

Office of the President

TO MEMBERS OF THE COMMITTEE ON FINANCE:

DISCUSSION ITEM

For Meeting of July 15, 2009

UPDATE ON THE 2009-10 BUDGET AND PRELIMINARY DISCUSSION OF THE UNIVERSITY'S 2010-11 BUDGET

Vice President Lenz will make a presentation on these and other related issues at the July meeting.

Update on the 2009-10 Budget

With the continuing deterioration of the State's fiscal situation and the failure of ballot initiatives in the special May 19 election, the Governor proposed significant additional cuts throughout State government to address an estimated \$24 billion statewide shortfall as part of his May Revision to the budget. Additional cuts to the University's budget have been proposed in both 2008-09 and 2009-10, some of which would be backfilled with additional federal economic stimulus funds beyond what had been anticipated in the February Special Session budget package. These proposals have been adopted by a legislative conference committee and a new version of the budget is being presented to both houses of the Legislature at the time of this writing.

The conference committee version of the budget includes additional program reductions statewide, revenue accelerations and fees, nearly \$2 billion in new tax revenue, and other technical adjustment actions such as fund shifts and borrowing. The budget conference committee rejected the Governor's proposals to eliminate new Cal Grants and decouple Cal Grants from University fee increases, eliminate most State funds for Hastings College of the Law, and eliminate the CalWORKS program. Instead, the conference committee proposed some reductions to these programs. Further negotiations will be likely before a final budget package is reached.

The attached table summarizes the reductions for 2008-09 and 2009-10 with additional detail that tracks each cut already approved and those proposed to date. Some reductions are one-time, some are permanent. The net reduction in State investment during 2008-09 is \$176 million, after accounting for one-time assistance from federal economic stimulus funds, and \$637 million in 2009-10. By way of illustration, the \$2.61 billion remaining in the University's base budget from State funds in 2009-10 is about 20 percent less than the \$3.25 billion in State funds appropriated to the University in 2007-08.

The Governor's proposal to eliminate all funds for the University's outreach program was rejected by the conference committee. Instead, the \$31.3 million that had been slated for the targeted reduction to outreach is now unallocated. In addition, another \$17.8 million was reduced from the University's budget to better align UC's cuts with those adopted for the California State University system.

In addition to the reductions of State funds, the University faces a further gap of \$335 million over the two-year period related to increasing costs that have not been funded by the State (increases in student enrollments, health benefit costs, faculty merit increases, utility costs, etc.). Fee increases already approved for 2008-09 and 2009-10 fill only about \$211 million of the shortfall described above.

The University has been working to ensure that it is conserving resources and curtailing spending:

- Spending at the Office of the President has been reduced by more than \$60 million and the workforce has been reduced by more than 30 percent.
- Salaries for senior managers have been frozen, and the highest-level leaders, including the president, are taking a five percent pay cut.
- Freshman enrollment slots were reduced by 2,300 for this fall.
- Campuses have achieved a range of budget cuts, including reducing or freezing hiring, curtailing faculty recruitment, and, in some cases, implementing layoffs.

The magnitude of the proposed cuts will force UC to consider painful options to address its budget shortfall. Proposals for compensation reductions through furloughs or pay cuts in 2009-10 are being brought before the Regents at the July meeting in a separate item. These actions are proposed as one-year actions subject to reconsideration for an additional year. A range of options for implementing compensation reductions is being considered, including pay cuts, furloughs, or some combination of both. It is likely that the compensation actions will generate a little more than \$190 million in savings to apply toward the State General Funds shortfall.

In addition, campuses will need to consider actions for implementing deep budget cuts, including consolidation or elimination of programs, additional layoffs, increasing class size, reducing hours of service in some programs, and other programmatic reductions. As part of the discussion of this item at the July meeting, Chancellors will present a brief description of the actions being taken at each campus to address the budget shortfall.

Preliminary Discussion of the University's 2010-11 Budget

The discussion of the funding and program issues that should be considered in the development of the 2010-11 UC budget is occurring within the context of a continuing State budget crisis that is likely to persist beyond the 2010-11 fiscal year.

Traditionally, the University's annual budget request includes funding recommendations for enrollment growth, compensation (including health benefits), and other specified University budget funding priorities. The State has provided no funding to address the University's budget

priorities for the last two fiscal years' budget and unless the State's economy and fiscal condition improve, State resources are likely to be limited for purposes of funding UC's budget priorities in the 2010-11 fiscal year. In fact, further budget reductions may be in store.

In this context, a preliminary discussion of the 2010-11 budget should include at least the following issues:

- **Enrollment Growth:** In the 2009-10 fiscal year, the University curtailed freshman enrollment by 2,300 FTE students, while increasing transfers from the California Community Colleges by 500 FTE, for a net reduction of 1,800 new students. Even with this action, total University enrollment is expected to grow by at least 700 students in 2009-10. Previous estimates indicated that the University was over-enrolled by 11,000 students. Recent additional budget reductions proposed by the Governor and being deliberated by the Legislature would indicate that the University's over-enrollment is significantly higher than 11,000, given the significant decline in resources. It is assumed the State will not be in a position to fund any increased enrollment in 2010-11, given the continuing fiscal crisis. Therefore, options are being developed to continue the curtailment of freshmen at the current 2,300 level as well as at higher levels. These options will be discussed in more detail at the September meeting.
- **Compensation:** Proposals for cost reductions through furloughs and/or pay cuts are being brought before the Regents at the July meeting in a separate item.
- **Health Benefits:** Options for addressing the rising cost of health benefit plans are being reviewed and will be reported to the Board at a future meeting.
- **Retirement Contributions:** It is anticipated that employer and employee contributions to the University's retirement system will begin on April 15, 2010. Options for funding the employer contribution for the State's share of this cost are still being developed in view of the fact that this funding is not included in the University's 2009-10 budget. It is critical, however, that the State begin making contributions for its share as soon as possible, despite the continuing fiscal crisis.
- **Student Fees:** The Regents implemented a 9.3 percent increase in mandatory systemwide student fees for the 2009-10 fiscal year. With the magnitude of additional budget reductions currently proposed for the University, it is possible that a mid-year fee increase will need to be considered for implementation in the second semester/winter term to help address budget shortfalls. In addition, further increases in student fees for 2010-11 are likely, given the budget gap that must be addressed, even if no further reductions are proposed for the coming fiscal year. As has been the case historically, it will be important to provide sufficient financial aid to mitigate the impact of these fee increases on needy students. Professional school fees are likely to rise consistent with the three-year plans reviewed at the May meeting.
- **Capital Outlay:** The State's fiscal crisis produced a temporary freeze early in 2009 on the sale of bonds needed to support capital outlay projects already approved by the

Legislature and the Governor, and the number and dollar volume of subsequent bond sales have been limited. Currently, UC has \$324.4 million in state General Obligation (G.O.) bonds and \$275 million in lease revenue bond projects that have already been approved by the Governor and the Legislature; however, the State does not have the ability at this time to sell commercial paper to fund these projects. The crisis also has created a reluctance in the Legislature to approve further debt financing for additional capital outlay projects, so the University's 2009-10 capital outlay program request of \$575 million has not been approved at this point. Because available bond funding has been severely limited over the past two years, the University's capital construction program has been unable to keep pace with its enrollment and renewal needs. The University will seek approval of a new General Obligation Bond for higher education to fund projects in 2010-11 and beyond. Campuses are developing new ten-year capital outlay plans that will include their priorities for 2010-11, reflecting the impact of delay in the capital program from the freeze and lack of funding in the coming year.

(Attachment)