

Office of the President

TO MEMBERS OF THE BOARD OF REGENTS:

DISCUSSION ITEM

For Meeting of July 30, 2020

UPDATE ON THE 2020-21 OPERATING BUDGET

EXECUTIVE SUMMARY

The COVID-19 pandemic continues to create uncertainty for many aspects of the University's operations, including but not limited to the University's academic medical centers, instructional delivery, research, and auxiliary enterprises such as housing and dining services. Although the Budget Act of 2020 provides greater clarity about potential State support for the University next year, the level of support is highly contingent on the availability of new federal stimulus funds by October 15. Similarly, a far-reaching federal rule regarding international student visas that was recently proposed—and then quickly rescinded—illustrates the unpredictable context in which campuses must develop and adapt their 2020-21 budget plans. Campuses are considering and/or employing a variety of strategies to address these challenges in conjunction with systemwide actions to contain costs and ensure adequate access to working capital.

BACKGROUND

The onset of the COVID-19 pandemic continues to create great uncertainty for many if not most aspects of the University's operations. Among the functions most immediately affected are the University's academic medical centers, instruction, research, and auxiliary enterprises such as housing and dining services.

Now, nearly five months into the pandemic, a clearer picture is only starting to emerge about the financial implications of the pandemic for some of these areas. For example:

- Between March 2020 and June 2020, the pandemic resulted in an estimated \$1.5 billion of lost revenue to the University. Approximately two-thirds of this amount was attributable to the University's academic medical centers and clinical operations, where the diversion of resources towards treating COVID-19 patients limited the ability to deliver other revenue-generating patient services. The remainder was primarily due to refunds of student housing and dining contracts, along with other auxiliary enterprises (e.g., athletics) where revenue declined as a result of curtailed campus operations.
- The University also incurred an estimated \$255 million in additional expenses attributable to the pandemic during this same period, including \$167 million for

emergency medical services (including the cost of personnel protective equipment, testing, and supplies), \$26 million for extraordinary cleaning costs, and \$62 million to support the rapid transition to remote instruction and remote employment.

- Federal assistance will offset a portion of these revenue losses and extraordinary costs. For example, the Coronavirus Aid, Relief, and Economic Security (CARES) Act allocated \$267 million to UC campuses (including at least \$130 million for student financial assistance) from the Higher Education Emergency Relief Fund, or HEERF. In addition, UC Health has received approximately \$485 million from the Provider Relief Fund, also established by the CARES Act. UC campuses and medical centers are also pursuing cost reimbursement from the Federal Emergency Management Agency (FEMA).
- The State Budget Act of 2020 provides upper and lower boundaries for the level of State support that the University can expect to receive in 2020-21, although the difference between the two—approximately \$470 million—is large. (The Budget Act is described in greater detail below.)

DISCUSSION

As previously discussed at the May 2020 meeting of the Finance and Capital Strategies Committee, the financial challenges caused by the pandemic can generally be grouped into two categories: those having an immediate impact with a high likelihood of gradual recovery, and those having a delayed impact for which the timeframe for recovery is less certain.

The two functional areas that have experienced the greatest financial impact to date—academic medical centers and auxiliary enterprises—fall squarely into the first category. Medical center revenues have already begun to show signs of recovery and hospital occupancy rates and ambulatory patient visits have increased gradually since April. Campuses are also developing plans to gradually reopen housing and dining facilities, along with other campus resources, although these plans are highly contingent on the trajectory of the pandemic and the successful implementation of all relevant health and safety protocols.

Compared to May 2020, the University now has better information about the range of State support that it can expect to receive in 2020-21. The University's 2020-21 State General Fund appropriation is detailed in the Budget Act of 2020, which was enacted by Senate Bill 74 (SB 74) and amended by Assembly Bill 89 (AB 89). As enacted, SB 74 provides the University with a base budget increase of approximately \$170 million (five percent) in addition to new funding for the UC Riverside School of Medicine (\$25 million), support for the UCSF School of Medicine Fresno branch campus (\$15 million), funding for graduate medical education to replace a projected shortfall in Proposition 56 revenue (\$3.7 million), and certain one-time appropriations.

AB 89, however, amends the Act and replaces the base budget *increase* of \$170 million with a *decrease* of approximately \$300 million from 2019-20 levels. The decrease in funding—just over \$470 million—would be fully reversed if the State receives \$14 billion in new federal stimulus funds by October 15, 2020. If the State receives less than \$14 billion but more than

\$2 billion, any amount over \$2 billion would be used to offset cuts to UC and several other State agencies on a proportionate basis.

The final State Budget Act represents a welcome improvement over the earlier May Revise budget proposal. Under that proposal, the University faced a base budget cut of \$372 million from 2019-20 levels if new federal stimulus funds did not materialize, and funding would have remained nearly flat at 2019-20 levels if stimulus funds were received. Moreover, the May Revise did not include any proportionate restoration of funding to the University if the State were to receive some, but not all, of the \$14 billion of new federal stimulus funds.

The University is closely monitoring indicators of student enrollment for fall 2020-21, which could significantly impact revenue from student tuition and fees next year. Preliminary indicators such as summer 2020 enrollment and students' Statements of Intent to Register (SIRs) continue to suggest that the University's total enrollment in 2020-21 will be at or near its targeted level. Nevertheless, actual enrollment and tuition revenue will not be known until the start of the fall term and remain difficult to predict. In early July, for example, colleges and universities across the country were stunned by a proposed rule from Immigration and Customs Enforcement (ICE) that, if implemented, would have forced currently enrolled foreign students to leave or face deportation if they were enrolled only in online classes this fall. Although the rule was rescinded eight days after its announcement, the episode illustrates the potential for unforeseen developments to further complicate campuses' planning efforts for 2020-21.

The University's research enterprise faces its own uncertainties as a result of the pandemic. To date, federal sponsors have generally been flexible in allowing additional time to address interruptions caused by curtailed campus operations. Research in some disciplines may benefit from the availability of new federal funding related to COVID-19 and pandemics generally. Nevertheless, the disruption of UC research activities can have a detrimental impact on graduate students, postdoctoral scholars, and early-career faculty members whose educational and professional advancement is highly dependent on their building a strong research portfolio.

Amid this uncertainty, campuses and the University as a whole are taking prudent steps to develop tools and resources to help address the immediate and longer-term financial challenges created by the pandemic.

- Campuses are taking full opportunity of the financial assistance provided by the CARES Act and FEMA reimbursement, as described above.
- The University continues to advocate for additional federal support to offset the impact of the pandemic. Access to additional federal stimulus funds will determine whether the University's State support increases by roughly \$170 million over 2019-20 levels or declines by \$300 million from the prior year.
- The University has taken significant cost containment steps related to hiring and compensation, including a salary freeze for nonrepresented staff and a voluntary salary reduction of ten percent for the President and Chancellors.

- Campuses have developed plans to scale their research activities down or up, as appropriate, according to tiered stages of research recovery tied to local public health indicators.
- The University recently priced a bond transaction that resulted in \$2.8 billion in proceeds at an extraordinarily low cost of capital (2.15 percent). Of this amount, \$1.5 billion will be provided to campuses for working capital to help address the reduced revenue and extraordinary costs that they anticipate in 2020-21. The remaining \$1.3 billion will be used for over capital projects at all ten campuses and to refund existing debt for cash flow savings.

Additional information about how the University and individual campuses are responding to the financial challenges created by the pandemic will be presented at the July 30 meeting.