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Office of the President

TO THE REGENTS OF THE UNIVERSITY OF CALIFORNIA:

DISCUSSION ITEM

For Meeting of September 17, 2020

REVIEW OF 2009 BUDGET ACTIONS

EXECUTIVE SUMMARY

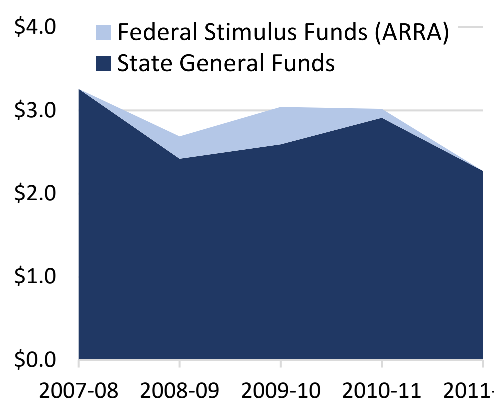
The COVID-19 pandemic continues to create uncertainty for many aspects of the University's operations. As the resulting financial challenges continue to unfold, campuses and the University as a whole are reviewing actions that may be needed, in addition to those already taken, to address the potential for both short- and long-term shortfalls in revenue as well as higher-than-expected costs.

The University last faced an acute budgetary challenge following the onset of the Great Recession. In response to dramatic declines in State support, the University took a series of actions from 2009 through 2011 to identify alternative revenues and to reduce costs—both on a one-time basis and on a permanent basis. This item reviews several of those actions to inform discussions about options for responding to the current budget crisis in a way that sustains, to the extent possible, the University's ability to fulfill its three-part mission of instruction, research, and public service and maintains its commitment to students, faculty, and staff.

BACKGROUND

The Great Recession and its impact on the State budget created a severe financial challenge for the University of California. As shown in Display 1, the full extent of the challenge was mitigated for several years by one-time federal stimulus funding provided by the American Reinvestment and Recovery Act (ARRA). Nevertheless, by 2011–12, State support for the University had declined by nearly $1 billion from 2007–08 levels. The decline was equivalent to 30 percent of the University's 2007-08 State appropriation and 18 percent of the University's 2007–08 total core funds budget.

Display 1:
State General Fund Support, 2007-08 to 2011-12



Figures are in billions and are not adjusted for inflation.

In 2009 and succeeding years, the University adopted several strategies to respond to this challenge in both the short and long term. These can be grouped into two broad categories: strategies to generate alternative resources and strategies to control or reduce costs.

Strategies to Generate Alternative Resources

One-Time Resources

- *Authorization of two percent extraordinary payout on true endowments.* The great majority of endowments held by the University of California are subject to donor restrictions on how they may be used. Moreover, for so-called "true endowments," the corpus of the gift must be held in perpetuity (or for a specified period of time) and only the resulting annual payout from investment income may be expended. Nevertheless, endowments can potentially serve as an alternative revenue source in cases where an increased payout may be directed towards departmental activity previously funded by a more flexible fund source. The Regents authorized an extraordinary payout of two percent on endowments in order to give campuses a degree of budgetary flexibility for one fiscal year as they addressed the shortfalls in State support described above.

- *Authorization of two percent extraordinary payout funds functioning as an endowment.* In addition to true endowments (where the corpus of the endowment may not be expended), the University also holds various funds functioning as an endowment (FFEs). In many cases, the permitted use of these funds is also restricted. As with true endowments, however, payouts from FFEs can provide budgetary flexibility in cases where the terms of the FFE are aligned with functions that would otherwise be supported by a more fungible fund source. The Regents also authorized an extraordinary one-time payout of two percent on FFEs to address budget shortfalls.

- *Authorization to draw down funds from employee/retiree healthcare reserve.* The University expected to end fiscal year 2010–11 with approximately $97 million in its employee/retiree healthcare reserve fund, which had been established to provide a hedge against substantial increases in the cost of providing health care to retirees. The Regents authorized the President to draw down up to $97 million over two years to provide one-time support to campuses.

Permanent/Ongoing Resources

- *Transfer of $1 billion from STIP to TRIP.* To increase investment returns available to the campuses, the Office of the President had previously established a systemwide target allocation for working capital consisting of 70 percent for the Short Term Investment Pool (STIP) and 30 percent for the Total Return Investment Pool (TRIP). The President asked the Regents to approve a rapid transition to a more aggressive balance of 60 percent STIP and 40 percent TRIP to generate a higher ongoing level of investment returns.

- *Increase endowment cost recovery by ten basis points.* The University recovers eligible administrative costs associated with *managing* endowments that fund research, teaching, and public service. The University recovers these management costs by means of an endowment cost recover (ECR) rate that is embedded in the endowment payout rate. In order to fully recover all allowable costs, the Regents were asked to approve an increase in the ECR rate by ten basis points in 2011.

- *Growth in nonresident undergraduate student enrollment.* In order to address the decline in State funds and to support the enrollment of California resident students beyond the numbers previously funded by the State, campuses began to enroll greater numbers of nonresident undergraduate students. In addition to increasing the geographical and cultural diversity of UC campuses, this strategy also provided essential support to campus operating budgets because the Nonresident Supplemental Tuition (NRST) paid by nonresident undergraduates, when combined with the other charges that they are assessed, exceeds the marginal cost of instruction.

- *Increases in mandatory student charges.* The Regents approved a series of increases in mandatory systemwide charges between 2008–09 and 2011–12 to partly backfill the decline in State support. A significant portion of the revenue was used to expand the University's undergraduate and graduate financial aid programs. (The University sets aside 33 percent of new tuition revenue from undergraduate students and graduate students in professional disciplines for financial aid, along with 50 percent of new tuition revenue from graduate academic students.) The additional resources for financial aid, together with the State's Cal Grant program, allowed the University to launch the Blue and Gold Opportunity Plan in February 2009. Under the Plan, eligible financially needy California undergraduates with incomes up to $60,000 could expect to have their UC systemwide tuition and fees covered by scholarship or grant awards for up to four years (two years for transfer students). The income ceiling was increased to $80,000 in 2011–12.

Strategies to Control or Reduce Costs

<u>One-Time Savings</u>

- *Salary freeze and suspension of bonuses/variable pay for Senior Management Group members.* In January 2009, the Regents imposed a salary freeze on members of the Senior Management Group (SMG) for fiscal years 2008–09 and 2009–10 along with other restrictions on participation in bonus and variable pay programs for the same time period.

- *Voluntary pay cut for selected senior University leaders.* In May 2009, the University moved forward with voluntary pay cuts of five percent that were unanimously taken by senior UC leaders—specifically, the President, all Executive and Senior Vice Presidents, the General Counsel, all Chancellors, and all Executive Vice Chancellors. The pay cuts were effective for the 2009–10 fiscal year.

- *Hiring freeze and/or deferral for faculty and staff.* All campuses introduced some form of hiring freeze, whether strictly controlled centrally or determined at the departmental or college level. In addition, all campuses cut back on the number of faculty recruitments, in several cases by 50 percent or more.

- *Temporary furlough/salary reduction plan.* In July 2009, the Regents approved a systemwide furlough/salary reduction plan for twelve months beginning September 1, 2009. Among the plan's distinctive features were the following:

  - The plan was designed to be progressive in order to lessen the financial impact on employees with lower salaries. Compared to employees with lower salaries, higher-paid employees were required to take a greater number of unpaid days off ("furlough days"), resulting in a proportionately larger reduction in earnings. (SMG members received a comparable reduction in earnings but were permitted to take no more than 10 furlough days.) The number of furlough days and equivalent salary reduction for employees at different income levels are shown in Display 2, below.

Display 2: Furlough Days by Salary Tier, 2009 Plan

Eligible Compensation	Furlough Days: Staff	Furlough Days: Academic Year Faculty*	Equivalent Salary Reduction (Approx.)
$40,000 or below	11	7	4%
$40,001 to $46,000	13	9	5%
$46,001 to $60,000	16	10	6%
$60,001 to $90,000	18	12	7%
$90,001 to $180,000	21	14	8%
$180,001 to $240,000	24	15	9%
$240,001 or higher	26	17	10%

*Furlough days for faculty paid on a fiscal year basis were generally similar to those for staff.

  - The plan was accompanied by changes to the UC Retirement Plan to ensure that the reduction in days worked did not affect employees' service credit for purposes of determining their post-retirement pension benefit.

  - The plan allowed the President to consider alternate plans for medical centers to achieve the same level of savings in order to ensure that essential services were not disrupted.

  - The plan excluded academic and staff employees who were funded entirely from extramural contracts, grants, or cooperative agreements, because any salary savings would have to remain within the contract, grant, or cooperative agreement and would not be available to increase general campus resources.

  - The plan was designed to minimize any negative impact on students. Student employees were excluded from the plan, and faculty members were not permitted to use furlough days on days of face-to-face instruction.

The plan was implemented pursuant to Regents Standing Order 100.4(qq) upon the Regents' declaration of an "Extreme Financial Emergency" in July 2009. The Standing Order defines an "Extreme Financial Emergency" as "any event(s) or occurrence(s) creating an imminent and substantial deficiency in available University financial resources which could reasonably be expected to jeopardize the ability of the University, campus, or multiple campuses, to sustain its current or future operations in a manner which would allow it to fulfill its tripartite mission consistent with past practices."

Permanent/Ongoing Savings

- *Forgoing merit increases or general range adjustments for nonrepresented faculty and staff.* In response to the fiscal crisis created by the Great Recession, no merit increases or general range adjustments were provided for nonrepresented faculty and staff in 2008–09, 2009–10, or 2010–11. Individual ladder-rank faculty members continued to be eligible for peer-reviewed, merit-based promotional increases but received no general range adjustment. Note that although this strategy resulted in annual (rather than one-time) savings, it also contributed to the erosion of UC ladder-rank faculty salaries relative to those at UC's benchmark institutions. The University has had to dedicate additional resources in recent years in order to make progress in closing this competitive gap.

- *Working Smarter Initiatives.* Beginning in 2010, launched a portfolio of projects to streamline and improve processes and to deliver significant cost savings or new revenue relative to the initial investment. Known collectively as *Working Smarter*, the projects spanned nearly every aspect of the University's administrative functions including procurement, travel, banking, employee benefits, risk management, and legal services. Many of these projects resulted in permanent operational efficiencies, and several were subsequently expanded beyond their original scope.

- *Voluntary separation programs.* In order to reduce the University's cost structure by increasing the number of employees who decide to retire or otherwise voluntarily separate from the University, the Office of the President issued guidelines for establishing local voluntary separation programs (VSPs) in 2009. Chancellors and medical center Chief Executive Officers were delegated authority to implement such programs in their respective areas of responsibility.

- *Position elimination.* In addition to the measures described above, positions were eliminated at every campus and at the Office of the President in response to the fiscal crisis. Between October 2008 and October 2011, the number of general campus career staff and faculty members supported by core funds declined by over 4,200 on a full-time equivalent basis.

Implications for Current Financial Challenges

As discussed at the July 2020 meeting of the Board of Regents, some of the financial challenges caused by the pandemic have had an immediate impact but also have a high likelihood of gradual recovery. Others will have a delayed impact for which the timeframe for recovery is less certain. A combination of short-term bridging strategies and longer-term structural changes will thus be needed to address a complex set of challenges. The mix of strategies will likely differ by campus in recognition that the nature and magnitude of the challenges also differ by campus.

Individual campuses and the University as a whole have already employed some of the strategies described above in response to significant revenue losses and/or extraordinary expenditures. Some of the strategies used in prior years are unavailable or less applicable today. (For example, there are diminished opportunities to shift working capital from STIP to TRIP, and Regents Policy 2109: Policy on Nonresident Student Enrollment limits campuses' ability to increase undergraduate nonresident enrollment.) Additional opportunities that were not contemplated in response to the last fiscal crisis may be available today.

As the dimensions of the current fiscal challenges become better known—in particular, the impact of the pandemic on fall 2020 student enrollment and State support for the University in 2020–21—the Office of the President is consulting broadly with the Academic Senate, Chancellors, students, and other stakeholders to develop a robust set of options for further consideration. Any proposed actions requiring Regental approval will be presented to the Board in November.