WORKING GROUP FIRST ROUND RECOMMENDATIONS

Funding Strategies – Executive Summary

> *"In finance everything that is agreeable is unsound and everything that is sound is disagreeable."*
>
> *–Winston Churchill, 1953*

The funding challenges facing the University of California are considerable, and the solutions are not easy. The University of California Office of the President currently estimates that UC's core funding from state funds, student fees, and other sources has fallen $1.2 billion below UC's current needs. At current levels of state support, this funding gap is estimated to grow to $3.5 billion by the 2015-16 fiscal year.

The funding gap is exacerbated by a significant unfunded post-retirement benefit liability, which is currently $1.9 billion and expected to reach $18 billion by 2013. Similarly, the University's unfunded post-retirement healthcare liability is projected to grow from $13 billion today to $18 billion by 2013. Because a separate Post-Employment Benefit (PEB) Task Force, established by President Yudof in 2009, is scheduled to finalize recommendations this summer, we do not address PEB issues in this report; however, we recognize that PEB issues have the ability to impact the future of our institution more than any other financial challenge facing the University.

No single strategy will likely prove sufficient, by itself, to meet the University's needs. To protect the University's financial health and academic quality, the Commission on the Future as well as the Regents should be prepared to support a range of strategies aimed at (1) increasing state funding, (2) improving operational efficiency (both administrative and academic)[*], and (3) generating additional revenues through student fees, federal funding, and other modes.

If state funding is the basic foundation of UC's long-term excellence, then operational efficiency is its framework. State funding and operational efficiency are of particular and equal importance in any discussion of university funding strategies. In an effort to establish the premises of our arguments and recommendations, we outline our fundamental principles regarding state funding and administrative efficiencies below. We then lay out specific recommendations in two sections: recommendations for immediate adoption, followed by recommendations for longer-term adoption under certain circumstances.

STATE FUNDING PRINCIPLES

- *State funding remains critical to UC.* State funding provides the foundational support that allows UC to attract the faculty, students, and outside funding that make the institution the highest-quality and most successful public institution in the world. The key word is public. As the finest public university in the world, UC opens the door of educational opportunity to highly qualified students only with the support of the taxpayers of this state, and it has done so at a level that substantially exceeds private university efforts. Yet the state has been steadily disinvesting in UC for the last 20 years. State funding per student has declined by 54% since 1990-91. This trend must be reversed.

- *Student fee increases cannot fully replace state funds*. UC has been considered a bargain for decades, due to the state's historical commitment to keeping fees low and public universities

[*] In terms of operational efficiency, this report focuses primarily on administrative efficiencies as opposed to academic efficiencies.

accessible in California. Over the last two decades, however, student fees have risen dramatically, principally in an attempt to partially offset state funding declines. If UC is to continue as a public university offering an alternative to costly private institutions for highly qualified students, it must remain affordable. Periodic large fee increases are not only contrary to that principle, but they are also inadequate under almost any fee modeling scenario.

- *State funding is UC's equivalent of endowment*. Private universities have large endowments, some of which have been created over centuries of effort, which support a substantial fraction of their operations. UC will not create endowments of this size any time soon, if ever. As a result, the reduction in state funding is as if a private university found its endowment continually reduced. No private university could maintain itself under these circumstances, and the University of California cannot do so with a steady reduction of state funds.

Administrative Efficiency Principles

- *We have not measured administrative performance in the past.* While metrics for the assessment of successful academic performance may be well known, no such standards exist for administrative performance. Indeed, the peer review process within which UC demonstrates its extraordinary academic quality does not have a counterpart for the assessment of administrative organizations and systems.

- *There is variance in the quality and efficiency of administrative systems both within and across UC campuses.* Like our academic programs, there is great talent among our administrative ranks; however, for many reasons (e.g., campus culture, workload, lack of resources and knowledge), there has not been a systematic method to identify and implement those systems and practices that are most effective within the UC system and beyond. Through an aggressive program to identify and encourage (if not require) adoption of the most effective and efficient practices, we can preserve resources that can then be dedicated to core academic programs. Of course, it is solely to support these academic programs that administrative operations exist.

- *Administrative efficiencies are most effective when mandated.* The change towards more uniform and efficient administrative systems will only be achieved if it is required by Chancellors, the President, and The Regents. Large organizations can suddenly become surprisingly nimble when it comes to protecting the status quo.

State funding and administrative efficiency are integral to the success of any funding strategy. With these basic principles in mind, we explore the following specific recommendations:

Recommendations for Immediate Adoption:

1. Develop multiyear grassroots opinion-leader advocacy campaign for state support
2. Administrative best practices system
3. Revise non-federal ICR policy
4. Improve federal ICR rates
5. Implement multiyear tuition-planning strategy
6. Increase nonresident enrollment

Recommendations for Longer-Term Adoption under Certain Circumstances:

7. Advocate for federal Pell Grant augmentations
8. Examine faculty compensation plans
9. Allow for possibility of differential tuition by campus

Working Group First Round Recommendations

Funding Strategies

Recommendations for Immediate Adoption

Recommendation 1: Develop a multiyear advocacy campaign aimed at grass roots opinion leaders throughout the State of California to foster public and political support for the University as a major priority for state funding.

This campaign would:

- Educate local public opinion leaders (e.g., media, business, non-profit, and other organizational leaders) throughout California about the contributions UC makes.

- Send the message that UC educates outstanding future citizens and employees; UC generates new ideas, innovations, and inventions that create new businesses and that nourish existing ones; and UC assists in improving operations and service delivery for government and non-profit institutions. In sum, UC helps make California the "Golden State."

- Use multiple media and methods including speakers' bureaus, e-advocacy, social media, large-scale events in Sacramento and elsewhere, and meetings with politicians, legislators, and opinion leaders.

- Get political by giving advocates the tools to be engaged with elected officials and candidates for office on an ongoing basis, demonstrating that UC has a political constituency that matters to them.

<u>Rationale:</u>

- *Public institutions must have the backing of those who pay taxes to support it.* In an era when term limits provide only a short period of time for the state's elected officials to understand and react to changing economic circumstances, it is critical to maintain a public base of support that will persist for more than the two-, four-, or six-year terms of state office-holders. UC must better communicate its value to all Californians and derive more public support from those who benefit from its services.

- *Activism is strongest at the local level.* UC must appeal to the real interests of local citizens and governmental leaders. By listening to the needs of these individuals and translating those needs into problem-solving actions, UC can reposition itself as a partner in their efforts to succeed as citizens and leaders.

- *Political leaders can gain from a relationship with UC.* Legislators, governors, mayors, local council members and everyday citizens can all benefit from knowledge and experience that resides within UC's walls. A concerted effort to listen to their issues and develop real-time answers to help address their problems can have a direct impact on the priority placed on providing adequate funding for UC.

Impact on Access:

- *State funds help maintain affordability at UC.* Affordability is highly valued at UC. Every fee increase in the last 20 years, with the exception of 2007-08, has been in response to budget shortfalls caused by the state's disinvestment in UC. Turning this trend around will help preserve quality *and* affordability, the twin pillars of excellence that characterize UC.

Impact on Quality:

- *The decline in state funding has a direct impact on the quality of education UC provides.* The average expenditure per student for a UC education has declined over 19 years by 25%. Without state funds, the challenge of supporting adequate salaries, maintaining a competitive student-faculty ratio, and providing adequate classes for timely completion of degrees remains immense. These functions require ongoing, stable sources of funding. While there is always room for improvement in terms of attracting other fund sources, the ability to provide the core programs that comprise the University's basic missions remains heavily reliant on state funding.

- *UC provides a vital and lasting contribution to the state's economy and the quality of life of its citizens.* Because of the core support provided by state funds, UC is able to train the workforce and provide the knowledge and research California needs to stay on the cutting edge of discovery and innovation. This, in turn, helps stimulate job growth and has a direct impact on the state's economic recovery. But UC's contributions to the state are far more broad. They include development of a health care system that provides research and care for those with the hardest illnesses to treat, assistance to K-12 schools to help improve the quality of instruction and expand educational opportunities, and discoveries and best practices for the agriculture industry, among others. If the public gains a greater understanding of the important role UC plays in everyday life and is able to signal their support for UC, the state's disinvestment in UC could be reversed.

Fiscal Implications:

- *An advocacy campaign could be costly.* The campuses and the Office of the President are already engaged in a wide range of advocacy activities, largely drawing on the engagement of alumni and other volunteer advocates. But expanding those efforts and breaking through the clutter of the modern communications environment to reach a wide audience of everyday Californians – those for whom the University does not have built-in communications mechanisms – would be costly. An intermediate strategy, recommended as a starting point here, is to focus on reaching local opinion leaders by working outwards from UC students and alumni to local communities. Key contacts and networks of students and alumni, supplemented by Internet research, could be used to identify local people and organizations (Chambers of Commerce, fraternal and business organizations, non-profit organizations) that could provide forums where UC faculty, students, alumni, or staff could present UC's message. This approach would be much less costly than a campaign to reach the mass public, and it would probably have a much greater impact for each dollar invested.

- *However, some exploration of a broader-based campaign may be a good idea.* This could involve focus groups and polling to identify the issues and messaging most resonant with particular audiences. Outside professional assistance would likely be needed to provide expertise in key areas such as polling, advertising, and event management. Paid media would likely need to play a role in an effective broad-based campaign. A campaign with these elements could cost several millions of dollars in the first year alone, and any campaign would need to be sustained to be truly effective. Appropriate non-state sources of revenue would need to be identified to fund these activities.

- *Inability to turn around the state's disinvestment could be devastating.* Recent studies commissioned by the Regents have shown that funding for basic costs at UC will skyrocket in the coming decade. Funding will need to increase from all sources – state and non-state – to meet this need. Failure to achieve additional state funding could be disastrous.

Challenges:

- *Development of an adequate campaign infrastructure.* In addition to the challenges associated with funding for such an effort, a grass roots campaign targeted at opinion leaders would need to develop organizational vehicles (e.g., grassroots organizations, etc), to find qualified strategists, to mobilize volunteers, and to make sure that various independent activities were adequately coordinated.

- *Development of campaign messaging.* The University already has developed and implemented messaging focusing on the institution's impact on the economy, health, and quality of life of California. Research is available on such topics as the life-time earnings of its students, regional economic impacts of the campuses, efficiency of the University in getting students to a four-year degree, and other issues. But additional issues meaningful to local opinion leaders in California would need to be identified and crafted in ways that are simple and persuasive.

- *Doing it the UC Way.* A campaign for UC should not be just another political campaign, it should adhere to the highest standards of scholarship, service, and teaching.

- *Internal constituencies need to be educated and "buy in" to the campaign.* In the last several years, notes of discord have been heard from various internal constituencies (students regarding fee increases, faculty regarding priority setting, etc.). A major element within the advocacy campaign should be the education of UC's family of faculty, students, and staff to ensure that we share a common message and join together in a common goal of changing the priority the state places on adequate funding for higher education.

Next Steps for Implementation:

- *Develop a common understanding of activities already underway.* The advocacy network at the Office of the President and on the campuses has been greatly enhanced recently and many programs are already underway – email and letter-writing campaigns, visits of UC-supportive delegations to Sacramento, increased use of social media, joint forums with legislators on policy issues important to the state, and more. The first step in the grass roots opinion leaders advocacy campaign would be to develop an outline of all these activities so that leadership is well-informed and an expanded campaign can be developed.

- *Develop recommendations for how to expand existing efforts.* The campaign envisioned here would go beyond existing efforts and seek to reach much larger numbers of Californians, educating them about what the University contributes to the state as a whole. A variety of activities will need to be further developed to achieve this higher level of public engagement – events, speakers' bureaus, advertising, expanded use of the web, and more. The content of this campaign would need to be designed, with a careful eye to the balance of activities best done at the campuses and those best done by the Office of the President.

- *Develop a plan for funding a major advocacy campaign.* A grass roots opinion leaders advocacy campaign will require activities at both the system wide and campus levels. It will be important to develop a plan for funding an ambitious effort that over time will help turn the tide of public opinion toward a call for adequate support for higher education as a basic value in California.

<u>Other Options Considered:</u>

- *Establishing a funding guarantee through legislative initiative or constitutional amendment.* Budgeting by ballot is very challenging, in terms of receiving public support. While Proposition 98 has been very successful for K-12 schools and community colleges, it remains unclear how successful future attempts to tie up the state budget would fare in an election, although it is noted that guaranteed funding for stem cell research was widely approved fairly recently. Both issues benefited from a wide political support base, which the University must still develop. Also, it is unclear how enforceable it would be in bad fiscal times if the Legislature and Governor can suspend it with a 2/3 vote. If an appropriate nexus could be found between an identified funding source and UC or higher education, and if the groundwork has been laid for an effective grass roots advocacy campaign, the idea may be worth pursuing and should remain under consideration as the grassroots opinion leaders advocacy campaign is developed.

- *Increased reliance on specific stakeholder partnerships – e.g. business, labor.* This is a high priority for the University – we can't turn around state support alone. Representatives from business, labor, alumni, agriculture, entertainment, Silicon Valley, other science and energy partners, health sciences, and the national labs are the spokespeople who help influence opinions – it is no longer political leaders who do this in California. It will be important to involve these stakeholders in UC's effort to gain public attention and renew support for UC as a priority for state funding. This is a critical element of the grassroots opinion leaders advocacy campaign.

- *Seek reestablishment of the Higher Education Compact Agreement with the Governor and/or Legislature.* While it is believed that the Compact is a good statement of the *minimum* resources UC should receive from the state, it is clear such an agreement is not enforceable in bad economic times, so it provides no certainty for planning purposes. More importantly, the previous Compacts lulled UC into thinking it could rely entirely on "elite bargaining" (UC staff working behind the scenes with key government staff) instead of developing effective grass roots lobbying to build more widespread support.

- *Secure explicit support for increased revenues and/or earmarked revenues.* While it is believed that identifying a dedicated fund source for higher education sends a message that UC is important to the state, it is also believed that without a constitutional guarantee of some maintenance of effort, such funding is not likely to be additive, especially in bad economic times. For example, the state could simply take away existing state General Funds and substitute the newly designated sources. Additionally, it fails to make the case that higher education is so important that it should be funded out of the general budget. There is also the possibility that the tax source might dry up or create significant opposition to UC among those who are taxed. UC could fare better with a general tax increase. Research shows UC drives the economic engine that fuels the state's economy – $1 invested in UC leads to $4 in return for the state because fewer people go to prison, fewer people rely on welfare, fewer people need social services, etc. (See *Return on Investment: Educational Choices and Demographic Change in California's Future*, Survey Research Center, University of California, Berkeley,).

- *Redirecting state funding away from specific other state programs, e.g. prisons, health & welfare programs.* The Governor's proposal to sponsor a constitutional amendment that would reverse the proportion of state funding spent on prisons vs. that spent on higher education is extremely helpful in framing a public debate on the state's funding priorities. The state should be questioning why so much more is spent on prisons than on higher education. Such a debate could be particularly effective if carried out by third parties on behalf of the University. However, a direct confrontation with another state entity, particularly one that is well-funded from special interests, may not result in more funding for UC.

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Recommendation 2: Design and implement a system to identify, promote, and adopt the best administrative practices within the UC system.

- Mechanisms need to be established to facilitate the acquisition and adoption of best practices throughout the system. Additionally, mechanisms need to be established to motivate and reward the campuses and other UC locations to implement best practices. Finally, chancellors, other leaders, and their staffs need to be measured on the implementation and encouragement of best practices.

- Work groups should be formed to analyze each of our core business operations: Finance, Human Resources, IT, Energy, Space Management, Student Services, and Procurement. This must be done with a clear mission to determine timeliness and effectiveness of current operational models. Those models that are outdated and/or no longer serve our needs need to be ramped-down, replaced, or eliminated.

- Fiscal efficiency metrics should be incorporated into all administrative reviews. Currently the revenue-based funding model results in a review system oriented towards asking what funds were spent on, not how effectively they were used and whether the core mission was addressed.

<u>Rationale:</u>

- *Administrative activity pervades any large organization, especially complex public research universities.* Significant faculty and staff effort is required to manage academic departments, research units, libraries, student service activities, operation and maintenance of plant, campus-wide and system-wide administration, fiscal operations, logistical services, and community relations. Costs not directly related to research and teaching (herein called administrative costs) are estimated to be as large as 25-30% of that which is funded by UC core funds. While recent actions have been made to reduce these costs, they remain substantial.

- *Our funding model may be misaligned with our efficiency goals.* While we decry across-the-board cuts at campuses, they serve as the basis for UCOP's incremental funding of campuses. Administrative funding should reward efficiencies and best practices, similar to the manner in which quality research is rewarded.

<u>Impact on Access:</u>

- *A penny saved is a penny earned.* To the extent that administrative costs can be reduced and operations improved, resources will be preserved for other functions, including access and affordability efforts.

<u>Impact on Quality:</u>

- *Cost-cutting <u>cannot</u> mean quality-cutting.* The manner in which additional administrative budget reductions are pursued will have a dramatic influence on the quality of the

University of California. Unless we adopt practices that acknowledge quality as a primary measure of both academic programs ***and*** administrative operations, lackluster administrative systems will degrade our academic performance.

Fiscal Implications:

- *It can work for UC.* When the University of Texas System enacted a shared-services model to improve administrative efficiencies, $250 million in value was added to system operations. The "Carolina Counts" program at UNC, focused on operational efficiencies, expects to deliver $90 - $160 million dollars of ongoing operational savings within five years. Most recently, UC Berkeley expects to generate tens of millions of dollars in annual savings as a result of administrative improvements suggested by external consultants Bain & Co. There is no reason to expect that similar results, scaled to the UC system, could not be delivered as well through the pursuit of an administrative efficiency framework.

- *There are opportunities for quick wins.* Most immediately, the sharing of best practices within the UC system should translate into substantial benefits quickly, given that these practices have already been proven within the system. This should not be costly to implement. In addition, a transition to common systems and programs would eliminate the inefficiencies that result from each campus managing independent systems. A report from the UC Work Group on Administrative Efficiencies titled "Building Administrative Efficiency – July 2008" has already identified potential strategies for streamlining processes and collaborating among locations to achieve tens of millions in cost savings.

- *Intangible benefits are significant.* While measureable savings are likely attainable, a substantial benefit can also be achieved through improvements in quality of services, given the deep cuts service units have experience to-date.

- *The budgeting model matters.* Ultimately, switching to a cost-based rather than the current revenue-based budgeting model will not only allow wiser decisions to be made regarding use of funds, but it will also render the impact of unfunded mandates fully transparent.

Challenges:

- *We must follow through.* We recognize that many of the administrative efficiency initiatives called for in this recommendation have appeared in previous UC white papers ("*Monitor Group Report to the Regents: University of California Organizational Restructuring Effort"; "UC 2025: The Power and Promise of Ten"; "Building Administrative Efficiency";* and most-recently, though focused on a single campus, the Berkeley-commissioned "*Operational Excellence" report.)* While we excel at producing reports, we have not excelled at implementation. Significant improvements in administrative efficiencies must be driven with the highest level of support, including the President, the Chancellors, and other senior leadership.

- *There is a time and place for campus autonomy.* The culture of the UC system does not strongly encourage each campus to collaborate with other campuses in such seemingly pedestrian but costly areas as IT support, administrative systems, and policies. By focusing too intently on the need for each campus to maintain autonomy and academic freedom, we have allowed "free range" and independent administrative systems.

Next Steps for Implementation:

- *Appoint a small staff to quickly identify best practices in UC and among other large universities.* As an example within the UC system, UC Berkeley has employed Bain Consulting to help drive "Operational Excellence" within the campus. A comprehensive implementation plan is in place. This seems to be a useful rubric for other campuses. UC Davis has also recently announced a similar initiative. Undoubtedly, other campuses have examples to be shared and emulated.

- *Speed is essential.* It is strongly encouraged that each campus appoint a key person (e.g., Vice Chancellor for Admin) to begin now to engage with his/her counterparts with the intention of defining a best practice sharing plan by June. A senior official within UCOP should be appointed to join in this effort. Such review could also be assisted by appointing an all-campus review team to visit each campus in both the collection and eventual dissemination of best practices.

- *We know what areas to work on.* Teeing off of work from UC Berkeley's Bain report, the focus of these best practices should be in the following areas: Finance, Human Resources, IT, Energy, Space Management, Student Services, and Procurement. Particular attention should be paid to those administrative services that are in direct support of academic and research activities as not all administrative functions occur in conventionally defined administrative departments.

- *There is often no better motivation than sunshine.* It is recommended that the chancellors report periodically to the President on the actions that they and their teams are taking, and the results attained. It is further recommended that the President periodically report the accomplishments and/or failures to the Board of Regents.

- *Accountability must also be positive.* Reward/recognition systems aimed at driving administrative efficiencies are to be encouraged at each campus.

Other Options Considered:

- *Large-scale common support systems.* Several studies have noted the inefficiencies from non-standardized support systems throughout the system. Lack of commonality not only is expensive, it inhibits collaboration. Designing and implementing such large-scale common systems is expensive and time consuming, but at a minimum there should be a definition of standards for such support systems so that any future systems development enhances long-term commonality.

- *Use the Commission momentum to prioritize and promote existing efforts as well as new ideas.* Provide greater support to current initiatives for collaboration and system improvement (e.g., PPS review, campus work on the development and adoption of Kuali systems). Out-of-the-box solutions will almost certainly be required, such as the adoption of shared-service models to improve efficiency of non-core business functions (such as payroll), regional IT server centers, and centralized administrative functions at the campus level to eliminate duplication across academic departments/colleges/centers/etc.

- *Keep longer-term transformational change in mind.* UC should evaluate longer-term and more systemic quality/cost endeavors, such as Six Sigma, but this should not interfere with the adoption of the above recommendations.

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Recommendation 3: Revise practice and policy on charging indirect cost recovery for non-federally funded research.

- Establish uniform and consistent policy and practice throughout the University of California to fully recover the fair share of indirect costs associated with non-federally funded research.

Rationale:

- *Total cost recovery.* Externally-funded research in the University of California is supposed to be conducted under the accounting principle of total cost recovery, including indirect costs. The indirect costs are intended to recover the facilities and administrative costs attributable to research.

- *Core funds subsidize research.* For a variety of historical reasons and local campus practices, indirect costs charged to non-federally funded research projects – those funded by the State of California, foundations, gifts, and corporations – do not fully recover the costs of research conducted for these agencies. Hence, the university subsidizes this research with core funds. This can be rationalized in times of ample budget in fulfilling one of our primary missions – research. It cannot be rationalized in times of insufficient core budget to fulfill one of our other primary missions – teaching.

Impact on Access:

- *Shift burden away from student fees.* As with any revenue-generating strategy, improved recovery of indirect costs associated with non-federal research could reduce need to raise student fees.

Impact on Quality:

- *Make more educational investments possible.* This strategy could free up core funds that could be re-directed to improving quality of education.

Fiscal Implications:

- *Significant potential.* The Research Strategies Work Group has taken the lead on this issue. Preliminary estimates are that current policies and practices of recovering indirect costs on non-federally funded research throughout the University of California are currently leading to the use of core-funds to subsidize this research in the range of more than $300 million per year.

Challenges:

- *State-funded research.* California state-funded research is charged an indirect cost recovery (ICR) rate that is less than half that charged to federal. Part of the rationalization of this is that the state already pays for facilities (although federal ICR rates are already discounted by this as well) and part of the faculty salaries engaged in research. Moreover, some research projects have special arrangements and limitations on ICR as part of the original funding conditions. Changing this will require considerable negotiations with the state.

- *Understanding among the faculty.* Faculty in general do not realize that ICR does not fully recover the costs of doing research, and indeed believe they already do not receive their “fair share” of the ICR for attracting the research funds to the campus in the first place. Hence, there are widespread practices of trying to waive or reduce overhead on non-federally funded research to more fully utilize any research funds for direct research expenses. The belief that the research “pie” is fixed and that the more that goes to ICR will mean less for direct research expenses will be difficult to overcome.

- *Differing effects on different disciplines.* There may be equity issues – perceived and real – among faculty in different disciplines. For example, faculty in the humanities and social sciences who receive funding from foundations without ICR may regard such changes as a “take-away” and question whether ICR should be the same for “laboratory” and “non-laboratory” disciplines.

<u>Next Steps for Implementation:</u>

- *Support the Research Strategies Workgroup.* As noted above, the Research Strategies Work Group has taken the lead on this issue. Our role will be to provide review and coordination with the resulting recommendation that arises from this effort.

<u>Other Options Considered:</u>

- None.

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Recommendation 4: Improve indirect cost recovery rates with federal agencies.

- Develop a system-wide team to negotiate Indirect Cost Recovery rates for the University of California campuses with federal agencies

Rationale:

- *Total cost recovery.* Externally funded research in the University of California is supposed to be conducted under the accounting principle of total cost recovery, including indirect costs. The indirect costs are intended to recover the facilities and administrative costs attributable to research. However, Indirect Cost Recovery (ICR) rates on federally-funded research at the University of California campuses does not fully recover the costs of research, and falls on average 25% short of full recovery.

- *Disparities among funding agencies.* Not all federal agencies provide the same ICR rates to the same campus. Additionally, we fall 5-10 percentage points behind some of our comparator institutions in ICR rates with the same federal agencies.[†]

- *Dedicated negotiating team.* While there are number for reasons for the disparities, best practices at comparator institutions include the establishment of a permanent government costing group dedicated to proposal development and negotiation, typically 3-8 FTE's plus consultants. In contrast, the ICR negotiations are done at UC on a campus-by-campus basis, often with a small temporary team drawn from existing offices (budget and planning, accounting, research, etc.), putting us at a distinct disadvantage with seasoned negotiators from the federal government.

Impact on Access:

- *Shift burden away from student fees.* As with any revenue-generating strategy, improved federal indirect cost recovery rates could reduce the need to raise student fees.

Impact on Quality:

- *Make more educational investments possible.* This strategy could free up core funds that could be re-directed to improving quality of education.

Fiscal Implications:

- *Significant potential.* The Research Strategies Work Group has taken the lead on this issue. Preliminary estimates are that we are 5-10 percentage points behind our comparator institutions in ICR rates, and recover 75% of facilities and administrative

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[†] For instance in FY 2010, UC campuses range from 51.5% to 54.5%, whereas University of Illinois and SUNY Buffalo are 58.5%, Stanford is 60%, Harvard is 67% and MIT is 68%.

costs attributable to federally-funded research. Increasing ICR rates by just 5% across UC could generate more than $70 million per year.

Challenges:

- *Understanding among the faculty.* Faculty in general do not realize that ICR does not fully recover the costs of doing research, and indeed believe they already do not receive their "fair share" of the ICR for attracting the research funds to the campus in the first place. The belief that the research "pie" is fixed and that the more that goes to ICR will mean less for direct research expenses will be difficult to overcome.

- *Multiple funding agencies involved.* Campuses deal with different federal agencies to negotiate their ICR. A permanent team will either have to consolidate negotiations with one agency or deal with several. Obtaining the best federal negotiator for UC is not a given.

- *Campus autonomy.* Some campuses already have designated teams for negotiating with federal agencies and may resist a system-wide team.

Next Steps for Implementation:

- *Support the Research Strategies Workgroup.* As noted above, the Research Strategies Work Group has taken the lead on this issue. Our role will be to provide review and coordination with the resulting recommendation that arises from this effort.

Other Options Considered:

- None.

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Recommendation 5: Adopt a multiyear strategy to replace student fees with tuition, generate new revenue to protect academic quality, and strengthen university planning.

- The Regents currently approve the UC operating budget and student fee levels on an annual basis. At present, there is no established multiyear plan or policy governing the projected levels of student fees. In past years, the Higher Education Compact Agreements and the Higher Education Partnership Agreement established limits on annual increases, but did not establish specific projected levels of student fees. As a result, the university lacks a basic input into its multiyear budget and enrollment planning. In addition, students and parents have no reliable basis with which to estimate future costs.

- Mandatory system wide fees consist of the Education Fee and the Registration Fee. The names of these fees are legacies from their establishment in the 1960s. The current use of the revenue from these fees differ significantly from the original purposes for which they were established. These revenues are now used to support the basic academic program (including faculty salaries and benefits), student services, student financial aid, and the university administrative structure – uses that are commonly supported by tuition at other universities. The use of the term "student fees" has also made it difficult for the university to qualify students for some forms of federal financial aid that will pay tuition but not student fees.

This recommendation would:

- Replace the existing Ed Fee and Reg Fee with a single tuition.
- Increase tuition levels under a multiyear plan to protect academic quality.
- Integrate the tuition plan with a multiyear budget and other planning activities.

<u>Rationale:</u>

- *Change misleading nomenclature.* The current use of the term "student fees" is misleading, implying that the fees pay for specialized or optional services. The term "tuition" more accurately describes the actual use of the revenue, which is to support academic programs, student services, student financial aid, and administrative services. In addition, the use of the term "student fees" has proved to be a barrier for establishing eligibility for some forms of federal student financial aid.

- *Simultaneously maintain focus on state funding.* This strategy must be combined with vigorous advocacy efforts to protect and increase state funding, and to reduce operating costs through academic and administrative restructuring efforts.

- *Utilize market headroom.* Notwithstanding recent major increases in student fees, the University of California remains a significant value within the marketplace of leading universities. At least in the short run, there is significant room to increase tuition levels without significant negative impacts on projected enrollment or access for students from low-income families. This market headroom, however, is likely more constrained for nonresident students than for California resident students.

- *Create an integrated planning framework.* The Regents, UCOP, and campuses lack a consistent framework for integrating planning for the budget, student access, employee compensation, and campus operations. A multiyear budget and tuition framework would better integrate these efforts.

- *Exhibit interconnectedness with the state.* A multiyear budget and tuition planning framework could strengthen UC's partnership with the State of California, to the extent that the plan could clearly demonstrate the relationship of state funding and planned tuition increases to the attainment of state objectives for higher education.

- *Increase predictability.* Adopting a broadly supported multiyear plan for tuition increases may allow for more predictable increases for students and parents, but would not constitute a tuition guarantee.

- *Look to successful precedents.* Multiyear tuition projections, coupled with annual Regental approvals, has proved effective for graduate professional programs.

- *Continue to address affordability.* Impacts of tuition increases on access and affordability could be effectively addressed through financial aid mechanisms.

<u>Impact on Access:</u>

- *Effect on middle class.* Increased tuition would place a higher financial burden on many California families. Federal, state, and UC financial assistance would defray much of the impact on lower income students, but middle class students and families would likely bear increased costs.

<u>Impact on Quality:</u>

- *Protect quality.* Because California fiscal experts agree that the state's severe fiscal problems are likely to persist for several years, the Regents should be prepared to approve tuition increases sufficient to contribute significantly to the University's funding needs, thereby protecting its academic quality.

<u>Fiscal Implications:</u>

- *Low increases.* 5% annual increases for five years would increase tuition for resident undergraduates from $10,302 in 2010-11 to $13,148 in 2015-16. Tuition for nonresident undergraduates would increase from $33,181 to $36,027. This option would generate $445 million over five years, net of aid.

- *Moderate increases*. 10% annual increases for five years would increase tuition for resident undergraduates to $16,591 in 2015-16. Tuition for nonresident undergraduates would increase to $39,470 in 2015-16. This option would generate $983 million over five years, net of aid.

- *Aggressive increases.* 15% annual increases for five years would increase tuition for resident undergraduates to $20,721 in 2015-16. Tuition for nonresident undergraduates would increase to $43,600 in 2015-16. This option would generate $1.63 billion over five years, net of aid.

- *Nonresident enrollment held constant.* These revenue estimates assume no change in the level of nonresident enrollment. Under the more aggressive scenarios, it might be necessary to reduce nonresident tuition to maintain competitiveness, which would reduce net revenues.

- *Return-to-aid held constant.* These revenue estimates assume that no increase in return-to-aid would be required in order to maintain access for low- to moderate-income students. If increased return-to-aid became necessary in order to address access problems, net revenues would be reduced.

- *Tuition is not a sole solution.* It is important to note that even under the most aggressive option, current UC priorities would not be fully funded by increases in tuition alone. Attaining current (and future) UC priorities would require not only increased tuition revenue, but also increased state funding and cost savings realized through academic and administrative restructuring efforts.

<u>Challenges:</u>

- *Continue to pursue state funding.* Adoption of a multiyear tuition plan cannot be construed as implying a reduced commitment to state funding for the university's public mission. Development of a multiyear plan by itself will not guarantee that the state would be willing or able to increase its financial support for UC core operations.

- *Enrollment and other impacts.* Depending on the rate at which tuition would increase, tuition levels may reach the point where they would begin to have an impact on less selective campus's ability to meet enrollment goals. Under the current system of uniform tuition for all campuses, this could limit the future revenue capacity of the more selective campuses. The potential impact of significant sustained tuition increases on student demand at individual campuses, quality of the admit pool, and affordability are not well understood.

- *Complex implementation.* The development of a multiyear plan is complex, involving the integration of strategic planning, academic planning, budget planning, student enrollment management, tuition setting, financial aid, and resource allocation models.

- *Avoid guarantee misunderstanding.* Approval of a multiyear tuition plan cannot be construed as a fee guarantee for students and parents.

- *Avoid Reg Fee misunderstanding.* The consolidation of the Registration Fee could be perceived as a "take-away" of funding for student services; this will require some mechanism to retain student involvement in the distribution of part of the tuition for student services.

Next Steps for Implementation:

- *Establish planning model.* Further refinement of existing budgetary and tuition planning models would be required.

- *Conduct market study.* Complete a professional marketing analysis regarding student demand, price elasticity, and the potential impact of tuition increases on enrollment, quality, and access.

Other Options Considered:

- *Cohort-based tuition.* We examined and discussed a recommendation from the Access and Affordability Workgroup. This recommendation would establish funding guarantees for entering cohorts of undergraduate students. Generally, we felt that while cohort-based tuition could be incorporated into a multiyear tuition plan, uncertainty regarding state funding would expose the university to substantial financial risk under such a plan. A cohort-based approach would reduce the University's flexibility to respond to budget changes and thereby expose affected cohorts to greater tuition hikes.

WORKING GROUP FIRST ROUND RECOMMENDATIONS

Funding Strategies

Recommendation 6: Increase enrollment of nonresident undergraduates.

- At present, the University of California enrolls 7,600 nonresident undergraduate students, constituting 4.5% of the University's 2007-08 budgeted undergraduate enrollment. In addition to all other system wide mandatory fees, most nonresidents also pay nonresident tuition, currently set at $22,879.

- This recommendation would substantially increase the enrollment of nonresident undergraduates over a five-year period. There are two options. Both would increase enrollment of nonresident students by an additional 7,600 students (100%) by 2015-16.

- The first option would add nonresidents as replacements to existing California residents who are enrolled above the 2007-08 enrollment targets. The state currently provides no funds for these so-called over-enrolled students. By substituting nonresidents for residents, instructional costs would remain unchanged, but the university would gain an additional $22,879 in tuition revenue per student.

- The second option would add nonresidents but maintain the existing level of overenrolled California residents. Like the first option, the university would receive additional nonresident tuition revenue, but these gains would be offset by additional instructional costs.

- This recommendation also anticipates that there would be no increases in the level of nonresident tuition. Nonresident students would pay the increases in system wide tuition, but nonresident tuition would be kept flat in order to prevent UC from pricing itself out of the marketplace. Specifically, total tuition paid by nonresidents would be limited to $5,000 under the levels charged by Harvard, Stanford, and similar institutions. Under some models calling for more aggressive increases in resident tuition, this would require actual reductions in the level of nonresident tuition in future years.

Rationale:

- *Revenue generation.* Increasing the enrollment of domestic and international nonresident undergraduates would generate a major increase in revenues for support of the academic program for California residents.

- *Positive impact on the state.* Increased nonresident enrollment would attract talented students to California, many of whom would choose to stay after graduation, a strategy that the University of Michigan has used for years to great effect.

- *Market headroom.* There is some headroom for increases in charges paid by nonresidents, but this headroom will be taken up solely by increases in system wide mandatory tuition.

- *Success at comparator institutions.* UC enrollment of both domestic nonresident students is lower than many flagship public universities in other states, and enrollment of international students is lower than many private institutions. Notably, all four of UC's public comparison institutions enroll a greater proportion of nonresident students. More than 30% of the undergraduate students at the University of Michigan and the University of Virginia are nonresidents.

Impact on Access:

- *Protecting racial diversity.* Increasing the number of nonresidents enrolled at UC campuses would enhance geographic diversity, but we would need to be vigilant to ensure that it does not have a negative impact on racial diversity.

Impact on Quality:

- *Improved admit quality and student body diversity.* Because nonresident applicants to the University will be held to academic standards that are at or above the standards required of resident applicants, increased nonresident enrollment would strengthen the overall academic quality and diversity of the UC student body by drawing from a larger pool of highly qualified applicants.

- *Enhanced worldwide reputation.* Increased nonresident enrollment would enhance UC's reputation as a national and international university.

Fiscal Implications:

- *Option 1:* Adding 7,600 nonresident students as replacements for existing resident students would generate $174 million in nonresident tuition revenue, with no new instructional costs.

- *Option 2:* Adding 7,600 nonresident students but maintaining the existing level of overenrolled California residents would generate $174 million in nonresident tuition, but this gain would be offset by an estimated $76 million in new instructional costs, for a net gain of $98 million. Instructional costs are estimated at $11,000 per student, the current level of state support under the marginal cost of instruction funding formula.

- *Revenue potential mitigated by possible tuition discounting.* These estimates represent gross tuition revenue. Net revenue could be substantially less, depending on the amount of tuition discounting needed to attract highly qualified applicants.

Challenges:

- *Recruiting infrastructure.* All campuses would need to build the infrastructure to recruit more nonresidents. At present, UC campuses do very little to recruit nonresident students.

- *Revenue potential limited by return-to-aid.* A portion of the revenue would need to support financial aid.

- *Perception issues.* Students, elected officials, and the public may perceive that UC is reducing access to California residents.

Next Steps for Implementation:

- *Assess campus readiness.*

- *Market analysis.* Conduct professional marketing study to establish more specific estimates of the amount of market headroom for nonresidents.

Other Options Considered:

None.

Working Group First Round Recommendations

Funding Strategies

Recommendations for Longer-Term Adoption under Certain Circumstances

Recommendation 7: Advocate for a Pell Augmentation Grant to Institutions ("Pell PLUS")

- If UC continues to face severe state disinvestment, and its efforts on operational efficiencies and increased revenue generation fail to close budget gaps, UC may have a heightened motivation and a stronger argument for an increased role of the federal government in funding university operations.

- *Background.* The federal government's traditional role in supporting higher education has primarily entailed:

  (1) Providing direct and indirect funding to institutions for the support of basic research.

  (2) Promoting access for low-income undergraduate students in the form of grants, loans, and work study programs.

  (3) Partially funding core operations at certain institutions serving highly disadvantaged populations.

- *Core operations precedent.* With respect to (3) above, Historically Black Colleges and Universities (HBCUs), Tribal Colleges and Universities, and more recently, some Hispanic-Serving Institutions (HSIs) have benefitted from federal support for core operations, in recognition of the special role they serve with respect to low-income students. However, four-year public institutions that serve large populations of low-income students are enrolling and graduating more disadvantaged students than the HBCUs, Tribal Colleges, and HSIs combined. Unfortunately, these institutions are facing pressure to admit more "full paying" students as states withdraw taxpayer funding from these enterprises.

- *Graduation Rate Component.* Because of reputation, high admission standards, and highly effective academic support programs, most UC campuses graduate low income students at almost the same rates as other students (80% for Pell Grant recipients versus 83% for all students). Other less selective public four-year institutions enroll higher proportions of Pell students, with wider ranges of academic preparation levels, and have graduation rates that are often below 50%. Academic support programs *at all colleges and universities are impacted by current budgetary constraints.* In order to maintain UC's ability to enroll and graduate high proportions of low-income students, and to improve the graduation rates at other institutions, additional funding for core instructional programs is required. The federal government would be well served to protect its investment in Pell Grants by ensuring that institutions do not simply *enroll* but also *graduate* Pell Grant recipients and receive the institutional support they need to keep their doors open to these students.

Four-Year Public Institution	% of UGs with Pell Grants	% of UGs who graduate within six years	Pell enrollment of at least 25% and six-year grad rate of at least 50%
UC Berkeley	30%	90%	Yes
UC Davis	32%	81%	Yes
UC Irvine	26%	81%	Yes
UCLA	32%	89%	Yes
UC Merced	40%	n/a	Yes
UC Riverside	40%	64%	Yes
UC San Diego	32%	85%	Yes
UC Santa Barbara	24%	81%	No[1]
UC Santa Cruz	26%	72%	Yes
Cal Poly SLO	15%	69%	No
Cal Poly Pomona	32%	50%	Yes
CSU East Bay	30%	44%	No
CSU Long Beach	31%	55%	Yes
CSU Fresno	40%	48%	No
CSU LA	55%	31%	No
CSU Northridge	45%	41%	No
CSU Sacramento	33%	41%	No
CSU Stanislaus	40%	53%	Yes
U. Michigan	13%	88%	No
U. of Florida	19%	82%	No
U. of Illinois	16%	82%	No
U. of Minnesota	17%	66%	No
SUNY Buffalo	26%	62%	Yes

SOURCE: IPEDS, 2007-08.

[1] Due to increases in the Pell Grant maximum since 2007-08, we expect that the percentage of Pell recipients at all UC campuses will equal or exceed 25% in 2008-09 and in the future.

- *Extend core operations support.* We are proposing that federal support for institutions enrolling large numbers of disadvantaged students be extended beyond HBCUs, Tribal Colleges, and HSIs to include additional public institutions that are successfully enrolling *and graduating* these students. Absent this infusion of federal dollars to replace diminished state core funding to bachelor's degree level (and higher) universities, the major public institutions in this country will be forced to concentrate their admissions efforts on a larger percentage of "full payers" in order to cross-subsidize the inclusion of lower-income students for whom state funding no longer provides support.

- *Award concept.* Under this recommendation, the federal government would incentivize higher education institutions to admit and graduate more low-income students by providing institutions with "Pell PLUS" augmentations associated with their Pell Grant enrollees. While the primary Pell Grant would still be assigned to the individual student, the Pell PLUS award would be assigned to the institution.

- *Award eligibility.* Under the Pell PLUS, institutions that demonstrate that they are enrolling and graduating Pell Grant recipients would be considered eligible for (but not entitled to) Pell PLUS institutional augmentation grants. In order to be eligible, an institution should be able to demonstrate that at least 25% (or FTE equivalent) of undergraduate degree-seeking students and post baccalaureate teacher training candidates enrolled are Pell-eligible and that the institution's six-year graduation rate is at least 50%.

- *Award criteria.* After eligibility is established, additional measurable objectives should be considered as the basis for Pell PLUS. The metrics would assure that federal funds are targeted and would also limit the overall cost of the program. Such metrics might include:

  (1) Average federal student loan debt among Pell Grant recipients and their parents.

  (2) Average non-federal student and parent education loan debt among Pell Grant recipients and their parents

  (3) Year-to-year persistence rates among Pell Grant recipients

  (4) Post-graduation metrics for Pell Grant recipients such as rates of employment, enrollment in graduate or professional school programs, teacher training programs, military, Peace Corps, etc.

- *Qualitative factors could also be considered*. Factors could include rigor of the academic program, level of support for community college transfer articulation agreements, and maintenance of effort in state student grant programs. The mix of quantitative and qualitative metrics provides the federal government with awarding flexibility.

- *Award calculation.* Pell PLUS awards would recognize institutions that successfully graduate Pell Grant recipients closest to "normative time to degree" for the particular degree objective (five-year engineering programs would not be expected to produce graduates on a four-year time table, for example.) The largest Pell PLUS awards would be available to institutions that meet the 25% Pell enrollment threshold and that produce the greatest percentage of graduates in periods of time closest to full-time degree completion rates. Basic guidelines for this could include the following:

  - For public degree-granting institutions with six-year graduation rates of at least 70%, the annual institutional Pell PLUS award will equal at least a 50% "add-on percentage" of the student portion of the Pell Grant. For example, a Pell Grant in the amount of $1,000 to the student would also result in an additional award of $500 to the institution.

  - For public, degree-granting institutions with six-year graduation rates between 50-69%, the annual institutional Pell PLUS award will equal at least a 30% "add-on percentage" of the student portion of the Pell Grant. For example, a Pell Grant in the amount of $1,000 to the student would also result in an additional award of $300 to the institution.

<u>Rationale:</u>

- *Avoid stratification.* Pell PLUS awards will combat economic stratification within higher education, whereby students from middle- and upper-income families attend elite private and public institutions and the remaining student population is relegated to under-funded public institutions.

- *Preservation of quality.* Without the intervention of the federal taxpayer, the world-class public higher education system that U.S. residents have prized for the last century will erode in quality and in level of public service to the detriment of our collective community interests.

Impact on Access:

- *Federal support is needed to support federal access objectives.* While UC and other similarly competitive institutions may be *able* to fill seats with "full paying" students, this would compromise diversity and access. These institutions will need the assistance of the federal taxpayer dollars in order to keep the door open to the bright, well-prepared students from low-income backgrounds. To keep access to the most successful public institutions available to Pell Grant recipients, we will need the federal government to support operations associated with educating these students.

Impact on Quality:

- *Access means little without quality.* We strongly believe that a high level of student access becomes irrelevant if we no longer have the capacity to ensure a quality education. Support for core operations and infrastructure will allow the University to hire quality professors, equip laboratories, expand physical plant, and carry out the other day-to-day activities that improve the quality of education, and ultimately, the country's return on every Pell dollar invested in an American student.

Fiscal Implications:

- *Impact on Core Funds.* Based on historical Pell Grant dollars received system wide over the last five fiscal years, the incremental boost to Core Funds would be significant:

Annual Incremental Core Funds Under Pell PLUS		
	Six-Year Grad Rate of at least 70%	**Six-Year Grad Rate of 50-69%**
Year	**50% Add-On Percentage**	**30% Add-On Percentage**
2004-05	$73,809,046	$44,285,428
2005-06	$71,758,474	$43,055,084
2006-07	$74,206,029	$44,523,618
2007-08	$85,057,005	$51,034,203
2008-09	$100,498,516	$60,299,109

Challenges:

- *Identifying available federal funds.* The federal government supports college loans in two ways: by making loans directly to students and by guaranteeing loans made by private lenders. The Obama Administration is proposing an end to the bank-sponsored loan guarantee program, creating an overhaul of the student loan business that would halt government subsidies to private lenders by making direct loans to students. The Congressional Budget Office (CBO) has issued savings estimates ranging from $47 billion to $87 billion over 2010-2019 (depending on how risk is factored). Even in the low-end scenario of $47 billion over ten years, the elimination of the Federal Family Education Loan (FFEL) Program in favor of a Direct Lending program represents a possible source of funds for federal education programs. However, dedicating any of these anticipated savings to a Pell PLUS award program may be difficult considering the many other pledges President Obama has made to increase funding of other higher education programs. The federal government will spend $26.9 billion on the Pell Grant program in fiscal year 2010 and $68 billion in fiscal year 2011. Funding for Pell PLUS awards could be made from these increased Pell funds, but again, that may be difficult vis-à-vis the many other spending commitments already envisioned.

- *Feasibility*. In order to enhance ongoing viability of a program like this, UC must be careful not to inadvertently create an entitlement program with awarding mechanisms that are too formulaic. It is important to preserve some awarding flexibility, and it is also important to consider other limiting factors that would reduce the federal government's budget exposure without reducing UC's ability to succeed in the program.

Next Steps for Implementation:

- *Legislative process*. The UC Federal Government Relations (FGR) Office in Washington DC has already been working with the Administration and Congress advocating for programs like the one proposed here that would assist UC in funding its core services activities. By distributing the White Paper to the Administration, Congress, and higher education associations, FGR has been a leader promoting these proposals. Strong views regarding the traditional role of the federal government in funding higher education would need to be changed for a proposal like this to be enacted. This will take time. President Yudof and his White Paper have started this process, and there is a National Academies study looking into the health of our research institutions. We need to continue to press the need for a new federal strategy for higher education. A program of this magnitude will require strong support from the Obama Administration. The best scenario would be for it to be proposed with the submission of the President's Budget for 2012 in January 2011. (The 2011 budget was released February 1, 2010). Congress could propose such a program on its own, but without Administration support, passage is unlikely. As mentioned earlier, Congress is working on legislation to revamp the federal student loan program. The House has already adopted its version of the legislation (HR 3321, Student Aid and Fiscal Responsibility Act), and the Senate has not acted. While not impossible, we are very late in the legislative process to get a program of this size adopted this year.

- *Business process.* Every institution of higher education that participates in the federal Pell Grant program routinely draws down federal funds on a daily (or nearly daily) basis around the beginning of each academic term. Once a campus has determined the Pell Grant amount for an individual student, the campus draws down that amount via fed wire (electronic cash management transmission system). The amount for each student is then transferred to that student's campus financial account. In order to retrieve Pell PLUS awards, the campus would draw down the supplemental funds associated with the student's Pell Grant in the same manner at the same time and would place it in a separate account for campus use.

Other Options Considered:

- *UC research advantage.* Among top-tier research universities, both public and private, the University of California is clearly at a competitive advantage in the realm of student-access. Advocating for recognition of student access within the top-tier research environment would benefit UC strongly. However, the federal government is more interested in student access generally, as opposed to student access specifically to research universities. Rather than tie our access argument to UC's research status, we instead chose to tie it to UC's six-year graduation rate. This shifts the argument to a broader, nationwide educational need in which the federal government is keenly interested, i.e., not only access to, but also *success* in higher education for low-income students.

- *Lower eligibility threshold.* As proposed, the minimum threshold for eligibility in Pell PLUS is two-pronged: 25% Pell enrollment and 50% six-year graduation rate. We acknowledge that these standards are somewhat stringent, with few institutions succeeding in both categories. Lowering either standard would naturally allow the program to be more inclusive initially; however, overly broad *initial* inclusion may impair the program's ability to spur improvement in low-income student access and success. While Pell PLUS appropriately recognizes institutions that already make significant contributions to low-income student access and success, it also represents an important opportunity to activate a "race to the top of higher education."

WORKING GROUP FIRST ROUND RECOMMENDATIONS

Funding Strategies

Recommendation 8: Examine alternate faculty compensation plans.

- The recommendation aims to examine ways of covering parts of faculty compensation with non-state funding. However, analytic data is currently unavailable to fully examine this issue. Additionally, a separate taskforce has recently been appointed to thoroughly address the issue. For these reasons, this recommendation may be best suited for longer-term adoption, as described further below.

Rationale:

- *Existing precedent.* There are already examples in the UC system of faculty salaries being covered in part by fees (professional schools), or by a combination of income from clinical practice and research (medical school). There have been a number of suggestions of ways to extend similar or derivative practices to other faculty:
    - Compensation plans similar to the medical schools for faculty in the biological sciences
    - The use of non-core funding (e.g., contract and grant money, or other external sources of revenue) to pay some portion of the off-scale component of faculty salaries, where feasible
    - More extensive use of contract and grant funds to support some fraction of faculty salary during their regular nine-month appointment.
    - Such practices would augment/replace core funds for instruction.

Impact on Access:

- *Shift burden away from student fees.* Although displacing non-state funding to cover salaries does not necessarily generate incremental revenue, it does ease the fiscal burden on Core Funds. By preserving a larger portion of Core Funds for instruction, student fee increases become less necessary.

Impact on Quality:

- *Positive or negative impacts are possible.* Depending on the action, it could redirect core funds to improve quality of education. On the other hand, it could make faculty recruitment and retention more difficult.

Fiscal Implications:

- *Analytic data is needed.* Data to assess the fiscal impact of various compensation schemes will not be available till mid-March. Depending on the compensation plan, the core funding displaced or new revenue created could be in the $10-100 million range.

Challenges:

- *Equity issues among disciplines.* Not all disciplines can access contract and grant money for faculty compensation plans, so some method to address equity issues would have to be devised.

- *Cultural shift.* Moving state funded salaries to (partial) contract-and-grant funding would be a significant cultural shift for UC, and would be resisted by many.

- *Faculty resistance.* Some faculty will resist displacing a portion of their contract and grant money to cover their base salaries. They would be less resistant if this displacement augmented their salaries.

Next Steps for Implementation:

- *Support the Task Force that is underway.* Interim Provost Pitts has just established a charged with looking at these types of faculty compensation plans. Our role will be to provide review and coordination with the resulting recommendations that arises from this effort.

WORKING GROUP FIRST ROUND RECOMMENDATIONS

Funding Strategies

Recommendation 9: Allow for the possibility of charging differential tuition by campus, as a means of mitigating potential future enrollment impacts on some campuses.

- Although tuition cannot singlehandedly solve UC's budgetary challenges, it is a key component of any funding strategy. As previously mentioned, there still exists substantial headroom on each campus for across-the-board tuition increases without impacting enrollments. However, at some point in time, campuses will cease to experience the same inelasticity of demand, and the possibility of a differential tuition model would come into play. We stress that UC has not yet exhausted other avenues of tuition revenue generation and may not exhaust them for some time; however, the Commission should consider building in flexibility now for future circumstances that could find UC both underfunded by the state and out of tuition headroom.

- Currently, all mandatory student fees (tuition) are set by the Regents. The Registration Fee is uniform for all students. There are minor differences in the Educational Fee based on student status – undergraduate vs. academic graduate vs. professional graduate, or resident vs. nonresident – but it is undifferentiated by campus. There are substantial differences in graduate professional fees, primarily between disciplines, but also to a lesser extent between campuses. Finally, there are significant differences in the level of campus-based fees.

- Allowing tuition to vary by campus is based on the premise that student demand for different campuses varies. Because there is more student demand to attend more selective campuses, allowing differences in tuition levels would expand the university's overall revenue capacity. A key variable in understanding the revenue potential of differential tuition is the elasticity of demand. Because the university is highly selective, demand is currently inelastic. In the short run, incremental increases in the level of tuition would have little or no impact on the number of enrolled students. The elasticity of demand, however, may vary considerably among campuses.

- Generally, it is expected that more selective campuses will have relatively inelastic demand, and that the less selective campuses – for example, those enrolling students from the enrollment referral pool – would have relatively higher elasticity. It also is expected that elasticity would increase as the level of mandatory system wide tuition rises. As a result, it is predicted that the less selective campuses would be the first to experience enrollment impacts as a result of system wide increased tuition, primarily because applicants would choose to attend out-of-state public universities or even private universities, especially when they are offered financial aid. We believe that all UC campuses are currently in the range of inelastic demand. In the future, however, the university could experience revenue losses in either of two ways:

    - Mandatory system wide tuition would continue to increase, and the less selective campuses would begin to experience reductions in enrollment.

    - The Regents would limit future increases in tuition to protect enrollment in the less selective campuses and thereby forego revenues that could have been generated at the more selective campuses by charging closer to market levels.

- A differential tuition could both protect enrollments at campuses beginning to experience demand elasticity, and allow tuition to increase at campuses where demand remains relatively inelastic.

- The approval of differential tuition by campus might take one of several forms:

    - The Regents would set the tuition level for each campus. This would require the Regents to establish a basis for differentiation. This would likely require the explicit or implicit establishment or two or more “tiers” of campuses.

    - The Regents would set a basic mandatory tuition level, and then delegate to campuses the authority to establish differential tuition add-ons, perhaps within a prescribed range.

    - The Regents would set a basic mandatory tuition level, and then delegate to campuses the authority to establish differential tuition discounts, perhaps within a prescribed range, either through price discounts or greater financial aid.

- We acknowledge that the issue of differential fees is controversial and that the controversy extends beyond questions about the appropriate level of tuition. The University’s choice to have uniform or differential tuition necessarily reflects more fundamental decisions about the nature of the UC system and the reputations and aspirations of the campuses. These choices also have important implications for internal campus management, especially challenges and opportunities for managing the shape, content, and pricing of academic programs. We believe that the UC Commission on the Future should consider and discuss the potential advantages and disadvantages of differential forms of tuition, and do so in an informed manner. On balance, however, we concluded that differential tuition is premature and that pursuing a multiyear strategy to increase tuition at all campuses is the preferred option at present. In future years, however, differential tuition may be needed to protect some campuses from losses of student enrollment.

Rationale:

- *Increase revenue capacity.* In an era of sharply increasing tuition levels, differential tuition would further increase the university’s overall revenue capacity.

- *Existing cost differentiation.* The undergraduate programs at the UC campuses are already differentiated by content and cost. For example, faculty salaries and operating costs are higher at Berkeley and UCLA than at other campuses.

- *Precedent in other states.* Differential tuition levels are a common practice among other multi-campus state systems. However, no other state has more than two public AAU universities, so other states are more readily able to justify higher tuition for clearly identified flagship campuses.

- *Discounts rather than add-ons.* We felt that if differential tuition was to be adopted in the future, it should take the form of tuition discounts, rather than add-ons, combined with a more aggressive strategy for mandatory tuition increases.

Impact on Access:

- *Mitigate future impacts on enrollment.* While most UC campuses are currently highly selective, sustained significant increases could eventually have negative effects on yield levels, quality of the enrolled student pool, and diversity at some campuses. Differential tuition could protect those campuses from the harmful effects of these increased tuition levels, and at the same time allow tuition at more selective campuses to more closely approach market levels.

Impact on Quality:

- *Enrollment management.* The potential impact of substantial tuition increases on campus enrollment, quality, diversity, etc., is not well understood. While the current price elasticity of demand may be relatively low within the range of tuition levels experienced in recent years, several of the planning models would increase tuition levels far higher, where price competition with other universities could be a more significant factor. The establishment of differential tuition should be done within the framework of strategic enrollment management, which is currently limited.

Fiscal Implications:

Multiple scenarios. The potential revenue gains from differential tuition are difficult to estimate, because doing so requires making assumptions about demand elasticity, the level of mandatory system wide tuition, and the choices made by campuses. The following scenarios illustrate the challenges facing our efforts to estimate the revenue impact.

Under the first scenario, a differential tuition add-on generates a major revenue gain:

- The Regents approve increases in system wide tuition (10% annually), and three campuses begin to experience impacts on enrollment. As a result, only six of the nine undergraduate campuses phase in a 25% differential tuition add-on by 2015-16. Mandatory system wide tuition would increase from the 2010-11 level of $10,302 to $16,591 in 2015-16. Differential tuition would be $4,148 (for a total of $20,739) and would generate $382 million over five years, net of aid.

Under the second scenario, differential tuition generates no revenue:

- No campus experiences any loss of students, allowing the Regents to increase tuition for all campuses in 2015-16 to the $20,739 level. In this case, the availability of differential tuition generates no incremental revenue, because it is already captured by the higher mandatory tuition level.

The likely outcome is probably between these two scenarios, and the key variable will be the extent to which students at specific campuses choose to attend other universities in response to tuition hikes.

Challenges:

- *Perception issues.* The perceived or actual tiering of campuses for tuition-setting purposes will be highly controversial. Some campuses may feel that establishing tiers for tuition-setting purposes may have a negative impact on their perceived reputation or academic quality.

- *Inclination to move to the maximum.* If campuses were given the option to establish differential tuition, all campuses could move initially to the maximum level. However, if mandatory tuition increased substantially, some campuses might be more willing to differentiate by price (discount) later.

- *Integrate with resource allocation efforts.* The allocation of revenues from differential tuition would have to be integrated with resource allocation issues and with enrollment planning in order to protect those features of campuses that allow them to attract students paying higher tuition and to aid those campuses where tuition discounting is required.

Next Steps for Implementation:

- *Establish planning model.* Further refinement of budgetary and tuition planning models would be required.

- *Enrollment management capability.* Development of a strategic enrollment management capability, including a professional marketing analysis regarding student demand and the potential impact of tuition increases on enrollment, quality, and access.

Other Options Considered:

- *Differential tuition by discipline.* The subgroup also discussed the concept of differential tuition based on undergraduate program. This concept was withdrawn from the November 2009 Regents agenda for further discussion and development. Similar undergraduate program charges are used at other universities to support programs with high student demand or high program costs. Business, engineering, and performing arts are the most common disciplines. Implementing these charges would present a number of administrative challenges, and would be most feasible for relatively self-contained academic or pre-professional programs. The revenue potential of such charges is modest and if adopted would best be retained by the program levying the charge, as is currently the case with graduate professional differential fees.