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Office of the President

TO MEMBERS OF THE COMMITTEE ON FINANCE:

DISCUSSION ITEM

For Meeting of January 19, 2012

UPDATE ON THE 2012-13 GOVERNOR'S BUDGET AND IMPACT ON THE UNIVERSITY'S BUDGET

EXECUTIVE SUMMARY

Governor Brown is due to release his proposed budget for the State of California on January 10, 2012. The Board will be presented with an update on the Governor's proposals at the January meeting.

The Board approved an expenditure plan for presentation to the Governor and the Legislature for the University's 2012-13 budget at the November meeting. The plan did not include any assumptions about revenues from either State or student tuition and fee sources. While several of the items included in the expenditure plan are mandatory, others are discretionary for 2012-13. Potential tradeoffs for the 2012-13 budget will be discussed at the January meeting. No action to amend the expenditure plan, identify fund sources, or approve student tuition and fee increases is being proposed at the January meeting.

BACKGROUND

Proposed 2012-13 Governor's Budget

On November 16, 2011, the Legislative Analyst's Office (LAO) released its annual California Fiscal Outlook on the State's economy, anticipated State General Fund revenues, and the State's expenditures. At that time, the LAO anticipated the State would fall $3 billion short in the 2011-12 fiscal year and nearly $10 billion short in the 2012-13 fiscal year, representing an overall State General Fund budget shortfall of $13 billion. On December 13, 2001, the Department of Finance (DOF) notified the Legislature that its updated State General Fund revenue estimate of $86.2 billion for the 2011-12 fiscal year was $2.2 billion lower than what had been assumed with the passage of the 2011 State Budget, and formally enacted the budget "trigger" reductions adopted as part of the final State budget package for 2011-12, including a $100 million mid-year reduction for UC.

While the DOF overall budget forecasting assumptions are a bit more optimistic than the LAO assumptions, there does seem to be agreement that there continues to be a $12 billion to

$13 billion structural budget gap. The Governor has proposed an initiative for the November 2012 ballot to temporarily increase the State sales tax by a half-cent and increase the rate on the personal income tax to generate $7 billion in State General Fund revenue. Other initiatives are being proposed by various interest groups, including a “Millionaire Tax of 2012” initiative to generate $6 billion in revenue by increasing the income tax by three percent for incomes between $1 million and $2 million and five percent on incomes over $2 million; the “Our Children, Our Future” initiative, which would raise the personal income tax on every Californian who earns more than $7,316 to generate $10 billion in revenue for the State; and the “Think Long” initiative to extend the current sales tax to services, raise taxes on out-of-state firms, and lower the personal income and corporate tax rate, and which is also expected to generate $10 billion in State General Fund revenue. The success of any one of these ballot initiatives would address over half of the State’s current budget shortfall. However, in the 2012-13 fiscal year the State budget would still be faced with a remaining structural budget deficit of $3 billion to $7 billion.

For 2012-13, UC has also proposed over $1 billion for State-funded capital facility construction as a result of the growing backlog of State-eligible projects and the State’s inability to adequately fund this backlog. California has not placed a State General Obligation (GO) bond measure on the ballot since 2006 and as a result many UC capital projects have been funded out of lease revenue bonds since 2006. However, the funding has been subject to the overall fiscal condition of the State; in addition, the increasing concern regarding the State’s overall debt service has led the State to be very cautious about approving further projects that would require the State’s debt service obligations to rise. For 2012-13, the DOF has refused to consider any of the University’s $1 billion capital outlay request. Still, UC is hopeful that the Legislature and the Governor will agree to a statewide GO bond initiative for November 2012 that would provide funding for a portion of the University’s capital outlay request. UC is also continuing efforts to work with the Governor and the Legislature on alternative financing that may allow UC to use its own credit rating to secure funding needed to address its most critical State-funded capital facility projects.

On January 10, the Governor will release his proposed budget for the State of California for 2012-13. Vice President Lenz will provide a presentation outlining the main features of the Governor’s proposal at the January Board meeting.

For the University, the Governor proposes no additional budget cuts, despite the $12 billion to $13 billion deficit still facing the State. However, the $100 million mid-year cut, effective January 1, 2012, is not temporary, as the University had requested, but permanent. On the positive side, the Governor does propose providing $92 million toward the State’s share of employer contributions to the University’s retirement program. This represents a major step forward in terms of securing the State’s participation in employer contributions for UC employees – support which is automatically provided for employees of California’s other two higher education segments. This, like all other elements of the proposed budget, will require legislative approval before it is implemented. However, it is very welcome news that the Governor supports the concept and will argue to have it included in the final budget agreement.

The Board will be updated on developments as they occur in the budget negotiation process.

Discussion of Options for Addressing the University's 2012-13 Budget

While the University's total budget for 2012-13 is estimated to exceed $22 billion, most of these funds are associated with self-supporting programs (research, medical centers, and auxiliary enterprises) and thus not included in the expenditure plan approved each year by the Board. The University's core funded budget, which supports core instructional and research programs and is the subject of most budget discussions, represents approximately 27 percent of total funding, and is comprised of State General Funds, revenue from student tuition and fees, and UC general funds.

At the November meeting, the Board approved an expenditure plan for core funds for 2012-13 that reflected the University's top priorities for the coming year, even as the University struggles against perhaps the worst fiscal crisis in its history. By way of context, the $2.27 billion State-funded base budget for the current year represents a 22 percent reduction from the prior year, down from $2.91 billion in 2010-11. In addition, unfunded cost increases totaling $362.5 million estimated for 2011-12 mean the University's existing budget gap totals more than $1.1 billion. The expenditure plan approved for 2012-13 sought to address a portion of this gap as well as anticipated new costs for 2012-13 through a combination of new revenue (although specific sources were not identified) and savings through efficiencies and cost avoidance measures.

Major elements of the expenditure plan for 2012-13 included funding for the following:

- one percent enrollment growth and support to continue expanding programs in medicine and nursing (including $15 million to continue planning for a new School of Medicine on the Riverside campus);
- an estimated three percent salary increase for staff and faculty;
- academic merit increases;
- an estimated seven percent cost increase in staff and faculty health benefits;
- contributions to the University's retirement program;
- deferred maintenance;
- non-salary price increases; and
- reinvesting in the University's academic excellence, including hiring to fill vacant faculty lines, restoring class sections, improving hours of service for academic support services, etc.

A total of $636.6 million in new funding would be required to support these items. In addition to items that require increased funding, the expenditure plan included an assumption of $100 million associated with efficiencies and cost avoidance measures as well as $125 million in new revenue from alternative sources (increased nonresident enrollment, higher indirect cost recovery rates, etc.). Thus, the expenditure plan anticipated a net increase of $411.6 million for 2012-13. Discussion of revenue sources to fund the plan, including State funds and student tuition and fees, was postponed to a later meeting.

Each of the items included in the expenditure plan represents a high priority for the University in terms of maintaining access and quality. Several are mandatory or unavoidable costs that must be funded. These include academic merit increases, contributions to the University's retirement program, and non-salary price increases. While the remaining items serve as important factors in maintaining access, competitiveness, and quality and reflect elements of an expenditure plan needed to help restore stability and fiscal health for the University and its employees, they are not mandatory in 2012-13. No action to amend the expenditure plan, identify fund sources, or approve student tuition and fee increases is being requested at the January meeting.