

Office of the President

TO MEMBERS OF THE COMMITTEE ON FINANCE:

DISCUSSION ITEM

For Meeting of July 22, 2015

UPDATE ON FINAL 2015-16 BUDGET

The Legislature adopted a final 2015-16 State budget on June 19, and on June 24, the final budget package was signed into law by the Governor. Executive Vice President Brostrom will provide an update on the final 2015-16 State budget package and an overview of the University's budget following this year's budget negotiations with the Governor and the State Legislature. The final State budget, which incorporates the funding framework developed by UC and the Governor, puts UC in a strong financial position, provides the University with predictability and stability for the next four years, and offers students and their families the certainty to be able to confidently budget for the costs of their UC education.

BACKGROUND

Overall State Budget

The final 2015-16 State budget totals \$167.6 billion, of which the State General Fund is approximately \$117.5 billion. The budget authorizes spending of over \$115.4 billion in State General Fund monies with the balance being used to build up the reserve and meet obligations for allocations to the Proposition 2 rainy day fund.

The Legislature initially approved a budget bill with expenditures exceeding the Governor's May Revision by \$750 million. However, after negotiations with the Governor, the final budget reflects spending that is nearly equal to the level proposed by the Governor, but with funding for legislative priorities such as a \$262 million reinvestment in the state's childcare and early learning system; approximately \$200 million General Fund for Medi-Cal, Denti-Cal, and other health programs; significant increases for the Cal Grant program; an additional \$70 million above the Governor's May Revision proposal for the California State University (CSU), targeted for enrollment growth, hiring of tenure-track faculty, and student support services; and an additional \$25 million for enrollment growth at UC if certain conditions are met (described more fully below). The Governor also called for two special sessions of the Legislature—already underway—to address outstanding budget issues related to roads and infrastructure, and healthcare issues such as MediCal reimbursement rates and support for programs that serve the developmentally disabled.

2015-16 State Budget for UC

With enactment of the 2015-16 State Budget Act, the University of California finds itself in a much better situation than a year ago. At the beginning of last summer, UC faced continued uncertainty over the University's budget and future State support. The State budget that had just been passed for 2014-15 provided limited new funding to the University, consistent with the Governor's multi-year funding plan for UC and CSU. The University had agreed not to increase tuition in 2014-15, including Professional Degree Supplemental Tuition (PDST) and Nonresident Supplemental Tuition (NRST), thus greatly limiting UC's other options for securing alternative revenues. The State budget did not include any funding for the University's pension costs. Also, in July, after the budget was passed, the State was unable to provide one-time funding for deferred maintenance that had been included in the budget contingent upon certain revenue levels being achieved. With new funding largely limited to the Governor's funding plan, the University faced another budget shortfall and thus another year of budget cuts. The modest augmentation in the State appropriation was not enough to cover basic mandatory costs including labor contracts and increases in benefits costs, let alone high-priority needs such as increased enrollment, investments in student success, hiring faculty, and providing more courses. The University braced for another year of cuts at a time when the State's economic recovery was strong and the State's revenues were growing.

At the same time, the University was taking a renewed look at its longer-term funding needs and how best to cover those needs. The overarching goal was to identify the amount of funding needed for both the short and longer term to ensure that the high-quality education provided to past generations of Californians was preserved for future generations of deserving California students. Between the passage of the budget in July and the Regents' meeting in November, staff explored all possible financial options available to move the University forward despite constrained State funding.

The long-term funding plan presented to and approved by the Regents in November presented a comprehensive approach to building financial sustainability for the University, providing predictable tuition for students and families, while protecting the quality of its core academic programs. That long-term funding plan was not an extravagant wish list, but rather a careful assessment of the minimum funding needed to meet basic costs based on a realistic understanding of the difficult funding environment the University faces over the next five years. It was built on the assumption that any sustainable funding plan for the University must involve a partnership between the University and the State, with the University covering a substantial portion of its basic needs from its own resources and efforts at reducing costs. Thus, the plan developed by the University included alternative revenues, such as nonresident supplemental tuition, and assumptions about continued aggressive efforts to reduce costs through operational efficiencies. In addition, it assumed predictable funding from the State and, in the absence of additional State support, modest tuition increases. For 2015-16, the plan called for either a five percent tuition increase or an additional \$98 million from the State or other sources. With the Regents' approval of the plan, the University was able to set a financially sustainable course. The budget plan and the associated tuition increases approved in November triggered an important conversation regarding higher education funding in the state and has been instrumental in leading toward the ultimate budget outcome.

The 2015-16 budget recently signed by the Governor includes the principal elements of the funding framework that UC negotiated with the Governor and which was incorporated into the Governor's May Revision. By providing additional one-time funds for the University's retirement plan (totaling \$436 million over three years), deferred maintenance, and energy projects, and by extending the Governor's commitment to State-funded base budget adjustments for two additional years (for a total increase in State General Funds over the next four years of \$507 million, as described below), the framework provides a stable foundation for UC to move forward to meet its basic needs as identified in the long-term funding plan. This marks a new period of financial stability and predictability sought in the November plan. The only item not addressed by the framework is funding for enrollment growth, an issue left to negotiation with the Legislature. The final 2015-16 budget indicates that if UC demonstrates it will enroll an additional 5,000 resident undergraduate students in 2016-17, \$25 million in additional funding will be provided at the end of the budget year,

Framework with the Governor

The framework agreed to with the Governor provides the University with base budget adjustments of four percent annually over the next four years, through 2018-19, extending by two years the horizon of the Governor's original multi-year funding plan for the University. These base adjustments will increase State funding over the next four years by \$507 million.

Under the agreement with the Governor, the University will also receive \$436 million in one-time funds over the next three years in Proposition 2 debt repayment funds for the UC Retirement Plan (UCRP), including \$96 million in 2015-16, \$170 million in 2016-17, and \$170 million in 2017-18. As specified in the State Constitution, Proposition 2 funds must be supplemental, above Regentally approved contribution rates, and must be used to help pay down the unfunded liability associated with UCRP. This funding is contingent upon Regental approval of a cap on pensionable salary at the same rate as the State's Public Employee Pension Reform Act (PEPRA) cap for the defined benefit plan for employees hired on or after July 1, 2016. The President will convene a retirement options task force to advise on the design of new retirement options that will include the new pensionable salary cap consistent with PEPRA. The retirement options will be brought to the Regents next year for review and approval. The pension cap now in place is equivalent to the Internal Revenue Service level, currently \$265,000; for employees hired on or after July 1, 2016, pensionable salaries would be capped at \$117,020 in 2015-16, for those in the defined benefit plan. These changes will only affect new employees hired after the new options are implemented. New employees will have the opportunity to choose a fully defined contribution plan as a retirement option, as an alternative to the PEPRA-capped defined benefit plan. For represented groups, retirement options will be subject to collective bargaining.

These changes to UC's pension obligations were a key priority of the Legislature and the Governor. The one-time money from Proposition 2 can be combined with additional internal borrowing to improve the funding status of UCRP and eventually reduce the employer contributions now being covered by the operating budget.

The framework also provides \$25 million in one-time funding for deferred maintenance. This is the first time since 2002 that the State has provided funding to the University to help address its

aging physical plant. The \$25 million in one-time Cap and Trade funds for energy projects proposed in the framework negotiated by the President and the Governor was not included in the final budget act, but is expected to be addressed by the Legislature in separate legislation later in the summer.

The framework also calls for no tuition increases in 2015-16 and 2016-17, with tuition increases generally pegged to the rate of inflation to be implemented beginning in 2017-18. The Student Services Fee is to increase five percent (\$48) in 2015-16 and each year thereafter with the customary one-third of the increase being directed to financial aid. Fifty percent of the remaining revenue generated from the increase will be used to enhance student mental health services, consistent with the University's priority to build resources to support mental health programs, and the remaining 50 percent will be distributed to support other student services programs consistent with the Regental policy on the Student Services Fee.

The framework also acknowledges the University's plan to increase nonresident supplemental tuition by up to eight percent for 2015-16 (or \$1,830) and 2016-17 and five percent thereafter, as approved by the Regents in May. The framework also recognizes the increases in PDST approved by the Regents in November for existing and new programs other than the law schools. The framework calls for no increases in law school PDST for the next four years.

In addition to these funding elements, the budget framework includes a number of performance-related provisions. These provisions were the subject of considerable discussion and examination during the Select Advisory Committee meetings and cover five basic performance areas involving delivery of the academic program. These areas include:

- An enhanced commitment to the transfer function. The framework confirms the University's goal of having one-third of its entering California undergraduates start as transfers, calls for UC to complete transfer preparation pathways for 20 top majors over the next two academic years, 2015-16 and 2016-17, and calls upon the University to request that the Academic Senate examine of the State's Common Identification Numbering (C-ID) system. The University launched the first ten pathways on July 7, 2015.
- Innovations to support student progress and improve time-to-degree. The framework requires that the University review the major upper-division requirements for attaining undergraduate degrees with the goal of reducing units to 45 where possible for 75 percent of undergraduate majors by July 1, 2017.
- Implementing measures to reduce time-to-degree. Under the terms of the agreement and consistent with the emphasis the Governor has placed on finding strategies to increase graduation rates and improve overall output of degrees, the University is to identify three-year degree pathways for at least ten of the top 15 majors across the system by March 1, 2016. The goal is to incentivize three-year degree paths and bring the number of students who are on a three-year degree track to five percent of students by summer 2017. The University is also to pilot alternative pricing models in summer sessions at three campuses by summer 2016 to determine effective strategies for increasing summer

enrollment. In addition, the University has agreed to provide guidance to campuses on supporting students to help them complete their degrees within four years and to help reduce the achievement gap among different socioeconomic cohorts of UC students. The University is to consult with the Academic Senate and request that it reexamine credit provided for Advanced Placement and College-Level Examination Program tests.

- Continued development of online undergraduate courses. In addition to continuing its current efforts to expand online courses, the University has agreed to give funding priority to bottleneck courses and convene industry and academic leaders to further identify online programs that may be developed to enhance delivery of UC's instructional programs to better meet industry workforce needs.
- Advance innovative use of data to identify students at risk, assess costs of instruction, and support student learning. The University is to expand its use of data systems (e.g., "predictive analytics") to identify undergraduate students at risk of academic difficulty; pilot "activity-based costing" at UC Riverside and engage two other campuses in a scoping study to potentially expand activity-based costing to other campuses; and pilot "adaptive learning technology" at UC Davis and two other campuses focused on improving instruction and increasing the number of students who master content in particularly difficult courses and persist to completion.

2015-16 Budget Act Funding

In the final budget negotiations, the Legislature approved all the major funding elements of the framework agreed to between UC and the Governor's Administration and as set forth in the Governor's May Revision. As noted above, the funding framework did not, however, address one significant element of UC's long-term funding plan, and that is UC's desire to significantly increase enrollment of California students. While independent groups have confirmed that UC has met its enrollment obligations under the California Master Plan for Higher Education even through the recession of the last several years, enrollment growth is a key priority for future years – a goal that is shared with the Legislature. The final 2015-16 budget language indicates that the University will receive an additional \$25 million above its four percent base budget adjustment if it can demonstrate in spring 2016 that it has admitted a sufficient number of resident undergraduate students to achieve an increase in 2016-17 of 5,000 students over the 2014-15 academic year.

The final budget also provides an additional \$4 million in permanent funding for the Labor Centers at the Berkeley and Los Angeles campuses above the four percent base budget adjustment and above the \$2 million in permanent funding directed to the centers from the University's base support in 2014-15. The budget also includes \$1 million in one-time funds for the Wildlife Health Center at the Davis campus.

The final budget also calls for UC to redirect funds within its existing base budget to fund several items that are priorities for various legislators, including planning for a School of Medicine at the Merced campus, the California DREAM Loan Program, and the Statewide Data project at the Berkeley campus.

For 2015-16, as provided in Education Code Sections 92493 and 92496 (AB 94), the Department of Finance has also authorized the University to finance 15 capital outlay projects totaling \$296.7 million with its State General Fund support appropriation.

Budget Bill Language

Language accompanying the funding calls for several reports and actions by the University and others.

One provision indicates the Legislature's intent that UC use revenue from enrollment of nonresident students to help fund the enrollment increase. Language in the budget also calls for several reports: a report on all "University fund sources legally allowable" to support costs for education; another three-year financial sustainability plan, which is again to be approved by the Board of Regents; and another on the use of funds for support services to increase graduation rates for low-income and underrepresented populations.

In addition, the University is asked to take two more actions: revise Market Reference Zones for Senior Management Group employees to include comparable positions in State government¹; and post information on its website that explains the details related to the subcategories of personnel within the Managers and Senior Professional personnel category and disaggregates personnel categories by fund source.

The higher education "trailer bill," which is legislation that accompanies the budget to implement certain related statutory provisions, also includes two studies of note: one asks the Legislative Analyst to study the need for new campuses for CSU and UC, and another asks CSU to conduct a new eligibility study with the University's participation.

Conclusion

By adopting the provisions of the funding framework agreed to by the Governor and the University, the budget approved by the Legislature puts UC in a strong financial position that provides the University with predictable and stable support for the next four years and offers students and their families the certainty to confidently budget for the costs of a UC education. This outcome resulted from the spirited debate over appropriate funding levels for higher education in California sparked in large part by the plan adopted by the Board in November. The University has come a long way since then, a result that should be welcome by all University stakeholders.

¹ The University intends to bring a revised Market Reference Zone proposal to the Regents for approval in January 2016.