

Office of the President

TO MEMBERS OF THE FINANCE AND CAPITAL STRATEGIES COMMITTEE:

DISCUSSION ITEM

For Meeting of May 20, 2020

PROJECTED COVID-19 IMPACT ON 2019-20 AND 2020-21 REVENUE

EXECUTIVE SUMMARY

The financial challenges created by the COVID-19 pandemic have implications for many aspects of the University's budget. The magnitude and potential duration of those challenges vary widely and, in some cases, cannot be readily quantified due to the evolving and unprecedented nature of the pandemic. Amid this uncertainty, the University is taking full advantage of federal and State resources and implementing prudent cost containment measures to address the most immediate financial challenges. At the same time, the University is developing preliminary multi-year scenarios to inform the development of a more comprehensive strategy, which will involve ongoing consultation and refinement as the pandemic's trajectory and longer-term implications for the University become clearer.

BACKGROUND

The COVID-19 pandemic has not only had a tremendous toll on public health across the globe but has also created financial challenges for the global economy, governments, public and private institutions, and individuals. These include significant challenges for institutions of higher education.

Compared to many other colleges and universities, the University of California is better prepared to weather these challenges due to a robust operating model with several important features.

- *Diversified revenue mix.* Revenue from the University's medical centers and affiliated clinics, student tuition and fees, State appropriations, auxiliary enterprises, and public and private grants all make critical contributions to the University's total operating budget of nearly \$40 billion.
- *Extraordinary demand for University-provided services.* Demand for the world-class instruction, research, and health care provided by the University has historically remained strong even during extended periods of economic distress.
- *Appropriate levels of working capital.* Collectively, UC campuses and medical centers had over \$14 billion in working capital as of March 31, 2020 – an amount roughly equivalent to 155 days' cash on hand.

- *Agility in responding to crises and opportunities.* As demonstrated by the University's rapid and successful shift to remote instruction earlier this year, as well as the ability of UC medical centers to provide care for COVID-19 patients while ensuring the safety of healthcare workers, the University is capable of adapting quickly to changing circumstances.

Even with these advantages, the University can anticipate difficult choices in responding to the financial challenges created by the pandemic, which are distinctive in at least three ways.

- *Scope.* To varying degrees, the pandemic will affect multiple components of the University's budget. Medical centers, for example, have experienced lower-than-expected revenues because services related to COVID-19 have limited their capacity to serve other patients. Revenues from auxiliary enterprises such as housing, dining, and athletics declined during the spring term and will likely be affected throughout the summer and into the fall. Potential changes in tuition and fee revenue (reflecting students' enrollment decisions), State support, contract and grant revenue, and investment income are all likely if not inevitable.
- *Scale.* Although the impact of the COVID-19 pandemic will vary by revenue source, its projected impact on some sources will be significant. The University estimates that the financial impact associated with pandemic-related revenue losses and cost increases during the months of March and April alone totaled \$1.2 billion across the system, including \$700 million attributable to the University's medical centers (with considerable variation by center). Although the pandemic has not affected State support for the University in the current fiscal year, the California Department of Finance and the Legislative Analyst's Office project a substantial budget deficit for 2020-21, as described below, suggesting that significant reduction in the University's State appropriation next year is possible.
- *Uncertainty.* Ultimately, the impact of the pandemic on the University's resources will be a function of multiple variables, including but not limited to how soon the spread of the virus is contained, how rapidly the general economy will recover, how students are taught and housed during the next academic year, the potential impact on students' enrollment decisions, and future State budget appropriations for UC. Because of the unprecedented nature of the pandemic, none of these can be predicted with great certainty at this point.

DISCUSSION

The revenue considerations resulting from the pandemic can be grouped into two general areas, each with different implications for the University's overall budget.

Areas with Immediate Impact Followed by Gradual Recovery

To date, most of the revenue loss attributable to the pandemic has been limited to (a) the University's medical centers and clinics and (b) auxiliary enterprises such as housing and dining.

For medical centers, the diversion of limited physical resources towards treating COVID-19 patients has greatly limited the ability of UC hospitals and clinics to deliver other essential inpatient and outpatient services, resulting in a large short-term reduction in operating revenue. Student housing and dining operations were severely curtailed in the spring as the University quickly shifted to large-scale remote instruction; students received refunds for the unused portion of their housing and dining contracts, resulting in lower-than-expected revenues for those enterprises.

As campuses and medical centers return to normal operations over time, annual revenues from both medical centers and auxiliary enterprises are expected to recover. Early signs of this trend are already evident at medical centers, where patient volume has started to increase after a sharp decline. Given strong student demand for on-campus housing and dining, a similar recovery is expected once campuses transition back to on-campus instruction and implement appropriate health and safety protocols. For these areas of the University's budget, therefore, a principal challenge is the development of an adequate "bridging" strategy until such a recovery occurs to address the intervening period of lower-than-expected revenues, the duration of which is not yet known.

Areas with Delayed Impact and Uncertain Recovery

Two revenue sources—student tuition and fees, and direct State support for the University—provide the vast majority of support for the University's core academic programs and the infrastructure needed to deliver them. To date, they have been largely unaffected by the pandemic. That will likely change in 2020-21, although the full scale of the impact is not yet known.

In a "Fiscal Update" issued on May 7, the Department of Finance projected a looming budget deficit of \$54.3 billion for the State, including \$13.4 billion in the current year and \$40.9 billion in 2020-21. (The overall projected deficit is equivalent to nearly 37 percent of budgeted General Fund expenditures in 2019-20.) A report published by the Legislative Analyst's Office on May 8 projects a deficit ranging from \$18 billion to \$31 billion. Although projections vary and are subject to change as more information becomes available about the pandemic's trajectory, the State economy, and other factors, a significant reduction in ongoing State support for UC in 2020-21 is possible. The timeline and prospects for full restoration of any such cuts could be uncertain for some time. (Even today, State support for the University remains below 2007-08 levels after adjusting for inflation, California resident enrollment growth, and other factors.)

The University has taken no action to increase base tuition, the Student Services Fee, or Nonresident Supplemental Tuition for 2020-21. Revenue from these sources, however, could potentially change next year based on changes in student enrollment. Very preliminary indicators of 2020-21 enrollment (including spring 2020 enrollment levels and partial information about admitted students' enrollment decisions for fall 2020) suggest that the University's total enrollment in 2020-21 will be at or near its targeted levels. As fall 2020 approaches, however, the possibility remains that travel restrictions and/or a continued reliance on remote instruction could cause some students to make different decisions. The uncertainty is highest among

nonresident undergraduate students—particularly international students—whose tuition provides critical support to campus operating budgets.

Planning Amid Uncertainty

Despite the many unknowns described above, the University has taken a number of concrete steps to address the immediate financial challenges and to anticipate longer-term challenges, the full extent of which may not be known for some time.

- The University will take full advantage of reimbursement opportunities for pandemic-related costs provided by the Federal Emergency Management Agency (FEMA).
- The University has accessed over \$260 million in federal support provided by the Coronavirus Aid, Relief, and Economic Security (CARES) Act to provide emergency grants to students and to cover institutional costs and revenue losses attributable to COVID-19.
- UC hospitals have received an additional \$288 million to date in CARES Act funding to cover a portion of their pandemic-related costs.
- Pursuant to another provision of the CARES Act, the University plans to defer an estimated \$700 million of the University's employer contribution to Social Security in 2020. Although the contribution will need to be repaid in 2021 and 2022, the deferral will provide additional liquidity for campuses this year.
- The University has taken initial, prudent cost containment steps related to hiring and compensation.
- The University has developed initial planning scenarios for how the pandemic and its second-order effects could affect the University's revenues over a multi-year period. These are being refined as more information becomes known and will be shared at the Finance and Capital Strategies Committee meeting. The scenarios represent one step in a longer, consultative process of developing strategic options for the Regents' review and consideration.