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Office of the President

TO MEMBERS OF THE COMMITTEE ON FINANCE:

DISCUSSION ITEM

For Meeting of May 16, 2012

UPDATE ON THE UNIVERSITY'S 2012-13 BUDGET

EXECUTIVE SUMMARY

At the November 2011 Board meeting the Regents approved an expenditure plan for 2012-13 that called for $326.6 million in increased expenditures. However, at that time the Regents did not approve any assumptions about revenues from either State or student tuition and fee sources, delaying action until after the Governor released his proposed 2012-13 budget for the State of California. This item addresses potential scenarios related to the revenue side of the University's budget plan. The Governor's January budget proposals for UC address only a small portion of UC's expenditure plan and the University's estimated $847 million funding gap from 2011-12.

At the time of the writing of this item, there continues to be much uncertainty surrounding the State budget for 2012-13:

- the Legislature has yet to act on the Governor's January budget proposals for UC;
- the "May Revise" – the Governor's revised State budget plan reflecting the most updated revenue estimates for 2012-13 as well as additional budget proposals – has not yet been released;
- several State leaders, including the Governor, have expressed an interest in providing an additional augmentation to UC to avoid tuition and fee increases in 2012-13; and
- there are several ballot measures likely to be on the November ballot, the passage or failure of which could dramatically alter the landscape with respect to State resources.

Vice President Lenz will provide an update about the May Revise, scheduled to be released on May 14, at the May Board meeting.

While it is unclear what State funds will be available to UC in the coming year, it is critical for campus planning to have a meaningful discussion about possible budget scenarios for 2012-13. With the start of the new fiscal year only six weeks after the May Board meeting, UC has yet to establish a full budget plan for 2012-13.

Campuses have implemented all possible cuts and efficiencies and cannot absorb additional budget reductions without doing irreparable harm to UC's instructional program. Past tuition and fee increases have mitigated less than half of the budget shortfall created by the current fiscal crisis that began in 2008-09; campuses have absorbed the remainder of the shortfall through actions to reduce programs, raise revenue, and increase efficiencies. In addition, campuses have been severely hindered by the lack of certainty about revenue sources and funding increases for 2012-13. Thus, while the University hopes to minimize tuition and fee increases to the greatest extent possible, without question the University needs new funding in 2012-13 in order to avoid otherwise inevitable decreases in quality.

This item lays out two scenarios to inform the revenue decisions the Regents will need to make at the July Board meeting:

- **Scenario A: A tuition and fee buy-out by the State for 2012-13.** This scenario assumes the May Revise will reflect sufficient revenues to augment UC's budget by $125.4 million in 2012-13, obviating the need for a tuition and fee increase in July 2012; and
- **Scenario B: No tuition and fee buy-out for 2012-13.** This scenario assumes that the State will not have enough revenue to buy out a tuition and fee increase for 2012-13; instead, a six percent increase in mandatory systemwide charges would be needed to help address UC's funding gap.

As discussed at previous Board meetings, the University experienced a $750 million reduction in State funds in 2011-12 alone. This includes the 2011-12 mid-year State budget reduction of $100 million that was funded on a one-time basis by the Office of the President in 2011-12 but which will be permanently absorbed by the campuses in the future. Either one of the scenarios above would provide $125.4 million in new money to the University. *Even with the efficiency savings and alternative revenues anticipated in the expenditure plan, the University will still face a funding gap of more than $1 billion for 2012-13,* including $847 million related to the current year shortfall and potentially another $139 million shortfall.

In addition, if the Governor's revenue-enhancing initiative on the November 2012 ballot does not pass, the University's State general funds budget would be cut by $200 million in the middle of the 2012-13 fiscal year. This item briefly discusses options that would be open to the Regents in the event of a mid-year budget reduction, e.g., revising the University's expenditure plan for 2012-13, recognizing that the expenditure plan includes assumptions that are unlikely to have the flexibility to be reduced; mandating actions that would further decrease instructional expenditures; and requiring the campuses to implement more employee layoffs. Alternatively, a mid-year tuition and fee increase – likely in the range of double digits – would raise enough revenue to backfill a $200 million mid-year budget reduction.

BACKGROUND

The State of UC in 2012

As discussed at the Board's March meeting, the University of California finds itself at a crossroads in 2012. UC's State support has eroded dramatically over time; UC today relies on the same absolute level of funding as in 1997-98, even though today it educates 73,000 more students and operates one additional campus. Despite consistently practicing strong and smart fiscal stewardship, a tradition that continues today with the Working Smarter initiative, in recent years student tuition and fees have increased precipitously in order to maintain the University's quality. However, increased tuition and fee revenue has not made up even half of the budget shortfall faced by UC since the most recent fiscal crisis began in 2008-09 – and students and their families have been forced to deal with unpredictable and significant increases in tuition and fees as a result.[1]

Campuses are currently implementing cuts and efficiency measures to address their massive budget reductions to date. They have been laying off employees every year since 2008-09 as well as leaving hundreds of positions unfilled; in 2010-11 alone, for example, UCLA estimates that 51 faculty positions and 524 staff positions were left unfilled. Campuses are also closing and consolidating multiple programs; over four years, UC Davis closed 15 programs, while in 2010-11 alone UC San Francisco closed 13 programs. UC Santa Barbara reports that over 87 percent of the campus' core-funded expenses are employee-related, so additional solutions to close its budget gap can only be accomplished through further reductions in employees; all campuses have already downsized, merged functions, leveraged economies of scale, and sought to improve efficiency through restructuring, collaboration, and strategic investments in technology. Campuses are also realizing savings by implementing energy efficiencies and other strategic initiatives, such as Operational Excellence at UC Berkeley and UC San Francisco, Organizational Excellence at UC Davis, and Focus on Excellence at UC Irvine.

While some of the administrative efficiencies can be regarded as positive, many of the actions taken to reduce costs in academic programs are not sustainable over the long run if the quality of a UC education is to be preserved. Campuses have reached a point where further deterioration in UC's support base will require dismantling of critical programs that are fundamental to the quality of teaching on our campuses, and indeed, the very character of this great public research university.

Multi-Year Funding Framework

As discussed at the March 2012 Board meeting, amidst the University's current funding crisis – arguably the worst funding crisis in UC's history – some promising possibilities exist for the State to address its ongoing structural deficit. Also as discussed at the March Board meeting, in his January budget proposal for 2012-13 Governor Brown stated his interest in entering into a multi-year framework with the University that would specify minimum funding levels for UC through 2016-17 and include accountability metrics that UC would be expected to meet. UC leadership has continued its discussions with both the Governor and the Department of Finance on the terms of such a framework. Success will require legislative endorsement of this agreement as well, which the Governor's administration and UC leadership have been jointly seeking and will continue to pursue over the next few months.

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[1] The University has worked hard to maintain financial accessibility for students at all income levels. The University's latest *Annual Report on Student Financial Support*, released in April 2012, is available at http://www.ucop.edu/sas/sfs/docs/regents_1011.pdf.

The features of the multi-year funding framework, which would cover the period from 2012-13 through 2016-17, include:

- annual base budget adjustments of six percent, beginning in 2013-14;
- moderate, predictable tuition and fee increases. UC would not increase tuition and fees in 2012-13 if the 2012-13 Budget Act includes a $125.4 million tuition and fee buy-out or some combination of augmentation and future base budget adjustments;
- accountability metrics for UC related to graduation rates and California Community College transfers; and
- changes in the funding of UC's capital improvement program.

Additional information about the features of the multi-year funding framework is included in the Attachment to this item.

Support for this framework is contingent on the passage of the Governor's revenue-enhancing initiative on the November 2012 ballot. The Governor's initiative earmarks no specific funds for UC, but the Governor has stated that if his initiative passes, he is committed to a multi-year framework with UC for stable funding from the State. *If the Governor's initiative does not pass, UC is slated to receive a mid-year cut of $200 million in 2012-13.*

This agreement, if endorsed by the Legislature, holds the promise of financial stability and provides the University with an ability to plan for the future after more than a decade of uncertainty and extreme volatility. The agreement sets a floor, not a ceiling, for State support – it specifically acknowledges that the University may receive additional funding for other high priorities if the State's fiscal situation permits. It also acknowledges that the University may be part of any future higher education general obligation bond. More importantly, it is an acknowledgement by the State of California that it will again become a reliable partner with the University of California.

The University's 2012-13 Expenditure Plan

While the possibility of a multi-year framework between the Governor and UC – and avoiding a $200 million trigger cut via the passage of the Governor's revenue-enhancing initiative in November – are promising possibilities, the beginning of a new fiscal year on July 1, 2012 is fast approaching. The University has in place an expenditure plan for 2012-13 that was approved by the Regents in November 2011; however, the Regents have not yet voted on revenue actions to finalize a complete fiscal plan for the University for 2012-13.

As noted in previous items, the State reduced its support for the University by $650 million when the 2011-12 Budget Act was enacted in July 2011, and the State reduced UC's funding by another $100 million in a mid-year budget cut in December 2011. When mandatory cost increases are also considered, the budget gap for the current year alone is about $1.1 billion. Tuition and fee increases mitigated only a portion of this gap ($265.8 million), leaving a shortfall for 2011-12 of $846.7 million.

In this context, in November 2011 the Regents approved a 2012-13 expenditure plan as the University's request to the State for 2012-13 funding. The expenditure plan approved in November included proposed increases for a normal workload budget (which includes salary and non-salary increases, employee health and retirement benefits, deferred maintenance, and enrollment), as well as assumptions related to restoration of excellence, efficiencies, and alternative revenues. While this was a true expression of the University's overall needs, a revised version of the expenditure plan is presented below for illustration purposes to indicate only those portions of the plan that reflect a normal workload budget as defined above. Those expenditures, shown in Display 1, total $326.6 million. The Board, however, has not proposed or acted upon any assumptions about revenues from either State or student tuition and fee sources, with the intention of reviewing potential revenue assumptions following release of the Governor's proposed 2012-13 budget for the State of California.

DISPLAY 1: Proposed 2012-13 Cost Increases (Excerpted from the Expenditure Plan Approved by the Regents in November 2011) (Dollars in Millions)

Enrollment Growth and Instructional Programs	$	36.6
Compensation and Non-salary Items		
Academic Merit Increases	$	30.0
Other Compensation Increases		
Finalized collective bargaining agreements	$	11.8
All other employees	$	85.8
Employee Health Benefits	$	22.8
Instructional Equipment, Library Materials, and Other Non-salary Items	$	21.8
Deferred Maintenance	$	25.0
Post-employment Benefits		
UCRP Contributions	$	87.6[2]
Retiree Health Programs	$	5.2
Total Increase in Expenditures	**$**	**326.6**

The Governor's proposed budget for 2012-13 includes an augmentation of $90 million toward the State's share of employer contributions to the University's retirement program, as well as $5.2 million for retiree health programs. These augmentations reduce the total needed to fund the expenditure plan to $231.4 million.

Note that the expenditure plan described above includes assumptions that are unlikely to have the flexibility to be reduced, such as academic merit increases ($30 million), the funds already collectively bargained for employee compensation ($11.8 million), UCRP contributions ($87.6 million), and retiree health program funds ($5.2 million). The University hopes to make progress on employee health benefit savings, but the positive fiscal effect for 2012-13 is likely to

[2] Represents one-fourth of the $255.6 million State share of the employer contributions to UCRP.

be minimal for the coming year, with more positive fiscal impact in future years. In addition, over the years campuses have absorbed the costs of non-salary price increases and deferred maintenance, but those are real costs that need to be met in the future. Further, the expenditure plan does not address the 2011-12 mid-year State budget reduction of $100 million that was funded on a one-time basis by the Office of the President in 2011-12, but will be permanently absorbed by the campuses going forward. This raises the total funding need for 2012-13 to $331.4 million.

2012-13 Revenue Scenarios

It is anticipated that approximately $67 million in savings to the core budget will be achieved in 2012-13 through UC's Working Smarter initiative and other administrative efficiency efforts. (As discussed at previous Board meetings, UC has set a target of $500 million in positive fiscal impact for the Working Smarter initiative. The initiative has already achieved $157.4 million in cost savings and revenue generation to date.[3])

Of the remaining $264.4 million revenue gap, a six percent increase in mandatory systemwide charges for 2012-13 would net five percent revenue or $125.4 million[4] to the campuses. The Governor has expressed an interest in providing additional funds to UC to avoid a tuition and fee increase in 2012-13, although recent State general fund revenue reports indicate there may not be sufficient resources available to achieve this goal. Either way, there would still be an unfunded shortfall of $139 million, as shown in Display 2, that campuses would need to absorb through additional budget cuts and redirection of resources.

DISPLAY 2: UC's 2012-13 Budget Shortfall (Dollars in Millions)

Increased Expenditures as Revised	($	326.6)
Mid-year 2011-12 Budget Reduction, Permanently Absorbed Going Forward	($	100.0)
Funding Provided in Governor's Proposed Budget	$	95.2
Savings to be Achieved by Working Smarter	$	67.0
Funding Provided by Tuition and Fee Buy-out or 6% Tuition and Fee Increase (annualized)	$	125.4
Total 2012-13 Budget Shortfall to Date	**($**	**139.0)**

The Regents are not being asked to approve revenue assumptions or tuition and fee increases at the May meeting. At the July Board meeting, however, the Regents will be asked to approve revenue assumptions to support the 2012-13 UC budget. Two potential scenarios for State and student tuition and fee funding are described in Display 3.

[3] More information about the Working Smarter initiative is available at http://workingsmarter.universityofcalifornia.edu.
[4] Includes revenue generated in the summer, which would not be realized until summer 2013.

DISPLAY 3: Possible Scenarios Informing Regental Action in July 2012

Scenario A:
Tuition and Fee Buy-out for 2012-13

- The May Revise reflects sufficient revenues for an additional augmentation to the University's budget in the amount of $125.4 million, obviating the need for a tuition and fee increase for 2012-13.

Scenario B:
No Tuition and Fee Buy-out for 2012-13

- Revenues assumed in the May Revise will not be enough for a tuition and fee buy-out by the State in 2012-13.
- A 6% increase in mandatory systemwide charges is needed to yield a 5% increase to UC's operating budget (with a portion of return-to-aid replaced by one-time assets; see below). This would net $116 million in fall, winter and spring[5] to be utilized by the campuses to help meet highest priorities and minimize further budget reductions that will be necessary to help meet increasing costs.
- In the event of this 6% tuition and fee increase in 2012-13, the University would maintain its practice of designating an amount equivalent to 33% of new revenue generated by undergraduates to additional UC financial aid to mitigate the impact on low- and middle-income families. Historically, the full amount of any augmentation has been funded by designating a portion of new tuition and fee revenue for this purpose (known as "return-to-aid"). However, as an alternative, the University is exploring using one-time funds available at the Office of the President to cover a portion (approximately $20 million) of the financial aid augmentation, thereby reducing the amount of return-to-aid funds needed from tuition and fee revenue to meet UC's commitment to its low- and middle-income students.
- It would be assumed that a combination of additional Cal Grant funds and additional institutional aid funds from return-to-aid, and the one-time funds from the Office of the President, would be sufficient to maintain the University's commitment to the Blue and Gold Opportunity Plan and cover 100% of an increase in mandatory systemwide charges for eligible financially needy undergraduates with incomes up to $120,000.

Campuses have already implemented all possible cuts and efficiencies and cannot absorb additional budget reductions without doing irreparable harm to UC's instructional program. There are no obvious solutions to solving the remaining $139 million shortfall, so campuses will have to do what they say they can no longer do, which is cut back programs, delay hiring faculty, consider additional layoffs, and make other programmatic consolidations or eliminations to save money in spite of the detrimental impact on quality that will result.

Possibility of a $200 Million Mid-year Budget Reduction

If the Governor's revenue-enhancing initiative on the November 2012 ballot does not pass, not only would the terms of the multi-year framework be inoperable, but the University's State general funds budget would be cut by an additional $200 million in the middle of the 2012-13 fiscal year.

In the event of a $200 million mid-year budget reduction, the Regents will need to consider a variety of options to balance UC's budget, including:

[5] The 6% fee increase would net $125.4 million on an annualized basis.

- revising the University's expenditure plan for 2012-13, recognizing that the expenditure plan includes assumptions that are unlikely to have the flexibility to be reduced, such as academic merit increases, the funds already collectively bargained for employee compensation, UCRP contributions, and retiree health program funds;
- mandating actions that would further decrease instructional and administrative expenditures (despite significant concerns about further cuts likely increasing students' time-to-degree rates and thus increasing the number of terms students must pay to attend UC);
- reviewing return-to-aid policies to achieve savings in future years; and
- further employee layoffs.

That said, campuses have already been slashing programs and laying off employees for four years. The campuses are adamant that absorbing further cuts would mean ushering in a new era at UC – that of irreversible decline.

Alternatively, a mid-year tuition and fee increase could raise enough revenue to backfill a $200 million mid-year budget reduction. It is anticipated that the increase would need to be in the range of double digits. As context to a potential mid-year tuition and fee increase, UC's mandatory systemwide charges have already increased 84 percent in the four-year period from 2007-08 to 2011-12. If the State cannot buy out an increase for 2012-13 and UC raises its mandatory systemwide charges by 6 percent this July, UC's mandatory systemwide charges will have increased 95 percent from 2007-08 to 2012-13 in only five years. (It should be noted that during the fiscal crisis of the early 1990s, fees increased by 157 percent over the five-year period – which only covered about one-fourth of the University's shortfall.)

Particularly in light of these significant tuition and fee increases, maintaining a robust financial aid program for UC's students continues to be a top University budget priority. UC continues to far outpace other major universities in enrollment of low-income students. Because of the priority UC has placed on financial aid, tuition and fee increases have thus far not proven to be a barrier to access. It is anticipated that UC's Blue and Gold Opportunity Plan, along with other financial aid resources, would cover a mid-year tuition and fee increase for eligible financially needy undergraduates from families with incomes below $120,000.

At this critical time for the University, the desire to preserve the University's world-class quality must be backed up with financial support. The campuses cannot absorb additional budget reductions without affecting quality in an irreversible way. Faculty both within UC and from other institutions are expressing a lack of confidence in UC's ability to address its fiscal challenges – a development that bodes ill for the University's ability to recruit and retain the high-quality faculty that make UC a great institution. The failure to secure sufficient support for academic programs could have an unquantifiable impact on UC's well-deserved reputation as the world's finest public research higher education system.

(Attachment)

ATTACHMENT

Features of Proposed Multi-year Funding Framework Between UC and the State

Framework Timeframe	• 2012-13 through 2016-17
Adjustments to UC's Base Budget	• 6% growth each year, beginning in 2013-14 • Would provide UC with sufficient revenue over a four-year period, beginning in 2013-14, to meet its minimum obligations with respect to UC Retirement Plan employer contributions, compensation agreements, health benefits costs, nonsalary price increases, and other heretofore unfunded cost increases • UC's base budget would also increase as a result of capital outlay changes (see below)
Enrollment	• No separate funding for enrollment growth – any enrollment growth would need to be funded from UC's base budget adjustment • UC would maintain total enrollment of California residents at least at 2011-12 levels
Capital Outlay	• Shifts lease revenue bond obligation to UC (debt service for lease revenue bonds is already in UC's base budget) • By moving capital outlay to the University's balance sheet, the State would eliminate approximately $2.5 billion from its balance sheet, lowering "the wall of debt" that has concerned the Governor • Shifts general obligation (G.O.) bond debt service to UC's base budget • Because G.O. bond debt service would be moved to the University's base operating budget, the cost adjustment amount for the University each year would increase. The increase each year could be used to finance a regular and predictable capital outlay program similar to that which the State funded for more than a decade until the recent fiscal crisis • UC would gain flexibility and efficiency in managing its capital outlay program
Accountability Metrics for UC	• Related to graduation rates and California Community College transfers • UC would continue to pursue creative methods for lowering the cost of instruction, e.g., three-year degree programs and reducing the number of units required to attain a degree • Efficiencies, beyond those already contemplated in past presentations of multi-year planning scenarios, would balance UC revenues and expenditures over the timeframe of the agreement • UC would report on metrics each fall
Tuition and Fees	• UC would not increase tuition and fees in 2012-13 if the 2012-13 Budget Act includes a $125M tuition and fee buy-out or some combination of augmentation and future base budget adjustments • For 2013-14 and beyond, UC would agree to develop a long-term tuition and fee plan for undergraduates designed to be predictable and to keep tuition and fee increases as low as possible. No level or cap has been specified. Because there is no tuition and fee plan specified in the agreement, a determination of tuition and fee levels will be decided by the Board of Regents each year, although the Governor and the Legislature could choose to approve budget augmentations in one or more years that would preclude increases in student tuition and fees • UC would maintain support for institutional financial aid, contingent upon the State maintaining support for the Cal Grant program • UC would develop a policy reflecting a commitment to limit the use of resident tuition and fees and State General Funds provided for any employee's salary above $225,000
Contingencies	• In the event the State did not meet its obligations with regard to funding, the University could impose tuition and fee increases as needed to cover the funding gap • The University could also reduce enrollment of incoming freshmen as necessary but would be expected to maintain community college transfer levels • In the event the University did not meet specified metrics by 2016-17, the State could reduce the University's base budget adjustment by up to 2% for 2017-18 if the University is unable to provide sufficient rationale for its failure to meet baseline targets