

Office of the President

TO MEMBERS OF THE COMMITTEE ON FINANCE:

DISCUSSION ITEM

For Meeting of July 17, 2013

UPDATE ON BUDGET FOR 2013-14 AND PRELIMINARY DISCUSSION OF 2014-15 BUDGET

The California Legislature adopted the 2013-14 State budget on June 15, meeting the constitutional deadline for sending a budget to the Governor. On June 27, the final budget package was signed into law by the Governor, along with a number of budget trailer bills. Vice President Lenz will provide an update on the 2013-14 budget package, along with a preliminary discussion of major budget issues facing UC in 2014-15.

BACKGROUND

With submission of the 2013-14 State budget to the Legislature in January, the Governor effectively completed his two-year effort to close a \$26 billion structural budget gap. His ability to close such a significant budget gap in a short period of time is due in part to the economic recovery at both the national and state levels and the successful passage of Proposition 30 last November. Consistent with the Governor's January budget proposal, the final budget package assumes \$138.3 billion in State General Funds and Special Funds, up 5.8 percent over the previous year's funding, and a \$1 billion budget reserve. The Governor's highest budget priority for 2013-14 is education, as reflected in his funding recommendations for K-12, the California Community Colleges, the California State University (CSU), and the University of California. For UC and CSU, these recommendations are embodied in a multi-year funding plan that will provide some level of fiscal stability for both university systems over the next four years.

2013-14 UC Budget

The Legislature approved the Governor's 2013-14 UC budget recommendation for a multi-year funding plan that will provide annual base budget increases over the next 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. This multi-year funding plan will provide campuses with some budget predictability that UC has needed to move forward after five years of severe State General Fund budget reductions. In addition to the augmentation to UC's base State support, the budget authorizes UC to achieve an additional \$80 million in savings of State funds through debt restructuring of State lease revenue bonds, which will help address operating budget needs over the next ten years.

The overall base budget for UC will increase from \$2.377 billion in 2012-13 to \$2.846 billion in 2013-14, or by \$469 million. The 2013-14 UC budget includes the following augmentations:

- \$125 million to fund the deferred tuition buyout promised in the 2012-13 fiscal year;
- \$125.1 million adjustment to the base budget, representing a five percent increase;
- \$6.4 million for the increase in annuitant health benefits;
- \$10.2 million to fund the increase in State lease revenue bond debt service; and
- \$202 million representing a shift of general obligation bond debt service to the UC base budget.

While this represents an increase of nearly 19.8 percent to the UC State General Fund appropriation, it does not represent a similar percentage increase in buying power for the 2013-14 fiscal year. The portion of funding associated with the deferred tuition buyout will be used to permanently fund cost increases that occurred in 2012-13. The sizeable transfer to UC's budget of funding to cover State general obligation bond debt service related to University capital projects is a pass-through and not available for UC's operating needs; however, this transfer increases UC's base from which future budget adjustments are calculated. Attachment 1 to this item details the State General Fund changes to UC's budget.

In addition, the following actions were taken by the Governor and the Legislature as part of the final deliberations on the 2013-14 UC budget:

Debt Restructuring – This initiative was originally designed at the request of the UC Regents as a creative financing mechanism that would mitigate the need for a dramatic increase in tuition and complement the overall reinvestment by the State in the University. The proposal is to restructure existing financing for capital facility projects to achieve approximately \$80 million in annual savings over the next ten years to address UC support budget expenditures. As proposed by the Legislature in the budget and budget trailer bills sent to the Governor (AB 110 and AB 94, respectively), this funding would address the State's 2013-14 share of UC's employer contribution of retirement system costs of \$67.2 million, freeing up the need to fund this commitment out of the \$125.1 million base budget increase.

Inclusion of the debt restructuring proposal in the budget also changes the State's approach to funding UC's capital facility projects by allowing the University to use State operating funds for capital outlay purposes. The Governor's commitment to reducing the State's "wall of debt" effectively precludes the State from securing bonds to finance the University's future capital facility needs. Instead, campuses will be required to prioritize funding debt service of critical capital facility projects against their support budget needs. The debt restructuring provision also fundamentally alters the State approval process for UC's capital facility projects, providing a streamlined State review process that will give UC an ability to address critical facility needs in a more expedient and efficient manner.

Performance Outcome Measures – The education trailer bill associated with the budget package includes a recommendation for UC (and CSU) to report on the following performance outcome measures:

- Number/proportion of transfers;
- Number/proportion of low-income students;
- four-year graduation rates for UC and CSU and six-year graduation rate for CSU (disaggregated by freshman entrants, transfers, graduate students, and low-income status);
- Degree completions (disaggregated by freshman entrants, transfers, graduate students, and low-income status);
- First-year students on track to degree completion (i.e. the percent of first-year students who earned a specified number of units);
- Spending per degree;
- Units per degree; and
- Number of science, technology, engineering, and mathematics (STEM) degrees in the following areas: computer and information sciences; engineering and engineering technologies; biological and biomedical sciences; mathematics and Statistics; physical sciences; and science technologies.

An additional measure was proposed related to degrees per 100 full-time equivalent students (FTES) but was ultimately not included in the final budget package.

Online Education – The budget adopted by the Legislature included language, with some minor changes proposed by UC, associated with the Governor’s request to direct \$10 million of UC’s base budget augmentation to development of online courses for students, particularly courses that can be accessed across UC campuses. However, the Governor vetoed this, and all other earmark provisions in the budget, saying the earmarks would “create cost pressures and unnecessary restrictions. Eliminating these earmarks will give the University greater flexibility to manage its resources to meet its obligations, operate its instructional programs more effectively, and avoid tuition and fee increases.” (The Governor’s veto message and a summary of the items vetoed are provided in Attachment 2 to this item.) Nevertheless, the University intends to honor the spirit of the language that was vetoed. This funding will allow UC to offer an additional 150 online courses over the next three years, while addressing student and campus support needs, facilitating greater academic program coordination across campuses, and establishing an evaluation and accountability framework.

Enrollment Target – The budget includes an enrollment target number recommended by the Legislative Analyst’s Office of 211,499 full-time equivalent students (FTES) for UC (and also a specific enrollment target for CSU) based on 2012-13 actual enrollments and an additional one percent growth. UC has been adamantly opposed to any enrollment target that fails to recognize approximately 9,000 students for whom the State has provided no funding. With the Governor and the Legislature focused on UC (and CSU) enrolling more low-income students and expanding transfer students from the California Community Colleges, it is imperative that any agreement with the State on enrollment targets be based on enrollments that the State has at some point actually funded. Both UC and CSU opposed this language, and President Yudof sent a letter to the Governor requesting a veto of this item, which the Governor agreed to do; the 2013-14 budget no longer includes an enrollment target.

Cost of Education – The budget includes language that requires UC (and CSU) to report on the cost of undergraduate, graduate academic, and graduate professional education, and research activities by funding source. Originally, the language required UC to report immediately on these costs by campus. UC has worked with the Department of Finance to amend this language to allow reporting on “core education funding” on a systemwide basis within two fiscal years and then on a campus-by-campus basis two years later.

AFSCME Request – The budget approved by the Legislature included a \$4.8 million budget redirection from the \$125.1 million base budget adjustment in 2013-14 for a “non-existent” MOU agreement with AFSCME (SX). At the University’s request, the Governor vetoed this redirection.

UC Riverside, School of Medicine – As part of the negotiations on the budget, the University agreed to direct \$15 million of new funding for the UCR School of Medicine. Funding for the new School of Medicine is an extremely high priority for the Regents and has been part of their annual budget request for the last four years.

UC Merced, Classroom and Academic Office Building – Also as part of the negotiations on the budget, UC agreed to direct \$3.6 million of new funding for the debt service associated with a \$45 million Classroom and Academic Building at the Merced campus. This project was funded with \$4.5 million out of remaining general obligation bonds in the 2012-13 UC budget for preliminary plans and working drawings.

Middle Class Scholarship Program – The final budget includes \$750,000 for the California Student Aid Commission (CSAC) to develop and implement a new Middle Class Scholarship Program within the California Student Aid Commission budget. The program will provide grants for students who come from families that earn less than \$150,000 in an effort to lower their tuition and fees by 40 percent. This program would begin in fall 2014 and increase over a four-year period, with annual State General Fund revenue to be capped at \$305 million. The funding would come from Proposition 39 funds that are not part of the Proposition 98 budget dedicated to energy efficiency and reduction of greenhouse gas (GHG) emissions.

2014-15 UC Budget Issues

There are a number of issues related to the development of the 2014-15 UC budget that will come before the Regents at their September meeting in preparation for final adoption at the Regents’ November meeting. The Governor’s multi-year funding plan assumes a five percent State General Fund increase to the 2014-15 UC base budget of \$2.846 billion, or an additional \$142.3 million. The Governor has also called for a continuing freeze on general tuition increases for 2014-15 with no promise of a State buyout, with which the University has several significant concerns. The budget request will also continue to assume more efficiencies and cost savings for the University, and will place a priority on maintaining access for California residents. UC will also develop revised requests for capital facility projects, continue working with the Governor and the Legislature on energy efficiency and greenhouse gas reductions in an effort to secure future Proposition 39 funding, and work with the California Student Aid Commission on the development and implementation of the Middle Class Scholarship Program.

(Attachments)

University of California
2013-14 Governor's Budget Proposal
(\$ in millions)

	<u>Proposed Governor's Budget</u>
2012-13 Operating Budget -- State General Funds	\$ 2,377.3
2012-13 tuition and fee buy-out (included in 2013-14 budget)	\$ 125.0
Revised Subtotal, 2012-13 State General Funds	<u>\$ 2,502.3</u>
2013-14 Increase in State General Funds	
5% base budget adjustment ¹	\$ 125.1
Annuitant health benefits	\$ 6.4
Lease purchase revenue bonds ²	\$ 10.2
Subtotal, New State General Funds for Operating Budget Purposes	<u>\$ 141.7</u>
<i>% Increase in 2013-14</i>	<i>6.0%</i>
<i>% Increase in 2013-14 (including deferred 2012-13 tuition buy-out)</i>	<i>11.2%</i>
2013-14 State General Funds for Operating Budget Purposes	\$ 2,644.0
Transfer of GO bond debt service to UC base budget	<u>\$ 201.7</u>
State General Fund Budget for 2013-14	\$ 2,845.8

¹ From the 2013-14 base budget adjustment:

\$10.0 is directed to the Innovative Learning and Technology Initiative

\$15.0 is directed to the UC Riverside School of Medicine

\$3.6 is directed to debt service for the Classroom and Office Building at the UC Merced campus

² Existing base budget already includes \$211.2 million for lease revenue bond debt service.

³ Budget package assumes savings of \$80 million in State General Funds related to debt restructuring, to be available for operating budget purposes.

⁴ Totals may not add up due to rounding.

Governor's Veto Message

Item 6440-001-0001—For support of University of California. I revise this item by deleting Provisions 6, 8, 10, 11, 12, 13, 14, 15, and 16.

I am deleting Provisions 6, 8, 10, 11, 12, 13, 14, and 15 because the requirements included in these provisions that the University of California expend funds for various purposes create cost pressures and unnecessary restrictions. Eliminating these earmarks will give the University greater flexibility to manage its resources to meet its obligations, operate its instructional programs more effectively, and avoid tuition and fee increases.

I am deleting Provision 16 as the appropriation establishes the expectation that the University will enroll 211,499 state-supported full-time equivalent students during the 2013-14 academic year. This provision would continue to make enrollment the primary driver of state budgeting for higher education. Instead, the investments made in the University should be used to ensure the timely graduation of students and make improvements on other performance measures established in this Budget.

Item 6440-301-0658—For capital outlay, University of California. I delete this item.

I am deleting the \$375,000 from the 1996 Higher Education Capital Outlay Bond Fund for the equipment phase of the Merced, Science and Engineering Building 2 project. The funding for this item is appropriated in a separate bill.

Summary of Vetoed Items

Provision 6 – \$10 million associated with the Governor's January budget recommendation to fund online education. While the Governor has vetoed the language association with this provision, UC has made a commitment to provide the \$10 million as requested by the Governor for this purpose.

Provision 8 – \$4.8 million for the “non-existent” MOU agreement with AFSCME Service Workers.

Provision 10 – \$8.3 million associated with the Charles R. Drew University of Medicine and Science. Governor Brown has vetoed this before; nevertheless, UC remains committed to providing this funding.

Provision 11 – \$8.75 million associated with AIDS research. Governor Brown has vetoed this before; nevertheless, UC has remains committed to providing this funding.

Provision 12 – This is an item identified as \$24.6 million in State General Funds for the Student Academic Preparation and Education Partnerships (SAPEP). In fact, this was an error in the budget as the State has only provided \$12.3 million and the University of California has provided a matching amount of \$12.3 million. Governor Brown has vetoed this provision before; nevertheless, UC remains committed to providing this funding.

Provision 13 – \$1.7 million funding for graduate and undergraduate nursing programs. Governor Brown has vetoed this provision before; nevertheless, UC remains committed to providing this funding.

Provision 14 – \$2 million allocated for the Programs in Medical Education (PRIME) funding. Governor Brown has vetoed this provision before; nevertheless, UC remains committed to providing this funding.

Provision 15 – budget bill language associated with the California Subject Matter Projects, California State Summer Schools for Mathematics and Science (COSMOS), Student Financial Aid, the Science and Math Teacher Initiative, and the Labor Centers. Governor Brown has vetoed these provisions before; nevertheless, UC remains committed to providing this funding.

Provision 16 – budget bill language requesting UC to meet a 2013-14 enrollment target of 211,499 in State-supported full-time equivalent students. The State has not provided funding for this level of students; UC calculates the appropriate number to be 203,573 FTEs.

6440-301-0658 – Equipment for UC Merced Science and Engineering Building 2

This is merely a technical deletion as a result of the funding provided in a separate budget trailer bill.