F4

Office of the President

TO MEMBERS OF THE COMMITTEE ON FINANCE:

DISCUSSION ITEM

For Meeting of September 18, 2013

REVISED LONG-TERM BUDGET MODEL

A detailed presentation about UC's long-term budget model was last made to the Regents in July 2012. Since then, several significant events have affected the University's fiscal situation, namely the passage of Proposition 30 by California voters in November 2012 and the potential for several years of State funding increases through a multi-year funding plan proposed by the Governor. In addition, UC's long-term budget model has been updated to reflect elements of the 2013-14 State budget and assumptions about State funding through 2016-17; to incorporate updated information on alternative revenue assumptions; to further delineate the difference between mandatory and high priority costs; and to further refine the assumptions regarding UC's "Reinvestment in Quality" initiatives. Details of the updated budget model are discussed in this item and will be presented at the September Board meeting, along with a range of scenarios showing the varying extent of the University's budget gap, utilizing different parameters.

BACKGROUND

The University's long-term budget model was first developed and presented to the Regents over two years ago, at the March 2011 meeting of the Board, and the most recent update was in July 2012. Subsequently, in November 2012, California's voters passed the Governor's revenue-raising initiative, *The Schools and Local Public Safety Protection Act of 2012* (i.e., Proposition 30), which enabled the University to avoid a $250 million trigger cut in 2012-13 and allows the State to implement the Governor's plan to provide multi-year funding for the University. The University is extremely grateful to California's voters for their support for Proposition 30 and UC. Without adequate State support, the challenge of continuing to provide a world-class education at an affordable cost to all eligible California residents would have been insurmountable.

The long-term budget model is intended to provide the Regents and other senior University leadership with an ability to understand the potential revenue sources and other positive fiscal solutions available to the University through 2016-17 as well as the cost drivers necessitating funding solutions. It is clear that while Proposition 30 marked a critical turning point in terms of UC's fiscal outlook, there are many challenges ahead and difficult trade-offs to consider.

Updates to the University's Long-Term Budget Model

With the passage of the 2013-14 budget, the University received State augmentations totaling $467 million, of which $256.4 million is available for unrestricted distribution to the operating budget. The budget also includes a $10.2 million adjustment for lease revenue bond payments and shifts $200.4 million of general obligation bond debt service to the UC base budget. In addition, the State budget authorizes UC to achieve an estimated $80 million in additional savings of State funds through debt restructuring of State lease revenue bonds, which will help address operating budget and capital outlay needs over the next ten years. For purposes of this planning exercise, the University anticipates in its long-term budget model that the Legislature will approve the Governor's recommendation for a multi-year funding plan that will provide further annual base budget increases over the next few years: five percent in 2014-15, four percent in 2015-16, and another four percent in 2016-17.

In addition, the budget model now reflects a few other significant updates, including the following:

- The model now differentiates between truly mandatory costs for the University – for example, UCRP contributions and employee and retiree health benefits that the University must fully fund in all budget scenarios going forward – and high priority costs, for which the University has discretion whether or not to fund them, and to what extent. High priority costs include compensation increases; deferred maintenance; expanding and renewing essential infrastructure and facilities; and maintaining progress on seismic and other life-safety improvements; and
- The model further refines the assumptions concerning UC's "Reinvestment in Quality" initiatives. As discussed in item E1 at the May 2013 meeting of the Board *(Academic Performance Indicators at the University of California)*, UC faces tremendous challenges in terms of sustaining UC's excellence as a public research university. The "Reinvestment in Quality" initiatives built into the long-term budget model target five areas that will enable UC to make necessary improvements to the quality of UC's core academic programs: reducing the student-faculty ratio; providing funds for start-up costs associated with hiring new faculty; reducing the salary gap for faculty and staff; increasing graduate student support; and enhancing undergraduate instructional support.

Multi-Year Funding Scenarios

A successful long-term funding plan for UC requires the optimal execution of the four elements of UC's budget plan:

1) Stable and predictable funding from the State;
2) Leveraging of alternative revenue;
3) Achievement of administrative efficiencies; and
4) A moderate and stable tuition plan.

All scenarios include two components that the University is committed to under any and all circumstances: realistic alternative revenue generation, and realistic achievement of administrative efficiencies. UC is well aware of the fact that the University must resolve a good portion of its future budget gap without relying on State funding or tuition increases; thus, internal solutions play a key role in the long-term budget model. The creativity, thoroughness, and follow-through that characterize the institution's efforts around generating alternative revenue sources and implementing administrative efficiencies is a positive outcome of the otherwise devastating fiscal crisis.

In addition, the University is very grateful to the Governor for his instrumental success in closing the State's $26 billion structural budget gap and making education his highest priority for 2013-14. The base budget augmentations provided to UC by the State in 2013-14 and planned for the next few years signify the welcome, necessary return of the State to being a true partner with UC. The State's historic commitment to UC has enabled the University not only to educate the brightest students, but to touch the lives of every Californian by conducting research that fuels the economy, providing state-of-the-art patient care facilities, and educating innovators and entrepreneurs who drive California's competitiveness and employ scores of Californians. State funds, along with tuition and fees, provide the resources essential to UC's academic program; fully 97 percent of ladder-rank and equivalent faculty are paid from these core funds, and UC's extraordinary faculty are the foundation of its excellence. State funds are also the basis upon which other funds are leveraged. The State's plan to provide base budget increases to UC over the next few years is a fundamental component of the University's return to fiscal health and the world-class quality that Californians deserve.

However, the State has expressed reluctance about the University increasing tuition and fees over the next few years, even moderately. As discussed in the following item F5, *Discussion of the 2014-15 Budget*, tuition and fees – not State General Funds – are now the largest single source of revenue supporting the University's basic educational mission. The State recognizes that moderate and stable increases to State General Fund support for the University are essential to maintain quality. Likewise, moderate and stable tuition increases are also essential to maintain the University's unmatched status as the world's finest public research institution.

Acknowledging Governor Brown's request that there be no tuition increases over the next four years, UC has developed scenarios illustrating what would happen if State support were provided but the University did not increase tuition and fees compared with what would happen if the University implemented modest tuition and fee increases in future years.

Given all these points, the different scenarios that will be presented to the Regents at the September meeting of the Board will assume increases in State support of five percent, four percent and four percent in 2014-15, 2015-16 and 2016-17, respectively; realistic alternative revenue generation; and realistic achievement of administrative efficiencies. Other parameters to be discussed with the Regents that may vary in different scenarios include tuition and fee increases; compensation increases; spending on deferred maintenance; enrollment growth; capital improvement expenditures; and funds allotted to UC's "Reinvestment in Quality" initiatives. The resulting budget gaps under various scenarios will also be discussed at the September meeting of the Board.

Multi-Year Funding from the State Does Not Close the University's Budget Gap

UC's modeling of various scenarios makes it clear that the University needs increases in State support *and* moderate and stable tuition and fee increases to maintain quality and access. If UC is not able to increase tuition and fees over the next few years, the University must start scaling back its scope – becoming smaller by admitting fewer students, eliminating programs, and decreasing the quality of its instructional enterprise.

UC's long-term budget model continues to show that there are no "magic bullets" or simple solutions to the University's budget shortfall. As described at previous Regents meetings, efficiency efforts and new revenue sources, such as increased philanthropy and research overhead, can realistically contribute only a portion of what is needed over the next few years to mitigate the University's funding gap. Even if the State provides annual base budget adjustments to UC, moderate annual tuition increases will still be needed to avoid a substantial decline in quality.

Regarding tuition increases, it is essential to note that the University's outstanding financial aid program, combined with the Cal Grant program and other aid programs, would alleviate the burden of tuition increases for many students. In 2012-13, grant and scholarship assistance fully covered mandatory systemwide tuition and fees for over half of California resident undergraduates. In addition, the Middle Class Scholarship Program sponsored by Speaker Pérez will provide new funds to many California families that had not previously qualified for financial aid. The program will effectively reduce net tuition at UC by 40 percent for those families with annual incomes of up to $100,000 and by ten percent for those with incomes up to $150,000. The program will be phased in over four years, beginning in 2014-15.