

AGENDA

COMMITTEE ON FINANCE

Meeting: 1:00 p.m., Tuesday, July 22, 2014
Glenn S. Dumke Auditorium

Roberta Achtenberg, Chair
Steven M. Glazer, Vice Chair
Talar Alexanian
Adam Day
Rebecca D. Eisen
Debra S. Farar
Margaret Fortune
Lupe C. Garcia

Consent Items

Approval of Minutes of Meeting of May 20, 2014

Discussion Items

1. 2014-2015 Support Budget, *Information*

**MINUTES OF THE MEETING OF
COMMITTEE ON FINANCE**

**Trustees of The California State University
Office of the Chancellor
Glenn S. Dumke Conference Center
401 Golden Shore
Long Beach, California**

May 20, 2014

Members Present

Rebecca Eisen, Acting Chair
Adam Day
Lillian Kimbell
Bob Linscheid, Chair of the Board
J. Lawrence Norton
Timothy P. White, Chancellor

Trustee Eisen called the meeting to order.

Approval of Minutes

The minutes of March 25, 2014 were approved by consent as submitted.

Report on the 2014-2015 Support Budget, *Information Item*

Mr. Ryan Storm, Interim Assistant Vice Chancellor for Budget, presented an update on the 2014-2015 support budget.

He highlighted the most significant components of the 2014-2015 Governor's Budget Proposal issued in January, which are: (1) an increase of \$142.2 million that could be used for operating and capital needs of the CSU and (2) a new capital budget proposal that would shift debt service and future capital funding responsibilities from the state to the university.

The May Revision is the DOF's opportunity to alter the January Budget Proposal. Anticipating this opportunity, the Chancellor's Office requested additional funding from the DOF for the capital budget proposal last month. But, no additional funding was provided at the May Revision to complement the statutory flexibilities and tools envisioned under the proposal.

The May Revision estimated state revenue increases of \$2.4 billion above the January budget forecast. Several other expenditure priorities have nullified any of these state revenues being used to augment the CSU budget under the DOF plan. These other priorities include a much larger than anticipated increase in Medi-Cal caseloads; a shoring up of the CalPERS & CalSTRS retirement systems; a required adjustment to the state's constitutional spending guarantee for K-

12 schools and community colleges (Proposition 98); and, new expenditures to combat the drought.

Mr. Storm informed the board that the Legislative Analyst's Office (LAO) released its analysis of the May Revision, and in it they estimated that state revenues will be \$2.5 billion higher than the DOF's estimate—or \$4.9 billion above the January budget forecast. However, he cautioned that the LAO revenue estimate could result in no more than several hundred million dollars of additional resources for non-Proposition 98 programs and departments like the CSU, given higher spending required on Proposition 98 for K-12 schools and community colleges.

In the past, the CSU has made final budgetary decisions at the May Board of Trustees meetings, when it was generally known how the state would fund the CSU at that time. In good economic times, a funding agreement or compact with the then governor would be assumed and ultimately funded. In more challenging economic times, the trustees anticipated in the March and May meetings the need to align the trustees' budget with budget reduction amounts indicated in the governor's January budget proposal or the May Revision.

This year is different. There is no budget reduction, however the DOF's funding plan is significantly less than the trustees' budget request. The state has positive revenues and there has been significant interest by the legislature to reinvest in the CSU after many years of significant funding reductions. Many legislators have expressed an interest in expanding capacity on CSU campuses - both in new student enrollments and more access to courses for current students. As a consequence, staff is working with the legislature to improve the CSU's budget picture with the end goal of producing additional degree-holding graduates that can serve California. The legislature may accomplish this by redirecting funding away from the other priorities to the CSU budget or they may accomplish this by assuming the higher revenue estimate of the LAO. With final state budget decisions still to be determined, there is not enough information to determine a final budget for the CSU at this meeting.

Instead, the Chancellor's Office will await final state decisions before finalizing the CSU budget, pursuant to the resolution (RFIN 11-13-07) passed in November 2013 that authorizes the chancellor to adjust and amend the support budget to reflect changes in the assumptions upon which the budget is based. The Chancellor's Office will provide proper notification to the Board of Trustees in the future.

Lt. Governor Gavin Newsom commented the he believes this is the right approach and feels the sentiment in Sacramento is the desire to invest in CSU. It is wise to not just give up and accept the budget proposal as it is currently drafted.

California State University Annual Debt Report, *Information Item*

Mr. George V. Ashkar, Assistant Vice Chancellor/Controller for Financial Services presented the debt report. This report is provided annually to give the status of the CSU revenue projects. The

Systemwide Revenue Bond (SRB) program provides capital financing for revenue generating projects of the CSU – projects in which the facility being built generates revenue through fees, rents, and other charges to use the facility. Typical projects include student housing, parking facilities, student union facilities, health center facilities, continuing education facilities, and certain auxiliary organization projects.

Mr. Ashkar reported the outstanding SRB debt to be \$3,605,000,000 as of June 30, 2013, and \$3,507,000,000 as of December 31, 2013. He explained that debt service coverage is an indicator of the financial strength of the overall SRB financing program and is the ratio of net operating cash flow available after operating expenses have been paid relative to debt service, (i.e. the principal and interest). For the year ended June 30, 2013, debt service coverage was 1.63, exceeding the minimum benchmark of 1.45 established by Executive Order 994. Exceeding the benchmark is desirable.

He informed the board that the SRB program has a rating from Moody's of Aa2 and a rating from Standard & Poors of AA-, both with stable outlooks. These two ratings are generally equivalent, and are very good ratings. The rating from Standard & Poors reflects an upgrade from A+ in July 2013. The impact of this improvement in the rating from Standard & Poors is roughly 20 basis points or 0.20% in the cost of financing a project based upon current market conditions. Stated differently, this would translate into an annual cash flow benefit of about \$20 thousand for every \$10 million that is financed through the program.

Since the last debt report a year ago, the CSU has had one bond issuance under its SRB program. That sale took place in July 2013 and totaled approximately \$309 million in bonds issued to refund existing SRB campus and auxiliary debt, producing net present value savings of approximately \$20 million.

The SRB program has been a valuable tool for our universities to rely on for needed facilities that are ineligible for any kind of state funded support. The program is well managed at both the system and campus level, and remains strong.

Approval to Issue Trustees of the California State University, Systemwide Revenue Bonds and Related Debt Instruments for Various Projects, *Action Item*

Mr. George V. Ashkar, Assistant Vice Chancellor/Controller for Financial Services presented an item requesting authorization to issue long term Systemwide Revenue Bonds (SRB) financing and the issuance of Bond Anticipation Notes (BANs) to support interim financing under the Commercial Paper Program in an aggregate amount not-to-exceed \$150,700,000 to provide financing for two campus projects, and to refund an outstanding issue of Auxiliary Organization Bonds. Mr. Ashkar noted that, as was discussed in the annual report on the Systemwide Revenue Bond program, the following are financing items in which revenue generated by the relevant facilities covers the cost of debt service and operating expense.

The board was asked to approve resolutions related to the financing and the refunding of:

1. The San Jose State University Campus Village Housing 2 Project

A ten story, 850 bed facility to be occupied by first-time freshman as part of the on-campus freshman housing requirement.

The approximately 193 thousand gross square foot facility will replace a portion of existing, older inventory that will be demolished, providing a net increase of 450 beds. The not-to-exceed par value of the proposed bonds is approximately \$141 million that includes project, program reserves, and financing costs. The housing program net revenue debt service coverage is 1.25 in 2017-2018, the first full year of operations, which exceeds the CSU benchmark of 1.10 for the program.

For all campus pledged revenue programs, the campus' overall net revenue debt service coverage for the first full year of operations is projected to be 1.62, which exceeds the CSU benchmark of 1.35 for the campus. Again, exceeding the benchmark is desirable. The specific benchmark requirements of 1.35 for a campus and 1.10 for a program are requirements set forth in Executive Order 994, Financing and Debt Management Policy. The levels are based off of feedback that CSU has received from rating agencies and the bond market industry as desirable for the CSU bond credit. The CSU has a goal to have an overall system minimum debt service coverage ratio of 1.45 per Executive Order 994 and 1.25 for auxiliary organizations.

The debt service coverage ratio is computed by taking the revenue, subtracting the operating expenditures, and then dividing by the annual debt service.

2. California State University San Marcos Field House Expansion

This project will be a multipurpose venue for sports, enabling the campus to achieve National Collegiate Athletic Association Division II membership standards. In June 2013, a \$25 per-term increase in Student Body Center fees was approved to support the project financing.

The not-to-exceed value of the proposed bonds is \$6,925,000 and is based on a total project budget of \$11,400,000, with Student Union Program Reserve contributions of \$5,500,000, and additional financing costs being funded by the bonds.

The campus financial plan projects a Student Union Program net revenue debt service coverage of 1.71 in 2017-2018, the first full year of operations, which exceeds the CSU benchmark of 1.10 for the program. For all pledged revenue programs, the campus overall net revenue debt service coverage for the first full year of operations is projected to be 1.80, which exceeds the CSU benchmark of 1.35 for the campus.

3. The CSU, Chico Research Foundation - Office Building Refinancing

The CSU Chico Research Foundation, a recognized Auxiliary Organization in good standing, seeks approval for the refund of an existing stand-alone auxiliary organization bond issue through SRB to generate savings of capital. On April 15, 2014, The Chico Research Foundation Board of Directors adopted a resolution authorizing the refunding of the auxiliary bonds through the SRB program.

The size of the proposed refunding, related to the original costs associated with the 2003 bonds for acquisition and improvements of a 19,000 square foot office building (known as "25 main"), is at a not-to-exceed par amount of \$2,915,000 and is estimated to generate a net present value savings of approximately \$237,000.

Staff recommended approval of these three projects authorizing the sale and issuance of SRB bond anticipation notes and CSU Systemwide Revenue Bonds not-to-exceed \$150,700,000. Upon motion duly made and seconded, the committee approved the Issuance of Trustees of the California State University, Systemwide Revenue Bonds and Related Debt Instruments for Various Projects (RFIN 05-14-03).

There being no further questions, Trustee Eisen adjourned the Committee on Finance.

COMMITTEE ON FINANCE

2014-2015 Support Budget

Presentation By

Steve Relyea
Executive Vice Chancellor and
Chief Financial Officer

Ryan Storm
Interim Assistant Vice Chancellor
Budget

Summary

The purpose of this agenda item is to inform the California State University (CSU) Board of Trustees of budget-related decisions made by the state affecting the CSU and describe the CSU expenditure plan for 2014-2015. The CSU must align the November 2013 support budget request of \$237.6 million with the \$142.2 million provided by the state in the final budget act.

Background

At its November 2013 meeting, the Board of Trustees approved the CSU 2014-2015 Support Budget Request. That budget request called for an increase of \$334.3 million, including \$237.6 million from state funds and \$96.7 million of net student fee revenues tied to enrollment growth. The approved uses of the increase included funding for:

- Mandatory cost increases, including health benefits and new space,
- Student success and completion,
- A three percent compensation increase pool,
- Enrollment growth, and for
- Financing maintenance and infrastructure needs.

As discussed at the January 2014 CSU Board of Trustees meeting, the 2014-2015 Governor's Budget identified a \$1.9 billion surplus for 2014-2015. This surplus was net of \$8.3 billion of increased state revenues between 2013-2014 and 2014-2015.

The governor utilized a portion of these revenues to provide a \$142.2 million state general fund increase for the CSU support budget. This amount is consistent with the governor's multi-year funding plan first proposed and adopted in 2013-2014.

By the end of May 2014, the governor and legislature had both estimated higher state revenues and priorities for those funds. Specifically, the governor estimated \$10.7 billion (\$2.4 billion more than his January 2014 estimate) and the legislature estimated \$13.2 billion of increased revenues between 2013-14 and 2014-15, net of a \$1.6 billion surplus for 2014-2015. While the governor maintained his January 2014 commitment of \$142.2 million at the May Revision, the Senate and the Assembly proposed an additional \$95 to \$100 million for the CSU, respectively. These latter amounts would have met the Trustees' request.

However, the final budget agreement presumes the lower of two statewide revenue estimates and the enacted budget is consistent with the governor's proposal released in January 2014 for the CSU. It provides a programmatic increase of \$142.2 million from the state General Fund, bringing state support for the CSU to \$2.7 billion.

Because the state provided approximately 60 cents for every dollar requested by the Board of Trustees, there is a need to further prioritize and re-size what were already reasonable and necessary new expenditure levels in the CSU support budget request.

Proposed Expenditure Plan

Enrollment

Many CSU campuses experienced record levels of applications for Fall 2014. A total of 761,000 individuals applied to CSU campuses for Fall 2014, an increase of over 14,000, or two percent. In spite of this, state budget cuts during the recession continue to have repercussions today that constrain the ability of the CSU to admit eligible applicants.

This revised budget attempts to achieve a balance between various critical program needs and a constrained budget augmentation from the state. The revised budget plan will allow growth in state-assisted enrollment in the CSU system by approximately 9,900 students (approximately 8,300 full-time equivalent students). Even with this additional funding, it is likely that campuses would have to redirect resources from other program areas to reach this student access goal.

Employee Compensation Pool

At this juncture, there are critical salary-related concerns across CSU employee groups that require attention by the CSU leadership and in the collective bargaining process. Reduced levels of funding from the state during the recent recession and the necessary priority given to preserving the quality of academic programs, student services, and public safety have limited the CSU to providing a general compensation increase of only 1.34 percent since 2007 and 2008. In fiscal year 2009-2010 furloughs were imposed and CSU employees experienced a nine percent salary reduction.

The proposed pool will provide resources that build upon the 1.34 percent provided in 2013-2014 to continue to address the pressing need to compensate employees fairly for the work they perform and enhance the CSU's ability to recruit and retain top quality faculty and staff. An allocation of approximately \$91.6 million amounts to approximately a three percent increase in the total CSU compensation pool to employees. However, the distribution of the pool to various groups will depend on market factors, the collective bargaining process, and other factors. It is not anticipated that all employee categories will receive raises or receive the same amounts.

Infrastructure Needs

There are ample examples on every CSU campus of academic and plant facilities that are in need of repair or replacement. The systemwide backlog cost is approximately \$1.8 billion with that cost growing by approximately \$100 million per year. With \$10 million annually dedicated to pay the debt service on bonds, approximately \$130 million of the university's most pressing facility repairs could be accomplished, depending upon market rates of interest. In lieu of this commitment, very limited financial resources are available for the CSU to make a marked improvement in existing campus facilities.

Student Access, Success, and Completion Initiatives

An allocation of \$22 million will be used to address key factors that impact student access and success such as reducing time to degree, closing the achievement gap, and improving graduation rates. Systemwide objectives will guide campus proposals to hire more tenure-track faculty and staff, scale up existing best practices or implement new and innovative strategies to enhance academic advising, improve student services focused on retention and shortened time to degree, and close the achievement gap through targeted academic and student support, specifically to underserved and under-prepared first-time freshman.

Mandatory Costs

Approximately \$14.3 million of the augmentation will be used to meet anticipated mandatory costs. Mandatory costs are the expenditures the university must pay regardless of the level appropriated by the state. These costs include recent increases to employee health benefits, operations, and maintenance of newly constructed space. Without funding for the mandatory cost increases, campuses would have to redirect resources from other program areas to meet their obligations. Funding mandatory costs preserves the integrity of the CSU programs.

Other Budget Items

Several issues are worthy of note.

Capital Outlay and Financing Framework

The state budget also contains the governor's capital outlay and financing framework proposal. This provides the CSU \$297 million that will be used in the short term to pay existing general obligation and state Public Works Board debt service. There remains an understanding in the out years that the spikes in debt service that have been discussed at Board of Trustee meetings will garner additional resources. As that debt is retired over time, this funding can be used for new infrastructure investments or other CSU priorities. This also provides the CSU new financing flexibilities and tools that provide the CSU significant new autonomy to repair, maintain, renovate, and construct academic-related facilities.

Student Success Fee Moratorium

New state law places a moratorium on new student success fees until January 2016. In addition, the chancellor is required to review the CSU Fee Policy as it relates to student success fees and recommend any changes to the board by February 2015. The board has the discretion to act on those recommendations.

Academic Sustainability Plan

State law established last year requires the CSU to report on a number of student success performance measures. Some examples include the number of students enrolled by different student categories, two-year and three-year graduation rates of community college transfer students, and the number of degree completions by varying student categories. The state budget builds upon these performance measures by requiring the CSU to prepare a multi-year plan that would establish annual goals for the performance measures and outline how assumed revenues and expenditures would sustain the plan and achieve the goals. This proposal would require the

trustees to adopt a multi-year budget plan based on yet-to-be defined assumptions prescribed by the Department of Finance (DOF). The plan is due to the state in November 2014. This will be a significant departure from the practice in which the trustees annually determine revenue and expenditure assumptions and adopt the CSU support budget.

Awards for Innovation in Higher Education

The state budget includes a one-time \$50 million program administered by a new seven-member selection committee. The purpose of the program is to identify and reward public colleges and universities that have particular success in: (1) increasing the number of bachelor's degrees awarded; (2) improving four-year graduation rates; and (3) easing transfer through the public higher education system and recognizing learning that has occurred across the public higher education system or elsewhere. Awards will be provided to the colleges and universities that have or plan to bring successful models to scale for the benefit of the three public higher education institutions. Campus applications are due to the DOF in January 2015. The structure of the program sidesteps Chancellor's Office involvement, which could be challenging in fulfilling the purpose of the program. The state does not have an institution that can take any identified best practices to scale at CSU campuses like the Chancellor's Office.

Possible Deferred Maintenance Funding

The CSU could receive up to \$50 million of one-time funding for campus deferred maintenance projects. The state budget structured this in a way that if state property tax revenues exceed May 2014 estimates by \$200 million, CSU and the University of California will each be provided \$50 million. This positive budget "trigger" is feasible, considering that property tax data this summer must eclipse the springtime estimate by only 1.3 percent. It is expected that the CSU will learn of the outcome by August 2014.

Summary

The governor signed the 2014-2015 Budget Act and the higher education budget trailer bill on June 20, 2014. In terms of appropriations for the CSU, the enacted budget is consistent with the governor's proposal released in January 2014 and sustained at the May Revision. It provides a programmatic increase of \$142.2 million from the state General Fund for support of the CSU, bringing state support for the CSU to \$2.7 billion out of a \$108 billion state General Fund budget.

The enacted budget is inconsistent with the spending plan tied to the amount approved at the November 2013 meeting of the Board of Trustees. While challenging to prioritize and to allocate funding among the many CSU needs, this will continue the process that began in 2013-2014 of

reinvestment in the students, faculty, staff, and campuses of the CSU. After careful consideration of the CSU's most pressing needs, the above plan is presented to the board.

The enacted budget also contains significant policy changes, including a temporary moratorium on the creation of new student success fees, the development of a multi-year academic sustainability plan, the competitive participation for one-time innovation awards, and the possibility of one-time deferred maintenance funding if state property tax revenues exceed earlier expectations.