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Office of the President

TO MEMBERS OF THE BOARD OF REGENTS:

<u>DISCUSSION ITEM</u>

For Meeting of March 14, 2019

PROPOSED MULTI-YEAR BUDGET PLAN

EXECUTIVE SUMMARY

This item presents a proposed multi-year budget plan that is aligned with the University's multi-year framework for increasing degree attainment, closing achievement gaps, and investing in the next generation of faculty and research. The plan addresses three critical categories of investment: sustaining core operations, fully funding the framework, and addressing urgent capital needs.

The plan includes a balanced funding strategy that includes contributions from the University's own efforts to increase fungible philanthropy, optimize the investment of working capital to support the operating budget, and contain costs; moderate annual increases in State support, including funding for enrollment growth; and holding mandatory systemwide charges flat in constant dollars.

The plan would advance each of the University's three overarching goals of access, excellence, and affordability. UC would serve a greater number of California resident undergraduates each year, provided that the State does its part to subsidize the cost of enrollment growth. The plan would fund efforts to increase graduation rates, reduce time-to-degree, and reinvest in faculty and students. Under the plan, tuition and fees would increase by no more than inflation—remaining flat in constant dollars—and would generate new funds for financial aid to help students cover other rising costs such as housing, food, transportation, and books and supplies.

BACKGROUND

As discussed in Item B1, *Multi-year Framework: Invest in the Next Generation of the Professoriate and Research,* the University's proposed multi-year framework has three primary goals:

- produce 200,000 more degrees by 2030,
- ensure the California Dream is for everyone by closing or eliminating achievement gaps between different student populations, and
- invest in the next generation of faculty and research.

Achieving these ambitious goals requires a stable funding plan for making and sustaining the necessary investments in faculty, staff, and facilities at each UC campus. A multi-year framework and funding plan offers many advantages compared to establishing objectives and funding plans on a year-by-year basis—not only for UC campuses but for California students and their families and the State as a whole. For example:

- Campuses can optimize their own multi-year plans for course offerings and class availability to reduce overcrowding or the likelihood that students would be unable to take courses that are required to make progress towards their degrees.
- Campuses can develop and implement long-term hiring strategies for faculty and staff and to link those plans to predictable, reliable funding streams.
- The University can achieve cost savings by entering into longer-term, systemwide purchasing agreements based upon a predictable set of needs and resources.
- Prospective students and their families benefit from knowing projected trends in UC tuition, fees, and financial aid.
- State Budget Acts can be developed to provide a predictable source of permanent funding for the University instead of one-time support, the availability of which can change significantly and unpredictably from year to year.
- The University can better prioritize its capital needs—including facilities that have historically relied heavily on State support to fund (e.g., classroom and teaching laboratory space) as well as facilities that the University can finance itself (e.g., student housing).

To achieve these benefits, the University has developed a proposed multi-year budget plan that reflects three principles:

- The plan must focus on access, excellence, and affordability—the hallmarks of a UC education.
- The University must constantly innovate and adapt in order to improve performance and efficiency amid changing circumstances.
- The State is an essential partner in sustaining and advancing the University's contribution to Californians and the world.

The proposed budget plan is included as Attachment 1 to this item and described in greater detail below.

ELEMENTS OF THE MULTI-YEAR BUDGET PLAN

The proposed multi-year plan encompasses three main elements, each of which is critical to the successful implementation of the multi-year framework: sustaining core operations, funding the multi-year framework, and addressing future capital needs.

Sustaining Core Operations

In order to achieve the ambitious goals related to degree production, closing achievement gaps, and investing in faculty and research described in the framework, the University must first ensure that core operations related to its three-part mission of instruction, research, and public service are maintained. These operations have been challenged over time and especially since the Great Recession. Among those challenges are the following:

- **Declines in State support, which has not fully recovered.** State support for UC declined precipitously in 2008–09 and again in 2011–12. UC's State appropriation has returned to pre-recession levels in nominal dollars, but State support remains low by historic standards when inflation and enrollment growth (discussed below) are taken into account. The decline was not fully offset by increases in student tuition and fees, partly because the University set aside—and continues to set aside—a large portion of the new tuition and fee revenue to expand its financial aid programs.

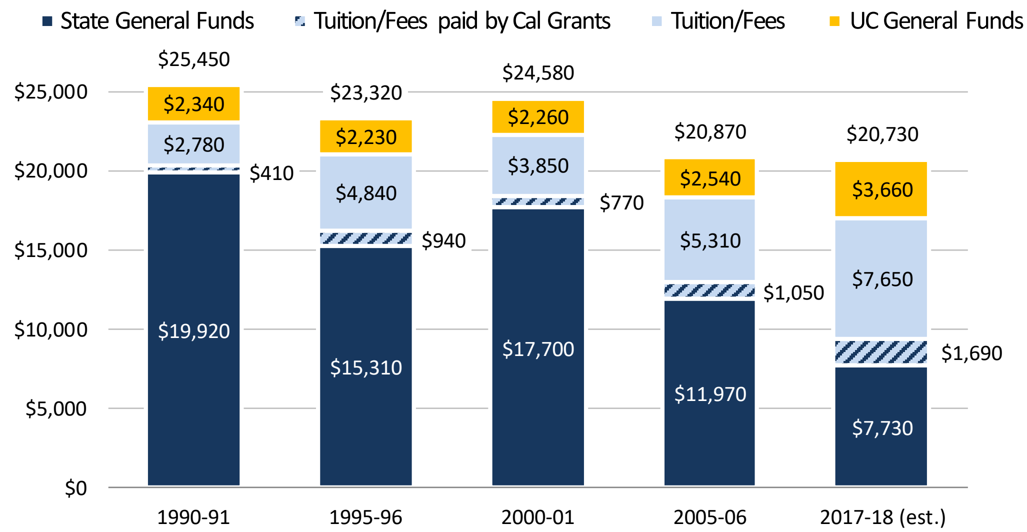
- **Restart of employer contributions to the University of California Retirement Plan (UCRP).** In the early 1990s, the Regents suspended University and employee contributions to UCRP after actuaries determined that UCRP was adequately funded to provide benefits for many years into the future. The University estimates that in the nearly 20 years during which contributions were not required, the State saved more than $2 billion in contributions for those UCRP members whose salaries were State-funded. The University restarted contributions in April 2010. The employer contribution from core funds now exceeds $400 million annually, resulting in less funding available for other parts of the University's operating budget.

- **Enrollment growth.** UC enrollment grew by more than 100,000 full-time-equivalent students between 2000–01 and 2017–18. This increase of 59 percent far outpaced growth in available core funds, which increased by only 10 percent after taking into account inflation and the other factors described above.

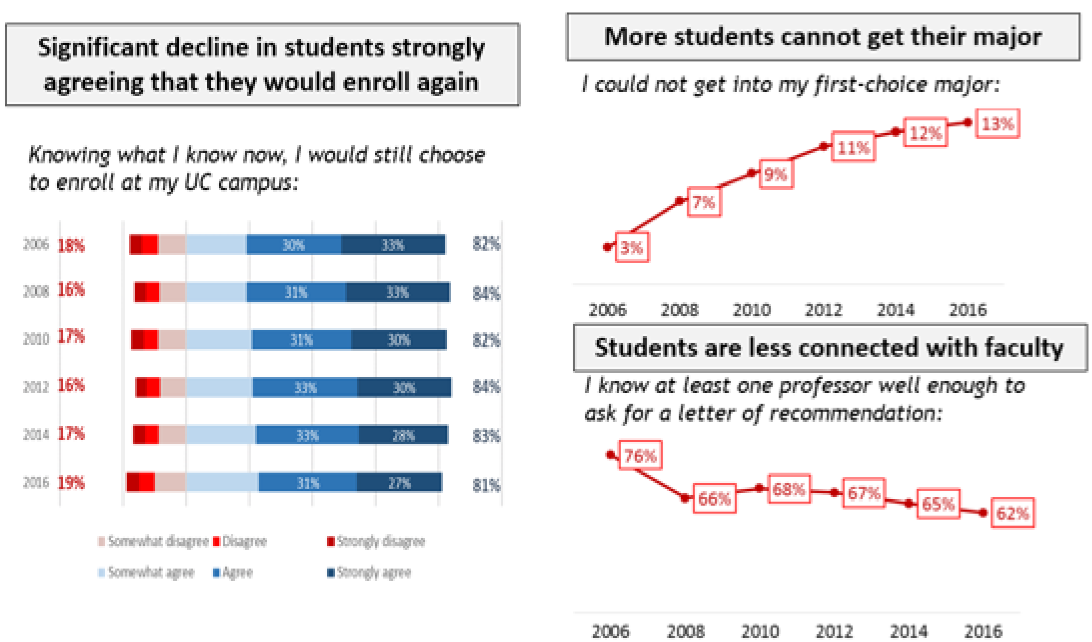
As a result of these challenges, the University today finds itself with fewer resources available than in past decades to carry out its instructional mission. As shown in Display 1 below, on a per-student basis, average expenditures for instruction in 2017–18 were substantially lower today than they were less than two decades ago.

Even as instructional expenditures per student have declined, the University continues to successfully graduate thousands of students each year, and outcome measures such as graduation rates and time to degree have generally improved. Achieving positive outcomes at a reduced cost could be interpreted as signs of increased efficiency and the effective use of limited resources—and that is, in fact, accurate to some degree. But signs have emerged that despite improvements in some measures of institutional performance, the quality of instruction and students' overall satisfaction with the UC experience have declined over time. This is reflected in Display 2, below.

DISPLAY 1: Average Expenditures for Instruction per Student from Core Funds



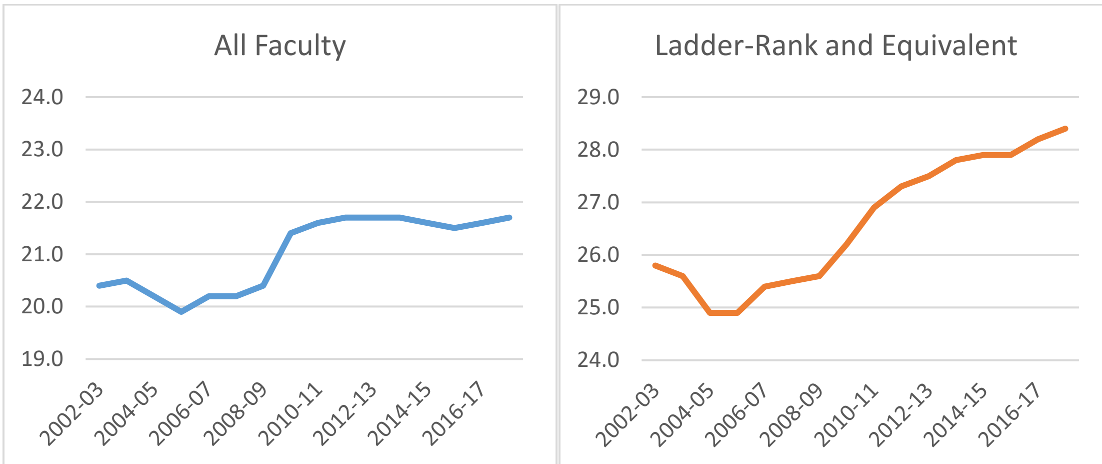
DISPLAY 2: Indicators of the Student Experience



Further analysis illustrates some underlying trends that have likely contributed to deterioration in students' satisfaction with their enrollment decisions, their ability to get into the major of their choice, and their ability to forge the type of meaningful relationship with faculty members that can be so important to their future academic and professional careers.

The first is a notable increase in the student-faculty ratio, as show in Display 3. Among all faculty members (including lecturers), the student-faculty ratio has increased by over 1.0 since 2002–03. The increase in the number of students per ladder-rank and equivalent faculty members, however, has been much larger: among these faculty members, the ratio grew from less than 25:1 in 2004–05 to over 28:1 in 2017–18.

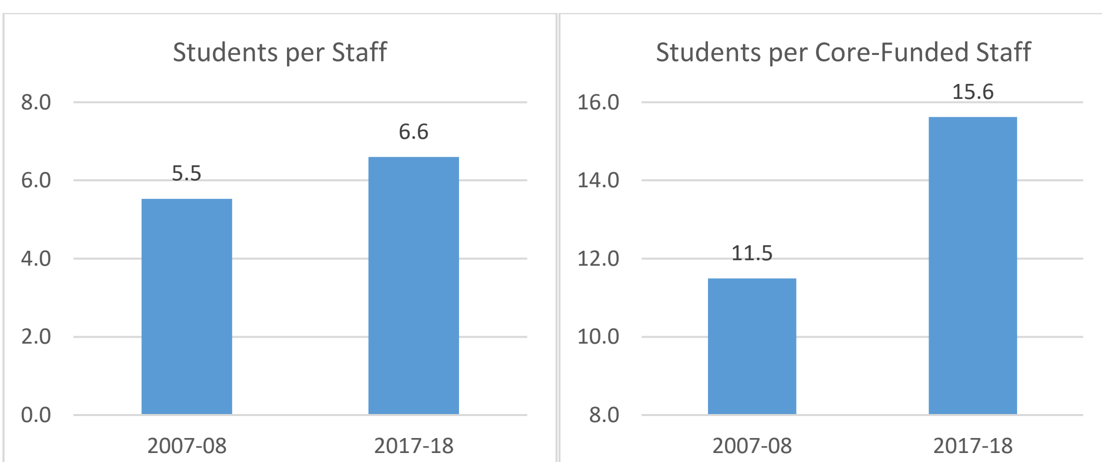
DISPLAY 3: General Campus Student-to-Faculty Ratio



There has been an even larger increase in the ratio of students per University staff members. University staff provide essential support services such as student advising, mental health counseling, financial aid administration, and registrar services. They also provide critical support to faculty members, graduate student researchers, and other members of the UC community.

As shown in Display 4, growth in University staff has lagged growth in student enrollment: the University employed one staff member for every 5.5 students in 2007–08, but the ratio grew to one staff member for every 6.6 students by 2017–18. Among staff paid from core University funds—state support, tuition and fees, and UC general funds—the ratio increased even faster, from 11.5 students per staff member in 2007–08 to 15.6 students per staff member in 2017–18.

DISPLAY 4: General Campus Student-to-Staff Ratio



Student survey responses that indicate a degradation in the UC experience suggest that further reductions in the resources available to support students—either in terms of faculty members or University staff—would work against, rather than support, the improvements in student outcomes that the University wants to achieve. Adequate investment in both personnel and non-personnel resources that define the UC experience for students must be an essential part of the University's multi-year budget plan.

Projected Cost Drivers

Personnel-related expenses—for both current employees and retirees—represent the largest single component of the University's operating budget, as they do at most universities. Creating and sharing knowledge in a safe and secure environment, which is the primary mission of every research university, is a people-intensive mission. Roughly two-thirds of all core fund expenditures are related to employee salaries and benefits.

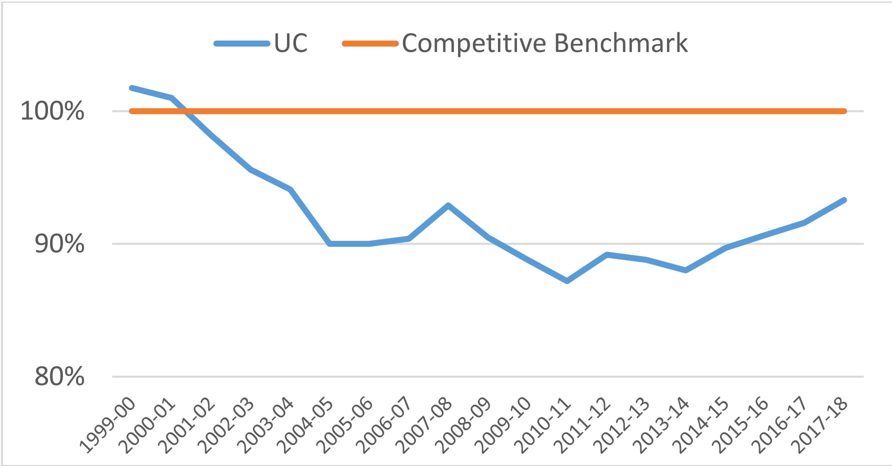
But the University incurs other costs as well. Instructional equipment, library materials, utilities, supplies and other services and materials that are essential to a research university can be expected to increase in price annually. A realistic budget plan must account for these cost increases, after taking into account the University's efforts to keep them at a minimum.

Cost drivers that affect the projected resources needed to sustain core operations—including both personnel and non-personnel costs—are described below.

- *Faculty and staff compensation.* The University's multi-year budget plan includes cost projections for both represented and nonrepresented faculty and staff. For represented employees, the plan reflects wage growth that is already built into existing collective bargaining agreements when known; projections are used for collective bargaining agreements that will come up for negotiation during the timeframe of the multi-year plan. The weighted average projected increase among all represented employees during this period is about 3.6 percent per year.

  For nonrepresented faculty, the multi-year-plan includes what are essentially mandatory cost increases associated with the faculty merit program, a cornerstone of the University's strategy for retaining and supporting faculty members as they grow in experience and productivity and progress through the ranks through a rigorous peer-reviewed process. In addition, the plan includes strategic investments to close the competitive gap that currently exists between faculty salaries at UC and at the University's "comparison eight" institutions, which are a combination of public and private universities. As shown in Display 5, below, the University's competitive position relative to this benchmark has eroded over time. To address this problem, the University proposes a multi-year salary strategy composed of a general range adjustment and a special salary plan for ladder-rank faculty. Once the University regains its competitive position, the special salary plan would no longer be needed and annual adjustments to faculty salaries would be more in line with changes in the University's faculty salary comparison benchmark.

DISPLAY 5: Ladder Rank Faculty Salaries as a Percentage of Market



For nonrepresented staff, the University proposes tying its annual merit increase budget to changes in the Consumer Price Index (i.e., inflation) for planning purposes. This approach would keep overall staff salary increases relatively flat in constant dollars while allowing individual employees to receive higher or lower salary adjustments based upon their performance.

- *Employee and Retiree Health Benefits.* The multi-year plan projects annual increases of four percent in the unit cost of employee and retiree health benefits. This rate is less than the annual increase projected by the annual health care survey conducted by the National Business Group on Health (five percent) but should be achievable given the University's ongoing efforts to control costs in this areas. For retiree health benefits, the overall cost of retiree health is projected to increase by an additional three to four percent annually due to projected increases in the number of UC retirees.

- *Contributions to the University of California Retirement Plan (UCRP).* Actuarial projections indicate that the current employer contribution rate to UCRP of 14 percent (including an employer contribution of six percent for Savings Choice participants in the Defined Contribution Plan) will lead to gradual, sustained improvement in the funded status of the plan. The University proposes maintaining that contribution rate for the duration of the multi-year plan.

- *AB 94 Capital Projects.* Under the multi-year plan, the University would continue to increase the portion of its operating budget dedicated to debt service on State-approved capital projects each year. This funding mechanism, established by AB 94 (2013), has allowed the University to pursue projects such as Merced 2020 and to address a limited number of capital needs throughout the system. The projected debt service on previously approved AB 94 projects grows each year, requiring annual increments to the portion of the University's operating budget that is earmarked for this purpose.

- *Student Mental Health.* The University continues to increase its investment in counselors and other student mental health professionals in order to improve student access to these critical resources. The multi-year student mental health funding plan approved by Regents in November 2014 included annual increases in permanent funding, which would be provided by a portion of the revenue generated by annual increases of five percent to the Student Services Fee from 2015–16 through 2019–20. Although the University proposes keeping tuition and the Student Services Fee flat in 2019–20, the budget plan includes $5.3 million in additional funding for student mental health next year, which is equivalent to the revenue that would have been generated under the original funding plan approved by the Regents.

- *Basic Needs.* The multi-year budget plan includes $15 million in new, ongoing support to help address basic needs such as food and housing insecurity for UC students. Consecutive years of one-time funding provided by UCOP and the State, combined with other resources generated at the campus level, have allowed campuses to expand basic needs services in recent years. The ongoing funding provided in the plan would enable campuses to develop more robust, longer-term strategies to assist students.

- *Financial Aid.* As discussed later in this document, the proposed multi-year plan includes modest increases in mandatory systemwide charges beginning in 2020–21 that would be based upon projected changes in the California Consumer Price Index (i.e., inflation). The multi-year plan includes additional funding for financial aid to fully cover the increases for approximately 100,000 financially needy UC undergraduates as well as graduate students whose financial support package include tuition and fee coverage. A more complete description of the interaction between tuition, fees, and financial aid appears below in the section titled "Tuition, Financial Aid, and Affordability."

- *Other Non-Salary Cost Increases.* Prices for items such as instructional equipment, laboratory supplies, computers, machinery, library materials, and purchased utilities tend to rise each year. Under the multi-year plan, the University would seek to limit those cost increases to the rate of inflation.

Funding the Framework

The resources needed to achieve the goals laid out in the University's multi-year framework in addition to sustaining core operations can be grouped into three broad categories:

- Funding for projected increases in enrollment growth
- Funding to enhance degree attainment, including improving graduation rates and reducing achievement gaps between different student populations
- Investments in faculty above and beyond what would normally be expected from enrollment growth alone

Each category of investment is discussed below.

Enrollment Growth

In addition to strategic investments to improve student outcomes, moderate levels of enrollment growth will be required at both the undergraduate and graduate levels in order to produce an additional 200,000 degrees between now and 2030 above the estimated one million degrees that the University already expects to produce during that period. The University's multi-year plan includes growth in California resident undergraduates, graduate students, and nonresident undergraduate students.

- *California resident undergraduates.* Under the multi-year plan, the University would continue to expand access for California resident undergraduates, growing enrollment by nearly 6,300 students between 2018–19 and 2022–23. By 2022–23, the University will have expanded California resident undergraduate enrollment by over 20,600 students since 2014–15.

- *Graduate students in academic and professional degree programs.* As described in Regents item B1, *Multi-year Framework: Invest in the Next Generation of the Professoriate and Research,* graduate students are critical for California's future workforce, conduct groundbreaking research themselves, and help instruct and mentor undergraduate students. The multi-year plan includes funding to increase graduate student enrollment by 4,000 students between 2018–19 and 2022–23.

- *Nonresident undergraduates.* Students from other U.S. states and from around the world contribute to the educational, cultural, and social environment at every UC campus. In addition, the higher tuition and fees paid by nonresident undergraduate students helps fund instructors, student services, financial aid, and other resources that benefit California students. The multi-year plan includes enrollment growth of 2,800 nonresident undergraduates between 2018–19 and 2022–23, primarily at campuses that currently enroll relatively few out-of-state students. Enrollment at every campus would be consistent with *Regents Policy 2109: Policy on Nonresident Student Enrollment.*

The State has been an essential partner in subsidizing enrollment growth for California resident undergraduates and graduate students throughout the University's 150-year history. The State's share of the cost of enrollment growth is based on the estimated marginal cost of instruction—the resources needed to educate each additional student at UC's historic level of quality. Using an agreed-upon methodology developed in conjunction with State policy-makers, the State's share of support for enrollment growth is based upon the marginal cost of instruction less the tuition and fees paid by each additional student (net of the portion of tuition and fees used for financial aid). For purposes of developing the multi-year plan, the estimated marginal cost is projected to increase by slightly more than three percent each year,[1] resulting in a similar increase in the State's contribution for each student.

[1] Based on projected increases in the implicit price deflator for state and local governments, an index commonly used by public agencies to project cost increases in the goods and services that they use. For 2019–20, the estimated marginal cost of instruction is $20,060 per student; of this amount, $8,548 is expected to come from the tuition and fees paid by each student (net of the amount set aside for financial aid), leaving $11,512 as the State's expected share.

Enhancing Degree Attainment and Reducing Achievement Gaps

As discussed in item B1, *Planning for a Multi-Year Framework,* from the January 17, 2019 meeting of the Board, each UC campus has developed strategies for achieving its ambitious goals for improving graduation rates and reducing achievement gaps by 2029–30. Display 6, below, illustrates the overall mix of strategies across the entire system based upon campuses' proposed levels of investment.

DISPLAY 6: Areas of Proposed Investment to Enhance Degree Attainment and Reduce Achievement Gaps

Strategy	Percent of Total
Student Advising	27%
Academic Support	20%
Online Course Development	15%
New Degrees/Courses	15%
Scholarships and Work-Study	5%
Analytical Tools	5%
Degree Completion	5%
Summer Bridge	3%
Other	5%
Total	100%

Projected expenditures for this portion of the budget plan are included in Attachment 1.

Investing in Faculty and Research

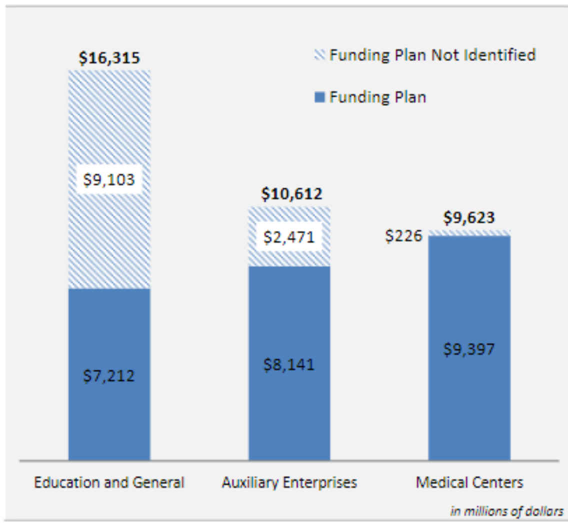
Regents item B1, *Multi-year Framework: Invest in the Next Generation of the Professoriate and Research,* summarizes campuses' goals related to faculty hiring and development—not simply to accommodate anticipated levels of enrollment growth, but also to enhance the quality of student instruction and engagement, increase faculty diversity, support graduate student growth, expand research opportunities and impact, and support California's health care needs.

Between 2018–19 and 2022–23, campuses propose adding approximately 1,100 ladder-rank faculty members, 850 clinical faculty, and 400 non-ladder-rank faculty. Funding for the majority of the proposed growth in ladder-rank faculty is already incorporated into the estimated marginal cost of instruction described earlier. Faculty hiring above-and-beyond the level needed to keep pace with enrollment growth requires additional funding, which has been incorporated into the multi-year budget plan shown in Attachment 1 (see the line "Faculty Investment"). Funding for the proposed increase in clinical faculty is expected to be largely derived from clinical funds and other revenue sources.

Capital

The University's ten-year capital financial plan for 2018 through 2028, which was presented to the Regents in November 2018, includes the capital investments that would be required over the course of the next decade for the University to deliver on its goals under the multi-year framework. As indicated in the plan, however, a substantial number of those projects lack an identified fund source.

DISPLAY 7: Capital Projects With and Without a Funding Plan



The University used a portion of State funds from its own operating budget to finance a number of projects using the AB 94 funding mechanism described earlier to address a portion of its most immediate capital needs. The needs outlined in the capital plan far exceed the level of capital investments that the University can finance itself using its annual State appropriation, however. It also exceeds the funding that could reasonably be obtained through private gifts or other non-State sources of support.

For many decades, funding provided from both State general obligation bonds and State lease revenue bonds were the most significant source of support for meeting the University's capital needs related to its mission of teaching, research, and public service. More recently, State funding for capital projects has shrunk due to the economic downturn during the last decade and the State's goal to reduce overall bond debt. The last general obligation bond measure that included UC facilities was passed in November 2006.

As the State economy recovers and its debt burden has declined, the University will continue to advocate for a future general obligation bond measure to support UC's core academic capital needs. Renewed investment from the State is essential to accommodate future enrollment growth, update classrooms and teaching laboratories to support the change nature of academic programs, and address the University's most pressing needs related to deferred maintenance and seismic corrections.

PROPOSED MULTI-YEAR FUNDING STRATEGY

As shown in Attachment 1, the proposed funding strategy to support the multi-year budget plan includes four categories of support:

- *Revenues and savings achieved from the University's own efforts to generate funds, reduce costs, and prioritize needs.* The University has made great strides over the past decade in identifying alternative revenue sources, reducing elements of its cost structure, and optimizing the use of existing resources. The multi-year budget plan expects further contributions from these efforts. Specifically:
  - Opportunities exist to shift a greater portion of the University's working capital into higher-yield investment vehicles, including the University's Total Return Investment Pool (TRIP) and a new Blue and Gold investment pool. The objective of the new pool is to provide a low-cost, liquid, diversified investment vehicle that campuses can utilize to earn a higher return than would otherwise be expected from short-term cash management vehicles. The budget plan incorporates year-over-year increases of $30 million of new, fungible resources to address a portion of the University's overall budget needs.
  - The budget plan also calls for sustained increases in philanthropic giving. Although unrestricted gifts represented only one percent of total private support in 2017–18, restricted gifts designated for certain purposes (e.g., financial aid or instruction) can help campuses make various investments identified in the multi-year plan.
  - The University continues to expand efforts to leverage its purchasing power in order to negotiate discounts and rebates from vendors and service providers. The budget plan anticipates additional year-over-year savings of $10 million attributable to purchases attributable to the University's core funds operating budget.
  - Acting at the request of the legislature, the University began phasing out nonresident undergraduates' eligibility for support from the University's primary need-based financial aid program, starting with the entering class of 2016–17, and redirected those funds to support other parts of the University's operating budget. The budget plan includes a final redirection of $14 million in 2019–20 since the last cohort of aid recipients (i.e., those who entered in 2015–16) will have mostly graduated by the end of the current academic year.

- *Revenue from tuition and the Student Services Fee.* The budget plan includes projected increases in tuition and the Student Services Fee attributable to the planned enrollment growth described above. In addition, with sufficient levels of State support, the University would limit increases in these charges to the rate of inflation, keeping these charges flat in constant dollars. The impact of tuition on financial aid and UC affordability is described below in the section titled "Tuition, Financial Aid, and Affordability."

- *Nonresident Supplemental Tuition (NRST).* Revenue projections for Nonresident Supplemental Tuition—which out-of-state students pay in addition to the mandatory tuition and fees paid by every student—reflect projected enrollment levels of these students and proposed inflation-based adjustments to undergraduate NRST.

- *State support.* Three categories of State support are shown in Attachment 1:
  - An annual base budget adjustment to the University's prior-year permanent budget, averaging about 3.2 percent for the last three years of the plan. (The requested increase during the first year of the plan is higher in recognition of the University's proposal to hold mandatory systemwide charges flat in 2019–20.)
  - Funding for enrollment growth based on the calculated State's share of the projected marginal cost of instruction (as described earlier in this document).
  - Funding for the degree attainment and faculty growth elements of the proposed multi-year framework, with proposed annual increases of $60 million for these efforts.

  In addition to the State funds identified in the plan for 2019–20, the plan also requests that the State make permanent $145 million of one-time funding provided to the University in the current year. The Governor's January budget proposal would convert $55 million of that support to ongoing funds in 2019–20.

TUITION, FINANCIAL AID, AND AFFORDABILITY

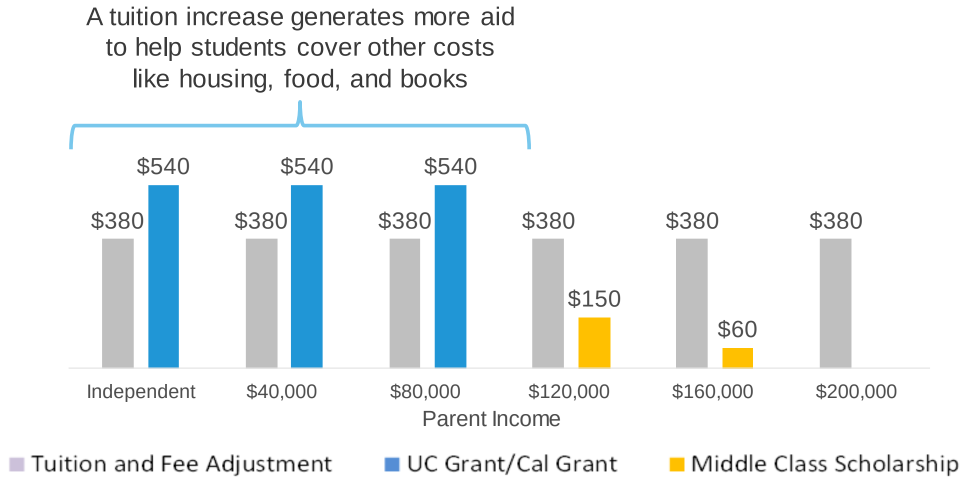
Financial aid helps students and their families cover the total cost of attending the University of California. That goes beyond tuition and fees—it also helps with housing, food, books, and other educational expenses. Last year, UC undergraduates received $850 million in UC, federal, and State grants to help cover these other costs while attending the University.

The relationship between UC tuition and both University and State financial aid programs has been key to the University's ability to sustain access, affordability, and excellence over time. In past years, when precipitous declines in State support resulted in higher tuition rates, additional financial aid from both the University's own aid program and the State's Cal Grant program not only offset those increases for most California resident students but also provided additional assistance to help the neediest students cover expenses such as housing, food, and books and supplies that also rose during the same period.

One-third of all new undergraduate tuition revenue is set aside to fund UC's robust financial aid program. As a result, the proposed adjustments to tuition and the Student Services Fee will also increase the pool of funds available for financial aid. In addition, over one-third of UC undergraduates benefit from the State's Cal Grant program, which fully covers in-state tuition and the Student Services Fee (along with any increase to those charges). The State's Middle Class Scholarship program also benefits students from eligible middle-income families earning up to $171,000 in 2018–19. Many middle-class families at UC also benefit from federal income tax deductions and credits that reduce the cost of college.

Because of this, California undergraduate students who currently receive need-based grants typically can expect to have any tuition adjustment completely covered; a Middle Class Scholarship Recipient can expect between 10 percent and 40 percent of the increase to be covered. For most California resident undergraduates, their financial awards would rise by more than the amount of any increase. The chart below shows the estimated effect that an inflation-based adjustment of three percent to tuition and the Student Services Fee would have on California resident undergraduates and their families at different income levels.

DISPLAY 9: Projected Change in Financial Aid for California Residents With a Three Percent Inflation-Based Adjustment to Tuition and Fees



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

Key to Acronyms

NRST	Nonresident Supplemental Tuition
STIP	Short Term Investment Pool
TRIP	Total Return Investment Pool
UCRP	University of California Retirement Plan

(Attachment)