

Office of the President

TO MEMBERS OF THE COMMITTEE ON FINANCE:

DISCUSSION ITEM

For Meeting of May 18, 2011

UPDATE ON THE 2011-12 STATE BUDGET

Vice President Lenz will make a presentation regarding the status of the 2011-12 State budget. The purpose of this presentation is to:

1. Update the Regents on the actions of the Legislature in response to Governor Brown's proposed 2011-12 State budget to address a \$25.4 billion State General Fund shortfall.
2. Report on the actions of the Governor and Legislature on the 2011-12 UC support and capital outlay budgets.
3. Outline the major revenue and expenditure measures still under consideration by the Governor and the Legislature as they approach the May Revise.
4. Indicate next steps for the Governor and the Legislature in their deliberations on the 2011-12 State budget.
5. Review options under consideration for a UC "Plan B" contingency budget if the State adopts an "all-cuts budget."

BACKGROUND

On January 10, 2011, Governor Jerry Brown submitted his 2011-12 State budget recommendations to the Legislature which outlined a balanced approach to address California's \$25.4 billion structural budget deficit. The Governor's budget proposed \$12.5 billion in expenditure reductions, \$12 billion in anticipated revenue, and \$1.9 billion in other budget solutions that would fully address the State budget gap and provide a \$1 billion budget reserve in the 2011-12 fiscal year. Key to his budget recommendations is an effort to secure voter approval for approximately \$11.2 billion in tax revenue by extending for five years the temporary increases in personal income tax (0.25 percent), sales tax (one percent), and vehicle license fees (0.5 percent) approved as part of the 2009-10 Special Session budget package. In addition, the Governor has proposed extending the Dependent Exemption reduction for this same period of time. The 2011-12 State budget also proposes significant reductions to Medi-Cal (\$1.7 billion), redevelopment agencies (\$1.7 billion), Welfare-to-Work (\$1.5 billion), UC and the California

State University (CSU) (\$1 billion), developmental services (\$750 million), State operation/compensation (\$580 million) and California Community Colleges (\$400 million).

As of this date, the Governor and the Legislature have not agreed on extending nearly \$11 billion in tax revenue, changes to current tax laws, or a date for an election to seek voter approval for extending the temporary tax increases. Since early March, the Governor and Legislature have agreed on many of the budget trailer bills as well as significant budget cuts to higher education, health, and social services programs, to address nearly half of the overall budget deficit; however, the budget bill is being held in the Legislature until an agreement on revenue can be produced. In addition to the inability to get the tax revenue issues on a statewide ballot, the Governor and the Legislature have not come to an agreement on the elimination of funding (\$1.7 billion) to local redevelopment agencies.

For the University of California, the Legislature approved the \$500 million budget reduction to the 2011-12 UC budget proposed by the Governor in January. The Legislature is still considering how prescriptive it wants to be relative to UC budget cuts and what (if any) should be UC's 2011-12 student enrollment target. The Legislature also approved a \$3 million budget redirection to fund a provision in the 2011-12 contract year for American Federation of State, County and Municipal Employees (AFSCME) service workers. The Governor and the Legislature agreed on provisional language for UC and CSU requesting that, in managing the \$500 million budget reduction, "the university shall minimize fee and enrollment impacts on students by targeting actions that lower the costs of instruction and administration." The proposed \$500 million budget reduction would bring the State General Fund support for UC to a level equivalent to funding provided in 1998-99, when the University enrolled 73,000 fewer students. (This reduction is compounded by increases in mandatory costs, which will add another \$365.9 million to UC's budget shortfall in 2011-12.) Therefore, UC believes actions need to be considered that include reducing non-instructional programs to the 1998-99 funding level or eliminating entirely State-funded earmarked programs that do not contribute to admitting UC students, classroom instructional resources, or financial aid assistance. Discussions are under way with State officials that, if successful, will result in added flexibility for UC to determine the appropriate level of funding for these programs. These programs will be discussed in more detail when a final budget for the Office of the President is approved at a future meeting.

There remain a few outstanding issues that will require deliberation by the Legislature over the next few months, such as the State-funded enrollment target and the funding for capital facilities in the 2011-12 State budget. With regard to the enrollment issue, UC currently enrolls about 214,600 California resident full time equivalent (FTE) students and the State has provided marginal cost funding for all but about 11,000 of these students at a cost to UC of approximately \$110 million. It is likely that this enrollment level will be maintained or modestly reduced for the 2011-12 academic year. The State is proposing to set a target of 209,977 FTE students for 2011-12. The University is deeply concerned about this proposal because it implies that only 4,000 of UC's students are "unfunded." Using the agreed-upon methodology for estimating the marginal cost as a basis, it is the University's contention that, with the reductions sustained by the University in recent years, the actual unfunded level of enrollment is much higher than the 11,000 students for whom no marginal cost funding has been provided. UC estimates that over 23,300 FTE students are arguably not funded, at a cost of over \$233 million. Thus, the

enrollment target should be set at 191,361 FTE students, rather than the higher number suggested by the State staff, in order to more accurately reflect the number of students who are actually funded.

With regard to the capital outlay budget, UC was successful in getting authorization for four campus equipment projects included in the budget bill approved by the Legislature. Unfortunately, as noted above, the Legislature will not send a budget to the Governor until the revenues, realignment, and other budget-related issues are resolved, placing the authorization for these equipment projects on hold. UC is coordinating with CSU in an effort to pursue authorization of these projects in separate legislation so that campuses can purchase this capital facility equipment in time for the start of the fall semester or quarter. UC is also working with the Governor and the Legislature on the potential for including additional capital facility projects in the 2011-12 State budget through the May Revise process.

Supporters and friends of the University have been engaged in intensive advocacy efforts on behalf of the University's budget needs throughout the budget process. Hundreds of advocates have traveled personally to the State Capitol as part of UC Day in Sacramento held in March, the Joint Higher Education Advocacy Day held in April with the CSU and community college systems, and other advocacy days organized by campuses and programs. The President, chancellors, and faculty, student, staff, and alumni leaders have all participated in these events. UC also has been reaching out to key representatives of the California business community to work together to convey to legislators the critical role higher education plays in the economic success of California. Corporate leaders are part of our advocacy efforts and have testified at legislative hearings this spring on the University's behalf. The University has continued to engage hundreds of thousands of "e-advocates" using email, and that effort has resulted in more than 27,000 emails being sent to Sacramento on UC's behalf thus far in 2011. UC also continues to expand its advocacy work using social media; its Facebook presence is growing and currently highlights videos from prominent UC supporters talking about why investment in public higher education is critical to California's future (www.facebook.com/ucforcalifornia).

Since the completion of the initial legislative deliberations on the State budget, there have been information hearings in the State Capitol and in various venues around the state on California's budget challenges for the 2011-12 fiscal year. These public events have allowed the Governor and legislative leaders to inform Californians about the need for tax revenue to close the State budget gap and the implications of an "all-cuts budget" on State programs and services, including higher education. The Governor has indicated that without the support of the additional tax revenue he proposed in his January State budget, he may be faced with supporting an all-cuts budget to finish closing a \$13 billion budget gap.

The University of California could be faced with an additional significant reduction – some have estimated up to an additional \$500 million – under an all-cuts budget. If an additional cut of that level were to occur, State support would be reduced to \$2 billion, or \$1.2 billion less than the State investment in UC in the 2007-08 fiscal year before recent cuts began to be implemented. This would represent a \$1 billion budget reduction from the 2010-11 fiscal year. That cut level would be unprecedented for UC – and could be further complicated by the failure of the Legislature and Governor to enact a timely budget, requiring UC to absorb that cut level several

months into the fiscal year. A significant budget delay reduces the options for UC to manage any additional budget reduction (UC is already past the point of reducing enrollment in 2011-12) and would force the University to rely on increasing student fee revenue to offset any additional State General Fund cut.

To address UC's overwhelming fiscal challenge in 2011-12, several actions are being undertaken centrally:

- The Office of the President and other specific programs will be reduced by \$80 million, leaving the campuses to contend with approximately \$420 million of the \$500 million reduction already approved for 2011-12.
- Balance sheet strategies including generating more revenue by moving Short Term Investment Pool (STIP) balances into the Total Return Investment Pool (TRIP), assessing overhead charges to existing gifts, implementing assessments on endowments, carry forwards, and other gifts will provide new revenues for the campuses.
- The Working Smarter initiative will change business practices, reduce inefficiencies, and generate cost avoidance measures which are estimated to save \$100 million per year over the next five years.

In addition, campuses are reducing their budgets by expanding class sizes, eliminating inefficient programs, consolidating programs where possible, cutting back service hours, implementing thousands of layoffs, and leaving thousands more positions unfilled. Quite literally, the University is doing all it can to address the cuts that have already happened or been approved. There are no additional "magic solutions" to managing additional cuts, should an all-cuts budget become a reality at the State level. Campuses have stated that they cannot absorb additional cuts without beginning to dismantle major programs and thus forever alter the quality of the University of California.

Thus, if additional cuts are approved for UC, further increases in student fees must be considered. One proposal under consideration is to commit that any further reductions in State General Funds are accommodated with fee increases needed to raise an equivalent amount of revenue, net of financial aid. For example, an additional \$500 million budget reduction would require an additional 32 percent increase in student fees beginning in the fall 2011. This has the unfortunate result of generating the needed amount of revenue over a smaller tax base than extending the temporary statewide taxes would have accomplished. However, the campuses have stated quite emphatically that they have literally exhausted all options for addressing budget shortfalls without embarking on a path of irretrievable decline. Therefore, the option of additional student fee increases to address future cuts must be seriously considered.

The budget discussion at the May meeting will include consideration of a "Plan B" contingency budget for how UC will manage any additional cuts from the State. A recommendation for action will be brought before the Board at a later meeting, once more is known about the budget outlook.