F8

Office of the President

TO MEMBERS OF THE FINANCE AND CAPITAL STRATEGIES COMMITTEE:

<u>DISCUSSION ITEM</u>

For Meeting of September 29, 2021

PRELIMINARY DISCUSSION OF THE UNIVERSITY'S 2022–23 OPERATING 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 in developing the Governor's January budget proposal for the next fiscal year. This item is intended to facilitate discussion about elements of such a proposal for 2022–23.

Among other elements, the University's budget proposal will include instructional expenditures associated with enrollment growth, particularly growth in California resident undergraduates; expanded efforts at every campus to improve student outcomes, consistent with the University's goals to eliminate equity gaps in student outcomes by 2030; critical investments in faculty and staff; 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.

To support these investments, the plan will include a balanced funding strategy that includes three broad categories of resources:

- contributions from the University's own efforts to operate more efficiently 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
- student tuition and fees, consistent with the multi-year plan for tuition and financial aid approved by the Regents in July 2021.

The 2022–23 budget cycle presents an opportunity for the University to strengthen its partnership with the State to advance shared goals of access, affordability, and inclusive excellence.

BACKGROUND

University of California students, faculty, and staff have faced challenges over the past 18 months that are unlike those at any other period in the University's history. The COVID-19 pandemic has affected the physical and mental well-being of members of the UC community; fundamental aspects of teaching, research, collaboration, and social and professional engagement have had to be rethought; and campuses and students have had to cope with ever-changing prognoses regarding the pandemic's trajectory, the return to "normal" operations, and many other factors.

Amid this uncertainty, the University has sought to maintain and, where possible, expand upon its unparalleled combination of access, affordability, and inclusive excellence.

- **Access.** The University enrolled more students in 2020–21—including more California resident undergraduates—than at any time in history. Although enrollment figures for 2021–22 are not yet known, additional growth is expected this year. The University is committed to growing enrollment further in the years ahead by making the best use of its current physical capacity, making strategic investments to expand that capacity, and using innovative approaches to educate students such as remote instruction and off-campus programs.

- **Affordability.** In July 2021, the Regents approved a multi-year plan for tuition and financial aid that will result in a lower net cost of attendance for over one-half of California resident undergraduates compared to a scenario in which systemwide tuition and fees remained flat. The plan will also provide new stability for those students and families who pay a portion of the University's systemwide charges out of pocket. In particular, under the plan, systemwide charges will remain flat for undergraduate students for the duration of their enrollment, up to six years, and will remain flat in constant dollars for graduate students, rising only by inflation. The plan also increases the percentage of new tuition and fee revenue that will be set aside for financial aid.

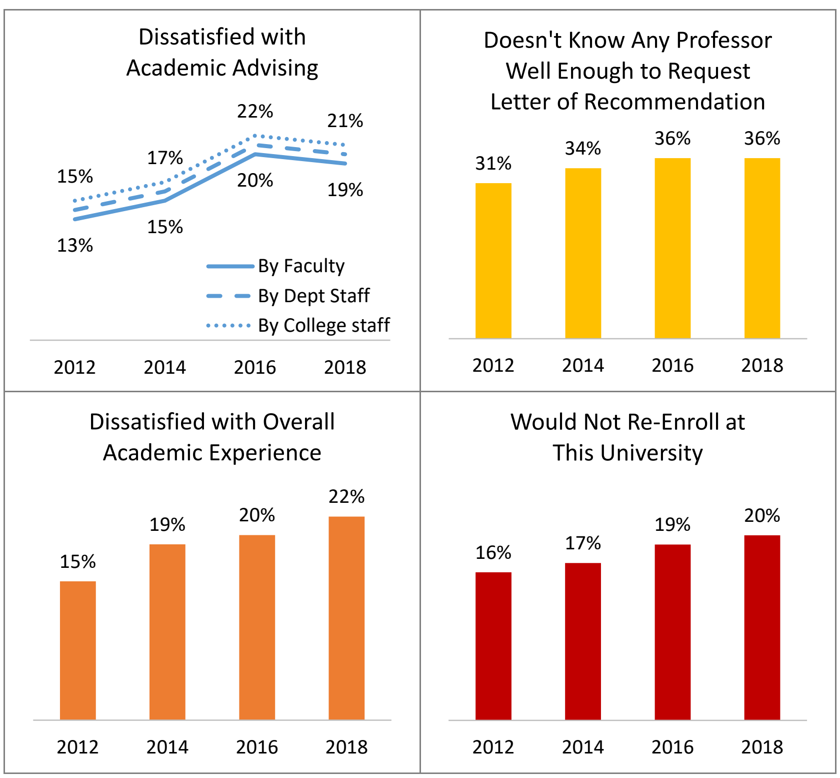
- **Inclusive Excellence.** Several metrics related to the quality of a UC education continue to improve. Four-year graduation rates, for example, have increased over time, and the average time to degree has declined. Individual UC campuses also continue to be highly regarded by the general public and recognized for their educational quality. In the recently released Forbes 2021 ranking of top colleges, for example, Berkeley was ranked the best university in the country—the first time that any public institution has ever held that position. Three other UC campuses—Los Angeles, San Diego, and Davis—were among the top 25 universities, and every undergraduate UC campus appeared in the top half of the Forbes list, which only considers the top 600 four-year public and private institutions nationwide out of 2,700 in total.

  Nevertheless, a closer look at several quality-related metrics reveals worrisome trends that must be addressed—trends related not only to excellence but to equity: the

University's ability to adequately support students who arrive at UC having overcome greater obstacles and/or having had fewer educational, social, or financial advantages compared to other UC students. Examples of such students include students from low-income families, students from underrepresented minority groups, and first-generation college students (i.e., students whose parents did not attend college).

Collectively, these students are frequently referred to as "new generation" students. For these students in particular, a UC education has the potential to make a positive and profound impact on the trajectory of their lives. It is thus of great concern that, for several years, shortfalls in campus resources for instruction and academic support—which are derived primarily from the University's State appropriation and revenue from tuition and fees—have led to growing levels of dissatisfaction among new generation students in areas that directly affect their ability to succeed, as shown in Display 1, below.

DISPLAY 1: Dissatisfaction with Academic Aspects of UC among New Generation Students



Source: University of California Undergraduate Experience Survey (UCUES). Dissatisfaction rates reflect the percentage of respondents who were somewhat dissatisfied, dissatisfied, or very dissatisfied. Due to the onset of the COVID-19 pandemic, spring 2020 UCUES survey results may not be comparable with those from prior years.

The figures in Display 1 reflect the following trends between 2012 and 2018:

- A higher percentage of new generation students are dissatisfied with the quality of their academic advising (shown in blue), including faculty advising, department staff advising, and college staff advising. This trend reflects enrollment growth that has exceeded the increase in resources for academic advising at UC campuses.

- A growing percentage of new generation students (shown in gold) report that they do not know any faculty member well enough to request a letter of recommendation from him/her. This trend is consistent with observed trends in the student/faculty ratio: the student/faculty ratio for ladder-rank and equivalent faculty increased from 27.4 in 2011–12 to 28.4 in 2017–18. (By comparison, the ratio was 24.9 in 2005–06.) The ratio has increased the fastest at the University's largest campuses.

- Dissatisfaction with academic advising and reduced contact with faculty likely contributed to new generation students' growing dissatisfaction with their overall academic experience (shown in orange): 15 percent of new generation students reported begin dissatisfied with their academic experience in 2012 compared to 22 percent in 2018.

- The cumulative impact of these and other consequences of inadequate campus resources has resulted in a higher percentage of new generation students (shown in red) expressing regret at having enrolled at the University in 2018 (20 percent) compared to 2012 (16 percent).

The erosion of critical resources over time is not always evident to individual students, who typically attend the University for only a few years. It is, however, evident to faculty and other University stakeholders who have a longer perspective. Professor Mary Gauvain, the 2020–21 Academic Senate Chair, described her own experience in comments made at the July 2021 meeting of the Regents:

> "Most faculty, including me, stay at the University for our entire careers. We are committed to the excellence of the University—it's what keeps us here. But it's getting harder and harder to maintain that excellence without an increase in stable core funds. My experience over 29 years as a faculty member at UCR has really changed. We can notice the deterioration on so many dimensions […] and this is disheartening. The number of students keeps going up and we continue to be concerned about accessibility and enrollment and we should be –we're a public university. But those kinds of aspirations can't be reached without paying for them."

To address these and other challenges, the University's long-term budget strategy must not only cover annual increases in operating costs attributable to inflation or other inexorable factors, or cover the additional marginal cost associated with future enrollment growth. It must also acknowledge shortfalls that the University already faces and the additional investments that are needed to ensure that all UC students, regardless of their socioeconomic background, have access not only to the substantial financial aid and basic needs resources provided by University and State programs, but also to the academic resources that they need to succeed at UC.

ELEMENTS OF THE BUDGET PLAN

The proposed budget plan is organized around three categories of critical investments: sustaining core operations, expanding student access and success, and addressing a portion of the University's most urgent capital needs.

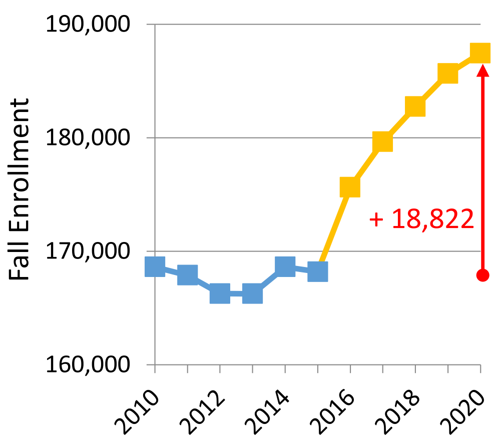
Sustaining Core Operations

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 its ambitious goals related to access, affordability, and inclusive excellence. These operations have been challenged due to a combination of factors, including but not limited to the following:

- **Enrollment growth not fully supported by new State funds.** Display 2, below, shows the trend in fall enrollment of California resident undergraduates since 2010. The growth in recent years is especially noteworthy: in fall 2020, UC campuses enrolled 18,822 more California undergraduates than they did in fall 2014. Display 2 also shows that between 2014–15 and 2020–21, growth in California undergraduate enrollment (including enrollment in State-supported summer programs) exceeded the levels funded in State Budget Acts by nearly 9,800 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 2: Trends in California Resident Undergraduate Enrollment and Funding

Fall Enrollment of California Resident Undergraduate Students



Actual vs. Funded Growth in California Resident Undergraduates Since 2014–15

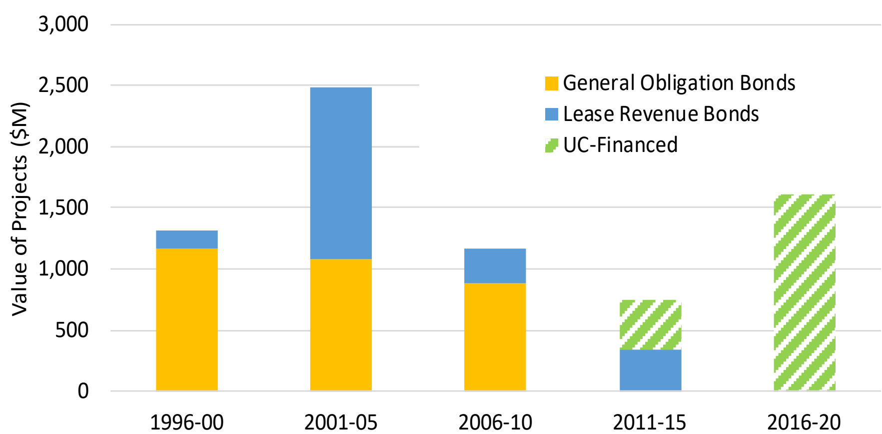
Year	*Total Enrollment*	*Change from Prior Year*	*Growth Funded in Budget Act*	*Growth Above Funded Level*
14-15	174,681			
15-16	173,642	(1,039)	-	(1,039)
16-17	180,389	6,747	5,000	1,747
17-18	185,059	4,670	2,500	2,170
18-19	189,133	4,074	2,000	2,074
19-20	193,445	4,312	4,860	4,804
20-21	198,797	5,352		
Total Since 2014-15		**24,116**	**14,360**	**9,756**

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

- **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 $500 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 3 illustrates the resulting shift from capital projects funded by State-issued bonds to projects financed under AB 94. Approximately $104 million of the University's 2021–22 State General Fund appropriation will be used for debt service on AB 94 projects instead of supporting campus operating budgets.

DISPLAY 3: Approved Funding for Capital Needs from State Bonds and UC-Financed AB 94 Debt



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. Moreover, research universities such as UC are especially reliant on employees with a college degree and, in the case of faculty members and many staff, an advanced degree. As shown in Display 4 below, research and development along with education—industry sectors that, taken together, represent the crux of the University's mission—rely on highly skilled workers to a much greater degree than most other industries. These employees are in high demand in the labor market, as shown by much lower unemployment rates among individuals with a bachelor's degree or higher.

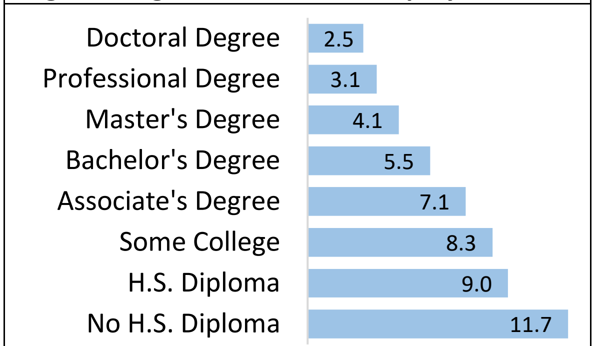
DISPLAY 4: Education Level by Industry and Unemployment Rate

Percentage of Employees with College Degree or Higher by Industry

Industry	%
Research & Development	77.0
Computer Systems Designs	71.8
Education	66.6
Medical Hospitals	49.8
Real Estate	41.9
Telecommunications	37.6
Electrical & Optical Equipment	31.7
Motor Vehicles	23.6
Construction	13.1

Unemployment Rate by Highest Degree Obtained, 2020

Highest Degree **% Unemployed**



Source: Educational attainment by figures are derived from the 2019 American Community Survey (data.census.gov). Unemployment rates by educational attainment are from the U.S. Bureau for Labor Statistics (www.bls.gov).

Within this context, the University's budget plan must address cost projections for both represented and nonrepresented faculty and staff.

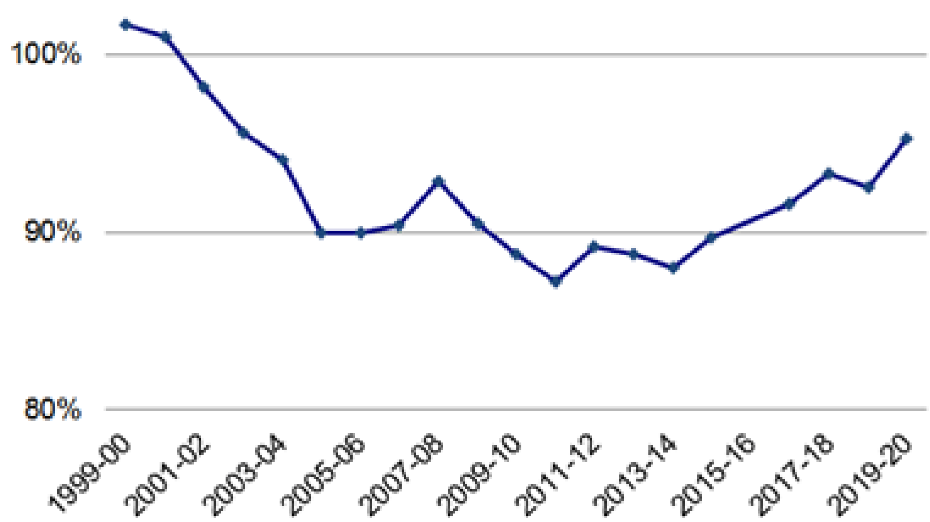
- For some represented employees, wage growth is already built into existing collective bargaining agreements. Projections must be used for employees covered by collective bargaining agreements that will come up for negotiation over the next fiscal year. The University projects wage growth for core-funded represented employees of approximately \$32 million next year, an increase of approximately 3.1 percent over estimated 2021–22 levels.

- For nonrepresented staff, the budget plan typically includes a merit increase budget that is based in part on the projected rate of inflation (in order to prevent an overall erosion in the University's payroll in constant dollars) while allowing individual employees to receive adjustments based upon their performance. A merit increase program of between three and four percent would require between $47 million and $63 million of core funds next year.

- For nonrepresented faculty, the budget plan must accommodate 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 program is projected to require approximately $34 million in core funds next year. (This cost is effectively mandatory; UC lost two class action lawsuits in 1994 filed on behalf of faculty members who were eligible for review in 1991–92 but who did not receive merit increases due to budget constraints that year.)

  Additional investment will be required to further close the competitive gap that exists between faculty salaries at UC and at the University's "comparison eight" public and private universities. The University's competitive position relative to this benchmark has improved slightly in recent years after years of decline, as shown in the display below. The recent improvement is partly attributable to a deliberate multi-year effort, beginning in 2018–19, to address the University's 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



As of 2019–20, UC's faculty salaries remained 4.7 percent below market, which represents an estimated aggregate shortfall of approximately $52 million. Closing this gap over three years would require annual investments of roughly $17 million in addition to the cost of annual scale adjustments (e.g., $60 million for a three percent scale adjustment) to prevent further erosion of the University's competitive position.

Employee and Retiree Health Benefits. The University currently 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 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). In September 2019, updated actuarial projections led the Regents to approve a plan to phase in a three percent increase in the employer contribution rate over six years, resulting in annual increases of 0.5 percent beginning in 2020–21. (The 2019–20 employer contribution rate was 14 percent, including an employer contribution of six percent for Savings Choice participants in the Defined Contribution Plan.) In light of recent, strong investment returns that have significantly improved the funded status of the plan, the need to increase the employer contribution rate beyond its current level of 15 percent is unclear—indeed, the University may consider reducing the rate from its current level to provide greater relief to the operating budget. (See "Revenue and Cost-Saving Components of the Budget Plan" below.)

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 proposal, the University would seek to limit those cost increases to projected changes in the implicit price deflator for State and local governments (the institutional equivalent of the Consumer Price Index, which applies to household expenses). For travel-related expenditures, however, the proposal would reflect a permanent reduction equivalent to 33 percent of core-funded travel expenditures made possible by the increased use of internet-based tools for remote collaboration, conferences, and the like.

Expanding Student Access and Success

Enrollment Growth. The University has set a goal of growing its existing population by roughly 20,000 students—nearly the equivalent of adding an eleventh UC campus—by 2030 and expanding its faculty in tandem. Growth would be achieved through a combination of traditional and alternative strategies, including greater utilization of existing physical infrastructure where possible, expanding physical capacity where necessary, improving student throughput to enable a shorter time to degree, continuing to deploy technology-enhanced education, and greater use of summer session, off-campus programs (e.g., Education Abroad Program, UCDC, and the UC

Sacramento Center), and partnerships with the California State University and the California Community Colleges.

The 2021–22 Budget Act clearly expresses the intent of the Legislature to support further enrollment growth among California resident undergraduates, including but not limited to funding that would allow certain high-demand campuses to reduce their enrollment of nonresident undergraduates and increase their enrollment of California resident undergraduates without incurring a net reduction in revenue associated with reduced levels of Nonresident Supplemental Tuition (NRST).

Although not specifically referenced in the Budget Act, graduate students are critical for California's future workforce, conduct groundbreaking research themselves, and help instruct and mentor undergraduate students. As a result, it is anticipated that about 4,000 of the planned growth of 20,000 students be in the University's graduate academic and professional programs.

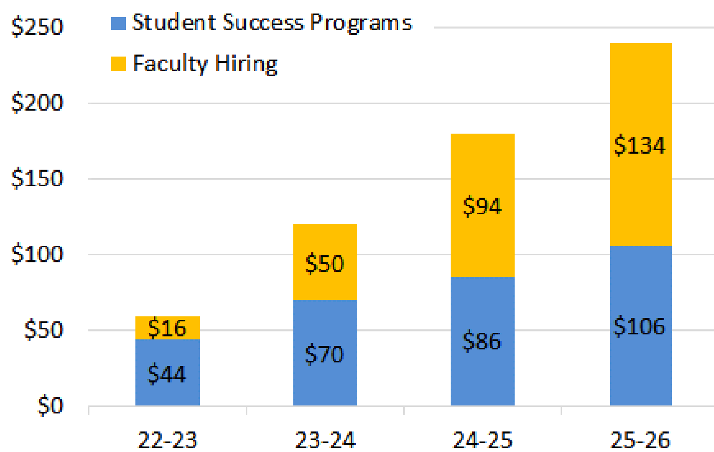
The University's enrollment growth targets for 2022-23, along with a concomitant request for State funding to cover the State's share of the marginal cost of instruction, will be developed in the ensuing weeks as campuses have better information about the number of students who ultimately enroll in 2021-22. (The first day of instruction at the University's quarter campuses is September 23.)

Enhancing Degree Attainment and Eliminating Equity Gaps. Each UC campus has developed strategies for achieving ambitious goals for improving graduation rates overall and reducing equity gaps—i.e., differences in graduation rates that currently exist between students from nontraditional college-going backgrounds and other UC undergraduates—by 2029–30. The largest areas for proposed investment are student advising, academic support, online course development, and increasing course availability.

Campuses have also 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.

Campus efforts related to degree attachment, eliminating achievement gaps, and investing in faculty are estimated to require annual funding of $240 million once they are fully phased in, as shown in the display below. The 2022-23 budget proposal will include $60 million as an initial investment towards achieving these longer-term goals.

DISPLAY 6: Proposed 2030 Framework Investments



All figures in millions

Student Financial Aid. The University's 2022–23 budget plan will include increased investments in student financial aid resulting from (a) the tuition and fee revenue generated by enrollment growth, (b) new tuition and fee revenue generated by the tuition stability plan approved by the Regents in July 2021, and (c) an increase in the marginal share (or "return-to-aid") of new tuition and fee revenue generated by the tuition stability plan that is to be used for financial aid.

Student Mental Health. The 2021–22 Budget Act provided the University with $15 million in new ongoing funding to enhance students' access to mental health services. Together with $5.3 million provided in the 2019–20 Budget Act, these resources represent a significant and much needed investment by the State to meet the fundamental mental health needs of UC students. To put this investment in perspective, however, a 2019 assessment of the University's systemwide mental health needs suggested that additional ongoing investments totaling $33 million per year would be needed for direct clinical services, targeted interventions for vulnerable populations, and the creation of healthy campus learning environments. This assessment occurred prior to the onset of the COVID-19 pandemic, which has taken an additional toll on students' mental health and well-being. Additional investments will be required in 2022–23 and future years to make further progress in meeting students' mental health needs.

Student Academic Preparation and Educational Partnerships (SAPEP). The University of California's portfolio of SAPEP programs prepares California students — including those who are first-generation college-goers or socioeconomically disadvantaged, and those for whom English is a second language — for postsecondary education and for graduate and professional school opportunities, as well as success in the workplace. SAPEP includes academic preparation programs; community college articulation support; school and community partnerships; undergraduate, graduate, and educator preparation programs; and online and technology-assisted services. The 2021–22 Budget Act provided one-time funding of $22.5 million to support this portfolio of programs; the multi-year projections assume that this funding would be made permanent in 2022–23.

Support for Undocumented Students, Former Foster Youth, and Carceral System Impacted Students. The 2020–21 budget plan approved by the Regents in November 2019 includes expansion of student services for three categories of UC students: undocumented students, foster youth, and carceral system-impacted students (including students who were formerly incarcerated themselves). The plan includes an ongoing investment of $20 million for programs and services to support these students, who have already overcome tremendous obstacles in pursuing their educational goals but who still face unique and significant challenges.

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 2022–23 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. 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.

REVENUE AND COST-SAVING COMPONENTS OF THE BUDGET PLAN

The proposed funding strategy to support the 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 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 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.

  - As noted earlier, strong investment returns have significantly improved the funded status of the UC Retirement Plan. As a result, the University could consider modest reductions in the employer contribution rate (currently 15 percent and scheduled to increase to 15.5 percent next year) in order to provide much-needed relief to campuses' operating budgets.
  - 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 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 will include projected increases in Tuition, the Student Services Fee, and Nonresident Supplemental Tuition attributable to the planned enrollment growth described above. In addition, the plan will include projected revenue increases resulting from the tuition stability plan approved by the Regents in July 2021.

- *State support.* The plan will request new ongoing support for enrollment growth, including the State's share of the marginal cost of instruction for unfunded enrollment growth that already occurred and additional planned enrollment growth; an annual base budget adjustment to the University's prior-year permanent budget; and support for the other elements of the University's budget request. The University is also working to identify areas where one-time support could be quickly utilized to address ongoing capital needs, support large-scale research efforts focused on high-priority issues, or otherwise advance shared State and University priorities.

Key to Acronyms

SAPEP	Student Academic Preparation and Educational Partnerships
UCRP	University of California Retirement Plan
UCSA	University of California Student Association