

AGENDA

COMMITTEE ON FINANCE

Meeting: 1:25 p.m., Tuesday, January 27, 2009
Glenn S. Dumke Auditorium

William Hauck, Chair
Raymond W. Holdsworth, Vice Chair
Roberta Achtenberg
Herbert L. Carter
Kenneth Fong
Margaret Fortune
Curtis Grima
A. Robert Linscheid
Glen O. Toney

Consent Item

Approval of Minutes of Meeting of November 18, 2008

Discussion Items

1. Report on the 2008-2009 Support Budget, *Information*
2. Report on the 2009-2010 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**

November 18, 2008

Members Present

William Hauck, Chair
Raymond W. Holdsworth, Vice Chair
Roberta Achtenberg
Herbert L. Carter
Kenneth Fong
Margaret Fortune
Curtis Grima
A. Robert Linscheid
Glen O. Toney

Approval of Minutes

The minutes of September 16, 2008 were approved by consent as submitted.

Chair Hauck noted that Item 5: Meeting Quality Standards in State-Supported Professional Business Graduate Programs with Revenue Support Derived from a Per-Unit Fee was deferred to a later meeting of the Board of Trustees.

Report on the 2008-2009 Support Budget

Robert Turnage, assistant vice chancellor, budget noted that after a record long impasse in the legislature this summer, lasting 85 days, the current state budget was adopted and signed by the Governor on September 23. Mr. Turnage described how difficulties experienced over the last several months in the national and state economies could not have been anticipated. Stock market and housing downturn “shocks” could not have been predicted. Nationally, the unemployment rate is 6.1 percent. In California, it stands at 7.7 percent, up from 5.6 percent earlier in the year. In addition, there have been seven consecutive months of job loss in the state.

Assistant Vice Chancellor Turnage explained that even when the economy has been strong, the state of California has had trouble balancing its budget. California has a tax-structure that is

hyper-sensitive to swings in the economy. When the state goes into a recession, the problems compound even further.

Since the last Board meeting, an official estimate, from the Department of Finance, of the state treasury revenue shortfall for the current fiscal year now stands at \$11.2 billion. This is more than 10 percent of the state general fund budget.

Looking ahead towards the next year, starting July 1, the Department of Finance is forecasting that the revenue shortfall will be \$13 billion; across the two fiscal years over \$24 billion of problem need to be solved.

The Governor has called the Legislature into special session during the first week of November and proposed a number of serious steps to try to bring balance to the current year's situation as well as rough balance to the following year. The Governor proposes allowing the \$1.7 billion reserve to shrink to zero in addition to spending cuts and revenue increases to solve the \$11.2 billion problem.

The Legislative Analysts' Office recently released an overview of the Governor's proposals for the special session and it serves as an excellent document in terms of explaining the magnitude of state's fiscal problems and contributing factors. According to the LAO, across the next twenty months, the state needs to come up with solutions that total \$28 billion.

The Governor, as part of his proposed solutions, is recommending that CSU's budget be reduced back to where he originally proposed it be in the budget that he released last January 10. Meanwhile, the state could run out of cash as early as February, marking an unprecedented situation for the state.

Lieutenant Governor Garamendi remarked how serious cuts took place in the current operating budget. Additional cuts, that the Governor is discussing, added on top of the current cuts are unprecedented, he continued. This is very serious for California's present and future.

Approval of the 2009-2010 Support Budget Request

As Robert Turnage, assistant vice chancellor, budget explained how this item was brought to the Board in preliminary form in September; the Committee was directed to two books (mailed along with the agenda) that contained further detail on the proposed budget for the CSU.

In an effort to set the stage for discussion of the 2009-2010 budgets, Mr. Turnage provided a brief recap of some of the current state and CSU budget numbers. With the assistance of a media presentation, Mr. Turnage presented a comprehensive overview of the final recommendations on the overall state budget as well as a number of issues related to the development of the 2009-2010 CSU budget.

Various points of interest in the report included revenue assumptions associated with the compact and components of compact spending, the CSU's budget augmentation request, and additional budget challenges. In addition, the Committee reviewed mandatory costs including health and dental benefits, new space, energy, and financial aid.

Mr. Turnage continued to explain to the committee how a number of steps, already taken by the legislature and the Governor, are limited in duration. Lieutenant Governor Garamendi commented that the "Budget Solution" will require that the first \$3.5 billion in revenue be automatically assigned to the reserve in 2010-11.

The California State University is the biggest contributor to the development to the work force of the state and it is essential that we maintain our investment in higher education.

The document, considered in this agenda item, lays out what it is that the state should be investing in 2009-10, while acknowledging the extreme difficulty in securing everything requested.

In addition to a \$341.2 million budget increase of compact revenue, there is a need to recover—on a going-forward basis—a core element of the compact for 2008-09 that was not received in the amount 116.7 million. The entire requested budget increase equals \$611.4 million. Of that amount, \$38.7 million would be fee revenue associated with a higher number of students and \$572.7 million would be coming from the state general fund.

Long term needs including library acquisitions, deferred maintenance, and academic technology also were presented to the committee.

Lieutenant Governor Garamendi extended his congratulations to the Chancellor and staff for proposing a realistic budget for the university based on the university's needs rather than accepting the limitations portrayed by the Department of Finance. Trustees discussed critical shortages in nursing, teaching and engineering and suggested using this message to make the CSU budget crisis personal to legislators. The committee unanimously recommended approval by the board of the proposed resolution to approve the 2009-2010 Support Budget Request (RFIN 11-08-10).

2009-2010 Lottery Revenue Budget

Prior to the presentation on this action item, Chair Hauck asked Robert Turnage, assistant vice chancellor, budget to speak specifically to the Lottery Modernization Act, which has to be submitted to voters and to clarify the "hold harmless" provision included in the measure, which requires that state, through the general fund, reimburse the CSU and other institutions for what was received in the previous year. Assistant Vice Chancellor Turnage noted that a first reading of the proposed lottery budget was presented to the Board in September. Since then, the projections have fallen for the amount of revenue the lottery is expected to generate next year. The

committee considered a proposed budget revised downward from \$46 million presented in September to \$44 million presented today. Similar to last year, September's reading has a \$5 million reserve built-in for contingencies. This proposed budget now is the same level of funding as the year before.

Mr. Turnage continued to explain that the Lottery Modernization Act, as part of the overall budget package adopted last September, included proposed changes to the lottery intended to enhance the appeal of the games and produce more revenue for the state. The measure, which would require approval by voters in a special election expected to be called by the Governor in the spring, would "securitize" future lottery revenue streams. Securitizing the lottery is a form of borrowing, meaning that the rights to the future lottery revenue stream are sold to private investors. In exchange, they give the state of California approximately \$10-11 billion, which would help address state general fund gaps in 2009-10 and 2010-11.

If passed by the voters in the special election, the "hold harmless" provision is not just a statement that the legislature promises to pay general fund money to the CSU and the other educational segments. It is an annual appropriation that is part of the measure that is to be ratified by the voters.

Lieutenant Governor Garamendi noted that this is the last place that the CSU could borrow money for ongoing operations.

The committee unanimously recommended approval by the board of the proposed resolution to approve the 2009-2010 Lottery Revenue Budget (RFIN 11-08-11).

2008-2009 Student Fee Report

Robert Turnage, assistant vice chancellor, budget presented the required annual report of student fees for information. Mr. Turnage reported on the 10% increase in student university fees this year. In addition, campus based fees were up almost 7% over last year; averaging \$801 from \$749 last year. Mr. Turnage pointed out that charts in the report provided further detail, in particular, the chart on page 3, which present a breakdown for the different campuses and the different campus mandatory fees. CSU fees remain the lowest of all 15 comparison universities.

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

This action item requested the Board of Trustees to authorize the issuance of Systemwide Revenue Bonds and the issuance of interim financing under the CSU's commercial paper program in an aggregate amount not-to-exceed \$104,910,000, to provide funds for a campus project and two auxiliary projects. In addition, the Board was asked to approve a set of resolutions relating to these projects. Colleen Nickles, assistant vice chancellor, financial services presented this item and explained that the long-term bonds would be part of a future

Systemwide Revenue Bond sale and were expected to bear the same ratings from Moody's Investors Service and Standard and Poor's Corporation as the existing Systemwide Revenue Bonds. The Committee reviewed the Long Beach Student Recreation and Wellness Center project, Fullerton Auxiliary Service Corporation requests to refinance two bank loans and to finance other costs associated with two faculty/staff housing projects and the CSU Long Beach Residential Learning College Renovation project.

The committee unanimously recommended approval by the board of the proposed resolution for approval to issue Trustees of the California State University, systemwide revenue bonds and related debt instruments for various projects (RFIN 11-08-12).

Trustee Hauck adjourned the Committee on Finance.

COMMITTEE ON FINANCE

Report on the 2008-2009 Support Budget

Presentation By

Benjamin F. Quillian
Vice Chancellor
Administration and Finance

Robert Turnage
Assistant Vice Chancellor
Budget

Summary

At the time this report was prepared the Department of Finance's estimate of the budget shortfall for the current fiscal year had grown to \$14.8 billion—about one dollar of every seven in the state's General Fund budget. The Governor called a succession of three special sessions of the legislature to address the emerging deficit. At the time this analysis was prepared none of these sessions had produced a package of legislation that the Governor was willing to sign. The course of the 2008-09 fiscal year has been marked by extended uncertainties for the system and its 23 campuses and a series of cuts that leave the CSU nearly \$313 million short of its workload needs. This is posing deep operational challenges for the campuses and impacts to students, faculty and staff.

Recent Developments Affecting the 2008-09 Support Budget

In January 2008, the Governor proposed a budget for support of the CSU in 2008-09 that was \$312.9 million below what the Department of Finance calculated as needed for a basic "workload" budget. In his "May Revision," the Governor recommended reversing \$97.6 million of the proposed reduction. The 2008-09 budget act passed by the legislature and signed by the Governor on September 23rd—after a record 85-day impasse into the fiscal year—approved the budget proposed by the Governor for the CSU, as revised in May. This resulted in essentially the same level of state funding provided to the CSU in the 2007-08 fiscal year, yet approximately \$215 million below workload needs.

At the time the Governor signed the budget act it was already apparent that California's economy and state revenues were falling short of budget estimates. Consequently, the administration allocated to state departments, agencies and other state entities \$390 million of expected savings from the enacted budget totals. The CSU's share was \$31,314,000, confirmed in a letter from

the Director of the Department of Finance dated October 20, 2008. In response to the administration, the Chancellor made it clear that in order to meet the CSU's mission-critical functions this would have to be one-time reduction, and not affect our general fund budget going forward.

Within a month of the signing of the budget act, it became increasingly apparent that the national and state economies had entered into a recession and that state revenues were going into a virtual "free fall." The Governor called a succession of special sessions of the legislature to address the emerging deficit; first on November 5th, again on December 1st, yet again on December 19th. At the time this analysis was prepared none of these sessions had produced a package of legislation that the Governor was willing to sign.

The Governor's special session proposals included a reduction to the CSU's General Fund base budget of \$66.3 million. The legislature adopted this reduction as part of the package of bills that it passed on December 19th, but the Governor vetoed the bills for reasons unrelated to the CSU budget. Combined with the separate one-time reduction of \$31.3 million, proposed state funding of CSU operations is now \$97.6 million below the budget act amount enacted last September. This places the CSU budget for 2008-09 at exactly the amount the Governor originally proposed one year ago.

Related to the inability of the legislature and governor to agree on a budget solution, and compounding matters for the current fiscal year, is the state's cash crisis. At the time this analysis was prepared the state had suspended interim financing of nearly all bond-funded capital outlay projects in the state, including CSU projects, due to the state's need to preserve cash and its current inability to borrow in the credit markets. The State Controller had announced that, as soon as February 1st, he might need to defer state payments or issue registered warrants (commonly referred to as "I.O.U's") to vendors, various state officials, recipients of income tax refunds, and others. The Controller intended to accord priority to continuing cash payments to bondholders and public institutions of education. (The State Constitution provides that: "From all state revenues there shall first be set apart moneys to be applied by the state for support of the public school system and public institutions of higher education.") This constitutional priority, however, does not extend to state payments of CalGrants to students. The Controller had indicated that he might not be able to make CalGrant payments on a timely basis.

The course of the 2008-09 fiscal year, thus, has been marked by extended uncertainties for the system and its 23 campuses and a series of cuts that leave the CSU nearly \$313 million short of its workload needs. This is posing deep operational challenges for the campuses and impacts to students, faculty and staff.

On January 9, 2009, the Governor provided his formal 2009-10 budget proposal to the legislature, which will be described in the next agenda item. The Governor has linked the

resolution of the 2009-10 budget with resolution of the 2008-09 deficit. In other words, he insists that the legislature must adopt, as soon as possible, a comprehensive 18-month package. In the view of the administration, and other observers, nothing short of this approach will satisfy investors of the credit-worthiness of California debt and enable the state to again sell capital outlay bonds and borrow for short-term cash needs. Therefore, the budgets for the “current year” (in this case, 2008-09) and the “budget year” (in this case, 2009-10) are inextricably bound in an unprecedented manner.

The Board will be provided at its meeting with updated information on efforts by the legislature and Governor to address the 2008-09 budget deficit.

COMMITTEE ON FINANCE

Report on the 2009-2010 Support Budget

Presentation By

Benjamin F. Quillian
Vice Chancellor
Administration and Finance

Robert Turnage
Assistant Vice Chancellor
Budget

Summary

The 2009-10 Governor's budget identifies a \$14.8 billion budget shortfall in 2008-09 that grows to \$41.6 billion by the end of 2009-10 if proposed solutions are not adopted by the Legislature. Unlike prior budget cycles, the Governor proposes that the legislature enact, as soon as possible, a package of legislation that would simultaneously solve the state's budget problem for **both** the 2008-09 and 2009-10 fiscal years. The Governor's budget proposal for this 18-month period reflects \$14.3 billion in revenue adjustments, \$17.4 billion in spending cuts, and \$10 billion in warrants and borrowing to achieve a balanced budget, including a \$2 billion reserve, through June 30, 2010.

The Governor's Budget calculates the CSU "workload" budget increase necessary to fulfill the Compact with Higher Education as \$217.3 million, but proposes **not** to provide any increase due to the state's dire fiscal condition. Thus, for the second fiscal year in a row, the Compact would not be funded. The net result of the Governor's proposed changes for the CSU is a \$68.6 million increase in overall revenue support, due entirely to a proposed 10 percent student fee increase. However, mandatory costs, enrollment funding, and the one-third financial aid set-aside that would be required for 2009-10 total \$84.4 million, \$15.8 million more than available revenue. This means CSU would face funding shortfalls during the budget year even with the Governor's proposed 10 percent increase in student fee rates. Moreover, changes proposed by the Governor for the Student Aid Commission budget would place additional financial aid cost pressures on the University.

State Budget Overview

The Governor released the narrative portion of his 2009-10 budget proposal on December 31, 2008, a departure from previous years when such budget details were released several days into

January. This early notification underscored the urgent nature of the state's fiscal downturn and the necessity for immediate action by the Governor and legislature to shore up the state's finances to preserve adequate cash flow for statewide operations. Consistent with the timeline spelled out in the State Constitution, the Governor released his formal budget proposal to the legislature on January 9th.

The 2009-10 budget identifies a \$14.8 billion General Fund budget shortfall in 2008-09 that grows to \$41.6 billion by the end of 2009-10 if proposed solutions are not adopted by the legislature. The Governor has proposed a combination of temporary and permanent solutions to address the state's budget challenges.

Unlike prior budget cycles, the Governor proposes that the legislature enact, as soon as possible, a package of legislation that would simultaneously solve the state's budget problem for **both** the 2008-09 and 2009-10 fiscal years. The Governor's budget proposal for this 18-month period reflects \$14.3 billion in revenue adjustments, \$17.4 billion in spending cuts, and \$10 billion in warrants and borrowing to achieve a balanced budget, including a \$2 billion reserve, through June 30, 2010.

The pace and extent to which the legislature and Governor successfully address the \$42 billion budget problem in the current special session, the course of the state's economy over the next 18 months, and the possibility of a major federal effort to aid state governments will all play significant roles in the state's ability to address its budget priorities for the 2009-10 fiscal year.

2009-10 CSU Support Budget

The Governor's budget calculates the University's "workload" budget increase necessary to fulfill the Compact with Higher Education as \$217.3 million, but proposes **not** to provide any increase due to the state's dire fiscal condition. Thus, for the second fiscal year in a row, the Compact would not be funded.

As summarized in Attachment 1, the Governor proposes the following budget changes for the CSU:

- Make permanent the \$66.3 million in budget reduction proposed for 2008-09.
- Restore the \$31.3 million amount associated with budget savings that the administration requested that CSU achieve in 2008-09. This means the impact of this reduction is one-time only, felt in the current year, as requested by the Chancellor.
- Add \$3.6 million of state General Fund and an estimated \$1,140,000 of student fee revenue to increase bachelor of science in nursing (BSN) enrollment by 340 students.

New General Fund support is provided at the 2006-07 nursing funding rate of \$10,600 per FTES.

- Assume Trustees will increase student fee rates for all students by 10 percent, which it projects will achieve \$130.4 million in gross revenue. The budget also assumes one-third of this increase will be set aside for student financial aid (\$43.8 million).

The net result of these budget changes represents a \$68.6 million increase in overall revenue support. However, mandatory costs, enrollment funding (primarily the nursing enrollment increase), and the one-third financial aid set-aside that would be required for 2009-10 total \$84.4 million, \$15.8 million more than available revenue. This means CSU will face funding shortfalls during the budget year despite the proposed 10 percent increase in student fee rates. Moreover, as explained below, changes proposed by the Governor for the Student Aid Commission budget would place additional financial aid cost pressures on the CSU (estimated \$15.5 million).

The Governor's budget would replace CSU Lottery funding with General Fund support, with the stipulation that these General Fund dollars be restricted to purposes identified in the Lottery Act. This change is dependent on enactment by the voters at a special election this spring of major changes to the state lottery that would permit the state to borrow against future lottery revenue streams. The Governor's overall state budget plan depends on this lottery "securitization" for \$5 billion of General Fund budget "solution" in 2009-10 and a similar amount in 2010-11.

Excluding the Lottery budget change proposal, CSU General Fund operating support decreases roughly 2 percent below the 2008-09 budget act appropriation enacted in September 2008. If special session actions are applied to CSU base funding, then budgeted operating expenses will remain relatively flat between 2008-09 and 2009-10 (increasing by .33%). To put these changes in perspective, CSU's share of total state spending in the 2008-09 enacted budget was roughly 3 percent (2.87%). CSU's share of proposed State expenditures for 2009-10 would be 3.1 percent (including its General Fund adjustment for Lottery).

Cal-Grant Financial Aid

The administration has proposed the following 2009-10 actions relative to the state's Cal-Grant program, currently administered by the Student Aid Commission:

1. Freeze the income ceilings (estimated impact to CSU of about \$600,000)
2. Reduce maximum award at independent institutions (no impact to CSU)
3. Eliminate new Competitive Cal Grant program awards (\$7.3 million impact to CSU)

4. Partially decouple awards to public institutions from fee increases. (\$7.65 million impact to CSU)

Details about the partial decoupling were lacking at the time of budget release, but it appears the proposal is to increase CSU Cal Grant awards by only 2/3rds of the 10% fee increase for undergraduate students, rather than by the full amount. The rationale is probably tied to a perceived lack of necessity for the state to cover the 1/3rd of the fee increase that augments our own institutional aid programs, since many CSU students receiving institutional aid also receive Cal Grant financial aid assistance in their award package.

5. Decentralize Cal Grant program administration to the campuses

It is estimated that the total impact of these changes could result in the loss of \$15.5 million in state financial aid grant assistance to CSU students. At the time this analysis was prepared we calculating the impact of these changes at CSU in terms of increased costs to the State University Grant program and/or non-grant assistance CSU students would have to take on in order to address the Cal Grant budget adjustments. CSU supports the decentralization of Cal Grant program administration.

Conclusion

The 2009-10 Governor's budget identifies a \$14.8 billion budget shortfall in 2008-09 that grows to \$41.6 billion by the end of 2009-10 if proposed solutions are not adopted by the legislature. Unlike prior budget cycles, the Governor proposes that the legislature enact, as soon as possible, a package of legislation that would simultaneously solve the state's budget problem for **both** the 2008-09 and 2009-10 fiscal years.

The Board will be provided at its meeting with updated information on efforts by the legislature and Governor to address the 2009-10 budget.

2009-10 Governor's Budget Proposal for the CSU

	Neutral* Impact General Fund Adjustments	Operating Budget Impact				Total 2008/09 through 2009/10 Budget Changes
		General Fund Base Budget Reductions	State General Fund Increases or Reductions	CSU Fee Revenue Increases		
Special Session Reduction		(66,303,000)				
Interest Payment Increase to General Fund		(242,000)				
Retirement Rate Decrease	(1,350,000)					
Lease Bond Payments Increase	5,511,000					
Annuitants Dental Premium Increase	730,000					
2009-10 Compact Workload Funding Increase			217,269,000			
Suspension of 2009-10 Compact Funding Increase			(217,269,000)			
BSN Nursing Program Cohort Increase (340 FTES)			3,600,000			
Replace Lottery Funding Related to Securitization	49,574,000					
BSN Enrollment Growth Fee Revenue Increase				1,140,000		
Base Enrollment 10% Fee Increase Gross Revenue				130,434,000		
Total Change in Funds	\$54,465,000	(\$66,545,000)	\$3,600,000	\$131,574,000		\$68,629,000

* Neutral means these dollars cannot be used to fund or increase funding for CSU general operating budget programs. These General Fund adjustments are pass-through items that fund PERS retirement and benefits costs, remain with in the State Treasury for debt service payments on CSU capital bonds, or are restricted for Lottery related program expenses only.

CSU 2009-10 Expenditure Plan - Operating Budget Impact

Mandatory Costs			
CSU Employee Health Benefits			8,484,000
CSU Employee Dental Benefits			2,713,000
New Space			10,152,000
Energy			12,200,000
Total CSU Mandatory Costs			\$33,549,000
Enrollment Growth and Fee Revenue Funding Adjustment			\$7,092,000
Financial Aid			\$43,780,000
Total Expenditure Plan			\$84,421,000
NET REDUCTION IN GENERAL FUND AVAILABILITY			(\$15,792,000)