and UC. Three provisions of the Act warrant special mention because of their potential implications for the development of the University's budget plan for 2018-19.

- *Funding is contingent upon meeting certain requirements.* Under the Act, $50 million of the University's 2017-18 State General Fund appropriation is contingent upon the University demonstrating a good-faith effort to satisfy five requirements: completing pilot programs of activity-based costing at three campuses by May 2018; attaining a freshman-to-transfer ratio of 2:1 systemwide and at every campus except Merced by 2018-19; implementing recommendations made by the California State Auditor in its recent audit of the Office of the President by April 2018; eliminating supplemental retirement payments for Senior Management Group employees hired after May 2018; and disclosing information about revenues, expenditures, and carryover funds for systemwide and presidential initiatives. The University expects to meet the requirements set forth in the Act; ultimately, however, the State Director of Finance is responsible for determining whether these requirements have been met.

- *Enrollment growth expectations for 2018-19.* The Act calls upon the University to enroll at least 1,500 more California resident undergraduates in 2018-19 compared to 2017-18. In a departure from previous Budget Acts, however, the Act provides no assurance of incremental State General Funds to support that enrollment growth. Instead, the Act suggests that this enrollment growth should be funded, at least in part, by reallocating existing resources from other parts of the University's budget. The Act directs the University to consult with the Legislature and the Department of Finance to identify possible areas where funding could be redirected towards enrollment growth.

- *Direct State appropriation for the Office of the President.* In a significant departure from past Budget Acts, the Budget Act of 2017 allocates $348.8 million of State General Funds to support the Office of the President and UCPath and requires the University to eliminate the general campus and UCPath assessments that would have otherwise funded those programs and activities. Although intended to be revenue-neutral to the University as a whole, the provision has far-reaching implications for the State's involvement in University governance and for how campuses that are particularly dependent on State support can respond to a permanent, long-term redirection of State funding to support the Office of the President instead.

PROPOSED 2018-19 OPERATING BUDGET PLAN

The 2018-19 budget plan supports additional enrollment growth, particularly for California resident undergraduates; enhances UC affordability for students with financial need; and allows for investments in student success such as improving the student-faculty ratio, increasing course availability, expanding access to student mental health services, and addressing the University's most critical capital needs. The plan incorporates a balanced funding strategy that includes University-initiated actions to limit cost increases and identify alternative revenue sources; additional State support for the University's base budget and a portion of the planned enrollment growth; and an adjustment to students' mandatory systemwide charges (tuition and the Student Services Fee) that are below the projected rate of inflation and which will be fully covered for over one-half of California resident undergraduate students by additional financial aid. Elements of the plan are described in greater detail below.

Major Expenditure Categories for 2018-19

Enrollment Growth. UC is dedicated to the mission of access for California residents consistent with its founding as the State's land-grant institution and in accordance with the Master Plan for Higher Education. As a research university, UC also must educate enough graduate students to meet the state's economic development and skilled workforce needs, help advance knowledge through its research mission, and work with faculty and undergraduate students as part of the education continuum. The 2018-19 budget plan provides the resources needed to increase enrollment at both the undergraduate and graduate levels.

The 2018-19 budget plan anticipates enrollment growth of 2,000 California resident undergraduate students and 500 graduate students over 2017-18 levels. The plan also reflects an additional 1,000 undergraduate nonresident students systemwide, the same number that was incorporated into the University's budget plan for 2017-18. Projected expenditures associated with this enrollment growth are approximately $18,800 per student (excluding financial aid) based upon the University's marginal cost calculation methodology. Of this amount, the State's expected contribution would typically be about $10,000 per student, with the remainder covered by the tuition and fees paid by the student (less the amount used for financial aid).

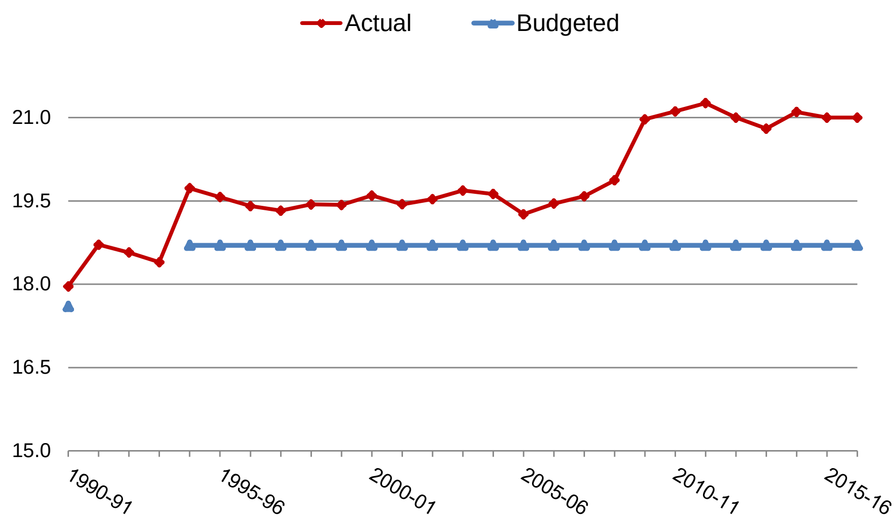
As the State's research university, UC is also concerned with enrollment of graduate students to complement and support dramatic undergraduate growth. As faculty are added in response to increased enrollment, graduate students are needed to partner with faculty in their research, teach and mentor additional undergraduates, and contribute to the State's skilled workforce and broader economy upon graduation. To address this need, the budget plan includes enrollment growth of 500 graduate students in 2018-19.

Investment in Student Success and Academic Excellence. Reinvestment in the academic infrastructure of the University remains a top priority, made even more essential by the University's recent enrollment growth noted earlier. The areas identified for investment in academic quality are critical elements in any academic institution's ability to maintain excellence and have remained high priorities of the Regents. The University's 2018-19 budget plan proposes a further investment of $50 million toward this effort, which would provide campuses with much-needed resources for the following types of programs:

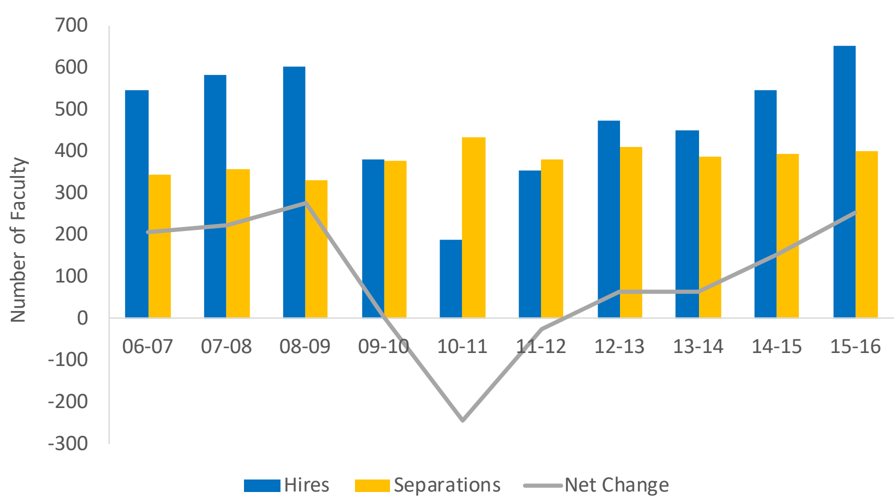
- *Improving the Student-Faculty Ratio.* As shown in Display 4, the University's student-faculty ratio ballooned during the recent fiscal crisis and stands currently at 21:1 – well above the ratio previously agreed upon with the State of 18.7:1 (sometimes referred to as the "budgeted" ratio). Reducing the student-faculty ratio would permit the University to offer smaller class sizes and expand the number of courses offered. A lower student-faculty ratio also creates more opportunities for contact outside the classroom, guidance in internships and placements, and undergraduate participation in research and public service, all of which directly benefit students. Reducing the student-faculty ratio also can contribute to improved performance outcomes such as graduation rates and time-to-degree.

  Improving the student-faculty ratio requires a sustained effort over the course of many years. Promising signs of preliminary progress can be seen in Display 5, which compares the number of ladder-rank equivalent faculty hired each year (shown in blue) with the number who leave the University. For several years, the number of newly hired faculty members was barely higher than – or in some cases well below – the number of faculty who left the University. More recently, this worrisome pattern has been reversed. Additional years of continued growth will be required in order to bring the student-faculty ratio closer to pre-recession levels.

DISPLAY 4: Budgeted and Actual Student-Faculty Ratios



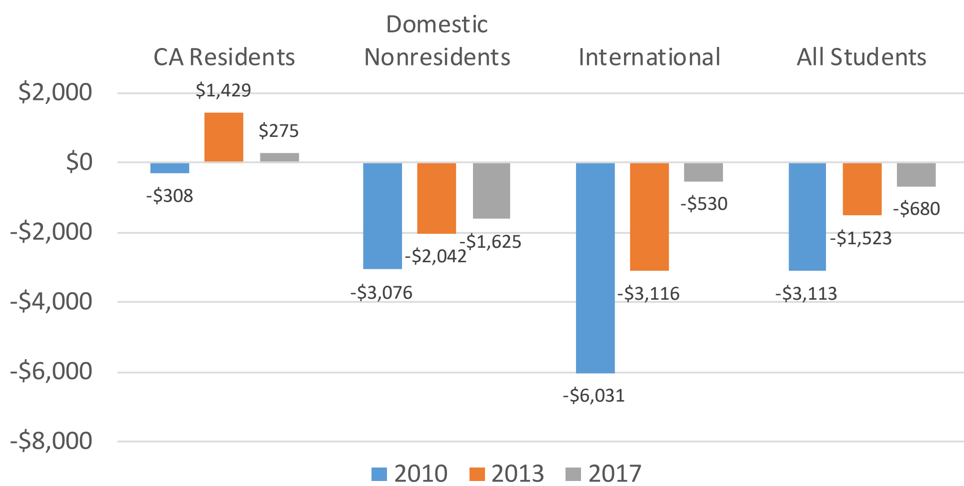
DISPLAY 5: Ladder-Rank and Equivalent Faculty Hires, Separations, and Net Change, 2006-07 to 2015-16



- *Supporting Startup Costs for New Faculty.* As campuses hire new faculty, they are faced with the need to cover the associated startup costs. These may include renovation of laboratory space; equipment; graduate student, postdoctoral scholar, and technical staff support; and other costs necessary for new faculty to establish their research teams and to become productive members of the University community. In some disciplines – especially health sciences, life sciences, physical sciences, and engineering – startup costs frequently exceed $1 million per faculty member. Since UC's top candidates have multiple job prospects and UC is in competition for these hires, candidates make decisions based in part on UC's ability to support cutting-edge research.

- *Augmenting Graduate Student Support.* Graduate education and research at the University fuel California's innovation and economic development, helping establish California as the sixth largest economy in the world. The strength of UC's graduate programs is also a key factor in attracting and retaining high-quality faculty. To maintain that strength, the University must ensure that the amount and duration of graduate student support are competitive. Since 2004, surveys of students admitted to the University's academic doctoral programs have repeatedly shown that UC's offers of financial support are, on average, less than the offers students receive from competing institutions. The University has attempted to address this issue on several fronts, including freezing graduate student Nonresident Supplemental Tuition for several years and increasing the average value of its graduate student support offers. Recent surveys suggest that these efforts have started to yield results. As shown in Display 6, UC's competitive gap has narrowed since 2010 – an important sign of progress. Nevertheless, students' offers from competing institutions continued to be higher, on average, than offers from UC, illustrating the need for continued investment in this area.

DISPLAY 6: Difference Between UC and Non-UC Stipends by Residence for 2010, 2013, and 2017



- *Enhancing Undergraduate Instructional Support.* Historically, the State has recognized chronic shortfalls in funding for key areas of the budget that directly affect instructional quality – instructional equipment replacement, instructional technology, libraries, and ongoing building maintenance. The University must reinvest in these areas if it is to keep up with technical innovations in equipment, libraries, and instructional technology, and address ongoing maintenance needs.

Improving Affordability. The budget plan for 2018-19 includes $47.1 million in additional student financial aid for undergraduate and graduate students. The additional aid is more than enough to cover the proposed adjustments to Tuition and the Student Services Fee for California undergraduates who qualify for need-based grants. In fact, in addition to covering the adjustments for these students, the revenue is expected to provide them with approximately $100 extra to help cover other expenses that they face such as rent, food, books and supplies, and transportation. The impact of the proposed adjustments on undergraduate and graduate students is described more fully in the "Tuition, Academic Excellence, and UC Affordability" section below.

Expanded Student Mental Health Services. The budget plan includes $4.7 million for expanded student mental health services, consistent with the high priority that the Regents and students have placed on this issue in recent years. Funding will allow campuses to make progress on their plans to hire additional mental health advisors and other professionals to improve students' access to counseling and related resources.

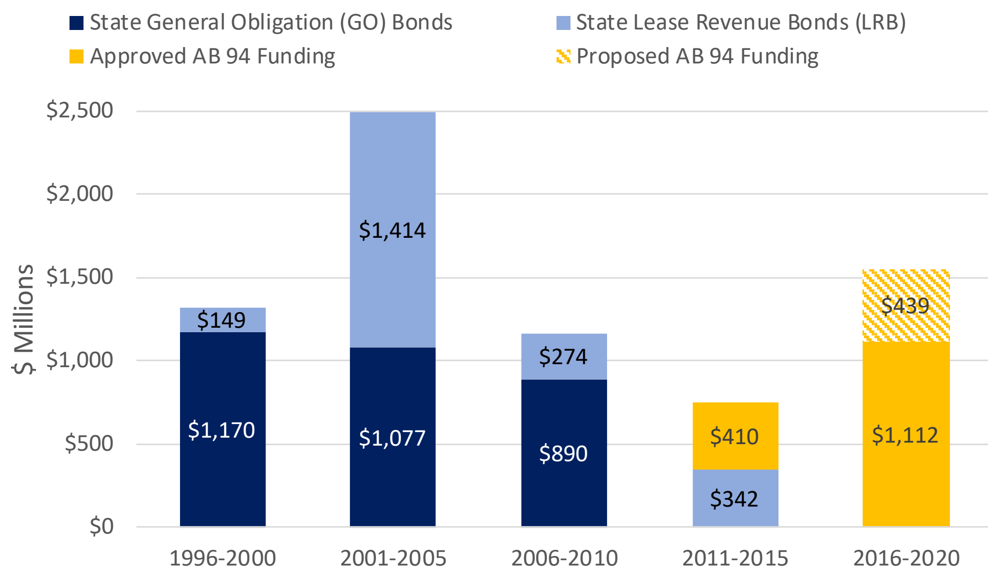
Capital Needs. Two components of the budget plan directly address the University's most pressing capital needs.

- *Deferred Maintenance.* The 2018-19 budget plan includes $35 million in one-time State funds for deferred maintenance, which continues to represent a substantial and growing safety and economic risk to the University. The University's current deferred maintenance need is estimated to exceed $8 billion, over $3 billion of which is eligible for State support. As University facilities deteriorate, the threat of a significant building or infrastructure failure grows – a failure that could place students, faculty, and other staff at risk, cause extensive damage to facilities and other property, destroy years of research, or disrupt instructional and other core mission activities for an extended period of time.

- *Capital Improvements.* The University continues to face a growing backlog of capital projects. The State process introduced by AB 94 allows the University to address its highest-priority capital needs until a new General Obligation bond can be brought before California voters. As shown in Display 7, the importance of this funding mechanism has grown in recent years due to the lack of additional capital resources from General Obligation bonds or State lease revenue bonds. To utilize this mechanism, however, the University must set aside sufficient revenue from other parts of its operating budget. The budget plan for 2018-19 includes an additional $15 million for debt service and related capital expenses, including those associated with the Merced 2020 Project, enrollment growth, seismic safety, and other approved capital projects.

  The University continues to pursue gifts and other potential sources to supplement State funding for construction. The University has capital needs for student-life and auxiliary programs, for example, that do not qualify for State support and can be addressed with non-State resources only. In this context, the University has intensified its efforts to make the most efficient use of existing facilities, to carefully define and analyze facility needs, to prioritize needs that maximize the value provided by available funds, and to continually improve management of project design and construction.

DISPLAY 7: Funding from General Obligation Bonds, Lease Revenue Bonds, and AB 94 Funds



Mandatory and Other High-Priority Costs. The University must pay a variety of cost increases each year, regardless of whether additional new funding is provided to support them. Significant mandatory and high-priority cost changes projected for 2018-19 are described below.

- *UC Retirement Plan.* The UCRP provides pension benefits for more than 59,000 retirees and survivors and has more than 126,000 active employee members as of July 1, 2017. The 2018-19 budget plan includes $17.1 million for increased employer contributions to the retirement system from core funds, which reflects maintaining the employer contribution to UCRP at 14 percent next year. This amount is approximately $33 million less than the contribution from core funds that would be required if the University were to increase the employer contribution to 15 percent in 2018-19, as had been approved by the Regents in July 2017. The University believes that maintaining the employer contribution at 14 percent for 2018-19 is prudent in light of lower-than-expected State support for the University in 2018-19 and other considerations described later in this item. (See the section below titled "Adjustment to the Employer Contribution to the University of California Retirement Plan.")

  Part of the multi-year funding plan for the University agreed to with the Governor in May 2015 called for UC to cap pensionable salaries consistent with the Public Employees' Pension Reform Act adopted by the State in 2013 in return for $436 million in Proposition 2 funds over three years. The Regents approved such a cap in conjunction with a new set of retirement options in March 2016, and the third installment of this contribution was made in 2017-18. The University is hopeful that, at a future date, additional support from Proposition 2 funds will be made available to support UCRP, which would be an important and appropriate use of those funds in light of the support that the State provides to other public segments of higher education for their retirement plans.

- *Employee Health Benefits.* Until recently, employee health benefit costs have risen rapidly, typically between 8.5 percent and 11 percent annually. Because no State funds have been provided for this purpose since 2007-08, campuses have redirected funds from existing programs to address these cost increases. Significant efforts have been made in the past several years to limit health benefit cost increases and reduce pressure on already strained operating budgets. Through negotiations with providers and other measures, UC has been able to hold its own health benefit cost increases to levels below the national trend. Overall core-funded health benefit costs in 2018-19 are expected to increase by about four4 percent, or $18.9 million.

- *Retiree Health Benefits.* In 2017-18, more than 63,000 UC retirees and beneficiaries are eligible to receive or are receiving an estimated $315 million in health benefits paid for by the University. The State had historically provided funding to the University equivalent to the per-employee funding provided for other State employees for the increased number of annuitants expected in the coming year. In the 2014-15 budget, the State stopped funding these costs separately, adding them to the expenditures to be covered within the base budget increase provided under the Governor's multi-year funding plan. The annuitant health costs paid from core funds are estimated to increase by $7.7 million in 2018-19.

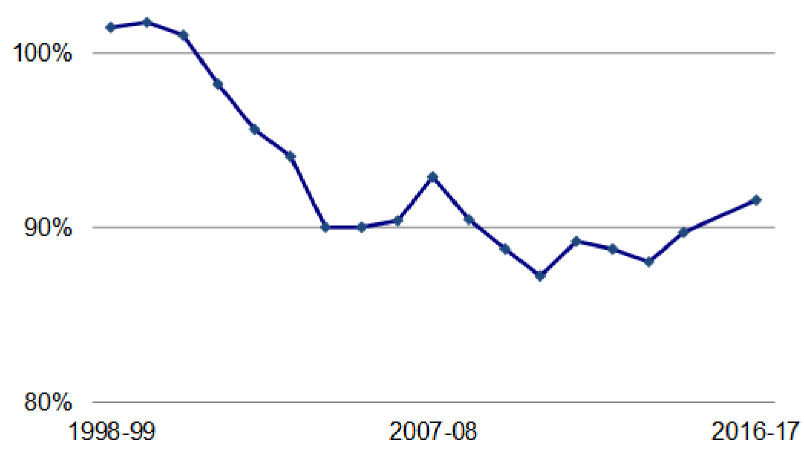
- *Contractually Committed Compensation.* Salary increases for represented employees are governed by collective bargaining agreements with each represented bargaining unit. These agreements are expected to result in additional costs of $28.3 million in 2018-19.

- *Faculty Merit Program.* The University has maintained the faculty merit program each year – even through years of fiscal crisis – because of its importance to the quality of the University. Faculty are generally eligible to be considered every two to three years for a merit increase, which is intended to reward them for excellent teaching and research, as well as fulfillment of their public service mission. This program requires a rigorous peer review process before a merit increase is awarded. The budget plan includes $32 million for this purpose in 2018-19.

- *Keeping Pace with Inflation.* To preserve the quality of the instructional program and support activities, the University must regularly replace, upgrade, or purchase new instructional equipment, library materials, and other non-salary items. The University must also purchase utilities to provide energy to its facilities. Just as costs for salaries and benefits for employees rise, the University’s non-salary spending is affected by inflation. The University’s 2018-19 expenditure plan includes $32.3 million for non-salary price increases of 2.5 percent. This level of increase is below the Department of Finance’s projections for general cost increases, but the University believes that it represents an appropriate budget target in light of the University’s ongoing cost-containment efforts.

- *Compensation.* The University regularly compares its faculty salaries with those of eight peer institutions to evaluate its market position. At the start of the last decade, UC's faculty salaries were on par with the market. As shown in Display 8, faculty salaries had slipped to 12 percent below market by 2010-11 and remained 8.4 percent below market in 2016-17, the latest year for which market data are available. Consequently, UC is at a competitive disadvantage relative to other institutions in recruiting and retaining top talent. To ensure that UC is able to recruit and retain faculty and prevent further growth in salary lags for both faculty and staff, the University must continue to support regular and predictable compensation increases. The budget plan in 2018-19 proposes an average increase in compensation of three percent for non-represented faculty and staff, resulting in a projected net increase in core fund compensation expenditures of $82.7 million (in addition to the faculty merit program described above).

DISPLAY 8: Ladder Rank Faculty Salaries as a Percentage of Market



Revenue and Savings Components of the 2018-19 Budget Plan

The 2018-19 budget plan proposes $428 million in new available revenue to address the expenditure needs described above. These increases fall into four revenue categories.

- *Cost Savings/Alternative Revenue Sources.* The budget plan assumes $50 million in funding attributable to continued asset management strategies, cost-saving strategies, and philanthropic giving. The plan also incorporates $14 million in new savings from continuing to phase out need-based financial aid for new cohorts of nonresident undergraduate students, along with $15 million to be redirected from other purposes – primarily from funds and/or programs administered by the Office of the President – to provide what has historically been the State's share of the marginal cost of enrolling 1,500 additional California resident undergraduates. These efforts continue the University's practice of resolving a substantial portion of its funding needs through internal actions to reduce costs, promote efficiencies, and generate new revenue.

- *State General Funds.* The plan includes a three percent base budget increase, or $103.1 million in new State General Funds. This figure is approximately $34 million less than the base budget increase of four percent proposed in the Governor's multi-year funding plan. The plan also includes requests for $5 million from the State to support the enrollment growth of an additional 500 California resident undergraduate students, along with $5 million to support graduate enrollment to complement and support the dramatic increases in undergraduate enrollment that have occurred since 2014-15. Lastly, the plan proposes $35 million in one-time funds for deferred maintenance, comparable to the funding provided in the Budget Act of 2016 for this purpose.

- *Systemwide Tuition and Fees.* The plan includes $136.6 million of new revenue from Tuition and the Student Services Fee. More than one-third of this amount ($47.1 million) will be provided as financial aid to UC students. (See the section "Tuition, Academic Excellence, and UC Affordability" below for additional details.) Another $30 million will help cover costs associated with the proposed enrollment growth levels described above. The remaining net revenue – $9.4 million from a $54 adjustment to the Student Services Fee and approximately $50 million from a $288 net adjustment to Tuition (which reflects the elimination of a $60 Tuition surcharge introduced to recover damages attributable to the Luquetta lawsuit and an adjustment of $348 to the base Tuition level) – will be available to hire additional faculty, improve the student-faculty ratio, increase class availability (including bottleneck courses), expand access to student mental health services, address a portion of the University's capital needs, and help cover a portion of the mandatory and high-priority expenditures described above.

  Note that the University's costs related to the Luquetta lawsuit are expected to decline by $9 million in 2018-19. Under the budget plan, funding that in prior years would have been provided by the Luquetta Tuition surcharge to cover that expense would instead be available as general tuition revenue to support the investments described above, in addition to the $136.6 million provided from new tuition and fee revenue. (This is shown in the budget plan as a reduction of $9 million in expenditures for 2018-19.)

- *UC General Funds.* Nonresident enrollment has helped campuses during periods of constrained State funding. The budget plan proposes $64.3 million in new revenue from Nonresident Supplemental Tuition based on a 3.5 percent adjustment to undergraduate nonresident Tuition and projected enrollment growth of 1,000 students. This will yield an estimated $54.3 million net of instructional costs after taking into account the other charges that students pay.

ADJUSTMENT TO THE EMPLOYER CONTRIBUTION TO THE UNIVERSITY OF CALIFORNIA RETIREMENT PLAN (UCRP)

Background

At the July 2017 meeting of the Board of Regents, the Regents approved increases in the University contribution rate for the Campus and Medical Centers (C/MC) segment of UCRP, effective July 1, 2018, to 15 percent (from 14 percent) for all member classes and tiers other than Tier Two and 7.5 percent (from seven percent) for Tier Two members, and an increase in the employer assessment to seven percent (from six percent) for Savings Choice Participants in the Defined Contribution Plan, to help pay down the UCRP unfunded liability.

The Regents also approved the transfer of funds from the Short Term Investment Pool (STIP) and/or external financing to UCRP in fiscal year (FY) 2018-19, FY 2019-20, FY 2020-21, and FY 2021-22 in amounts equal to the difference between the approved total UCRP contribution and the projected ARC. These transfers will not exceed $500 million in FY 2018-19, $500 million in FY 2019-20, $600 million in FY 2020-21, and $700 million in FY 2021-22.

As described in this item, the University now anticipates that the State will provide only a three percent budget augmentation for the University in 2018-19, which is one percent lower than expected and results in State funds falling short of expectations by over $30 million. As such, the President of the University and the Chief Financial Officer recommend maintaining the current employer contribution rate at 14 percent for the C/MC segment of UCRP. Such action will save roughly the same amount for the University in terms of contributions from core funds.

Given the alternatives – not investing in student resources, worsening the faculty salary gap, etc. – rescinding the planned increase in the University's employer contribution is a prudent strategy. The University would, however, remain committed to the goal of bringing the total annual contribution to the "Annual Required Contribution" (ARC) level in each of the next four years. This is consistent with the University's strategy to improve the Plan's funded percentage by augmenting UCRP funding with internal borrowings from STIP to meet the ARC. UC also benefitted this year from strong investment performance that was not yet known when the increase to 15 percent was proposed. This investment performance was more favorable than the 7.25 assumed rate and so improved the funded percentage of UCRP to approximately 85 percent on both a market value of assets basis and on an actuarial (smoothed) value of assets basis as of July 1, 2017.

Projected Financial Impact on the Campus and Medical Center Segment of UCRP

Under the University contribution rate increase to 15 percent beginning July 1, 2018, and including the funds transferred from STIP and/or external financing to UCRP to bring the total annual contribution up to the ARC in FY 2018-19, FY 2019-20, FY 2020-21, and FY 2021-22 as approved by the Regents in July 2017, the C/MC segment was projected to be 90 percent funded by July 1, 2023.

If instead the University contribution rate remains at 14 percent and including the STIP transfers and/or external financing to UCRP approved by the Regents in July 2017 mentioned above, the C/MC segment is still projected to be 90 percent funded by July 1, 2023.

All of the actuarial projections are based on current assumptions, including the 7.25 percent assumed earnings rate. The projections indicate that if the University contribution remains at 14 percent, there will be a $44 million shortfall to fully fund the ARC in the fiscal year beginning July 1, 2018. However, for the three fiscal years from July 1, 2019 through June 30, 2022, the internal transfers needed to fully fund the ARC will be less than the approved “up to” limits even if the University contribution rate remains at 14 percent, as noted in Display 9. This is why the projected funded ratios under both scenarios described above reach 90 percent in the same year.

DISPLAY 9: Projected Utilization of STIP Transfers to UCRP

	FYs With Approved STIP Borrowing			
	2018-19	**2019-20**	**2020-21**	**2021-22**
UCRP Employer Rates: UCRP / Savings Choice	14% / 6%	14% / 6%	14% / 6%	14% / 6%
STIP Transfer Needed to Fully Fund Projected ARC	$ 544	$ 477	$ 484	$ 457
STIP Transfer Amount Approved in July 2017	$ 500	$ 500	$ 600	$ 700
(Projected ARC Shortfall)	$ (44)			
Amount of Approved STIP Transfers Not Needed to Fully Fund Projected ARC		$ 23	$ 116	$ 243

Amounts in $millions
C/MC segment only; July 1, 2017 valuation assumptions including:
7.25% rate of return, 0.7% active population growth, 20% election rate for Savings Choice

Consequently, rescinding the increase in the employer rate from 14 percent to 15 percent would not have a significant impact on the C/MC segment funded percentage over the short term as discussed above.

Related Prior Actions by the Board

March 2016: The Regents approved the Retirement Choice Program effective July 1, 2016 for newly hired faculty and staff and certain rehires and newly eligible employees. Pensionable earnings are limited to the Public Employees’ Pension Reform Act (PEPRA) limit, which is $118,775 effective July 1, 2017.

July 2017: The Regents approved the *Authorization to Increase the University Employer Contribution Rate and Make Additional Contributions to the University of California Retirement Plan*, which included:

- Increases in the University contribution rate for the Campus and Medical Centers segment of the UCRP, effective July 1, 2018, to 15 percent (from 14 percent) for all member classes other than Tier Two and 7.5 percent (from seven percent) for Tier Two members, and an increase in the employer assessment to seven percent (from six percent) for Savings Choice Participants in the Defined Contribution Plan, to help pay down the UCRP unfunded liability.

- The transfer of funds from STIP to UCRP in FY 2018-19, FY 2019-20, FY 2020-21, and FY 2021-22 in amounts equal to the difference between the approved total UCRP contribution and the ARC. Should STIP have insufficient funds, funds will be transferred from the Total Return Investment Portfolio (TRIP) to STIP. External financing may be obtained in lieu of or in addition to the STIP transfers if it is expected that this option could be accomplished at a lower cost or is more practical for the University. These transfers shall satisfy certain requirements and will not exceed $500 million in FY 2018-19, $500 million in FY 2019-20, $600 million in FY 2020-21, and $700 million in FY 2021-22.

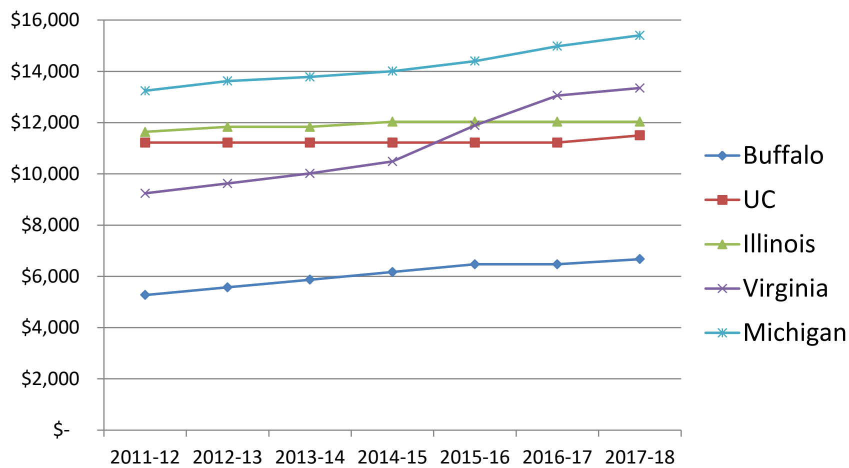
TUITION, ACADEMIC EXCELLENCE, AND UC AFFORDABILITY

Ensuring that students from every socioeconomic background can attend and graduate from the University of California has been central to the University's mission since its founding 150 years ago. Consequently, any consideration of a tuition adjustment must take into account, first and foremost, its potential impact on UC students – both in terms of the additional resources provided by such an increase, which allow campuses to maintain and enhance the quality of students' overall educational experience, and its impact on UC affordability when combined with other student expenses (room and board, books and supplies, transportation, etc.) that collectively comprise a student's total cost of attendance. These factors are discussed in greater detail below.

Context: Trends in Tuition at UC and Other Institutions

Between 2011-12 and 2017-18, UC tuition rose by a total of $282 (2.5 percent) and actually declined in inflation-adjusted dollars. In contrast, tuition increased consistently – and more rapidly – at most of UC's four public comparison institutions, as shown in Display 10. UC tuition remains below tuition at three of the University's four public comparison institutions.

DISPLAY 10: Trends in Tuition at UC and Public Comparison Universities



Figures not adjusted for inflation.

Tuition and Academic Excellence

The tuition increase approved by the Regents for 2017-18 is expected to provide an estimated $48 million in incremental revenue for UC campuses during the current year, net of the amount set aside for undergraduate need-based aid. This revenue has enabled campuses to budget for a variety of investments that directly and indirectly enhance students’ educational experience. These include, but are not limited to, the following:

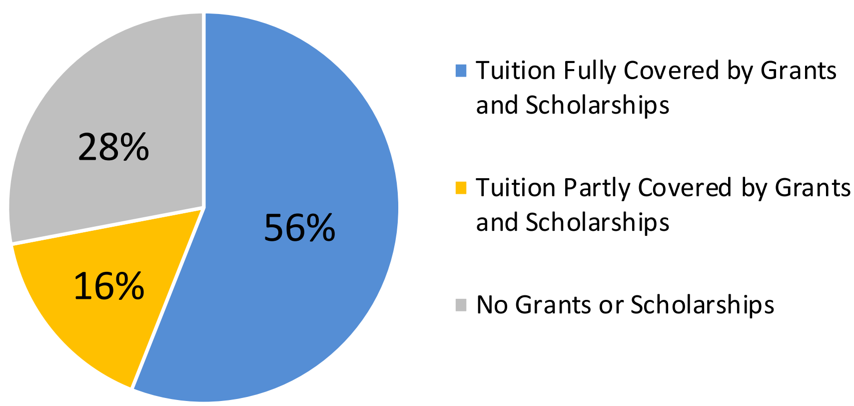
- Hiring additional ladder-rank faculty, lecturers, and graduate student teaching assistants to further expand undergraduate course sections
- Enhancing graduate student fellowships
- Improving service delivery in financial aid offices, academic advising, student counseling, and other areas of student support
- Technology upgrades in classrooms and lecture halls, particularly to support expanded instruction in data science
- Addressing critical deferred maintenance and student safety needs
- Library support

These investments benefit can students in myriad ways. Increased opportunities to work with outstanding graduate students and faculty members, for example, can influence undergraduates’ choice of major and careers, allowing students to make academic and professional contributions that they had not previously thought possible. Having adequate class sections for in-demand courses can increase the likelihood that students graduate within four years – or sooner – which can greatly reduce their educational expenses and student debt at graduation. Living and learning within a safe, modern physical environment can improve student health and safety. All of these investments require resources. To the extent that other fund sources are already fully utilized to address mandatory cost increases described above, revenue from a tuition adjustment can provide critical budget relief and enable these types of student-focused investments.

UC Affordability, Tuition, and Financial Aid

The University of California's demonstrated success in making a world-class education available to students from every socioeconomic background is due in large part to the grants and scholarships that UC students receive from a combination of University, State, federal, and private sources. As a result of these resources, 56 percent of California resident undergraduates had their tuition and fees fully covered by grant and scholarships last year, while only 28 percent paid the actual "sticker price." (See Display 11, below.)

DISPLAY 11: Mandatory Systemwide Charges Covered for Resident Undergraduates, 2016-17

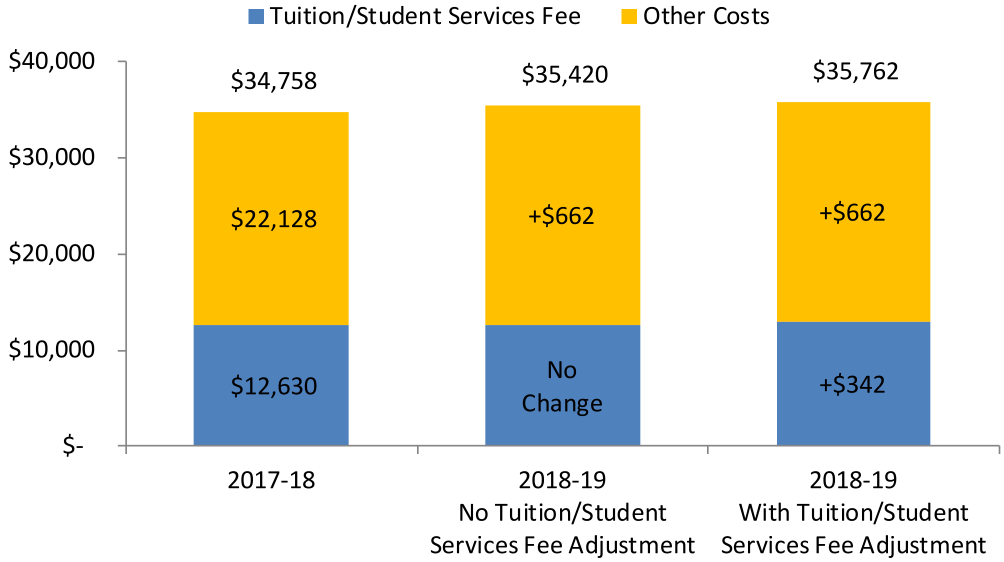


The University has long recognized, however, that financing a UC education requires more than covering the cost of tuition and fees. Students also face expenses such as room and board, books and supplies, transportation, health insurance, and other costs that must be addressed. For that reason, Regents Policy 3201: The University of California Financial Aid Policy calls upon the University to enable California resident undergraduates to cover their *total cost of attendance* through a combination of a manageable parental contribution calculated according to a federal formula, a manageable student contribution from borrowing and work, and grant assistance from federal, State, and University sources.

Display 12, below, shows the average total cost of attendance in 2017-18 for students who live in on-campus housing, the most common housing choice among first-year UC undergraduates. Mandatory systemwide charges of Tuition and the Student Services Fee (shown in blue) represent less than half of these students' total costs.

Display 12 also shows projected 2018-19 costs under two scenarios: one in which Tuition and the Student Services Fee remain flat compared to 2017-18 and one where they are adjusted by a total of $342. In both scenarios, other student expenses (shown in yellow) are assumed to increase by three percent ($662) due to inflation.

DISPLAY 12: Average Total Cost of Attendance for Undergraduates in On-Campus Housing, 2017-18 and 2018-19 (Projected)



To assess the impact of these cost increases on UC *affordability*, however, it is important to consider the additional need-based grant assistance that will be generated by a tuition adjustment. That additional grant aid is provided by two sources: the State's Cal Grant program, which covers increases in mandatory systemwide charges for over 65,000 UC undergraduates, and UC's own undergraduate student aid program, which is augmented by 33 percent of all new revenue generated from an adjustment to Tuition and the Student Services Fee. Because both awards are made to students on the basis of financial need, the impact of these awards depends upon the financial resources of the student's family. For an estimated 100,000 UC undergraduates, *the combination of these awards will increase by more than the increase in systemwide charges* – resulting in about $100 of additional aid to help students cover the assumed $662 increase in other costs shown in Display 12. As a result, in the event of a tuition increase, the net cost of attending UC would actually be *less* for about 100,000 UC students than if tuition were to remain flat.

In addition, the State's Middle Class Scholarship Program (MCSP) will cover between ten percent and 40 percent of an increase in mandatory systemwide charges for families earning up to $165,000 if the student does not otherwise qualify for need-based grants.

Display 13, below, shows the impact of a tuition adjustment on the total cost of attendance, grant aid, and the net cost of attendance for typical students with different parent income levels. For the first three categories of students (those with parent incomes of $20,000, $60,000, and $100,000), the net cost of attendance – i.e., the combined contribution from parents and students – would decline by $100 due to a tuition adjustment. For the student with parent income of $140,000, net cost would increase by only $261 instead of the full $342 due to the MCSP. In general, only students from families with parent income above $165,000 would pay the full cost of the adjustment.

DISPLAY 13: Estimated Impact of a Tuition/Student Services Fee Adjustment on UC Affordability by Parent Income

	With Flat Tuition/Student Services Fee Total Cost (Sticker Price): $35,420				With Tuition/Fee Adjustment of $348 Total Cost (Sticker Price): $35,762				Change In Net Cost Due to Tuition Adj.
Parent Income	Typical Grant Assistance	Parents	Student Self-Help (Loan/Work)	Net Cost (Parent + Student)	Typical Grant Assistance	Parents	Student Self-Help (Loan/Work)	Net Cost (Parent + Student)	
$20,000	$24,920	$0	$10,500	$10,500	$25,362	$0	$10,400	$10,400	($100)
$60,000	$20,120	$4,800	$10,500	$15,300	$20,562	$4,800	$10,400	$15,200	($100)
$100,000	$6,620	$18,300	$10,500	$28,800	$7,062	$18,300	$10,400	$28,700	($100)
$140,000	$2,985	$21,935	$10,500	$32,435	$3,066	$22,296	$10,400	$32,696	$261
$180,000	$0	$24,920	$10,500	$35,420	$0	$25,362	$10,400	$35,762	$342

Note that for those students with greater financial resources who do not receive financial aid to help cover their fees, UC's fees are still likely to remain below those of three of the University's four public comparison institutions – and well below the amounts charged by private institutions. As shown in Display 14, UC's resident tuition and fees are lower than the amounts charged by three of UC's four public comparison institutions for undergraduate and graduate residents.

DISPLAY 14: Comparison of Tuition and Fees at UC and Public Comparison Institutions, 2017-18

	Undergraduate Resident	Undergraduate Nonresident	Graduate Resident	Graduate Nonresident
Public Comparison Institutions				
SUNY Buffalo	$9,828	$27,388	$13,382	$24,724
Illinois				
Lowest	$15,918	$30,544	$16,542	$31,034
Highest	$20,922	$42,178		
Average	$18,420	$36,361		
Michigan				
Lowest	$14,826	$47,476	$22,696	$45,484
Highest	$20,446	$56,772		
Average	$17,636	$52,124		
Virginia				
Lowest	$13,982	$46,554	$20,962	$32,822
Highest	$20,192	$51,796		
Average	$17,087	$49,175		
University of California	$13,964	$40,569	$13,514	$28,616

Note: Comparison institution figures include tuition and required fees. UC figures include campus-based fees, mandatory systemwide charges, and Nonresident Supplemental Tuition for nonresident students. Waivable health insurance fees are not included. Undergraduate figures for Illinois, Michigan, and Virginia represent the average of the highest and lowest rates at each school. Actual rates may vary by major and/or year in school.

The increased financial aid derived from the proposed adjustments to tuition and the Student Services Fee is thus expected to result in *lower* overall costs for the neediest UC undergraduates, while the modest level of the proposed adjustments should be manageable for those who do not receive financial aid.

Maintaining Competitiveness for Graduate Academic and Professional Students

Under the 2018-19 budget plan, the University would continue its practice of setting aside 50 percent of new tuition revenue attributable to graduate academic students, and 33 percent of new tuition from students in professional degree programs, for graduate student support.

The funding provided under the budget plan would be available to programs and departments to provide those forms of student financial support that are most appropriate in light of their enrollment goals and the students that they serve. For example, fellowship and assistantship support is particularly important to academic doctoral programs that compete against the very best public and private institutions worldwide to enroll the most talented students. New funding provided under the plan would enhance these programs' ability to craft desirable multi-year offers of support.

Graduate programs in professional disciplines provide fellowships and grants to assist students from all socioeconomic backgrounds to obtain professional degrees, thereby enabling these students to make significant contributions to their respective fields. In addition to funding provided under the budget plan from mandatory systemwide charges, professional degree programs are also expected to supplement financial aid resources by an amount equivalent to at least 33 percent of new Professional Degree Supplemental Tuition revenue, or to maintain a base level of financial aid equivalent to at least 33 percent of the total Professional Degree Supplemental Tuition revenue.

Key to Acronyms

ARC	Annual Required Contribution
CFO	Chief Financial Officer
C/MC	Campus and Medical Centers
FY	Fiscal Year
PEPRA	Public Employees' Pension Reform Act of 2013
STIP	Short Term Investment Pool
UCRP	University of California Retirement Plan

ATTACHMENTS:

Attachment 1: 2018-19 University of California Budget Plan for Core Funds
Attachment 2: 2018-19 Budget for Current Operations