COMMITTEE ON FINANCE

Planning for the 2017-2018 Support Budget

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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 2017-2018 California State University Support Budget. The CSU Board of Trustees will be provided preliminary assumptions for purposes of crafting the 2017-2018 budget request to the governor. The final budget request will be presented to the board for review and approval in November 2016.

State Budget Overview

Significant tax revenues produced by Proposition 30 and ongoing 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 $33.2 billion (or 38 percent) between the recession low point in 2011-2012 and the current fiscal year 2016-2017. Also, the economic recovery allowed the state to set aside $8.5 billion in operating reserves and retire $1.3 billion of operating debt in 2016-2017. The CSU has benefited from the state's recovery with permanent, unallocated general fund increases of $637.8 million over the last four years. Had the state chosen to invest more in the CSU during this period, the state could have reaped greater civic and economic benefits than experienced over the past several years.

While the state has made significant strides on the path to economic recovery, significant expenditure obligations and risks persist. The state is challenged by long term debts, deferrals, and budgetary obligations in excess of $200 billion, according to estimates by the Department of Finance. Examples of these obligations include health and pension costs for state employees and teachers 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 and because this revenue source is highly volatile it causes dramatic swings in state revenue from one year to the next.

The message on the near term economy is mixed. If the state's economic expansion continues, revenues could grow by five percent in 2017-2018 but slow to two percent in 2018-2019 and 2019-2020, according to projections by the Legislative Analyst's Office. Separately, the Department of Finance estimates more modest revenue growth of three percent in 2017-2018, one percent in 2018-2019, and three percent in 2019-2020. Under these assumptions, the outlook over the next three fiscal years ranges from continued 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 seven years. The expectation of a downturn in economic growth 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.

The Governor's Funding Plan for 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 recent fiscal crisis and that an ongoing investment in higher education is important to the vitality of the state's economy, the governor's administration has since added additional years and new permanent funding commitments. The cumulative, potential increase to CSU occurs in annual increments as follows (actual funding provided by the state noted in parenthesis):

- $125.1 million in 2013-2014 (provided by the state)
- $142.2 million in 2014-2015 (provided by the state)
- $119.5 million in 2015-2016 ($216.5 million provided by the state)
- $139.4 million in 2016-2017 ($154 million provided by the state)
- $157.2 million in 2017-2018
- $136.5 million in 2018-2019
- $142.0 million in 2019-2020
- Cumulative, potential increase in CSU funding = $961.9 million

Although the legislature never formally adopted this multi-year plan, it did approve the first and second year increases of $125.1 million and $142.2 million, and, with the governor's agreement, went above and beyond in the third year to fully fund the CSU support budget request of $216.5 million, and provided $154 million in 2016-2017. If the increases through 2018-2019 remain at the actual and proposed levels, the new seven-year total would be $961.9 million.

This is very close, but still short of the cuts totaling approximately one billion dollars from 2008-2009 through 2011-2012.

Early Estimates are that CSU Support Budget Request Will Exceed State Plan for 2017-2018

The preliminary 2017-2018 budget plan would allow the CSU to dedicate funds to Graduation Initiative 2025 priorities, meet its mandatory cost obligations, fund compensation and grow full-time equivalent student (FTES) enrollment by one percent. Additionally, progress can be made on infrastructure and deferred maintenance needs.

The governor's funding plan would provide a $157.2 million increase in 2017-2018. Under the most likely of scenarios, the governor's funding plan would only afford the CSU the opportunity to fund required current employee compensation commitments and other mandatory cost increases and would not be enough to permanently invest in Graduation Initiative 2025, infrastructure, and FTES enrollment growth.

At this early stage, the state's funding plan does not include sufficient resources to meet the CSU preliminary budget plan. As a result, additional resources above the governor's funding commitment would be required. Three potential options exist: (1) increased state funding from the governor and legislature, (2) increased tuition revenue, and (3) campus budget reductions. The Chancellor's Office will engage in continued consulting with students, faculty, staff, campus executives, the state, and other CSU stakeholders to explore alternatives for balancing budget priorities and necessary resources.

2017-2018 CSU Support Budget—Preliminary Planning Approach

This preliminary plan is to begin the discussion of a support budget request for 2017-2018. The planning approach represents a credible statement of the university's key funding needs. At this stage, it is important for the board to provide input on fiscal policy priorities for 2017-2018.

The preliminary incremental budget request and expenditure plan is summarized on the following page. These estimated recurring amounts are approximate and would add to our 2016-2017 base budget of $5.4 billion.

Proposed Incremental Expenditures:

• Graduation Initiative 2025	$75.0	million
• Full-Time Equivalent Student Growth: 3,600 FTES	$40.0	million
• Compensation: Current Commitments	$140.0	million
• Compensation: New	$55.0	million
• Facilities and Infrastructure Needs	$10.0	million
• Mandatory Costs	$26.0	million
Total Incremental Expenditures	**$346.0**	**million**

Anticipated Revenue

• General Fund Revenue from Governor's Funding Plan	$157.2	million
• Net Tuition from Enrollment Growth	$20.0	million
Total Anticipated Revenue	**$177.2**	**million**

Preliminary Support Budget Request	**$168.8**	**million**

Graduation Initiative 2025

Under the preliminary plan, 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 first year of the Graduation Initiative 2025, campuses will 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 4-year graduation rates for first time freshmen and 2-year graduation rates for transfer students.

Full-Time Equivalent Student Enrollment Growth

Over 830,000 undergraduate applications were submitted to CSU campuses for Fall 2016, an increase of over 40,000, or nearly five percent, over the prior year. In spite of this, state budget cuts during the recession continue to have repercussions that constrain the ability of the CSU to admit and enroll every new eligible applicant. Access to education and the preparation of the state's future workforce depends on the state investing in the CSU.

The proposed expenditure plan to support enrollment represents a one 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 a steady number of students admitted and served. The costs of accommodating additional enrollment are covered by additional tuition revenue from new students and state general fund. For planning purposes, a one percent increase in enrollment would cost approximately $40 million and would allow for growth of approximately 3,600 FTES.

Employee Compensation: Current Commitments

This component has two parts. First, collective bargaining agreements and commitments to non-represented employee groups total an estimated $107 million for 2017-2018. Second, $33 million of collective bargaining agreement costs were covered by one-time funding in 2016-2017. The preliminary plan for 2017-2018 converts the $33 million of one-time funding into recurring funding to cover these ongoing costs.

Employee Compensation: New

This item would conditionally commit $55 million for collective bargain units with open contracts in 2017-2018, pending final agreements with collective bargaining units. This amount includes a commitment for non-represented employee groups.

Facilities and Infrastructure Needs

There are numerous examples on every CSU campus of academic and plant facilities that are in need of repair or replacement. The systemwide state-supported deferred maintenance backlog will be reduced to approximately $2.0 billion once funded projects are completed. The previous support from the state of one-time and recurring funds has enabled a reduction in the backlog from $2.6 billion to $2.0 billion. This is good progress, but, unfortunately, the backlog will grow by approximately $150 million per year as facilities continue to age and due to the partial funding of the support budget request in 2016-2017. Unlike 2013-2014 and 2014-2015, the CSU was not able to dedicate new permanent funding for annual debt service on longer-term bond-financed projects due to the 2016-2017 funding level. Instead, the university is utilizing $25 million from 2015-2016 and $35 million from 2016-2017 of one-time state funding to address the CSU’s most urgent facility maintenance and infrastructure needs.

Under estimated bond market conditions, dedicating $10 million of recurring funds in 2017-2018 would finance approximately $150 million of needed infrastructure projects. This would roughly keep pace with the aging infrastructure, but would not reduce the backlog. Also, the CSU continues to look to other ways to fund its infrastructure needs and we will keep the board informed on ways to do so.

Agenda item 1 of the September 20-21, 2016 joint meeting of the Committees on Finance and Campus Planning, Buildings and Grounds includes the draft priority list for the 2017-2018 Capital Outlay program. The list prioritizes critical infrastructure and utility renewal projects and facility renovation to support the academic program needs. The addition of $10 million in recurring funds would enable the CSU to fund limited capacity student growth to 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.

The CSU would separately request $50 million from the state to further address the deferred maintenance backlog and $25 million of cap and trade funds to implement greenhouse gas and energy reduction projects.

Mandatory Costs

Funds would be used to meet anticipated mandatory costs that the university must pay regardless of available state allocation. There is little to no discretion over these costs, which include recent increases to employee benefits, operations and maintenance of newly-constructed space, as well as new costs associated with state and federal wage laws. Without funding for mandatory cost increases, campuses would have to redirect resources from other program areas to meet obligations. Setting aside funding for mandatory costs helps preserve the integrity of CSU programs.

Preliminary Revenue Plan

The preliminary expenditure plan continues to addresses many of the CSU's educational and operational needs. But if required to do so, it would be exceedingly difficult for the CSU to operate within the confines of the governor's funding plan without receiving additional resources. Increased mandatory costs and current compensation commitment costs together would cost approximately $166 million—more than the $157.2 million available from the governor's funding plan. Without additional revenue, this could require strategies that include reductions to campus budgets and minimal investment in Graduation Initiative 2025 activities, FTES enrollment growth, and infrastructure. This scenario would not serve prospective and current student needs, would not address the deferred maintenance and critical infrastructure backlog, and would not sustain fiscal stability within the CSU.

At this preliminary stage, the planning effort focuses on stating the CSU's budget priorities and needs. Accounting for enrollment growth revenue and the governor's funding commitment of $157.2 million, these recommended items would require additional new ongoing revenues from state and tuition revenue sources of roughly $168.8 million.

A more detailed information item on revenue will be discussed at the November 2016 meeting.

Conclusion

This is an information item presenting a preliminary framework for the 2017-2018 CSU Support Budget request to the governor and the Department of Finance. Estimated amounts for each item may be revised based on updated information in the course of preparing the budget for the board's review and approval. The board will be presented with an updated and detailed support budget recommendation in November 2016 as an action item.