

**Office of the President**

**TO MEMBERS OF THE COMMITTEE ON FINANCE:**

**DISCUSSION ITEM**

*For Meeting of July 16, 2014*

**UPDATE ON THE UNIVERSITY'S 2014-15 BUDGET**

The Legislature adopted a 2014-15 State budget on June 15, meeting the Constitutional deadline for sending a budget to the Governor. On June 20, the final budget package was signed into law by the Governor. Vice President Lenz will provide an update on the final 2014-15 State budget package and its implications for the University.

**BACKGROUND**

**Overall State Budget**

The final 2014-15 State budget totals \$156.3 billion, of which the State General Fund is approximately \$107.5 billion. The budget assumes a “rainy day fund” of \$1.6 billion if the proposition enacting the measure is approved by the voters in November; the fund would grow to \$4.6 billion by the 2017-18 fiscal year. The budget also includes a reserve of nearly \$450 million. The final budget is based on revenue and expenditure assumptions consistent with the Governor’s May Revision, which projected an additional \$2.5 billion in State General Funds over the budget presented in January, representing a more conservative estimate than what had been recommended by the Legislative Analyst.

Funding priorities supported by the Governor and the legislature in the 2014-15 State budget include:

- \$10 billion in new Proposition 98 funding for K-14 education;
- \$10 billion to reduce the “Wall of Debt,” paying down deferral payments to schools, paying off Economic Recovery Bonds, repaying special fund loans, and providing \$100 million in mandate claims to local government;
- \$2.4 billion to address increasing Medi-Cal enrollment under the federal Affordable Care Act;
- \$832 million of cap-and-trade revenue for greenhouse gas reduction programs, including \$250 million for high-speed rail;
- \$276 million (approximately one-third from State General Funds) to address the California State Teachers’ Retirement System (CalSTRS) unfunded liability;

- \$172.2 million (\$354.4 million ongoing commitment) for in-home supportive services to meet U.S. Department of Labor regulations and pay overtime to providers who work greater than 40 hours per week; and
- \$160 million for the judiciary to address trial court funding costs.

### **2014-15 Budget for UC**

For the University of California specifically, the budget includes the following provisions:

- an additional \$142.2 million from the State General Fund, representing a five percent increase in the University's base State General Fund budget. This is the same base budget adjustment initially proposed in the Governor's January budget proposal and is consistent with the Governor's multi-year funding plan for the University;
- \$2 million in one-time funding for the Labor Centers at UC Berkeley and UCLA;
- \$2 million in one-time funding to establish the California Blueprint for Research to Advance Innovations in Neuroscience (Cal BRAIN) program, which would leverage federal funding opportunities to accelerate the development of brain mapping techniques;
- \$770,000 for the Statewide Database Project at UC Berkeley;
- funding for the UC Berkeley Tolman Hall Seismic Replacement Project in the 2014-15 budget;
- up to \$50 million in one-time funding for UC generated from 2013-14 property tax revenue;
- \$15 million from the Proposition 63 mental health fund for the Behavioral Health Centers of Excellence for California at UC Davis and UCLA (with three years to expend); and
- \$50 million in one-time funds for the Governor's Innovation Awards, an initiative he proposed in his January budget that would fund proposals from any of the three California higher education segments for programs that promote increased graduation rates, decreased time to degree, or improved Community College transfer.

In addition, the State budget includes funding for the first year of the new Middle Class Scholarship Program, which will provide new assistance to students at UC and the California State University (CSU) with family incomes up to \$150,000. The University estimates that UC students will receive approximately \$30 million from this program in 2014-15, growing to over \$100 million by 2017-18 as the program is phased in. UC students are also expected to receive an additional \$2 million in Cal Grants in 2014-15 due to a modest increase in Cal Grant B awards.

The State budget provides no new permanent funds for key components of the University's 2014-15 budget plan. Specifically:

- The State budget includes no new funding toward the State contribution to the UC Retirement Plan (UCRP). The Regents' budget plan requested \$64.1 million of additional State funding to cover the State's share of the incremental increase from 12 percent to 14 percent of the employer contribution to UCRP. The State budget does provide \$876.2 million to address higher costs for State employee pensions (including employees

of CSU) and, as noted above, initiates a long-term infusion of State funds to fully fund CalSTRS.

- The State budget provides no new funding for enrollment growth. UC's budget plan requested \$21.8 million for one percent enrollment growth. Note that UC currently enrolls approximately 7,600 California resident students for whom it has never received State funding.
- Nor does the State budget provide any funding for reinvestment in academic quality. The University's budget plan requested \$35 million from the State for the first year of a multi-year effort to reinvest in critical areas of the academic program that have been adversely affected by the State's recent fiscal crisis, such as reducing the student-faculty ratio, addressing the current competitive gap in faculty and staff salaries, increasing graduate student support, increasing undergraduate instructional support, or supporting start-up costs for new faculty.

### **Implications for the University**

The 2014-15 State revenue is consistent with the multi-year funding plan proposed by the Governor and approved by the Legislature in 2013. That plan called for annual base budget increases over four years – five percent in 2013-14, another five percent in 2014-15, four percent in 2015-16, and another four percent in 2016-17.

The multi-year funding plan provides campuses with some predictability about State funding following multiple years of dramatic reductions in support for the University. It falls far short, however, of the funding required to address the University's projected funding needs. The University's 2014-15 budget proposal reflected \$168.1 million in mandatory cost increases alone – about \$26 million more than the 2014-15 base budget adjustment in State General Funds provided in the final budget. Under the University's proposal, total expenditures for mandatory cost increases, high-priority costs, and efforts to reinvest in academic quality were projected to increase by \$383.1 million over 2013-14 levels.

For 2014-15, the University has agreed to forego increases in systemwide Tuition and the Student Services Fee for the third consecutive year. Professional Degree Supplemental Tuition (PDST) levels will remain flat as well.

Consequently, the importance of alternative fund sources and cost-saving efforts will continue to grow in 2014-15. Examples included in the University's budget plan are as follows:

- *Nonresident Supplemental Tuition (NRST)*. Enrollment of nonresident undergraduate students will increase in 2014-15 and is likely to generate an additional \$26 million for the campuses. The revenue provided by these students, who pay roughly \$23,000 in NRST in addition to their in-state tuition and fees, will be critical if the University is to maintain current levels of California resident enrollment for whom the State has never provided funding.
- *Asset management*. The University believes that an additional \$35 million in revenue can be realized by moving a portion of current University assets into a higher-yielding investment portfolio.

- *Internal efficiencies.* The University's 2014-15 budget plan called for savings of \$30 million from 2013-14 levels through systemwide procurement contracts and other efforts to achieve economies of scale.
- *Philanthropy.* The University's budget plan called for an additional \$25 million in revenue from increased philanthropy to the University and new models for gift-giving to increase the availability of these funds for operational needs.

Individual campuses differ in the extent to which they leverage these alternative strategies to meet their funding needs. Moreover, even with these efforts, the University will be unable to fund all of the needs identified in its 2014-15 funding plan.

Given the funding shortfall, campuses will need to weigh and balance among competing priorities with the understanding that there is not enough increased revenue to fund mandatory cost increases, let alone the other high-priority costs identified in the November budget plan. Moving forward, the University is developing a multi-year budget plan that reflects an appropriate mix of strategic investments, cost-saving efforts, and revenue from a diverse mix of fund sources, including but not limited to State General Funds, tuition and fees, patent revenue, indirect cost recovery, and philanthropy. That plan will be discussed in greater detail at a future meeting.

In addition, trailer bill language associated with the budget package asks UC and CSU to develop three-year plans for financial sustainability using budget assumptions to be provided by the Department of Finance in August. These plans are to be approved by the respective Boards and submitted to the Department of Finance by November 30, 2014.