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Office of the President

TO MEMBERS OF THE FINANCE AND CAPITAL STRATEGIES COMMITTEE:

DISCUSSION ITEM

For Meeting of September 18, 2019

PRELIMINARY DISCUSSION OF THE UNIVERSITY'S 2020-21 BUDGET

EXECUTIVE SUMMARY

Like other State agencies, the University of California is expected to submit a preliminary budget proposal to the California Department of Finance each fall for the Department's consideration as it prepares the Governor's January budget proposal for the next fiscal year. This item is intended to facilitate discussion about elements of such a proposal.

In March 2019, the Regents reviewed a proposed multi-year budget plan to support the University's multi-year framework for increasing degree attainment, closing achievement gaps between different student populations, and investing in the next generation of faculty and research. The plan proposed a balanced funding strategy that includes support from three broad categories of resources:

- contributions from the University's own efforts to operate more efficiently, increase unrestricted philanthropic support, and optimize the investment of working capital to support the operating budget;
- moderate annual increases in State support, along with State funding for enrollment growth and for new efforts required to support the multi-year framework; and
- student tuition and fees, which the University would seek to keep flat in constant dollars over time, rising by no more than inflation.

The budget plan also anticipated new instructional expenditures associated with enrollment growth, particularly growth in California resident undergraduates; expanded efforts at every campus to improve student outcomes, consistent with the goals of the multi-year framework; investments in faculty and staff; projected increases in retirement-related expenses; and the need for the University to set aside a growing portion of its operating budget each year to address its most pressing capital needs.

The 2020-21 budget cycle presents an opportunity for the University to partner with the State on a multi-year plan that advances shared goals of access, academic excellence, and affordability.

ELEMENTS OF THE MULTI-YEAR BUDGET PLAN

The proposed budget plan is organized around three categories of investments that are critical to the successful implementation of the multi-year framework: sustaining core operations, funding the multi-year framework, and addressing critical capital needs. Each is described below.

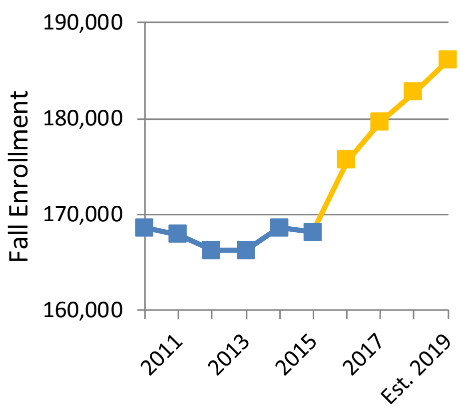
Sustaining Core Operations

The University must ensure that current core operations related to its three-part mission of instruction, research, and public service are maintained as a prerequisite to achieving the ambitious goals related to increased degree production, closing achievement gaps, and investing in faculty and research described in the multi-year framework. These operations have been challenged in recent years due to a combination of factors, including but not limited to the following:

- **Enrollment growth not fully supported by new State funds.** Display 1, below, shows the trend in fall enrollment of California resident undergraduates since 2010. The growth in recent years is especially noteworthy: in fall 2019, UC campuses expect to enroll more than 17,000 additional California undergraduates than they did in fall 2014. Display 1 also shows that between 2014-15 and 2018-19, growth in California undergraduate enrollment exceeded the levels funded in State Budget Acts by nearly 5,000 full-time equivalent students. Without the critical support that the State has historically provided to cover its share of enrollment growth, campuses must use limited resources to serve an ever-growing student population.

DISPLAY 1: Trends in California Resident Undergraduate Enrollment and Funding

Fall Enrollment of California Resident Undergraduate Students



Comparison of Actual vs. Funded Growth in California Resident Undergraduates

Year	*Total Enrollment*	*Change from Prior Year*	*Growth Funded in Budget Act*	*Growth Above Funded Level*
14-15	174,681			
15-16	173,642	(1,039)	-	(1,039)
16-17	180,389	6,747	5,000	1,747
17-18	185,059	4,670	2,500	2,170
18-19	189,133	4,074	2,000	2,074
Total Since 2014-15		**14,452**	**9,500**	**4,952**

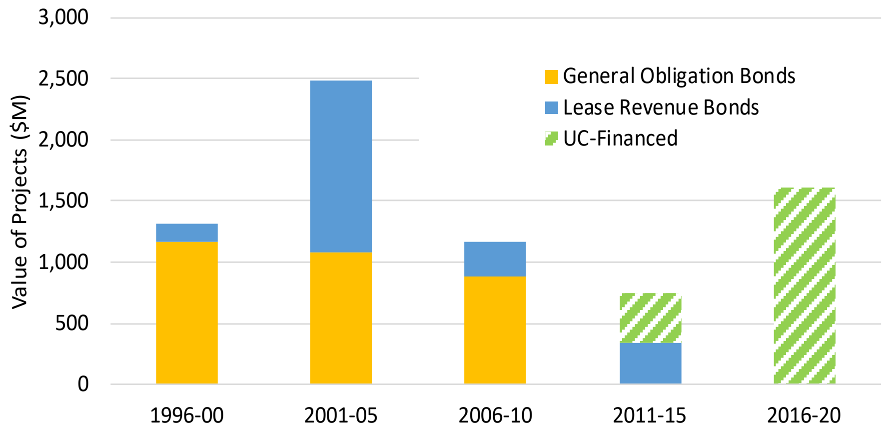
(Full-time-equivalent enrollment, including summer.)

- **Net loss of $95 million in one-time State support in 2019-20.** The University received $105 million of one-time funds in 2018-19, including $70 million to avoid the need for a tuition increase that year, $25 million for past California resident enrollment growth above the growth previously funded by the State, and $10 million for 2018-19 enrollment growth. One-time funding is not an equivalent substitute for tuition revenue—a permanent fund source—or a viable funding strategy for sustaining student enrollment, since instructing and supporting students are ongoing expenses. The 2019-20 Budget Act discontinued most of this funding, providing instead $10 million for ongoing support of 2018-19 enrollment growth. The result is an ongoing shortfall in core funds.

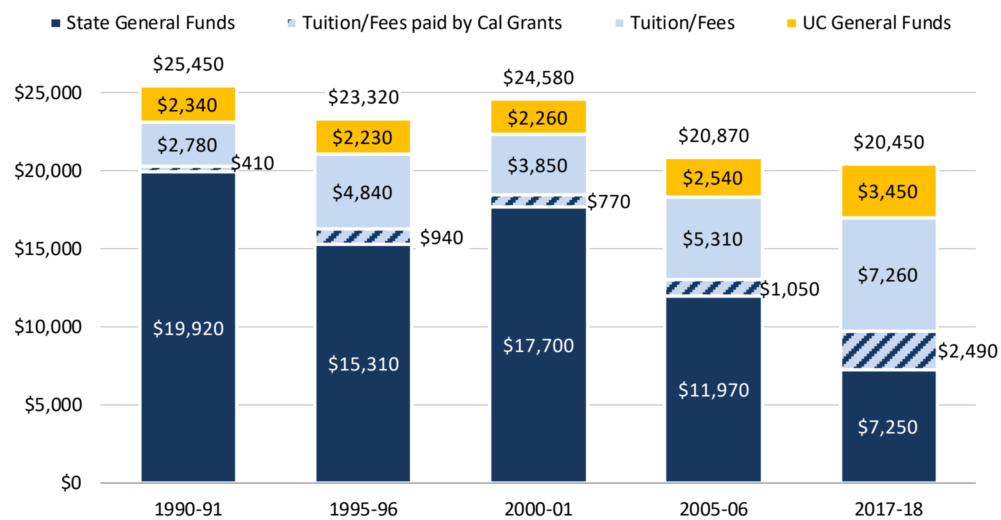
- **Restart of employer contributions to the University of California Retirement Plan (UCRP).** In the early 1990s, the Regents suspended University and employee contributions to UCRP after actuaries determined that UCRP was adequately funded to provide benefits for many years into the future. The University 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.

- **Increased need to divert operating funds for capital needs.** For many decades, the University relied extensively on State-issued bonds to meet capital needs associated with a growing student population and an aging infrastructure. The last State general obligation bond that provided funding for UC capital outlay projects was passed in 2006, however, and the State has not issued lease revenue bonds for the University since 2012. More recently, the University has used alternative fund sources—including a growing portion of its State General Fund appropriation—to finance critical capital projects. The ability to use State funds for debt service and related payments for State-approved projects was established by AB 94 (2013). Display 2 illustrates the resulting shift from capital projects funded by State-issued bonds to projects financed under AB 94. Over $70 million of the University's 2019-20 State General Fund appropriation will be used for debt service on AB 94 projects instead of supporting campus operating budgets.

DISPLAY 2: Approved Funding for Capital Needs from State Bonds and UC-Financed AB 94 Debt



DISPLAY 3: Average Expenditures for Instruction per Student from Core Funds



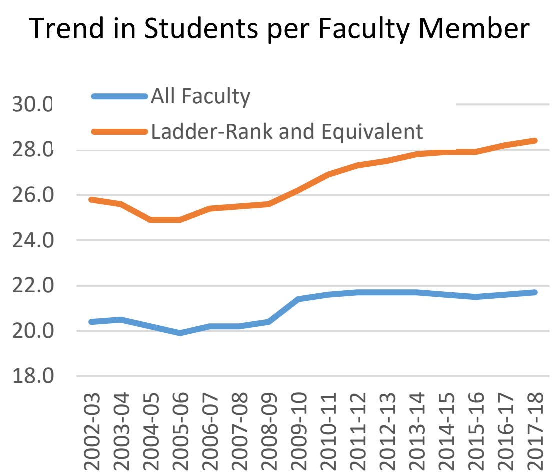
These and other challenges have contributed to an overall decline in the resources available to the University to carry out its instructional mission. As shown in Display 3 above, on a per-student basis, average expenditures for instruction in 2017–18 were substantially lower than they were less than two decades ago.

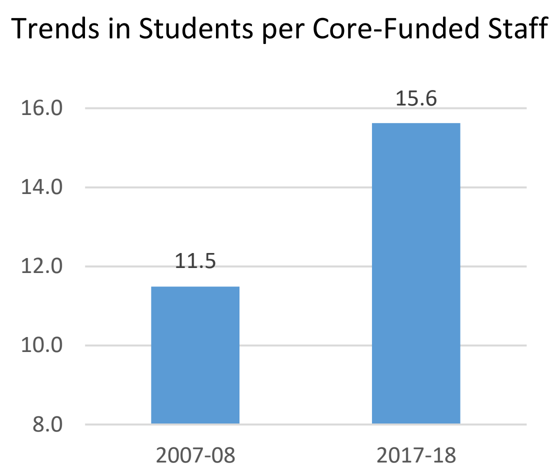
The University continues to enroll and graduate thousands of students each year even as instructional expenditures per student have declined. Achieving positive outcomes at a lower cost can be interpreted as a sign of increased efficiency and the effective use of limited resources. Yet signs have emerged that despite improvements in some measures of institutional performance, the quality of instruction, the adequacy of student services, and students' overall satisfaction with their educational experience have declined over time.

Indicators of this trend are shown in Display 4 below. The number of students per faculty member (including lecturers) has increased by more than 1.0 since 2002–03. More striking, however, is the larger increase in the number of students per ladder-rank and equivalent faculty member, which has grown from fewer than 25 in 2004–05 to more than 28 in 2017–18.

The number of students per University staff member has grown even faster. 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. The number of staff supported by core University funds—State support, tuition and fees, and UC general funds—has not kept pace with student enrollment: core funds supported one staff member for every 11.5 students in 2007–08 compared to one for every 15.6 students in 2017-18.

DISPLAY 4: Trends in Students per Faculty Member and Students per Core-Funded Staff





These trends are consistent with several troubling findings from the University of California Undergraduate Experience Survey (UCUES). Compared to 2006,

- students are much less likely to strongly agree with the statement, “Knowing what I know now, I would still choose to enroll at my UC campus”;
- a declining percentage of students are able to get into their first-choice major; and
- students are less likely to know at least one professor well enough to ask for a letter of recommendation.

Responses like these suggest that further reductions in the resources available to support students—either in terms of faculty members or University staff—would work against 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 are an essential part of the University’s multi-year budget plan.

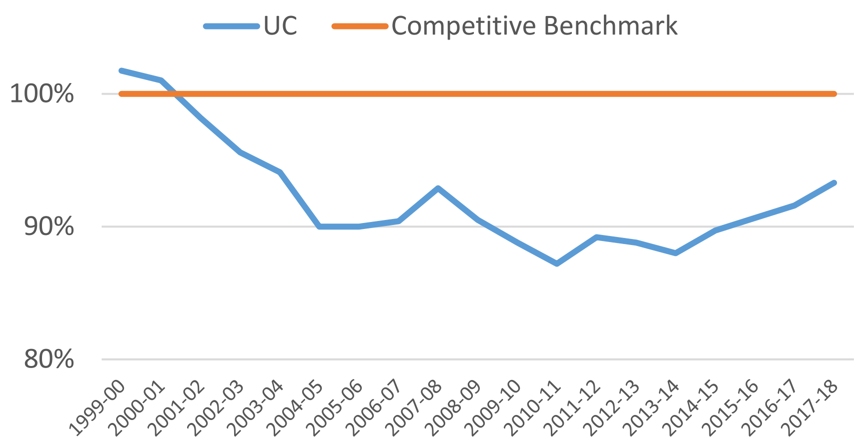
Specific cost drivers that affect the projected resources needed to sustain core operations are described below.

- *Faculty and staff support.* Creating and transmitting knowledge in a safe and supportive environment is, inherently, a people-intensive mission. As a result, faculty and staff salaries represent a significant portion of the University's expenditures from core funds, as they do at other colleges and universities. The University's multi-year budget plan must address cost projections for both represented and nonrepresented faculty and staff. For some represented employees, wage growth is already built into existing collective bargaining agreements when known; projections must be used for employees covered by other collective bargaining agreements that will come up for negotiation during the timeframe of the multi-year plan.

  For nonrepresented faculty, the budget plan must accommodate 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.

  The University must also make strategic investments in order to further close the competitive gap that exists between faculty salaries at UC and at the University's "comparison eight" public and private universities. As shown in Display 5, below, the University's competitive position relative to this benchmark has improved slightly in recent years after years of decline. In 2019-20, the University initiated a multi-year salary strategy to address this competitive disadvantage through both a general range adjustment and a special salary plan for ladder-rank faculty.

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 California Consumer Price Index (i.e., inflation) for planning purposes. This approach would keep overall staff salaries relatively flat in constant dollars while allowing individual employees to receive adjustments based upon their performance.

- *Employee and Retiree Health Benefits.* The University currently projects annual increases of 3.6 percent in the unit cost of employee and retiree health benefits. This rate is less than the annual increase projected by the National Business Group on Health annual survey (five percent), but it is comparable to recent cost increases among large employers and should be achievable given the University's ongoing efforts to control costs in this area. 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).* Updated 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), combined with the current employee contribution rate, will not be sufficient to adequately fund the plan. The University will need to incorporate any increase in the employer contribution rate approved by the Regents into its budget plan for 2020-21 and future years.

- *Student Mental Health.* The University must continue to increase its investment in counselors and other student mental health professionals in order to improve student access to these critical resources. The 2019-20 Budget Act included $5.3 million in new permanent support for this purpose, which will allow campuses to sustain investments that they had made using one-time funds that were provided in 2018-19 in lieu of an increase to the Student Services Fee. Additional investments, however, will be required in 2020-21 and future years to make meaningful progress in meeting students' need for mental health services.

- *Financial Aid.* As discussed later in this document, the proposed budget plan includes modest increases in mandatory systemwide charges beginning in 2020–21. As in past years, the University would set aside additional funding for financial aid to fully cover the increases for approximately 100,000 financially needy UC undergraduates and to provide additional funding to help these students cover a portion of cost increases such as housing, food, and other components of the total cost of attendance. The increase in mandatory charges would also be covered for graduate students whose financial support packages include tuition and fee coverage.

- *Other 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 budget plan, the University would seek to limit those cost increases to the rate of inflation.

Funding the Multi-Year 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; and
- investments in faculty above and beyond what would normally be expected from enrollment growth alone.

Each category of investment is described below.

Enrollment Growth

Moderate levels of undergraduate and graduate enrollment growth will be required to achieve the University's goal, under the multi-year framework, of producing 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.

The 2019-20 Budget Act provides welcome support for California resident enrollment growth in both 2019-20 and 2020-21, calling for an additional 4,890 students by 2020-21 over 2018–19 levels. Preliminary estimates suggest that the University will enroll between 3,400 and 3,600 more full-time-equivalent students in 2019-20 than it did in 2018-19, allowing for additional enrollment growth of between 1,400 and 1,600 next year.

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, which would begin to reverse a long-term decline in the percentage of UC students who are graduate students.

The multi-year plan also 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. By continuing and strengthening that partnership, the University and the State can ensure that future generations of UC students have access to the same or better quality of instruction, academic support, equipment, and other resources that were available to earlier generations of students.

Enhancing Degree Attainment and Reducing Achievement Gaps

Each UC campus has developed strategies for achieving ambitious goals for improving graduation rates and reducing achievement gaps by 2029–30. Display 6 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 Close 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%

Investing in Faculty and Research

Campuses have developed multi-year 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 enrollment growth. Faculty hiring above and beyond the level needed to keep pace with enrollment growth requires additional funding.

Addressing Critical Capital Needs

As noted earlier, the University has relied increasingly on the AB 94 funding mechanism to meet a portion of its immediate capital needs. This mechanism allows the University to use a portion of its State General Fund allocation, subject to certain conditions, to finance the design, construction, and equipment of academic facilities to address seismic and life safety needs, enrollment growth, modernization of out-of-date facilities, and renewal or expansion of infrastructure to serve academic programs. The University's budget proposal for 2020-21 will require an additional allocation of $15 million to cover projected increases in debt service for State-approved projects that are scheduled to be completed that year.

The University's total capital needs, however, far exceed the amount that can be realistically financed though AB 94 alone. As noted in the University's 2018-28 Capital Financial Plan, facilities that support the instructional and research mission of the University are aging; sustained enrollment growth will require additional space; and changes in pedagogy and technology require the modernization of existing space. In addition, the University's Seismic Safety Policy calls upon the University to provide an acceptable level of earthquake safety for students, employees, and the public who occupy University facilities, to the extent feasible by present earthquake engineering practice.

A new State General Obligation Bond would provide much-needed resources to help close the gap between the University's projected capital needs and currently available resources. Until such funding is available, however, the University will continue to use the AB 94 funding mechanism to help address its most critical capital needs.

REVENUE COMPONENTS OF THE BUDGET PLAN

The proposed funding strategy to support the multi-year budget plan includes three categories of support:

- *Revenues and savings achieved from the University's own efforts to generate funds and reduce costs.* 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:
  - Additional opportunities exist to shift a 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 University believes that such a strategy could generate year-over-year increases of up to $30 million in 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 from purchases attributable to the University's core funds operating budget.

- *Revenue from Tuition, the Student Services Fee, and Nonresident Supplemental Tuition.* The budget plan includes projected increases in Tuition, the Student Services Fee, and Nonresident Supplemental Tuition attributable to the planned enrollment growth described above. In addition, with sufficient levels of State support, the University would seek to limit increases in these charges to the rate of inflation, keeping the charges flat in constant dollars. (Alternatively, if the University were to adopt a cohort-based approach to assess tuition and fees, the University would propose a cohort-based schedule of increases that would yield approximately the same net revenue over time. See item B3 on the agenda for the full Board, *Update on Cohort-Based Tuition*, for a more complete description of this approach.) The impact of tuition on financial aid and UC affordability is described below in the section titled "Tuition, Financial Aid, and Affordability."

- *State support.* The plan will include three categories of State support:
  - An annual base budget adjustment to the University's prior-year permanent budget. Preliminary estimates suggest that annual increases of between 3.5 percent and four percent, in conjunction with the other revenues and cost-savings efforts described above, would allow the University to meet ongoing budget needs related to sustaining core operations.
  - Funding for enrollment growth based on the State's share of the projected marginal cost of instruction.
  - 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.

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. UC undergraduates received $850 million in UC, federal, and State grants in 2017-18 to help cover these other costs while attending the University.

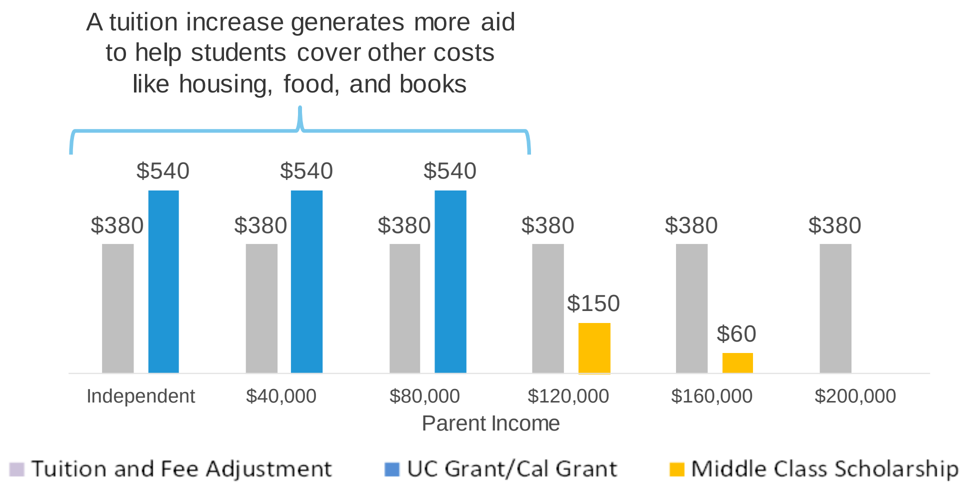
The relationship between UC tuition and both University and State financial aid programs has been key to the University's ability to sustain access, affordability, and excellence over time. In past years, when precipitous declines in State support resulted in higher tuition rates, additional financial aid from 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, 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, and a Middle Class Scholarship recipient can expect between ten percent and 40 percent of the increase to be covered. The financial awards for most California resident undergraduates would rise by more than the amount of any increase.

The chart below depicts 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. As shown in the chart, the increased financial aid derived from an inflation-based adjustment to tuition and the Student Services Fee is 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.

DISPLAY 7: Projected Change in Financial Aid for California Residents With a Three Percent Inflation-Based Adjustment to Tuition and Fees



STUDENTS' BUDGET PRIORITIES

Staff from the University of California Office of the President (UCOP) have consulted with representatives from the University of California Student Association (UCSA) about students' budget priorities for the upcoming fiscal year and beyond. UCSA leadership recently provided UCOP with its preliminary list of budget priorities, which includes the following items:

- *Establishing summer Cal Grants.* This year, following a joint advocacy effort, UC received $4 million of new support to provide financial aid to students who enroll in summer. UCSA would like to continue working with the University to establish and fund summer Cal Grant awards as an entitlement for all eligible students.

- *Addressing the impact of underfunded enrollment growth.* Campus budgets are currently challenged by enrollment growth that has not been fully supported by new State funding. UCSA proposes partnering with the University to seek additional State funds to significantly enhance student mental health services, expand academic advising, and reduce the student-faculty ratio. These investments are particularly critical for students from marginalized and underserved communities; additional support would thus help eliminate achievement gaps between these and other students.

- *Securing ongoing resources to support historically marginalized and underserved students.* UCSA has identified several priority areas for State investment to further assist students from marginalized and underserved communities, including outreach, retention, and recruitment programs (such as the State's one-time commitment in 2019-20 for outreach to students from Local Control Funding Formula Plus high schools); undocumented resource centers and services (such as legal and mental health services); and resources for student parents, transfer/re-entry students, and formerly incarcerated students.

- *Supporting student access to local and regional public transit.* UCSA notes that housing costs are causing many UC students to commute longer distances, which can adversely affect students' academic performance and hinder progress towards UC's commitment to carbon neutrality. UCSA proposes advocating for a State buy-out of local or regional public transit fees to deliver free or reduced-price transit passes for all UC students.

- *Keeping tuition flat.* UCSA has historically opposed all tuition increases and hopes to keep tuition flat for all students in the 2020-21 academic year. (The UCSA Board has not yet taken a position on moving to a cohort-based tuition model.)

Key to Acronyms

UCRP	University of California Retirement Plan
UCSA	University of California Student Association