AGENDA

ASSEMBLY BUDGET SUBCOMMITTEE NO. 2 ON EDUCATION FINANCE

Assembly Member Susan A. Bonilla, Chair

WEDNESDAY, APRIL 11, 2012

4:00 P.M. - STATE CAPITOL ROOM 126

OVERVIEW HEARING ON THE GOVERNOR'S PROPOSED FUNDING FOR THE STATE'S HIGHER EDUCATION SYSTEMS

BACKGROUND

RECENT FUNDING HISTORY FOR THE UNIVERSITY OF CALIFORNIA AND CALIFORNIA STATE UNIVERSITY

State budgets in recent years reflect vast and deep changes in funding levels for the state's 4-year public institutions. By way of context, the following is a summary of adopted budget reductions and policy changes to the University of California (UC) and California State University (CSU) as a result of past budget negotiations.

2008-09 BUDGET ACT

General Fund Support. The enacted budget provided the UC with $3.3 billion in General Fund support, and the CSU with $3 billion in General Fund support. The budget included language (proposed by the Governor), which characterized UC and CSU's budgets as including unallocated reductions of $201 million and $172 million, respectively. These amounts represent the difference between what the budget provides and what the segments had expected to receive under the "compact" they signed with the Governor in 2004. The budget also reflects *allocated* reductions (from the level expected under the compact) to executive administrative costs of $32.3 million at UC and $43.2 million at CSU.

Student Fees. For 2008–09, the UC and CSU have enacted fee increases of 7.4 percent and 10 percent, respectively. The enacted budget assumes these fee increases will provide additional revenue of $125 million for UC and $110 million for CSU. When both General Fund support and fee revenue are combined, UC's base funding increased by 3.2 percent and CSU's base funding increased by 3.4 percent.

Enrollment Growth. In a departure from recent practice, the budget did not specify an expected level of student enrollment for UC and CSU, nor did it specify a "marginal cost" associated with enrolling additional students at the universities. Instead, supplemental report language adopted by the Legislature required the two university systems to provide reports by January 10, 2009, that described any enrollment growth and account for how that growth is being funded. During budget hearings, UC indicated that it expected to enroll about 5,000 additional full–time equivalent (FTE) students in 2008–09, while CSU indicated that it was taking steps to serve about 7,000 to 10,000 *fewer* FTE students in 2008–09. (The CSU estimated that its enrollment had exceeded its funding target by 10,000 FTE students in 2007–08).

Compensation Increases. In a departure from recent practice, the enacted budget did not assume any particular amount of funding would be used for compensation and other cost increases. Moreover, the Governor vetoed a provision, added by the Legislature, directing UC to redirect $15 million from administrator compensation to salary increases for low–wage workers. Supplemental report language required both segments to report by January 10, 2009, on any compensation increases they provided in 2008–09, including how such increases were being funded.

Labor Institutes. The Governor vetoed $5.4 million in General Fund support for UC's labor institutes. The Legislature had adopted budget language earmarking funding for this purpose.

2009-10 BUDGET ACT

Overall Funding. The 2009–10 budget provided University of California (UC) with $2.6 billion, and California State University (CSU) with $2.3 billion, in General Fund support. These amounts reflect reductions of about 20 percent from 2007–08 levels. The *2009–10 Budget Act* provisions reverted $1.5 billion in 2008–09 General Fund support from UC and CSU. About $64 million of this unallocated reduction originally took the form of cuts the Governor imposed through an executive order in fall 2008.

Student Fees. For 2009–10, UC and CSU enacted fee increases of 9.3 percent and 32 percent, respectively. The enacted budget assumed these fee increases would provide additional revenue of $166 million for UC and $366 million for CSU. Because fee revenue is unrestricted, the fee increases effectively offset General Fund reductions. Both segments plan to direct about a third of this new revenue to augment campus–based financial aid for their students.

Enrollment. The budget did not specify an expected level of student enrollment for UC and CSU, nor did it specify a "marginal cost" associated with enrolling additional students at the universities. In budget hearings, UC indicated that it expected to enroll about 2,300 fewer new freshmen, and about 500 more transfer students, in 2009–10 compared to 2008–09. The CSU indicated it intends to admit no students in spring 2010, thus trying to reduce overall enrollment by about 40,000 students. The budget directed the segments to report by March 15, 2010 on whether they met their 2009–10 enrollment goals, which stated that UC enrolled 2,136 fewer new freshman and 775 more transfer students.

Academic Preparation Programs. The Legislature rejected the Governor's proposal to eliminate funding for academic preparation (outreach) programs. Instead, the enacted budget contained language requiring the segments to limit any redirection of funding from these programs to an amount proportionate to their overall reduction in General Fund support.

2010-11 BUDGET ACT

Overall Funding. The 2010–11 budget provided the University of California (UC) with $2.9 billion, and the California State University (CSU) with $2.6 billion, in General Fund support. These amounts reflect increases of $317 million and $267 million, respectively. While these augmentations are relatively large given the state's fiscal constraints, they do not fully restore the universities' General Fund support to their 2007–08 levels. However, when other core funding sources are included, total core funding for the universities was well above pre-recession levels.

Student Fees. For the 2010–11 academic year, UC's undergraduate fee is $10,302, which reflects a 15 percent increase from the prior level. The CSU initially adopted a 10 percent increase for 2010–11. However, prior to final enactment of the state budget, the Assembly added new General Fund augmentations to the universities' budgets to "buy out" their fee increases. The CSU responded by lowering its fee increase to 5 percent, which results in an undergraduate fee of $4,230. (The UC did not adjust its 15 percent fee increase). Later, the Budget Conference Committee deleted from the final budget the General Fund augmentation associated with the Assembly's fee buyout. The CSU reconsidered its fee levels before the spring semester, and raised the undergraduate fee level to $4,440.

Enrollment. The budget nominally includes funding for enrollment growth of 2.5 percent at the universities. Specifically, UC received $51.3 million and CSU received $60.6 million for enrollment "growth." Associated budget language directed UC and CSU to enroll a total of 209,977 full–time equivalent (FTE) students and 339,873 FTE students, respectively.

Language included in the budget act (originally proposed by the Governor in January) also specified General Fund per student "marginal cost" amounts for UC and CSU of $10,011 and $7,305, respectively. Because recent budgets did not set enrollment targets for the universities, these unit costs were based on targets and funding formulas in place in 2007–08, updated for inflation and fee increases. The methodology employed in the Governor's language departs from the methodology used in prior years when growth funding had been provided.

University of California Retirement Program (UCRP). The budget package removed a statutory provision (added in 2009–10) that declared the Legislature's intent that no new General Fund augmentations be made toward UCRP. As a companion to that action, the Legislature also adopted budget language directing UC to provide a proposal for the long–term funding of UCRP. The Governor vetoed this language.

2011-12 BUDGET ACT

Overall Funding. The 2011–12 budget provides $2.4 billion in General Fund support to the UC, and $2.1 billion to the CSU. For both university systems, these amounts reflect net reductions of 18 percent. Specifically, each segment received a General Fund reduction of $650 million, a General Fund *augmentation* of $106 million to replace one–time federal stimulus funds in the 2010–11 budget, and a variety of other technical adjustments. Approved tuition increases (net of amounts set aside for student financial aid) will backfill about $266 million and $300 million, respectively, of UC and CSU's General Fund reductions. As a result, the decline in total programmatic funding for each system is about 11 percent.

Further General Fund Reductions Triggered on January 1, 2012. The UC and CSU budgets each reflect a $500 million reduction originally proposed in the Governor's January budget, as well as an additional $150 million reduction included in the final budget agreement. The enacted budget authorized an additional $100 million General Fund reduction to each university system in the event that anticipated state revenues are not realized. The Director of Finance determined on December 15, 2011 that revenues were projected to fall more than $1 billion short, reduced UC and CSU's General Fund appropriations by $100 million each.

Enrollment Targets. The 2011–12 budget sets state–supported enrollment targets of 209,977 full–time equivalent (FTE) students at UC and 331,716 FTE students at CSU. The target for UC is the same as the 2010–11 target, while the CSU target is about 8,000 FTE students lower than in 2010–11. The CSU's enrollment fell short of its target in 2010–11, and a provision in that year's budget caused $75 million in General Fund support associated with that enrollment shortfall to be reverted from CSU's budget. In a departure from past practice, the 2011–12 budget provides for no reversion of funding if either university system falls short of its enrollment target.

Student Tuition. Both UC and CSU have approved the following tuition increases for the 2011–12 academic year:

- The UC Regents initially adopted an 8 percent increase at their November 2010 meeting. In July 2011, following adoption of the *2011–12 Budget Act*, they approved an additional 9.6 percent increase. Together, those actions bring 2011–12 mandatory systemwide charges to $12,192—an overall increase of 18.3 percent. Including mandatory campus fees, undergraduate students will pay an average of about $13,218 at UC campuses.

- The CSU Trustees initially adopted a 10 percent tuition increase for 2011–12 in November 2010, and approved an additional 12 percent increase in July, for an overall increase of 23.2 percent. Mandatory systemwide charges for CSU undergraduates will be $5,472, with campus fees (some of which may increase) adding another $1,000 on average.

Other Provisions. The budget included several new requirements for the universities. One provision required UC to allocate $3 million of its General Fund appropriation for scheduled salary increases for its service employees. Other provisions provided guidance as to how the universities allocate their budget reductions, prohibiting disproportionate cuts in academic preparation and outreach programs at both segments, and in certain math, science, and nursing education programs at UC. The *Budget Act* made explicit a longstanding prohibition on the use of General Fund appropriations to support auxiliary enterprises or intercollegiate athletic programs at UC. Trailer bill language strengthened requirements for CSU's annual systemwide audit and removed a requirement for individual campus audits.

GOVERNOR'S 2012-13 HIGHER EDUCATION BUDGET PROPOSALS

This agenda item is to provide the Subcommittee with background on the Governor's 2012-13 budget proposals for higher education.

OVERVIEW OF THE GOVERNOR'S 2012-13 BUDGET

For 2012-13, the Governor’s Budget proposal provides $9.4 billion for higher education. This amount is $348 million, or 3.6 percent, less than the revised current-year level. When comparing the Governor's higher education funding level with that provided in 2007-08 (known as the last "normal" budget year), the proposed General Fund support for higher education declines by 21 percent.

Higher Education General Fund Support
(Dollars in Millions)

	2007–08 Actual	2008–09 Actual	2009–10 Actual	2010–11 Actual	2011–12 Revised	2012–13 Proposed	Change From 2007–08	
							Amount	Percent
UC	$3,257.4	$2,418.3	$2,591.2	$2,910.7	$2,273.6	$2,570.8	–$686.6	–21%
CSU	2,970.6	2,155.3	2,345.7	2,577.6	2,002.7	2,200.4	–770.2	–26
CCC	4,272.2	3,975.7	3,735.3	3,994.0	3,276.7	3,740.2	–532.0	–12
Hastings	10.6	10.1	8.3	8.4	6.9	8.8	–1.8	–17
CPEC	2.1	2.0	1.8	1.9	0.9	—	–2.1	–100
CSAC	866.7	888.3	1,043.5	1,251.0	1,481.7	567.9	–298.8	–34
GO bond debt service	496.2	591.4	762.0	809.3	724.9	330.8	–165.4	–33
Totals	**$11,875.8**	**$10,041.1**	**$10,487.8**	**$11,552.9**	**$9,767.3**	**$9,418.9**	**-$2,456.8**	**–21%**

Hastings = Hastings College of the Law; CPEC = California Postsecondary Education Commission; CSAC = California Student Aid Commission; and GO = general obligation.

Source: LAO

Note that from 2007-08 through 2012-13, the state reduced General Fund Support for UC and CSU by roughly $1.5 billion. The most notable consequences of these reductions have been significant student tuition fee increases, as illustrated in the following chart, effectively shifting a larger share of total education cost to students, and declining course offerings, which have made it difficult for students to complete their degrees in a timely manner.

As the chart on the next page shows, tuition now represents about 57 percent of UC’s average cost to education an undergraduate. The respective percentages for CSU and CCC are 48 percent and 20 percent. These shares are up from 2007-08, when UC and CSU students were paying a third of their education costs, and CCC students were paying about a tenth.

Higher Education Annual Tuition/Fees
Mandatory Charges per Full–Time Resident Student

	2007–08	2008–09	2009–10	2010–11	2011–12	2012–13 Proposed	Change From 2007–08 Amount	Change From 2007–08 Percent
University of California								
Undergraduate	$6,636	$7,126	$8,373[a]	$10,302	$12,192	$12,192	$5,556	84%
Graduate	7,440	7,986	8,847	10,302	12,192	12,192	4,752	64
California State University								
Undergraduate	2,772	3,048	4,026	4,440[a]	5,472	5,472[b]	2,700	97
Teacher credential	3,216	3,540	4,674	5,154[a]	6,348	6,348[b]	3,132	97
Graduate	3,414	3,756	4,962	5,472[a]	6,738	6,738[b]	3,324	97
Doctoral	7,380	7,926	8,676	9,546	10,500	10,500[b]	3,120	42

[a] Amount reflects full effect of midyear increase. [b]Although the Governor's proposal assumes no increase in CSU tuition for 2012–13, CSU has approved tuition increases of approximately 9 percent for fall 2012, which would result in tuition charges of $5,970 for undergraduates, $6,930 for teacher credential students, $7,356 for graduate students, and $11,118 for doctoral students.

Source: LAO

BACKGROUND

The Governor's Budget proposal for higher education reflects three broad themes:

1. ***New Approach to Segments' Budgets.*** The Governor's proposal reduces various restrictions on the three segments' budgets, including the elimination of enrollment targets and other requirements. At the same time, it promises funding increases in subsequent years, contingent on the segments' meeting as-yet undefined performance standards. For the universities, the proposal also would change how bond debt service and retirement costs are funded.

2. ***Budget Solutions Concentrated in State Financial Aid Programs.*** Virtually all of the Governor's proposed General Fund savings in higher education - $1.1 billion – is concentrated in the state's financial aid programs. Almost two-thirds of this amount comes from replacing General Fund support with other fund sources, and thus would have no programmatic effect on students, but impacts low-income families and children because of the proposed level of reductions made to the CalWORKs program. The remaining one-third of this General Fund savings is achieved by tightening financial and academic requirements for receiving aid, reducing the size of some grants, and eliminating some smaller programs.

3. ***Segments' Budgets Linked to Fate of Tax Package.*** While the Governor seeks no General Fund savings from the segments in his main budget proposal, all three segments would be subject to midyear cuts if the Governor's proposed tax increases are rejected by voters in November 2012. Specifically, the University of California and California State University would each receive midyear General Fund reductions of $200 million, while general purpose funds for the California Community College would be cut by almost $300 million.

According to Department of Finance, some of the major details of the plan are still not available, and may be introduced, as part of the Governor's May Revise process, but the basic elements of the plan include:

- ***Long-Term Funding Plan for Each of the Public Higher Education Segments.*** Although the Administration does not use the term "compact" to describe its proposed funding commitments, the proposal is similar to multiyear funding pacts developed between the segments and previous Governors. Governor Brown's proposal includes no new cuts for the colleges or universities in 2012-13 (assuming the passage of his tax package), and would provide annual General Fund increases of at least 4 percent for each of the segments beginning in 2013-14. These augmentations would be contingent on the segments' meeting improvement standards in such areas as graduation rates and enrollment of transfer students.

- ***Addressing Affordability in terms of Increased Tuition Costs.*** The Governor proposes to "curtail" tuition and fee increases at the public segments. The budget assumes no such increases for 2012-13. However, the governing boards of UC and CSU have the authority to set tuition on their own.

- ***Modifying the Debt Service Repayment & Retirement Costs to the Segments' Base.*** The proposed budget moves into UC and CSU's base General Fund appropriations some costs that until now were treated separately. Specifically, in 2012-13 debt service payments for UC and CSU facilities, as well as the State's share of UC and CSU retirement costs, would be included in their respective base budget. These amounts would not be separately adjusted in future years, although the entire, enlarged base budgets would be subject to the 4 percent annual increase described above.

- ***Budgetary Flexibility.*** The Governor's Budget seeks to increase flexibility for the segments in several ways. First, in moving retirement and debt service costs into the universities' base budget, the Governor proposes to remove restrictions on those funds. In addition, the Governor's Budget deletes longstanding provisional language and budgetary schedules that in prior budgets had tied portions of the universities' appropriations to specific programs or expenditures. Similarly, the budget consolidates over $400 million of CCC categorical funding into a single appropriation that can be used for a wide variety of purposes.

ITEMS TO BE HEARD

ISSUE 1: ELIMINATING EARMARKS & PROVISION LANGUAGE

The issue for the Subcommittee to consider is the Governor's proposal to eliminate earmarks and provisional language.

PANELISTS

- Department of Finance
- Legislative Analyst's Office
- California State University
- University of California

BACKGROUND

Current Law. Typically, the annual budget act includes a number of restrictions on UC's and CSU's General Fund appropriations. For example, recent budget acts have required UC to spend a certain portion of its funding on specified research programs, and have required both UC and CSU to direct a portion of their funding to student outreach programs. Other provisions have linked a portion of the universities' General Fund support to start-up costs at particular campuses. These and other "earmarks" for UC and CSU funding have varied over the years in keeping with the Legislature's and Governor's particular concerns at the time. The chart on the following page details all of the programs that are either separately scheduled in the system's General Fund appropriations or contained in provisional language.

Governor's Proposal. The Governor's Budget eliminates virtually all earmarks from the UC's and CSU's budgets. The Administration asserts that this will provide the universities with greater flexibility to manage recent unallocated budget reductions.

The Administration indicates that this proposal is intended to expand the segments' freedom to determine how their funding should be used and, when taken as a whole with other proposed changes, to provide incentives for the segments to make better use of their base funding. In addition, the Administration indicates that this proposal is intended to assist the segments in their management of recent unallocated budget reductions.

April 1st Department of Finance Letter. The Administration is requesting that $5.0 million be added to the University of California's (UC) main General Fund item (6440-001-0001) to reinstate base funding for the California Subject Matter Projects (CSMP). These funds were previously earmarked in UC's budget because they serve as a match to receive federal Title II funds for the CSMP program through the State Department of Education (SDE). The Governor's Budget earmarked the $5.0 million in the SDE's appropriation, with provisional language that the SDE would transfer the full amount back to UC with no change in program activity. However, the SDE has since stated that, as budgeted, it would be required to assess administrative costs prior to transferring the funds to UC, which would result in more money being spent on overhead costs and less on direct program activities.

The UC has confirmed that the state funds provided for its CSMP program do not have to be earmarked in the Budget Bill, and has committed to spending the entire $5.0 million for the CSMP even if the funds are not earmarked in provisional language. This proposal will maximize the use of both federal and state funds for the program.

UC and CSU General Fund Earmarks

From 2011–12 Budget Act (In Millions)

University of California		California State University	
Separately Scheduled General Fund Appropriations		**Separately Scheduled General Fund Appropriations**	
Charles R. Drew Medical Program	$8.7	Assembly, Senate, Executive, and Judicial Fellows Programs[a]	$3.0
AIDS research	9.2	Lease–purchase bond debt service	65.5
Student Financial Aid	52.2		
San Diego Supercomputer Center	3.2		
Subject Matter Projects[b]	5.0		
UC Merced	15.0		
Lease–purchase bond debt service	202.2		
Cal Institutes for Science & Innovation	4.8		
Provisional Language		**Provisional Language**	
Energy service contracts	$2.8	Science and Math Teacher Initiative	$2.7
COSMOS	1.9	Entry–level master's degree nursing programs	0.6
Science and Math Teacher Initiative	1.1	Entry–level master's degree nursing programs	1.7
PRIME	2.0	Baccalaureate degree nursing programs	0.4
Nursing enrollment increase	1.7	Baccalaureate degree nursing programs	3.6
2/12/09 MOU for service employees	3.0	Student financial aid	33.8
		Affordable Student Housing Revolving Fund	0.35

[a]Remains earmarked in Governor's 2012–13 budget proposal.
[b]Would be funded through State Department of Education in Governor's 2012–13 budget proposal.
COSMOS = California State Summer School for Mathematics and Science; PRIME = Program in Medical Education; and MOU memorandum of understanding.

Source: LAO

ISSUES TO CONSIDER

Unlike most state agencies, UC and CSU are governed by independent boards that make various decisions about how the universities will spend their resources. This includes the number of students that will be admitted, the number of faculty, executives, and other employees on the payroll; the salaries and benefits to be provided to those employees; tuition levels paid by students; the amount of tuition revenue redirected to financial aid; and other choices.

Given the delegation of so much budgetary authority to UC and CSU, the State has relied on earmarks as one way to ensure that its key concerns and priorities are addressed with the funding it appropriates to the universities. The inclusion of earmarks in the budget bill also provides a clear public record of budgetary allocations and expectations. The Governor's proposal would eliminate this budgetary tool, and thus would reduce the Legislature's ability to ensure that state funds are spent in a manner consistent with its intent.

It is also a legitimate concern that recent budget reductions have made it more difficult for the segments to fulfill the public mission assigned to them. While they are able to absorb some budget reductions by drawing on funding reserves, increasing efficiencies, and dramatically increasing student fees, reductions of the magnitude sustained

LAO RECOMMENDATION

It is reasonable for the Legislature to make some adjustments to the conditions it places on funding for UC and CSU, given recent budget reductions. Such adjustments should take into the net change in UC's and CSU's programmatic funding, rather than simply the change in General Fund support. To the extent that the Legislature choses to retain any earmarks, the budget bill should be amended accordingly.

ISSUE 2: ELIMINATING ENROLLMENT TARGETS

The issue for the Subcommittee to consider is the Governor's proposal to eliminate enrollment targets.

PANELISTS

- Department of Finance
- Legislative Analyst's Office
- California State University
- University of California

BACKGROUND

Current Practice. In most years, UC's and CSU's budget is tied to a specified enrollment target. To the extent that the segments fail to meet those targets, the state funding associated with the missing enrollment is reverted. As part of the 2011 Budget Act, budget trailer bill language SB 70 (Budget and Fiscal Review Committee), Chapter 7, Statutes of 2011, provided enrollment targets for UC and CSU; companion budget bill provisional language stated that the state would not revert funds appropriated to the universities even if the universities did not meet their enrollment targets.

The state Master Plan for Higher Education promises admission to all higher education applicants within defined eligibility pools. Demand for enrollment depends on a number of factors, including the perceived cost and benefit of attendance versus other options. In addition, segments regularly seek to increase or decrease total enrollment to fit available capacity, using enrollment management tools such as application deadlines, program impaction, and course scheduling.

- **University of California.** Drawing from the top 12.5 percent of the state's high school graduates, the UC has ten campuses and is the primary institution authorized to independently award doctoral degrees and professional degrees in law, medicine, business, dentistry, veterinary medicine, and other programs.

  In addition, a number of UC campuses have sought to increase their nonresident enrollment as a way to increase revenue. Although UC receives no state funding for nonresident students, the amount of their tuition payment ($35,070 for a nonresident undergraduate) exceeds the additional costs these students impose on UC. As a result, UC receives excess revenue from these students that it redirects to other purposes. Since 2007-08, UC's non-resident enrollment has increased by about a third, from about 17,500 FTE students to over 23,000 in the current year.

- **California State University.** Drawing students from the top one-third of the state's high school graduates, as well as transfer students who have successfully completed specified college work, the CSU provides undergraduate and graduate instruction through master's degrees and independently awards doctoral degrees in education, nursing practice, and physical therapy, or jointly with UC or private institutions in other fields of study. With 23 campuses, the CSU is the largest and most diverse university system in the country, playing a critical role in preparing the workforce of California. It also is one of the most affordable.

Governor's Proposal. The Governor's proposal would allow UC and CSU to make their own decision about how many students to enroll with the funding available to them.

Higher Education Enrollment

Resident Full–Time Equivalent Students

	2007–08 Actual	2008–09 Actual	2009–10 Actual	2010–11 Actual	2011–12 Estimated	2012–13 Projected	Change From 2007–08	
							Amount	Percent
University of California								
Undergraduate	166,206	172,142	174,681	175,607	175,409	175,409	9,203	6%
Graduate	24,556	24,967	25,233	25,202	24,686	24,686	130	1
Health Sciences	13,144	13,449	13,675	13,883	14,017	14,017	873	7
Subtotals	(203,906)	(210,558)	(213,589)	(214,692)	(214,112)	(214,112)	(10,206)	(5%)
California State University								
Undergraduate	304,729	307,872	294,736	287,733	298,119	305,396	667	—
Graduate/post baccalaureate	49,185	49,351	45,553	40,422	41,881	42,904	−6,281	−13%
Subtotals	(353,914)	(357,223)	(340,289)	(328,155)	(340,000)	(348,300)	(−5,614)	(−2%)
Source: LAO								

ISSUES TO CONSIDER

Enrollment levels are a fundamental building block of higher education budgets. They bear a direct relationship to access provided to the higher education system; they are a central cost driver for the segments; and they affect other costs, such as state financial aid. For these reasons, enrollment targets have been a major concern of the Legislature in recent years.

Changes to the segments' overall funding raise the question of what changes, if any, should be made to their enrollment levels. In some cases, the Legislature has reduced enrollment targets in recognition of funding reductions. In other cases, the Legislature has directed the segments to accommodate funding reductions without reducing enrollment below budgeted levels.

The Governor's proposal would allow the segments to make their own decisions about how many students to enroll with the funding available to them. In theory, the segments could significantly reduce the number of students served, thus raising the average amount of funding available per student. This funding could be used to increase salaries for faculty, staff, and executives – a goal all three segments have expressed at various times. Alternatively, they could reduce the number of undergraduates served, and use the funding to add a smaller number of higher-cost graduate students. Alternately, UC and CSU could employ an enrollment reduction to shift a larger amount of their budget away from direct education costs toward research or other non-instructional programs. These kinds of decisions have implications not just for the costs that the segments pay to educate students; they also could have a profound effect on the level of access provided at each segment.

LAO RECOMMENDATIONS

The LAO recommends that the Legislature reject the Governor's proposal to eliminate enrollment targets. Instead, they recommend the Legislature restore provisional language that specifies enrollment targets for UC and CSU, and reject proposed trailer bill language that would decouple community college funding from enrollment. As a starting point, the Legislature may wish to consider maintaining each segment's enrollment at its current-year level, given that the budget proposes roughly flat funding for each segment. To the extent that the Legislature chooses to significantly reduce or increase a segments' budget, it may wish to modify the enrollment targets. Alternatively, the Legislature may wish to require the segments to achieve greater efficiencies without reducing enrollment.

STAFF COMMENTS

During the March 2012 Board of Trustees meeting, CSU announced plans to cut enrollment for the 2013-14 academic year by 20,000 to 25,000 students, by first closing most of its campuses for spring admissions. Eight CSU campuses will take applications only for community college transfer students who complete the Associate Degree for Transfer, which was made possible through recent legislation (SB 1440). In addition, CSU plans to waitlist all eligible students applying for fall 2013 until after the November 6th election when the outcome of the Governor's tax measure is known. In order to assure that all enrolled students have fair access to the limited supply of courses, limits will be set on the number of courses students can take. Students will be able to take 15 to 17 credits each term, depending on the type of courses involved. Exceptions will be allowed for graduating seniors.

ISSUE 3: CHANGING THE DEBT SERVICE PAYMENT PROCESS

The issue for the Subcommittee to consider is the Governor's proposal to change the manner in which both the general obligation and lease-revenue bond debt repayment is made for UC and CSU facility projects.

PANELISTS

- Department of Finance
- Legislative Analyst's Office
- California State University
- University of California

BACKGROUND

Background. There are two major types of debt service in higher education:

- **General Obligation (GO) Bond Debt Service.** The California Constitution requires that general obligation bonds be approved by a majority of the voters and sets repayment of this type of debt before all other obligations of the state except those related to K-14 education. State bond acts continuously appropriate this debt service from the General Fund. Funding to repay this debt is not included in direct budget appropriations for the higher education segments. Due to the varying debt service payment schedules related to different projects, general obligation bond debt payments the state makes on behalf of the segments fluctuate from year to year.

- **Lease-Revenue Bond (LRB) Debt Service.** Lease-revenue bonds are also used to finance infrastructure projects for the segments. These bonds may be authorized with a majority vote of the Legislature, and their debt service is covered from the future rental payments on the facilities that are built. Funding for these rental payments is included in the segments' budget appropriations. The funding, however, is restricted specifically for paying the debt service, and is adjusted each year in the Governor's Budget to account for fluctuations in the amount of debt to be repaid.

Higher Education Capital Outlay Appropriations
(In Millions)

	2007–08	2008–09	2009–10	2010–11	Proposed 2011–12
University of California					
General obligation bonds	$450.0	$57.0	$30.9	$9.8	$9.3
Lease–revenue bonds	70.0	205.0	—	342.9	45.3
Subtotals	($520.0)	($262.0)	($30.9)	($352.7)	($54.6)
California State University					
General obligation bonds	$417.0	$72.0	$16.1	$13.4	$2.8
Lease–revenue bonds	—	224.0	—	76.0	201.2
Subtotals	($417.0)	($296.0)	($16.1)	($89.4)	($204.0)
California Community Colleges	$536.0	$444.0	$205.0	$111.0	$48.6
Totals	**$1,473.0**	**$1,002.0**	**$252.0**	**$553.1**	**$307.2**

Governor's Proposal. There are three major components of the proposal for UC and CSU:

1. **Debt Service Payment Shifted into the Segments' Base Budget**. UC and CSU's base budget appropriations are increased to reflect what the Administration estimates would be the 2012-13 general obligation bond debt service payments. In 2012-13, UC and CSU would receive base budget augmentations of $196.8 million and $189.8 million, respectively, related to GO bond debt. UC and CSU would also receive one final adjustment of $9.7 million and $5.5 million, respectively, related to LRB debt.

2. **No Restrictions or Future Adjustments on Debt Funding.** After making adjustments for 2012-13, the Governor further proposes not to adjust the segments' budget appropriations in the future to reflect any changes in lease-revenue and general obligation bond debt service costs, nor to restrict the funding provided to the segments for the purpose of repaying debt. Although the proposal does not include any further adjustments for this purpose, the Administration proposes a minimum 4 percent annual increase to the segments' base budgets from 2013-14 through 2015-16.

3. **No Proposed Changes to the State Review Process.** According to the Administration, the current process through which both the Administration and the Legislature review and approve state-funded capital projects for the segments would remain the same under the Governor's proposal. The Administration asserts that the segments would still have to request approval from the Administration and the Legislature for any projects to be funded with general obligation bonds approved by the voters. Moreover, the Administration and the Legislature would still need to review and approve any future lease-revenue projects.

ISSUES TO CONSIDER

Potential Need for Statutory Language to Prevent Unintended Consequences. Some of the details of this proposal remain unclear, including what, if any, budget trailer bill language the Administration will propose as well as applicability of the new approach to existing vs. future LRB debt service costs. It is also unclear, contrary to the Administration's assertions, if UC and CSU would be required to seek Administration and legislative approval for all projects in future years.

Potential Cost-Reductions by Refinancing Debt for UC. According to UC, there could be some debt payment reductions under the Governor's plan, by potentially refinancing some of the existing lease-revenue bond debt related to UC facilities and lower its debt service primarily by extending repayment periods. Given these actions cannot be predicted in advance, it is unclear what effect the Governor's proposals would have on debt service costs. It appears that CSU does not have the same flexibility to reduce their debt payments by refinancing.

What is the Appropriate Funding Level for Debt Service? The Governor's proposal would increase the UC's and CSU's base budget appropriation one last time to reflect the 2012-13 bond debt costs, and then allow the base to grow by four percent over a three-year period. How can the Legislature determine that this funding level would result in the right level of resources to fund the segments' long-term capital outlay needs?

LAO RECOMMENDATIONS

Below are listed various issues raised by the LAO that the Legislature will need to consider before acting on this proposal.

- ***Potential Incentives to Scale-Down Projects.*** The current process, which funds debt service payments separate from other operational expenses and automatically adjusts each year, provides no incentive for the segments to limit the number of scope of capital projects that they submit to the Administration and the Legislature. In past budget analyses, the LAO has found that the scope of projects submitted by the segments often exceeds what they would consider to be necessary, such as requesting additional space that exceeds state needs.

- ***Future Fiscal Implications.*** It is difficult to predict how the segments' state-funded debt payments could change in the future, especially when annual debt service payments on existing bonds (including estimates for bonds that have been authorized but not yet sold) are expected to increase slightly through 2015-16. Whether the segments' debt costs would further increase relative to these existing obligations would largely depend on what future capital projects the segments request, whether the Legislature approves those projects, or what actions UC takes to issue its own debt. It appears the Administration did not perform an analysis to determine how this amount of funding relates to what the universities might reasonably require in the long term.

- ***Potential Loss of Legislative Oversight & Control.*** In the future, the Legislature would no longer be responsible for allocating funding for support operations versus infrastructure debt service. This is particularly troublesome since it is not clear whether the amount of debt funding that would be shifted into the segments' base budget is the appropriate amount to support the universities' long-term infrastructure needs. Without additional information on reasonable debt costs per student, it is unclear whether this amount of funding is appropriate, or whether it is too low or too high. Shifting this amount of control over spending priorities to the universities raises serious questions given that they are statewide, public institutions.

  The Administration asserts that the segments would still request bond funding for capital projects from the Legislature. However, it appears that it could be possible for the segments to circumvent the capital outlay budget request process. For instance, UC could potentially issue its own bonds for projects for which it currently requests state bond financing. This means that in the future UC might not submit many (or even any) state-related project proposals to the Legislature for its review. This is a serious concern that needs to be addressed if the Legislature is to consider this proposal, in order to ensure the Legislature retains its ability to review projects to ensure that they are consistent with state needs.

Recommend Rejecting the Governor's Proposal. While the LAO agrees with the Administration that certain aspects of the current state debt financing system for the segments do not always provide the right incentives, overall the LAO finds that the Governor's proposal does not fully address these issues and makes the Legislature's future capital outlay budgeting decisions for the segments even more difficult. Moreover, the LAO finds some aspects of the proposal regarding Legislative oversight of the segments' state-related projects to raise serious concerns.

The LAO recommends rejecting this proposal and reducing the General Fund appropriations for UC and CSU by $196.8 million and $189.8 million, respectively, to take debt service for general obligation bonds out of their base budgets and delete the associated budget bill language. Also, the LAO recommends restricting the amounts proposed for lease-revenue bond debt service in 2012-13 to that purpose only.

ISSUE 4: CHANGING THE CALIFORNIA STATE UNIVERSITY RETIREMENT COST PAYMENT PROCESS

The issue for the Subcommittee to consider is the Governor's proposal to make major changes related to funding for CSU retirement costs.

PANELISTS

- Department of Finance
- Legislative Analyst's Office
- California State University

BACKGROUND

CSU Pension Benefits. CSU employees are members of the California Public Employees Retirement System (CalPERs) – the same retirement system to which most state employees belong. Funding for this system comes from both employer contributions and employee contributions. Each year, as is the case with other state departments, CSU's employer contributions to CalPERs are charged against its main General Fund appropriation. The employer contribution is based on a percent of employee salaries and wages that is determined by CalPERs and specified in the annual budget act. The Governor's budget annually adjusts CSU's main appropriation to reflect any estimated changes in the employer contribution. For example, the Governor's Budget reduces CSU's main appropriation by $38 million due to a lower employer rate and lower payroll costs in the current year. The CSU is expected to contribute $400 million in CalPERs in 2012-13.

Governor's Proposal. For CSU, the Governor proposes to no longer make base adjustments to reflect changing retirement costs and expects that state-related retirement costs be funded entirely from CSU's unrestricted base budget. The Administration's proposal removes the CSU from the budget bill Code Section 3.60 that allows the Director of Finance to adjust any appropriation affected by changes to employer contributions for 2012-13 fiscal year and creates a new Code Section 3.61, which states that CSU employer retirement contributions are to be paid out of their base budget item 6610-001-0001.

ISSUES TO CONSIDER FOR CSU

State law requires that CSU be part of CalPERs. The benefit structure for CalPERs members – such as the payment rates at various ages and the minimum retirement age – is also specified in state law. This means that the university has virtually no control over the pension benefits that its employees earn. In addition, state case law protects these benefits as contracts under the State and U.S. Constitutions. As a result, there are strict legal limits on even the state's ability to change these benefits for current employees in order to reduce government costs.

Given that the overall benefit structure is very difficult to change in the near term, the only significant lever CSU would have to control its pension costs is the employee contribution rate. For example, an increase in this rate would mean that the university's contribution rate could be lowered. The employee contribution rate for CSU employees, however, is also set in state law, as are contribution rates for other state employees. As a result, CSU is not able to change this rate without Legislative approval. For state employees, these rates also have recently been subject to collective bargaining. Recent negotiated changes in the employee contribution rate for other state employees suggest the university would also likely have to offer a benefit in exchange for increased employee contributions, such as increased salaries. This could offset any near-term pension savings.

The only way that the LAO could identify for the university to reduce its pension costs would be through managing its payroll costs. Either by reducing the number of employees or their salaries, but these are blunt tools at best and unlikely to have a significant impact on reducing pension costs for the university.

LAO RECOMMENDATIONS

Given the statutory and other constraints that CSU faces, the LAO finds that overall the Governor's proposal would place on CSU a level of responsibility for funding pension costs that is out of proportion with its ability to control those costs. For this reason, the LAO recommends that the Legislature reject the Governor's approach. Specifically, the LAO recommends that the Legislature adopt intent language in the budget specifying that future budget adjustments shall be provided to CSU to reflect its pension costs.

ISSUE 5: CHANGING THE UNIVERSITY OF CALIFORNIA RETIREMENT COST PAYMENT PROCESS

The issue for the Subcommittee to consider is the Governor's proposal to make major changes related to funding for UC retirement costs.

PANELISTS

- Department of Finance
- Legislative Analyst's Office
- University of California

BACKGROUND

UC Pension Benefits. Employees of UC (and Hastings) are members of the University of California Retirement Plan (UCRP). This retirement plan is separate from CalPERs and under the control of UC. Prior to 1990, the state adjusted UC's General Fund appropriation to reflect increases and decreases in the employer's share of retirement contributions for state-funded UC employees. Starting in 1990, however, UC halted both employer and employee contributions to UCRP because the pension plan had become "super-funded." Specifically, the plan at that time was enjoying exceptional strong investment returns, resulting in assets that exceeded liabilities by more than 50 percent. This "funding holiday" lasted nearly 20 years until the plan's assets had declined considerably and contributions once again became necessary. In April 2010, both UC and its employees resumed contributions to the plan. The state, however, has not provided UC with any additional resources specifically for that purpose.

Governor's Proposal. For UC, the Governor proposes (1) a $90 million base augmentation that could be used for pension costs or other purposes, and (2) no out-year adjustments for retirement costs, to be paid from UC's unrestricted base budget.

ISSUES TO CONSIDER FOR UC

The request for pension-related funding for UC is more difficult and complicated than that for CSU. This is because (1) the state currently is not providing any pension-related funding for UC, and (2) UC has full control over its pension system. To address the Governor's proposal, the Legislature should consider the following questions:

- What is the main justification for the state to provide funding for UC's retirement costs? In other words, why is funding for these costs a state responsibility?

- Given that UC controls its own pension plan, are UC's pension benefits reasonable? How do they compare to the pension benefits the state provides state employees?

- How much funding should the state provide UC in 2012-13? More specifically, what methodology or calculations support the request for $90 million?

- Finally, should the state lock in the pension amount provided to UC at the 2012-13 contribution level or provide UC with budget adjustments for pension costs in future year?

Pension Costs are Funded as Part of Other State Agencies' Workload Budget, but not for UC. The state currently provides funding for pension-related costs for all other state agencies as part of a normal, workload budget. In other words, the state provides funding to state agencies for the salaries and benefits (including pension benefits) related to their budgeted positions. Given that the state provides UC with funding for the salaries and benefits of some of its employees, it would make sense from a standard, workload budgeting perspective to also provide funding related to pension costs.

University has restarted UCRP Contributions for both Employees and as the Employer. The UC Board of Regents has begun taking actions that largely mirror recent changes to state employee pension benefits. For example, the Regents have taken action to reduce pension costs in the long term by increasing the minimum retirement age for new employees. In addition, as shown in the chart below, the Regents have approved increases to employee contribution rates that are beginning to bring them in line with state employee contribution rates, which are now generally 8 percent. Additional contribution increases beyond July 2013 will also likely be necessary to reduce the plan's significant unfunded liability that has accrued due to the decades-long pension funding holiday and recent market downturns. Note: Some of UC's proposed employee contribution increases are still subject to collective bargaining.

University of California Retirement Plan Contributions Approved by the Regents

	Employee[a]	Employer	Total
April 2010	2.0–4.0%	4.0%	6.0–8.0%
July 2011	3.5	7.0	10.5
July 2012	5.0[b]	10.0	15.0
July 2013	6.5[b]	12.0	18.5

[a] For most employees. Safety and some other employees may pay a different rate.
[b] Not all employee unions have agreed to this rate yet.

Source: LAO

LAO RECOMMENDATIONS

The LAO Believes the Estimate of State Share of 2012-13 Pension Costs is Overstated. The $90 million that UC requested from the Administration is only a fraction of the $255.6 million that UC estimates to be the state's share for 2012-13. The UC state it requested the lower amount in recognition of the state's severe fiscal shortfall. The university further indicates that it will likely seek the full amount of what it estimates to be the state's share (which it calculates could rise to roughly $450 million) in future years. The LAO created the chart below to show how UC calculates the state's share of retirement contributions.

UC Calculation of State Retirement Contribution
(Dollars in Millions)

	2010–11	2011–12 (Increase)	2012–13 (Increase)
Calculate Employer Contribution			
Employer contribution rate	4%	3%	3%
Employee compensation cost[a]	$2,878	$2,878	$2,921
Employer contribution amount	**$115**	**$86**	**$88**
Calculate State Share[b]			
State General Fund	46%	41%	—
Student fee	41	47	—
Total State and Student Fee Share	**87%**	**89%**	**—c**
State contribution	$100	$77	$78

[a] For employees paid from "core funds" only—state General Fund, student fees, UC General Funds, and (for 2010–11 only) federal American Recovery and Reinvestment Act funds.
[b] Percent of core funded employee compensation from state and student fee sources.
[c] The UC used the same percent as 2011–12.

Source: LAO

The LAO found two issues that the Legislature should carefully consider with respect to how the university has estimated the state's share of UC retirement costs.

1. The LAO finds that the request for $90 million in 2012-13 is overstated. As the chart shows, UC's estimate of the state's share of its 2012-13 retirement cost increase totals about $78 million. The UC appears to be requesting a greater amount because it believes that the state should provide contributions to account not only for incremental retirement costs in 2012-13, but also for part of the cost increases in the two prior years.

   The UC has managed, by both redirecting internals resources as well as increasing student tuition, to fund all of its employer contributions in both 2010-11 and 2011-12. If the Legislature were to provide funding related to prior years, the funding would in effect free up existing UC base funding for other purposes. In the LAO's view, given the state's fiscal shortfall, such an augmentation would be unwise.

2. The LAO states that the university's calculation of the state's share of retirement contributions includes employer costs related to tuition-funded salaries. Given, however, that the Governor's budget assumes no increases for tuition in 2012-13, the Legislature may wish to consider providing the funding for pension costs related to tuition-funded salaries in 2012-13. In future years, higher pension costs – just like any other UC costs – presumably would be covered by the General Fund and tuition fees in proportion to their current funding levels.

STAFF COMMENTS

Bad Timing to Lock In Base Funding for Pensions. Given that the Governor is proposing to modify public employee pension to reduce future state costs, it appears that now is not the appropriate time to be making these permanent changes is the system's base budget. UC intends to increase its employer contributions over the next few years, although it has not yet reached agreement with all of its union-represented employees on the employee contribution rate.

It might be in the Legislature's interest to carefully evaluate future requests from UC for pension funding on a year-to-year basis in the context of the university's current pension benefit and contribution structure. In the long term, however, it could make sense to expect UC to fund its pension costs out of its base budget, given that the university's retirement system is separate from the state's. This could only work once a reasonable funding level has been identified and contribution amounts have stabilized.

Reasonable to Begin State Contribution, Need to determine Appropriate Level of Funding. Given that the university has had to restart its contributions to its pension plan in recent years, it appears justifiable that the state also resume providing pension related funding. The LAO recommends that the Legislature only provide funding for the incremental change in 2012-13 in UC's pension costs for state- and tuition-funded employees – which the LAO estimates it to be $78 million. In addition, the LAO recommends that the Legislature adopt intent language in the budget specifying that in the future funding for UC retirement costs (1) shall be determined annually by the Legislature, (2) shall be contingent on such factors as the comparability of UC's pension benefits and contributions to those of state employees, and (3) shall not necessarily include funding for tuition-supported employee pension costs or pension costs incurred prior to 2012-13.

ISSUE 6: THE GOVERNOR'S NEW HIGHER EDUCATION LONG-TERM PLAN

The issue for the Subcommittee to consider is the Governor's proposal to provide a long-term funding structure based on performance metrics for UC and CSU. This proposal is contingent upon the passage of the Governor's tax initiative in November 2012.

PANELISTS

- Department of Finance
- Legislative Analyst's Office
- California State University
- University of California

BACKGROUND

Funding Agreements or Higher Education Compacts with Prior Administrations. Funding agreements or compacts as they have been previously called are not a new idea or approach. Similar agreements between prior administrations and UC and CSU generally took the form of uncodified agreements between the Governor and the universities. The Legislature was not a party to those earlier agreements. Those prior agreements also largely proved themselves to be unworkable. While the desire for budgetary stability and predictability is understandable, the state budgets on a one-year cycle. In this vein, one Legislature cannot tie the hands of another; therefore, and as in the past, any budget decision made one year about a future year is at best a statement of legislative intent.

Governor's Proposal. A central component of the Governor's higher education proposal is the commitment of 4 percent annual base increases for the public segments in exchange for meeting performance standards. To the extent, those standards are met; augmentations would be provided in 2013-14, 2014-15, and 2015-16.

The Governor relies on this funding and accountability proposal as an integral element of his higher education budget package. For example, the cost of the base increases is affected by his separate proposals (previously discussed) to move debt service and retirement payments into the universities' base budgets. All of these proposals presume that State will no longer make unallocated (or even targeted) reductions to the universities' budgets to deal with future fiscal shortfalls. Moreover, the development of accountability mechanisms could help the Administration's effort to justify its proposal to remove restrictions on the segments' base funding.

ISSUES TO CONSIDER

Details of Performance Metrics Are Not Finalized for Public Input. The Administration is still working out the details of their accountability proposal. At this time, the Legislature is left with more questions than answers regarding this new funding agreement, such as:

- **Nature of the Agreement.** The Governor proposes that this agreement apply to all segments, including the Community Colleges, and suggests that the Legislature would somehow be involved in its development. However, the Administration and the segments, specifically UC, have been negotiating aspects of the proposal. At this time, it is uncertain what role the Governor proposes that the Legislature would have in providing additional input and/or suggestions and what form this agreement would take, i.e. trailer bill language or budget bill, or remain an uncodified agreement like prior compacts.

- **Measuring Student Success & Funding Based on Outcomes.** Under the Governor's proposal, higher education performance would be measured using "accountability metrics" and annual augments of up to 4 percent would be contingent on each institution achieving these metrics. The Administration suggests as possible candidates a number of common higher education performance indicators: *graduation rates, time to completion, enrollment of transfer students, faculty teaching workload, and course completion.* However, because details are vague it raises the following questions:

    - Which specific metrics would be used?
    - How would these metrics be defined?
    - How would the data be collected and by whom? (Note: The California Postsecondary Education Commission, the agency authorized to collect all of the public institutions' data, was eliminated in last year's budget via the Governor's veto process.)
    - What performance targets are the segments expected to meet?
    - What level of overall performance would merit a base increase? Would the segments have to meet all the metrics or some, is there an incremental process?

- **What is the Longevity of the Governor's Accountability Provisions?** The Administration indicates that the proposed annual augmentation of 4 percent to the institutions' base budget would not be made if the Governor's proposed tax initiative were not approved by voters. It is not clear whether the accountability provisions would also be suspended if the tax package failed. For the longer term, it is not clear whether the segments would be expected to maintain any particular performance levels once the final year of the proposed base increases had passed.

- **Is the State in a Position to Commit to Out-Year Base Increases?** The higher education segments, like many states and local entities, have experienced unpredictable, significant changes to their budgets in recent years. It is understandable that those who receive state funding would desire greater budgetary stability and predictability. However, agreements such as the one proposed by the Governor have been tried before, and have proven unworkable for the most part.

- ***Budget Volatility Would be Redirected & Amplified in Other Areas.*** The budget uncertainty experienced by the segments in recent years stems from underlying revenue volatility that affects the entire state budget. By promising to insulate the segments from these effects through stabilized budgets and annual base increases (contingent upon meeting certain performance targets), the Governor's proposal would in effect concentrate the effects of revenue volatility in other areas of the budget.

- ***Legislative Discretion Would Be Constrained.*** To the extent that the Legislature decided to approve the Governor's proposal, the Legislature would have less discretion in allocating funds toward its priorities. For example, under the Governor's proposal the three segments would receive General Fund increases totally about $350 million in 2013-14, which would reduce the amount of available revenue the Legislature could appropriate for other purposes. Moreover, the Legislature would not be able to reallocate funding among the segments in response to differing needs.

  - ***Example.*** If enrollment demand at CSU increased more rapidly than the growth at UC, the Legislature would not be able to redirect funding to accommodate the shift in demand.

LEGISLATIVE EFFORTS

The accountability proposal in the Governor's Budget is something of a departure from prior compacts, which is commendable. For years now, the Legislature has spent considerable effort in trying to develop a higher education accountability framework. In fact, the Legislature has twice passed comprehensive higher education accountability legislation, which was vetoed. More recently, the Legislature's Joint Committee on the Higher Education Master Plan identified serious shortcomings in the State's ability to oversee and set standards for the higher education system, and called for renewed efforts to develop goals and oversight mechanisms for higher education.

A current legislative effort in this direction is SB 721 (Lowenthal), which would establish higher education goals and create a working group of representatives of the Legislature, Administration, higher education segments, and other stakeholders to develop specific accountability metrics. Other current and recent legislative efforts have focused on similar objectives.

The Assembly Speaker has also introduced AB 2190 to establish a new higher education coordinating body to oversee and monitor postsecondary education goals for the state, including reporting on the process of the postsecondary segments effectiveness in meeting the state's needs.

The Legislature has also held hearings and is considering possible legislative responses to address the data and oversight issues created by CPEC's demise. The Subcommittee No. 2 on Education Finance held a Joint Hearing on March 14, 2012 with Assembly Higher Education to discuss the need to re-establish a stronger, oversight board that can assist the Legislature in coordinating all of the state's higher education needs while tracking and maintaining relevant student record data and information.

LAO RECOMMENDATIONS

The LAO believes that the Governor's proposal provides a good opportunity to move forward with the Legislature's accountability efforts. However, the LAO recommends that accountability metrics be used to help the Legislature in identifying policy and budget priorities, rather than as a mechanism for triggering the preset 4 percent augmentations for the segments.

Promising out-year base augmentations to the segments would complicate budgeting in other areas; reduce the Legislature's discretion in allocating resources. For these reasons, the LAO recommends that the Legislature reject the Governor's approach of promising base increases to the segments. Instead, the LAO recommends the Legislature continue its current practice of making higher education funding decisions as part of each year's budget deliberations.

ISSUE 7: BUDGETARY TRIGGER REDUCTIONS

The issue for the Subcommittee to consider is the Governor's proposal to reduce General Fund support for both the University of California and California State University by $200 million each, if the November tax initiative is not approved by voters. The triggered reduction would take effect January 1, 2013.

PANELISTS

- Department of Finance
- Legislative Analyst's Office
- California State University
- University of California

BACKGROUND

Prior Budgetary Triggers. The 2011 Budget Act included $100 million reductions for both the University of California and California State University to be triggered if estimates of state revenues as of December 2011 were $1 billion or below the forecasted amount. This trigger was pulled effective January 1, 2012.

Governor's Budget. The Governor's Budget relies on revues from a tax package to be placed before voters in November 2012. In the event that voters reject that plan, the January budget proposes a number of automatic reductions (trigger cuts) to the General Fund appropriations, primarily in the areas of Proposition 98 and the universities, which would take effect January 1, 2013. For UC and CSU, their appropriation would be reduced by $200 million each, a reduction of 7.8 percent and 9.1 percent, respectively.

ISSUES TO CONSIDER

The Governor's trigger plan attempts to address the potential for imbalance in the state budget in the event that his proposed revenue package is rejected by voters. Even if the triggers were not ultimately pulled, they could have negative impacts on higher education to the extent the segments hedge their bets and make preparations for the academic year on the assumption the cuts will be made. The following has some of the key decisions that the Legislature needs to be aware of, as it determines the appropriate level of funding available for higher education.

- **Setting Enrollment Levels.** As discussed earlier, the Governor's Budget proposal includes no enrollment targets for higher education. This spring, the universities will be making decisions on enrollment applications for the 2012-13 academic year. These decisions will help determine their enrollment levels – a key driver of costs – in the budget year. Although the Master Plan specifies the size of the universities' eligibility pools, the universities have some ability to manage their enrollment levels by restricting eligible students' admission to particular campuses or programs.

- **Staffing Decisions.** Universities also must make faculty and staff hiring decisions in order to accommodate their planned enrollment in the budget year. Campuses and departments have varying degrees of flexibility in making these decisions, depending on tenure rules, collective bargaining, and other factors.

- **Setting Student Fee Levels.** The universities have the authority to set their own tuition and fee levels. The UC has not yet made a decision on its fall 2012 tuition, while CSU has already approved a 9.1 percent increase for the fall. However, the Governor's Budget assumes CSU will rescind that increase. While there is no strict deadline for approving fall tuition levels, many students, and their families need to know what costs they face in order to plan for the fall.

LAO RECOMMENDATIONS

Given that a significant portion of the Governor's revenue assumption is subject to voter approval in November, it makes sense to include a contingency plan in the event voters reject the tax proposal. However, the Legislature has choices as to how the contingency plans are structured. The LAO provides a few alternative options for the Legislature to consider.

- **Allocate Contingency Cuts Among Programs.** The Governor places almost all the trigger cuts in K-14 education and higher education. The Legislature could instead allocate the cuts differently among the state's education and non-education programs. For example, the cuts could be targeted to programs most able to respond to midyear reductions, or they could be spread across more programs to reduce their impact on any one program.

- **Build Core Budget Without Triggers.** The Governor's approach is to build a budget that assumes his tax package is adopted, with contingency cuts that would reduce operating budgets midyear if needed. The Legislature could instead take the opposite approach: build a budget that does not rely on the Governor's tax package, with contingency augmentations if the tax package is approved. This might mean, for example, appropriating less funding for higher education or other agencies than the Governor proposes. In the event tax increases are approved in November, the Legislature could direct the resulting revenues to critical one-time investments, such as paying down debt or funding deferred facilities maintenance. This alternative provides segments more certainty as to what level of General Fund support to expect for their core programs.