Systemwide Issues Update – November 2021

# Summary

* The [November Regents meeting](https://regents.universityofcalifornia.edu/meetings/agendas/nov21.html) (November 16-18) includes a number of financial actions and updates with relevance to UCSF. Several key items:
* The Regents will be asked to approve an initial 2022-23 budget proposal requesting $370 million from the State and including funding for a 3% merit salary program for non-represented staff, a 3% adjustment to the faculty salary scales, and an additional 1% for faculty equity adjustments, among other programs. Actual salary program actions will be announced by the President at a later date.
* The Regents will also receive updates on the UC Retirement Plan (UCRP) and Retiree Health Benefit valuations and unfunded liabilities. UCRP is now 94% funded on a market value basis ($5.5 billion unfunded), after extraordinary market gains during 2020-21. The retiree health benefit plan, which has no assets and is funded on a pay-as-you-go basis, represents a total liability of $24.5 billion. UCSF’s share of these liabilities is generally around 20%, reflecting our share of the systemwide workforce.
* Due to the reduction in the unfunded UCRP liability, the Regents will be asked to reduce the employer contribution rate from 15% to 14% for active members. UCSF Health will experience savings immediately beginning July 1, 2022, while campus departments and sponsored awards will experience reduced Composite Benefits Rates, net of any other cost increases, in future years.

# Specific Items

**INVESTMENTS COMMITTEE**

**Discussion Item I1. Review of First Quarter Performance for Fiscal Year 2021-22 of UC Pension, Endowment, Retirement Savings Program, Blue and Gold Pool and Working Capital**

After extraordinary gains during 2020-21, UC’s investment portfolios were almost flat during the first three months of 2021-22. The GEP returned 0.4% and STIP returned 0%; but UCRP, TRIP, and BGP were all slightly negative. All vehicles were extremely close to their policy benchmarks. As a reminder, UC Investments experienced a 28.9% increase in 2020-21 that represents the largest one-year jump in UC Investments’ history. The total portfolio grew to $168 billion in assets as of June 30, 2021, gaining $37.7 billion over the prior year. GEP and UCRP gains both exceeded 30% and the pension is estimated to be 94% funded on a market-value basis. TRIP gained 21.3% and the BGP earned 5.8% in just three months last spring. STIP earned just 0.6% over the course of the 2020-21 fiscal year.

**UCSF Impact:** UCSF is moving $125 million from STIP to the BGP each month from August through November. The leveling-off of gains in the first quarter is not surprising after the unprecedented growth of the portfolio in the second half of last year. However, the UCSF ten-year plan assumes compound average growth rates that are valid over decades, and not intended to predict short-term market fluctuations. It is unlikely that UCSF will need to adjust the investment strategy, which is already rather conservative, but these rates of return will be closely monitored throughout the year.

**FINANCE & CAPITAL STRATEGIES COMMITTEE**

**Action Item F4.  Approval of the 2021-27 Capital Financial Plan**

The item requests approval of the University’s 2021-27 Capital Financial Plan (CFP, distinct from UCSF’s Core Financial Plan), which delineates the six-year program of proposed new construction, renovation, and other capital investments.  The CFP represents $75 billion of capital need as articulated by the campuses and medical centers.  Notably, only $29 billion of this need has funding identified.

**UCSF impact:**  The plan includes $6.7 billion of need for the UCSF campus, with $4.7 billion unfunded.  This need is identified as $1.8 billion for seismic remediation, $1.6 billion for replacement or renewal of aging plant, and $3.3 billion for program improvements.  For UCSF Health, the plan includes $6.1 billion of need, all of which is funded, including the New Hospital at Helen Diller Medical Center and the Benioff Children’s Hospital Oakland Master Facilities Plan Phase 2.

The main differences between the CFP and UCSF’s ten-year capital plan are:

* The CFP is a six-year plan including the current fiscal year plus five years.
* The CFP includes only those projects that have not received full budget approval as of July 1, 2021 (or for which a budget increase is needed); the campus plan includes all active projects.
* Funding is shown in the CFP in the anticipated year of budget approval, while the campus capital plan shows funding schedule based on projected cash flow.
* The CFP excludes remediation projects and studies, which are included in the campus plan.
* The CFP includes projects without a funding plan, equivalent to the campus’s list of Category 2 projects.

Approval of the CFP is important as it is one of the planning documents used for determining whether project approvals can be done at the campus level or need to go to the Regents. It also is used in discussions with the State about much needed State funding to support seismic, deferred maintenance, and affordable housing priorities.

**Action Item F5. University of California Financial Reports, 2021**

The Universitywide income statement shows significant improvement over prior years but still shows a loss from core activities.

* Notably, thanks to the reduced pension expense, the loss in core activities is entirely due to growth in unfunded retiree health liability and is offset by market gains. Revenue from auxiliary enterprises is just 38% of 2018-19.
* Unlike 2019-20, when all revenue sources except auxiliary enterprises and DOE lab revenues grew, revenue growth across the system was modest (just 2.2%), with declines in net tuition and fees, State funds, contracts and grants, and auxiliary enterprises.
* Systemwide expenses declined, due to the pension asset gain and reductions in “other” expenses.
* Thanks to the pension and other investment gains, UC overall now has a positive net position of $4.9 billion (while last year the balance sheet was negative).

**UCSF impact:** UCSF had an overall net position increase of $1.5 billion, $633 million from core activities and $859 million from market investment gains, net of non-cash retiree benefit adjustments.  Based on our own analysis, UCSF’s net position as of June 30 is $1.87 billion, representing 38% of the systemwide net position. Also notable, UCSF experienced core activity revenue growth of 8% during 2021.

**Action Item F6.  Approval of the University of California’s 2022-23 Budget for Current Operations**

The Regents are asked to approve the proposed budget plan, which represents a statement of the University’s funding priorities in advance of the Governor’s January budget proposal for the 2022-23 year. The plan is focused on the UCOP definition of core funds, primarily State funds, tuition and fees, and a portion of F&A cost recovery and other sources, which represent 23% of systemwide operating revenues.

* The plan calls for a total recurring expenditure increase of $500.5 million, including salary increases for represented staff based on bargaining agreements, policy-covered staff (3% merit), and faculty (merits, 3% range adjustments, and 1% for equity adjustments).
* The State funding request totals $369.6 million including a 5.0% base budget adjustment to help cover salary and benefit cost increases, enrollment growth, funding to replace lost nonresident tuition revenue (associated with a reduction in nonresident enrollment at Berkeley, UCLA and San Diego), and other programmatic funds (degree attainment efforts, student academic preparation, menstrual health and equity, support programs for carceral system-impacted students, undocumented students, and former foster youth. The proposal also includes $4 million for a Cancer Center Consortium.
* The plan also assumes increases in Tuition and Student Services Fee levels for graduate students pegged to the rate of inflation, as approved by the Regents in July 2021.
* One time-fund requests include a $600 million one-time request for deferred maintenance, energy and capital investments and $9 million for psychiatric mental health nurse practitioner programs.

**UCSF impact:** The plan is balanced, and the amount of self-funding in the plan is limited to $10 million in procurement savings. UCSF would benefit primarily from the 5% base budget increase in State support. Actual salary program actions will be announced by the President at a later date and will depend in part on funding for UC included in the Governor’s budget proposal.

**Information Item F9. Annual Actuarial Valuations for The University of California Retirement Plan and Its Segments and for the 1991 University of California-Public Employees’ Retirement System Voluntary Early Retirement Incentive Program**

The actuarial accrued liability is $97.2 billion as of June 30, 2021. On an actuarial basis, the smoothed asset value is $80.8 billion, yielding an unfunded liability of $16.4 billion and the plan is 83% funded on an actuarial value. On a market value basis, assets total $91.7 billion and the liability is 94% funded. These figures represent a decrease in the unfunded liability due largely to exceptional investment gains. The normal cost is 20.5% of payroll -- this represents present value of future benefits earned by participants in the year that the pension valuation is prepared. The total funding policy contribution rate is 32.68% -- this is the percent of covered payroll that must be contributed in order to fully fund the plan (the normal cost plus the amount needed to amortize the unfunded liability in about 20 years), a decrease from 34.47% last year. The policy contribution rate is projected to rise gradually over time if all approved contributions are funded and average market growth is 6.75% annually, even as the normal cost decreases slightly over time due to more employees entering the less-expensive 2013 and 2016 tiers.

Employer contribution rates are currently 15.0% for UCRP members and 7% for Savings Choice participants. These rates were scheduled to rise over the next four years to 17% and 9%, respectively, but the Regents are being asked to halt the increases and return to the 14% for active members and 6% for Savings Choice participants.

**UCSF impact:** The improved asset valuation is beneficial to the UCSF balance sheet and puts the University in a better position for external financing.

**Action Item F10. Authorization to Decrease the University Employer Contribution Rate and Make Additional Contributions through Transfers from the Short Term Investment Pool and/or External Financing to the University of California Retirement Plan**

The action item requests authorization for the President of the University to (1) decrease the University/employer contribution rates to the University of California Retirement Plan from 15% to 14% for active members and from 7% to 6% for Savings Choice participants, effective July 1, 2022, and (2) make contributions (up to $1 billion) to UCRP during 2022-23 and 2023-24 via internal borrowings from the Short Term Investment Pool (STIP), external financing, or a combination of both.

**UCSF impact:** UCSF Health will benefit immediately from the reduction in employer contribution rates, helping it achieve improved EBIDA margins. The campus will experience reductions in composite benefits rates over time. Savings will accrue to core-funded budgets, but also to sponsored activities, with the latter savings being directly offset by reduced cost recovery.

**Information Item F11. Annual Actuarial Valuation of the University of California Retiree Health Benefit Program**

The actuarial consultant estimates the total retiree health liability at $24.5 billion as of July 1, 2021, up from $23.3 billion a year earlier. The liability is expected to increase every year as active participants earn additional service credit, but $0.2 billion of the increase is due to the change in the discount rate from 3.5% to 2.21%, offset by a decrease of $0.4 billion due primarily to lower-than-expected insurance premiums during 2019-20. (A lower discount rate means that future costs will be discounted less, and therefore seem more expensive from today’s perspective. Counter-intuitively, a higher inflation rate will increase the discount rate that the actuaries are required to use, thereby making future costs seem less expensive at the same time that current costs are rising.) UC does not fund the full liability, however, but only pays the actual cash costs of benefits each year. Actual cash costs for 2021-22 ($347 million) are expected to rise slightly (4.5%) from last year’s amount ($332 million).

**UCSF impact:** None this year. The liability and “pay-as-you-go” contribution amounts are projected to rise steadily over the next decade, but it is not clear that this would represent a significant increase for UCSF as a percent of payroll.

**Action Item F12. Amendment of the Fiscal Year 2021-22 Budget for the University of California Office of the President**

The current approved budget for UCOP is $960.6 million, which was approved in May 2021. Subsequently, the State budget authorized a return to the campus assessment model for UCOP and UCPath operations, eliminating direct state appropriations. The State budget included new funding for UCOP, specifically for ANR and other academic and research programs. Based on these new State funds, the proposed amended budget is $1,006.6 million.

**UCSF impact:** The elimination of the direct state appropriations is helpful in that it simplifies communication about UCOP funding and impacts on campuses and provides flexibility to allow the University to address systemwide needs. UCSF is paying 12.8% of the UCOP assessment during 2021-22, based on our shares of students, employees, and total expenses. UCSF received an additional $20,000 in SAPEP funding for 2021-22.

**Discussion Item F13. Report of Budget to Actual Expenditures for Fiscal Year 2020-21 for the Office of the President and First Quarter Fiscal Year 2021- 22 Results**

The Office of the President reports that 2020-21 year-end expenditures were 2.1% below budget, with underspending attributed to COVID-19. Fund balances declined 41% due to use to address a budget shortfall. First quarter spending during 2021-22 is below budget by 18.1%, due at least in part to timing of expenditures and outflows for research programs.

**UCSF Impact:** Nothing specific.