

Office of the President

TO MEMBERS OF THE FINANCE AND CAPITAL STRATEGIES COMMITTEE:

DISCUSSION ITEM

For Meeting of September 18, 2024

PRELIMINARY DISCUSSION OF THE UNIVERSITY'S 2025-26 OPERATING BUDGET

EXECUTIVE SUMMARY

Each fall, the University of California submits a budget proposal to the California Department of Finance for consideration in developing the Governor's January budget introduction for the next fiscal year. This item is intended to facilitate discussion about elements of the University's operating budget plan for 2025-26.

Given the State's projected multi-year budget deficits—\$46.8 billion in 2024-25 and \$28.4 billion in 2025-26—the increased funding for UC in the Budget Act of 2024 demonstrates strong support for the University's mission. The final budget appropriates a total of \$4.9 billion to the University, including \$134.8 million of new ongoing support and a net reduction of \$2.6 million in one-time funding for systemwide programs. While the University will receive increased support reflecting the third year of the Compact with the Governor, it must also absorb a reduction of \$125 million, providing less than the needed funds for core operating cost growth. In addition, for 2025-26, the State has signaled its intent to both restore the \$125 million cut in 2024-25 and reduce the University's base budget by 7.95 percent—a net reduction of over \$270 million (5.6 percent).

The State demonstrated its continued commitment to the University by providing increased funding despite a period of economic uncertainty and in a year in which many other State agencies will see flat or reduced funding levels. Additional ongoing State resources, together with new revenues for campus operations and student financial aid attributable to the University's Tuition Stability Plan, directly support campus investments towards ensuring the University's success in providing a world-class education to generations of exceptionally talented and socioeconomically diverse students.

Expenditure elements of the budget plan will include those related to enrollment growth, improving student services, and expanding access to a debt-free pathway for California resident undergraduates, along with continued investments to support core University operations. Revenue elements of the plan will include State support consistent with the Compact agreement, contributions from the University's own efforts to operate more efficiently and optimize the

investment of working capital to support the operating budget, and student tuition and fee levels consistent with the multi-year Tuition Stability Plan.

BACKGROUND

The University's total operating budget—covering ten campuses; six academic health centers and five teaching hospitals; Agricultural Field Stations, Cooperative Extension offices, and the Natural Reserve System; and dozens of institutes, centers, and research laboratories throughout the state—reflects the broad and diverse impact on Californians, the nation, and the world.

Total operating revenue, estimated to be approximately \$54.7 billion in 2024-25, funds essential programs related to teaching, research, and public service, as well as a wide range of other activities, including University Extension, housing and dining services, and critical student service programs.

The University's "core funds," which include revenues from State General Funds, UC General Funds, and student tuition and fees, provide permanent funding for the University's core missions, as well as the administrative and support services needed to perform them. Totalling an estimated \$10.8 billion in 2024-25, these funds represent approximately 21.5 percent of UC's total operations. While all fund sources are critical to the success of the University, much of the focus of UC's strategic University-wide budget process and interaction with the State is dedicated to the sources and uses of these core funds.

Altogether, the final 2024-25 State budget provided the University with \$134.8 million in new ongoing support, reflecting a five percent increase consistent with the Compact alongside a reduction of \$125 million to the University's base budget. While this is less than the amount anticipated under the 2024-25 Budget for Current Operations, this funding provides UC with critical resources to address a portion of the budget pressures attributable to benefit, retirement, and labor costs, as well as non-salary cost increases in other critical areas of the University's operations.

Campuses can also anticipate new support from systemwide tuition and fees in 2024-25, consistent with the Tuition Stability Plan approved by the Regents in July 2021. The University's 2024-25 budget plan includes \$190.9 million of new resources from systemwide tuition and fees, including Nonresident Supplemental Tuition. Of this amount, \$75 million will be used for student financial aid, resulting in \$115.9 million available for campus operations. Combined, new State funds and revenues from tuition and fees will support a portion of the estimated \$650 million increase in core fund expenditures reflected in the University's 2024-25 budget plan.

The 2025-26 budget plan for core-funded operations must align critical new investments and projected cost growth with anticipated new revenues while preserving the University's tripartite mission of instruction, research, and public service. Elements of such a plan are described below.

ELEMENTS OF THE BUDGET PLAN

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

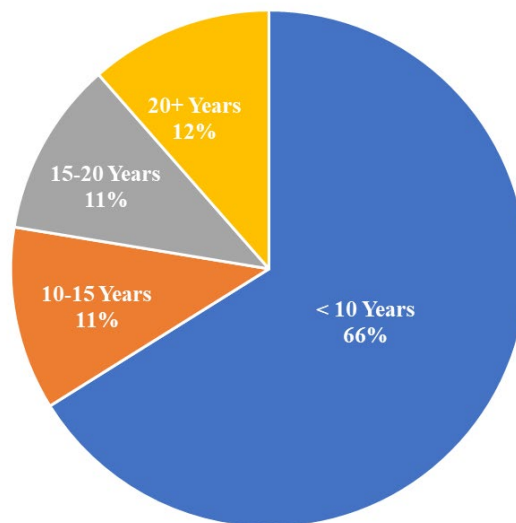
Sustaining Core Operations

Expanding access to students from all backgrounds, ensuring an affordable experience, and maintaining the educational quality enjoyed by generations of students requires that the University sustain support for its core operations. Consequently, the budget plan must include investments in the following areas.

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.

Timely hiring of new faculty and staff is necessary for maintaining and expanding high-quality instruction and support services. It is critical, however, that the University’s core budget reflect the importance of cultivating and retaining its existing workforce. Experienced employees possess the insights, skills, and institutional memory that reinforce consistency and operational efficiencies. Moreover, high turnover rates result in an inefficient use of limited resources: a 2022 report from the Work Institute found that each departure costs approximately one-third of the employee’s salary.

Display 1: UC Employee Service Years (October 2023)¹



¹ Source: UCOP Institutional Research and Academic Planning

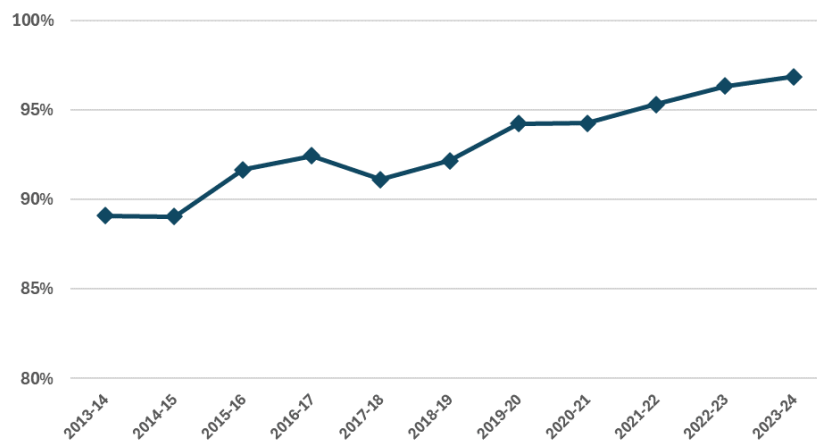
As shown in Display 1, approximately one-third of the University's staff have ten or more years of UC experience. Competitive salary and benefit programs at UC are one component of an efficient budget strategy that supports employee retention, facilitates the preservation of organizational knowledge and expertise, and highlights the value of a career in support of public higher education.

Within this context, the University's budget plan must address cost projections for both represented and policy-covered (i.e., non-represented) faculty and staff.

- Wage growth is already built into existing collective bargaining agreements for some represented employees. Projections must be used for employees covered by collective bargaining agreements that will come up for negotiation over the next fiscal year.
- For policy-covered staff, the budget plan may include a salary program that provides for wage growth designed to retain and recruit employees and decrease the cost of staff turnover.
- For policy-covered faculty, the budget plan must accommodate adjustments to faculty salary scales, along with 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. (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 following the Great Recession, as shown in Display 2, with improvements in recent years 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. Even with these efforts, the latest available estimates suggest that UC's faculty salaries remain 3.1 percent below the benchmark.

Display 2: Ladder-rank Faculty Salaries as a Percentage of Benchmark²



Employee and Retiree Health Benefits. The budget plan must account for projected increases in the unit cost of employee and retiree health benefits. For retiree health benefits, the overall cost of retiree health is estimated to increase by an additional 2.5 percent annually due to projected increases in the number of UC retirees.

Contributions to the University of California Retirement Plan (UCRP). For 2025-26, the University's employer contribution rate to UCRP is expected to increase from 14.5 percent to 15 percent (including an employer contribution of seven percent for Savings Choice participants in the Defined Contribution Plan). In addition to the added cost to the University associated with the half percentage point adjustment to UCRP, growth in faculty and staff covered compensation will increase the amount of the University's annual employer contribution.

Other Cost Increases. Prices for items such as instructional equipment, laboratory supplies, computers, machinery, library materials, and purchased utilities tend to rise each year. 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). That index is currently projected to increase by 3.16 percent in 2025-26.

Expanding Student Access and Success

Enrollment Growth. The University's 2025-26 budget plan will include enrollment growth consistent with expectations under the multi-year Compact agreement and outlined as part of the 2024-25 State budget. State funding will allow the University to continue expanding access and grow enrollment to 209,535 full-time-equivalent (FTE) California resident undergraduates by 2025-26, including:

² Source: UCOP Academic Personnel and Programs

- California resident undergraduate growth of approximately one percent, to be funded from the University’s base budget adjustment of five percent that year; and
- 902 FTE made possible by a reduction in the proportion of nonresident undergraduates at the Berkeley, UCLA, and San Diego campuses.

The University’s enrollment growth targets for 2025-26 will be developed in the ensuing weeks as campuses have better information about the number of students who ultimately enroll in fall 2024. (The first day of instruction at the University’s quarter system campuses is September 23.)

Enhancing Degree Attainment and Eliminating Equity Gaps. Consistent with the multi-year Compact agreement, UC campuses will seek to achieve ambitious goals for improving graduation rates overall and eliminating equity gaps—i.e., differences in graduation rates that currently exist between students from non-traditional 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.

Student Financial Aid. The University’s 2025-26 budget plan will include increased investments in student financial aid resulting from: (a) tuition and fee revenue generated by enrollment growth, and (b) new tuition and fee revenue generated by the Tuition Stability Plan approved by the Regents in July 2021, which included an increase in the marginal share (or “return-to-aid”) of new tuition and fee revenue used for financial aid. Assuming that the State continues to expand its investment in the Middle Class Scholarship and anticipated increases to the federal Pell Grant are realized, these new funds will allow the University to increase the number of undergraduate students who can potentially graduate without having to rely on student loans to finance their education.

Addressing Critical Capital Needs

In the absence of recent State-issued general obligation bonds or lease revenue bonds, the University has increasingly relied on the funding mechanism authorized in 2013 by Assembly Bill 94 (AB 94) to meet a portion of its immediate capital needs. AB 94 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 currently sets aside \$229.9 million of its annual State appropriation for debt service for projects financed pursuant to AB 94, including \$105 million for projects funded in recent State budgets. Consequently, these funds are not available to support campuses’ core operating budgets.

The University’s total capital needs far exceed the amount that can be realistically financed through 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.

For 2025-26, the University will need to decide whether to: (a) continue to redirect new State resources to finance additional AB 94 projects, or (b) use new ongoing resources to support campus operating budgets and seek one-time State funds for capital projects. In both the 2023-24 and 2024-25 budget cycles, for example, the University requested \$1.2 billion in one-time State support for projects related to deferred maintenance, seismic safety, energy efficiency, and campus expansion. The final State budgets in both years provided few resources towards this request, with one project receiving debt service support through State funds.

REVENUE AND COST-SAVING COMPONENTS OF THE BUDGET PLAN

The proposed funding strategy to support the budget plan includes three categories of support.

Alternative Revenue Sources

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 likely exist to further optimize the investment of the University's working capital to generate higher investment returns while maintaining appropriate liquidity. To the extent that a rebalancing of working capital between the Short Term Investment Pool (STIP), the Total Return Investment Pool (TRIP), and the Blue and Gold Pool (BGP) yields new, unrestricted revenue, the University will have additional resources to address a portion of its overall budget needs.
- 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.

Student Tuition and Fees

The budget plan will reflect increased revenues from Tuition, the Student Services Fee, and Nonresident Supplemental Tuition attributable to the planned enrollment growth described above. The plan will also include projected increases in Tuition and the Student Services Fee revenues consistent with the Tuition Stability Plan approved by the Regents in July 2021.

In addition, the budget plan may include an increase to undergraduate Nonresident Supplemental Tuition that is greater than the increases to Tuition and the Student Services Fee; consistent with the Tuition Stability Plan, however, this increase would only be assessed to the incoming cohort of nonresident undergraduates.

State Funding

The University’s budget plan will assume new State support consistent with the multi-year Compact agreement with the Governor. The Compact calls for annual, year-over-year ongoing General Fund base increases of five percent. In addition, the Compact permits requests for one-time funding, “particularly to support capital projects in energy efficiency, seismic renewal, and deferred maintenance.” The Compact also allows consideration of Legislative additions to the University’s ongoing funding, including funding to support further California resident enrollment growth and graduate health sciences programs designed to improve access to health care for medically underserved populations.

Additional Context on State Support for 2025-26

As part of the State’s multi-year approach to addressing budget shortfalls, the Budget Act includes language outlining proposed funding levels for the University through 2026-27 (and deferral funding that would be received in 2027-28), as shown in Display 3:

Display 2 – Proposed Multi-year Funding for UC in the 2024-25 Budget

	Actual 2024-25	Projected 2025-26	Projected 2026-27	Projected 2027-28	Total
Ongoing State Funding					
<i>2024-25 Compact</i>	\$ 227.8				\$ 227.8
<i>2025-26 Compact</i>		deferred	\$ 240.8		\$ 240.8
<i>2026-27 Compact</i>			deferred	\$ 240.8	\$ 240.8
<i>NR Swap (2024-25)</i>	\$ 31.0				\$ 31.0
<i>NR Swap (2025-26)</i>		deferred	\$ 31.0		\$ 31.0
<i>NR Swap (2026-27)</i>			deferred	\$ 31.0	\$ 31.0
<i>UCM Medical Education Bldg.</i>	\$ 14.5				\$ 14.5
<i>Proposition 56 True-up</i>	\$ (13.5)				\$ (13.5)
<i>2024-25 Cut / Restoration</i>	\$ (125.0)	\$ 125.0			\$ -
<i>7.95% Cut in 2025-26</i>	\$ -	\$ (396.0)			\$ (396.0)
Total New Ongoing Funding	\$ 134.8	\$ (271.0)	\$ 271.8	\$ 271.8	\$ 407.4
Total One-time Funding	\$ 2.4	\$ 1.3	\$ 271.8	\$ 271.8	\$ 547.3
Total New Ongoing + One-time	\$ 137.2	\$ (269.7)	\$ 543.6	\$ 543.6	\$ 954.7

While the University’s budget plan will reflect increased funding consistent with the Compact, campuses must begin to plan for the possibility of reduced State support in 2025-26, which may require the expansion of existing efforts to address core funds challenges and deficits.

STUDENT BUDGET PRIORITIES FOR 2025-26

Staff at the Office of the President meet regularly with University of California Student Association (UCSA) leaders to consult on budget matters of importance to students and to the University. These calls serve as a mutual opportunity for requesting feedback, exploring options for collaboration, and maintaining the critical connection between UC students and University representatives.

UCSA has identified its own budget priorities for 2025-26, outlined below:

- *Support for a Phased Implementation of the Cal Grant Equity Framework.* UCSA supports a phased implementation of the Cal Grant Equity Framework to expand access to financial aid for underserved students. UCSA urges the Regents to back this approach, noting the importance of addressing financial barriers and promoting equity, particularly for historically marginalized groups and community college transfer students.
- *Expanded Food Security Programs for Undocumented and International Students.* UCSA requests \$4.5 million in ongoing support to expand food security programs to all undergraduate campuses that would support undocumented and international students.
- *Additional Funding for Disability Service Centers.* Building on the \$1.5 million in ongoing support provided by the State in the Budget Act of 2023, UCSA requests \$3 million in additional ongoing funding to address wait times, service delays, and staffing shortages in Disability Service Centers across the system.
- *Ongoing Funding for an Intersegmental Course Articulation and Pathways Development Infrastructure.* UCSA requests \$1 million in ongoing funding to create intersegmental articulation infrastructure in support of recent transfer reforms.