

AGENDA

COMMITTEE ON FINANCE

Meeting: 1:00 p.m., Tuesday, September 11, 2018
Glenn S. Dumke Auditorium

John Nilon, Chair
Peter J. Taylor, Vice Chair
Jane W. Carney
Douglas Faigin
Emily Hinton
Jack McGrory
Hugo N. Morales
Lateefah Simon
Christopher Steinhauser

- Consent** 1. Approval of Minutes of the Meeting of July 24, 2018, *Action*
- Discussion** 2. Planning for the 2019-2020 Operating Budget, *Information*

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

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

July 24, 2018

Members Present

John Nilon, Chair
Peter J. Taylor, Vice Chair
Jane W. Carney
Douglas Faigin
Emily Hinton
Jack McGrory
Hugo N. Morales
Lateefah Simon
Christopher Steinhauser
Adam Day, Chairman of the Board
Timothy P. White, Chancellor

Trustee John Nilon called the meeting to order.

Public Comment

Trustee Nilon noted there were no public speaker requests.

Approval of Minutes

The minutes of the July 24, 2018 meeting of the Committee on Finance were approved as submitted.

Appointment of the California State University Investment Advisory Committee Chair

Trustee Nilon presented agenda item two as a consent information item.

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California State Polytechnic University, Pomona Lanterman Real Property Acquisition Update

Trustee Nilon presented agenda item three as a consent information item.

2018-2019 Final Budget

A report on the final 2018-2019 CSU operating budget was provided. A summary of allocations for both ongoing and one-time funding was reviewed. The state provided a \$197.2 million ongoing budget increase. Of special note is an additional \$120 million of one-time funding to increase enrollment over a four-year period, which will require the submission of an expenditure plan to the state.

Following the presentation, the trustees asked when the expenditure plan for the one-time \$120 million enrollment money would be available, to which Assistant Vice Chancellor Ryan Storm responded it should be available at the end of the summer. He added that funding from this one-time allocation will be available for use starting this Fall, and that one target area being considered is funding students who are re-directed and enroll at an alternate campus.

The trustees offered suggestions for improving the next year's budget request and centrally covering CSU's portion of retirement costs.

Trustee Nilon adjourned the meeting on Finance Committee.

COMMITTEE ON FINANCE

Planning for the 2019-2020 Operating Budget

Presentation By

Steve Relyea
Executive Vice Chancellor and
Chief Financial Officer

Ryan Storm
Assistant Vice Chancellor
Budget

Summary

The California State Constitution requires the submittal of the governor's budget proposal each year by January 10. In order to meet consequent deadlines of the Department of Finance, it is necessary to commence planning for the 2019-2020 California State University Operating Budget. The CSU Board of Trustees will be provided preliminary assumptions for purposes of preparing the 2019-2020 budget request to the governor. The final budget request will be presented to the Board of Trustees for review and approval in November 2018.

State Budget Overview

Significant tax revenues produced by Propositions 30 and 55 and the economic recovery have allowed the state to continue to invest in public higher education. Specifically, it is estimated that state tax revenues will have increased by \$44.8 billion (or 51 percent) between the recession low point in 2011-2012 and the current fiscal year 2018-2019. In addition, the economic recovery allowed the state to set aside \$15.9 billion in operating reserves and retire \$1.7 billion of operating debt in 2018-2019. The CSU has benefited from the state's recovery with permanent general fund increases of just over \$1 billion over the last six years.

While the state made significant budgetary strides since the Great Recession, significant expenditure obligations and risks persist. The state is challenged by long-term debts, deferrals, and budgetary obligations in excess of \$290 billion, according to estimates by the Department of Finance. The preponderance of these obligations are health and pension costs for state employees and teachers. Other obligations and risks are outstanding loans, K-14 funding obligations, and state property deferred maintenance. While the state's economy is growing, capital gains taxes make up a significant portion of the state budget revenue picture. This revenue source is highly volatile and can cause dramatic swings in state revenue from one year to the next. As examples over the past decade, tax revenues from capital gains were \$3 billion in 2009-2010 (lowest) and an estimated \$13.3 billion for 2018-2019 (highest).

The message on the near-term economy is continued growth. If the state’s economic expansion continues, revenues could grow by 3.1 percent in 2019-2020, 3.9 percent in 2020-2021 and 4.6 percent in 2021-2022, according to projections by the Legislative Analyst’s Office earlier this year. Separately, the Department of Finance earlier this year estimated more modest revenue growth of 3.7 percent in 2019-2020, 2.4 percent in 2020-2021, and 2.6 percent in 2021-2022. Under these assumptions, the potential over the next three fiscal years ranges from a modest investment in higher education to the potential for additional growth. However, it is widely recognized by economists that the average length of an economic expansion is five years with the longest expansion being ten years. The current period has seen expansion over nine years. While economic forecasts do not project a recession between now and 2021-2022, a sudden and unexpected downturn sometime in the next one to three years would have a negative impact on the state general fund and the state’s ability to continue to invest in CSU students.

Recent Funding of the CSU

In January 2013, Governor Brown’s budget proposal included a four-year plan to provide funding stability to CSU and the University of California (UC). This multi-year plan called for state funding increases totaling \$511 million to each university system and required no tuition increases between 2013-2014 and 2016-2017. Recognizing that both CSU and UC endured state funding reductions in equal dollar amounts during the Great Recession and that an ongoing investment in higher education is important to the vitality of the state’s economy, Governor Brown’s administration added additional years and new permanent funding commitments. On several occasions over the past six years, the state legislature and governor agreed to provide more funding in the final budget act than originally proposed. Only once since 2011-2012 did the CSU determine it necessary to raise tuition rates. The governor’s commitments, the CSU’s requests, the tuition increase (as applicable), and final budget allocations for the last six years are as follows.

Fiscal Year	Governor's Budget	CSU Request	Final State Budget	Tuition Increase	Unfunded
2013-2014	\$125.1	\$371.9	\$125.1		\$246.8
2014-2015	142.2	237.6	142.2		95.4
2015-2016	119.5	216.6	216.5		0.1
2016-2017	139.4	241.7	154.0		87.7
2017-2018	157.2	324.9	177.2	\$79.1	68.6
2018-2019	92.1	263.0	197.2		65.8
2019-2020	----To Be Determined----				
Total	\$775.5	\$1,655.7	\$1,012.2	\$79.1	\$564.4

(in millions, excludes all one-time funding)

Future Funding of the CSU

Governor Brown will end his fourth term in office and transfer his executive powers to a new governor in early January 2019. It will open a new chapter where the state legislature and the newly-elected governor will likely take a fresh look at funding priorities for, and commitments to, the CSU.

While it was not a perfect recipe for longer-term financial sustainability, Governor Brown's multi-year budget plan for CSU was valuable. It generally established a funding floor, upon which the system and the 23 campuses could thoughtfully address many financial needs of the university that were curtailed or neglected during the Great Recession including the Graduation Initiative, employee compensation, and student enrollment. Because of that commitment, the CSU was able to regularly invest in critical areas over a multi-year period.

As the CSU enters the 2020's, it is important for the university to place a greater emphasis on longer-term financial sustainability. As experienced through the latter half of the 2010's, consistent financial support of the university has been a critical building block toward greater student successes.

Over the coming months, the CSU is committed to develop a multi-year budget model to help inform the trustees, CSU stakeholders, the state legislature, and the new governor of what it will financially take to equip the university for even greater successes. A potential product stemming from this modeling could be a multi-year funding agreement or compact between the CSU, the new governor, and the legislature. Another outcome could be a ballot initiative that would authorize general obligation bonds to help address CSU infrastructure needs.

The 2019-2020 CSU Operating Budget Will Require a Significant, New Investment from the State

The preliminary 2019-2020 budget plan would allow the CSU to provide another round of investment in Graduation Initiative 2025, meet its mandatory cost obligations, fulfill compensation commitments already made to the preponderance of CSU employee groups, and grow full-time equivalent student (FTES) enrollment. Additionally, progress could be made on infrastructure and deferred maintenance needs.

But unlike the past several years, the state legislature's and next governor's funding commitment is not known at this time.

The state is in an excellent fiscal condition with revenue expected to continue to grow and the state is already equipped with a large rainy day fund. This condition should make the decision easier for state leaders to invest in California's future through the CSU. However, as demonstrated in the

table above, the state has seldom fully funded the gap between the governor's proposal and the trustees' request. If a gap were to occur in 2019-2020, the CSU would have to more aggressively advocate for additional state funding and consider several budget-balancing options, including:

- limit investment in new budget priorities;
- redirect campus resources to other priorities;
- new revenue sources; and
- a tuition increase.

The Chancellor's Office will engage in a consultation process with students, faculty, staff, campus executives, the state, and other CSU stakeholders to garner additional state support and to explore alternatives for balancing budget priorities and necessary resources.

2019-2020 CSU Operating Budget—Preliminary Planning Approach

It is very early in the budget development process and it is premature to discuss any budget gap-closing strategies at this time. Instead, the Board of Trustees can begin the discussion of CSU priorities to build an operating budget request for 2019-2020. The planning approach presented below represents a range of funding levels that can be balanced to communicate the university's key funding needs. At this stage, it is important for the trustees to provide input on fiscal policy priorities for 2019-2020.

These estimated incremental funding amounts or ranges provide an opportunity for discussion about priorities and would add to the 2018-2019 base budget of \$6.7 billion.

Preliminary Expenditure Plan - \$446 Million to \$528 Million

Graduation Initiative 2025 - \$75 million

The CSU will continue to invest in people, programs, technologies, and strategies that have demonstrated success in improving graduation rates, shortening time-to-degree, and eliminating achievement gaps. Each campus has developed multi-year plans to reach their Graduation Initiative 2025 goals that will require multi-year investments across the system in: tenure track faculty hiring, increased course taking opportunities, enhanced advising and education plans, academic and student support, and leveraging data for campus decision-making. Over the course of this third year of the Graduation Initiative 2025, campuses plan to spend at least \$75 million on their local priorities to improve student success and completion with particular focus on those efforts that improve four-year graduation rates for first time freshmen and two-year graduation rates for transfer students. To properly support the Graduation Initiative, an incremental recurring investment of \$75 million in 2019-2020 is necessary. This would fund the third year of a six-year, \$450 million investment plan in support of the Graduation Initiative.

Full-Time Equivalent Student Enrollment Growth - \$123 million to \$205 million

The Public Policy Institute of California (PPIC) concludes that the state will fall about 1.1 million college graduates short of economic demand by 2030 if current trends persist. The PPIC suggests that in order to close the degree gap, there is a need for 480,000 CSU graduates beyond the current trend. Demand for the CSU continues to climb, as more students graduate from high school having met the A-G requirements for admission to the CSU, and more transfer students complete the Associate Degree for Transfer. Earlier this year, the CSU adopted an application redirection policy to give CSU eligible first-time freshman, upper-division transfer and Associate Degree for Transfer students the option to have their applications reviewed by other campuses, without campus-wide or program impaction, if the first-choice campus(es) has student demand that exceeds available space at the campus or campuses they applied. Redirection will be helpful to a limited number of prospective students, but substantial increases to funded enrollment growth would be necessary to help narrow the PPIC's reported degree gap.

The range of \$123 million to \$205 million represents a three to five percent increase in full-time equivalent students (FTES). This increase would allow for growth in the average unit load for continuing students in support of graduation rate goals, and fund access for more new students. That range of growth also would be a substantial step in helping narrow the state's degree gap. Additional tuition revenue from new students and state general fund cover the costs of accommodating additional enrollment. For planning purposes, each one percent increase in enrollment would cost approximately \$41 million and would allow for growth of approximately 3,600 FTES.

Facilities and Infrastructure Needs - \$50 million

There are examples of academic and plant facilities on every CSU campus that are in need of repair or replacement. Based on a recent analysis, the systemwide academic facilities deferred maintenance backlog has been significantly revised upward to approximately \$3.7 billion. Previous support from the state in one-time and recurring funds has enabled a reduction in the backlog by approximately \$600 million. Unlike 2014-2015 and 2015-2016, the CSU was unable to dedicate new support from the state for annual debt service on longer-term bond-financed projects in 2016-2017, 2017-2018, or 2018-2019 due to the funding of other budget priorities and insufficient revenue levels.

Agenda Item 4 of the September 11-12, 2018 meeting of the Committee on Campus Planning, Buildings and Grounds includes the preliminary list for the 2019-2020 Capital Outlay program. The list prioritizes critical infrastructure and utility renewal projects and facility renovation to support the academic program needs. The addition of \$50 million in recurring funds would finance approximately \$750 million of needed infrastructure projects that increase capacity for student growth and complement the plan to address deficiencies in existing facilities. The CSU continues to refine the planning and financing process in light of the increased capital financing authority granted in 2014.

Additionally, the CSU could request \$150 million in one-time funds to further address the deferred maintenance backlog. In the past two fiscal years, the state has deemed billions of dollars of state revenue as temporary. Specifically, the CSU received \$35 million in one-time funds for deferred maintenance in 2018-2019. If state revenue growth patterns and assumptions continue into 2019-2020, it is possible that the state could again supply the CSU with tens of millions of one-time dollars for this purpose.

Employee Salaries – \$160 million

Many bargaining units are under multi-year contracts that extend through 2019-2020 and a preponderance of CSU employees are represented by those units. Early estimates indicated that salary increases for all employee groups will cost, at the low end, approximately \$145 million. However, that cost is likely to rise because the CSU has hired many new faculty and staff to support the Graduation Initiative and to offer more courses and services to new students because of funded enrollment growth over the last few years. As CSU employee ranks increase, so too does the cost to provide salary increases to veteran and newer employees. Chancellor's Office staff will have more precise figures from campuses and complete its analysis by the November meeting, but for conservative planning purposes, an estimate of \$160 million is reasonable.

Mandatory Costs - \$38 million

Chancellor's Office staff anticipate that mandatory cost increases for existing university commitments will be approximately \$38 million in 2019-2020. These cost increases factor in state of California estimates, such as retirement and health care rate changes. Mandatory costs also include increases to operations and maintenance of newly-constructed facilities and other compensation-related costs, such as state wage law changes. If operating budget requests do not include these types of mandatory cost increases, campuses must redirect resources from existing programs, services and priorities to meet those cost increases. Fewer course sections would be available to students, average unit load would go down and less academic and student support services would be available. Setting aside funding for mandatory costs helps preserve the integrity of CSU programs.

Preliminary Revenue Plan

At this preliminary stage, the planning effort focuses on stating the CSU's budget priorities and needs. Accounting for enrollment growth revenue (approximately \$20 million per one percent increase in enrollment targets), the preliminary plan's range of new investments would require additional new ongoing revenues from state of \$386 million to \$428 million.

Conclusion

This is an information item presenting a preliminary framework for the 2019-2020 CSU Operating Budget request to the governor and the Department of Finance. Using feedback provided by the Board of Trustees at the September 2018 meeting, Chancellor's Office staff will present an updated and detailed operating budget recommendation for the trustees' approval in November 2018.