AGENDA

ASSEMBLY BUDGET SUBCOMMITTEE NO. 2 ON EDUCATION FINANCE

Assembly Member Wilmer Amina Carter, Chair

WEDNESDAY, MAY 13, 2009
STATE CAPITOL, ROOM 126
4:00 PM

VOTE ONLY

ISSUE 1: APRIL 1ST DEPARTMENT OF FINANCE LETTERS

The issues for the Subcommittee to consider are various technical amendments proposed by the Department of Finance (DOF) to the 2009-10 Budget Act.

BACKGROUND:

As part of the annual budget process, DOF submits a letter to the Legislature on April 1 that includes proposed changes to the Governor's January budget. This year, since the 2009-10 Budget Act has already been enacted, the "April letter" contains amendments to the 2009-10 Budget Act. The proposed revisions are largely technical and include adjustments to state operations and local assistance, and capital outlay funding.

	University of California
1	Item 6440-402 Capital Outlay (Issue 001). Authorize Garamendi financing, related to the construction of projects on the UC Santa Barbara and UC San Diego campuses.
2	Item 6440-491 Capital Outlay (Issue 001). Reappropriate funds for 14 capital projects (numbered 1-14) due to delay in Pooled Money Investment Board financing.
3	Item 6440-492 Capital Outlay (Issue 001). Extend period of liquidation for 24 capital projects (numbered 1-24) due to delay in Pooled Money Investment Board financing delays.
	California State University
4	Item 6610-491 Capital Outlay (Issue 001). Reappropriate funds for 24 capital projects (numbered 1-24) due to delay in Pooled Money Investment Board financing.
5	Item 6610-492 Capital Outlay (Issue 001). Extend period of liquidation for 9 capital projects (numbered 1-9) due to delay in Pooled Money Investment Board financing delays.
	California Community Colleges
6	Item 6870-001-0001 State Operations (Issue 001). Increase reimbursements to reflect interagency agreement with the California Emergency Management Agency. $400,000
7	Item 6870-001-0001 State Operations (Issue 004). Increase reimbursements to reflect receipt of additional Workforce Investment Act (WIA) funds from the Employment Development Department (EDD). $600,000

8	Item 6870-111-0001 Local Assistance (Issue 003). Increase reimbursements to reflect the receipt of additional funds from the Carl D. Perkins Vocational and Technical Education Act. $19,546,000
9	Item 6870-111-0001 Local Assistance (Issue 005). Increase reimbursements to reflect the receipt of continuing WIA funds for use in the nursing program. $6,000,000
10	Item 6870-111-0001 Local Assistance (Issue 006). Increase reimbursements and adopt provisional language to reflect of WIA funds in allied health programs. $2,000,000
11	Item 6870-111-0001 Local Assistance (Issue 007). Increase reimbursements and adopt provisional language to reflect the receipt of continuing WIA funds for use in programs in train Corpsmen/Paramedics for Nursing careers. $1,200,000
12	Item 6870-301-6028 Capital Outlay (Issue 301). Revert authority for preliminary plans and working drawings for the San Diego City College Child Development project at district's request. $594,00
13	Item 6870-497 Capital Outlay (Issue 303). Revert project savings from 11 facilities projects. $13,321,000
14	Item 6870-497 Capital Outlay (Issue 303). Revert construction and equipment authority for the Santa Barbara City College High Technology Center. $8,150,000
15	Item 6870-301-6049 Capital Outlay (Issue 304). Reduce appropriation for Santa Barbara City College High Technology Center by the $8,150,000, as noted above. $22,522,000
16	Item 6870-490 Capital Outlay (Issue 305). Reappropriate funds for 68 capital projects due to delay in Pooled Money Investment Board financing.
17	Item 6870-491 Capital Outlay (Issue 302). Extend liquidation period for two years for 49 capital projects due to delay in Pooled Money Investment Board financing.
18	Item 6870-493 Reappropriation (Issue 002). Reappropriate and adopt accompanying provisional language related to federal Department of Labor funds for the Logistics Program. $100,000
	California Student Aid Commission
19	Item 7980-001-0001 State Operations (Issue 007). Amend provisional language for compliance audits.

ISSUE 2: APRIL 1ST DEPARTMENT OF FINANCE LETTER: CAL GRANT PROGRAM REDUCTIONS

The issue for the Subcommittee to consider is the reintroduction of the Governor's four reduction proposals to the Cal Grant programs. In total, these proposals would add up to a reduction of $87.5 million. The Legislature rejected similar proposals last session and from the 2009-10 Budget Act, as these programs signify the importance of maintaining access and affordability for California students.

PANELISTS

- Department of Finance
- Legislative Analyst's Office
- California Student Aid Commission
- Public Comment

BACKGROUND:

Item 7980-101-0001

- **Freeze Cal Grant Income Eligibility Levels at Current Year Levels** – This proposal would save $7 million General Fund. Holding income eligibility constant while inflation is minimal and family incomes are dropping should have minimal affect on the number of students that would otherwise qualify for Cal Grants. Applicable control language was proposed in Provision 3 of this item in the Governor's Budget.

- **Reduce Maximum Cal Grant Amount for Students Attending Private Institutions** – This proposal would save $11 million dollars. Reducing maximum grants for students attending private institutions will largely be mitigated by increases in Pell Grants and Tuition Tax Credits enhancements authorized in recently enacted federal stimulus legislation. Applicable control language was proposed in Provision 4(c) of this item in the Governor's Budget.

- **Partially De-couple Cal Grant Award Levels from Public Segment Fee Increases** – This proposal is estimated to save $16.6 million. This proposal would still cover two-thirds of the anticipated fee increases, the difference of which would be mitigated by the increases in Pell Grants and federal tuition tax credits. Applicable control language was proposed in Provision 4(a) and (b) of this item in the Governor's Budget.

- **Eliminated New Awards for the Competitive Cal Grant Program** – This proposal is estimated to save $52.9 million. Applicable trailer bill language that would make new awards subject to the Budget Act was transmitted previously in

RN 0902567. Given that the Cal Grant High School Entitlement Program has been in place since 2001, most students who would qualify for the Competitive program had the opportunity for a Cal Grant when they graduated from high school. Additionally, the Community Colleges Transfer Entitlement affords students a second opportunity for a Cal Grant upon completion of transfer requirements. For any student whose circumstances would not entitle them to take advantage of these programs, many other forms of financial aid and federally guaranteed loans are available which still ensures the ability of older students with modest means to achieve a Bachelors Degree.

While it would be desirable to maintain all Cal Grant programs with current eligibility requirements and increasing award levels, and to offer grants to every student, the state's financial condition requires that hard choices be made. We believe the Competitive Cal Grant Program is largely redundant and unaffordable at this time and that the other cost savings measures proposed in the Governor's Budget are necessary to help achieve a balanced budget.

ADDITIONAL BACKGROUND INFORMATION

Impact of Decoupling. The Governor's proposals fail to protect financially needy students, who have been held harmless from the effects of fee increases, which ensure access to higher education. The impact of decoupling the Cal Grants from fees would affect 116,860 new and continuing Cal Grant recipients of the Cal Grant awards at public institutions Preserving the linkage between the Cal Grant with fees has helped protect access and affordability for financial disadvantage students.

Impact of Reducing Private College Cal Grant Awards. About 9,600 new Cal Grant recipients would be affected by the reduction of the Cal Grant award at the private institutions. Reducing funding support for students who seek to attend private institutions, including independent nonprofit universities such as Stanford and the University of Southern California, and for-profit educational institutions such as the University of Phoenix may lead to more students seeking admission to the public universities. This will cause pressure on UC and CSU, and CCC, at a time when sufficient enrollment funding is not available.

Impact of Eliminating Cal Grant Competitive Program. The Administration has not offered a rationale for eliminating this program that recognizes that not all needy students are eligible for the Entitlement award. About 22,500 new grants are awarded annually and the students served under this program are older and more likely to attend community college. Many have experienced challenges that make it more difficult for them to pursue higher education, but have demonstrated to meet the same criteria as entitlement recipients, and in fact, Competitive program recipients have higher average grades than those in the entitlement program.

Impact of Freezing Income Eligibility. It is estimated that 2,110 students would no longer qualify for the Cal Grant award to this policy change. Income and asset ceilings for Cal Grant programs were established in Chapter 403, with a requirement that CSAC annually adjust them for the change in the state's per capita personal income. This permits income ceilings to keep pace with the earnings of Californians, so that roughly the same proportion of students and families will meet the eligibility requirements from year to year. This proposal to reduce eligibility for grants while increasing fees, in contrast, would harm affordability for needy students.

ISSUE 3: APRIL 1ST DEPARTMENT OF FINANCE LETTER: DECENTRALIZE CAL GRANTS & CONSOLIDATE CALIFORNIA STUDENT AID COMMISSION AND CALIFORNIA POSTSECONDARY EDUCATION COMMISSION

The issue for the Subcommittee to consider is the Governor's two proposals to consolidate two higher education commissions and decentralize the financial aid administration. The Administration assumes the three components would yield a total of $2 million in savings in the budget year, growing to $4 million on a full-year basis.

PANELISTS

- Department of Finance
- Legislative Analyst's Office
- California Student Aid Commission (CSAC)
- California Postsecondary Education Commission (CPEC)
- Public Comments

BACKGROUND:

Decentralize Cal Grants and Consolidate the Functions of the Student Aid Commission and California Postsecondary Education Commission – This proposal is estimated to save $2 million General Fund in the 2009-10 fiscal year if implemented in this session and to save over $4 million on an ongoing basis. A trailer bill proposal was previously transmitted through RN 0902499.

ADDITIONAL BACKGROUND INFORMATION

There are three distinct initiatives in this proposal:

1) Decentralize administration of financial aid programs from CSAC to the higher education segments.

2) Eliminate CSAC and move its remaining responsibilities to a new executive branch department.

3) Eliminate CPEC and move its responsibilities to the same executive branch department.

Proposal would Decentralize Financial Aid Programs

Public Segments Would Administer Cal Grants. The Governor proposes to decentralize financial aid program administration from CSAC to the higher education segments. Specifically, each of the public segments would administer Cal Grant entitlement awards for students attending its institutions. In addition, the Chancellor's office of the CCC would administer competitive awards for students at all segments and entitlement awards for students attending private institutions.

Other Programs Could be Contracted Out. The CSAC administers a number of smaller financial aid and outreach programs in addition to Cal Grants. The Governor's proposal would authorize CSAC's successor agency to contract with the public segments to administer the financial aid programs, and with the public segments or a not-for-profit agency to administer the outreach programs.

Proposal Would Eliminate CSAC and CPEC, Move Responsibilities to Executive Branch

California Student Aid Commission. The CSAC has 15 members, including 5 representatives of the higher education segments, a high school representative, 2 postsecondary students, and 7 public members. The Senate Rules Committee and the Assembly Speaker each appoint two public members. The other 11 members are appointed by the Governor and confirmed by the Senate.

CSAC administers Cal Grants and other state financial aid programs for California students attending college, universities, and career training schools in the state. Other duties include reporting on the impact and effectiveness of its programs; reporting on the financial need and resources of students in the state, and the extent to which existing programs meet needs; and disseminating information about financial aid. The Commission also serves as the federal student loan guaranty agency for California.

California Postsecondary Education Commission. The CPEC governing board has 16 members, including representatives of the state's major educational systems (the three public segments, independent institutions, and the State Department of Education), 2 student members, and 9 public members. The public higher education segments designate their respective members. The Governor appoints the independent institutions representative, the students, and three public members. The Assembly Speaker and Senate Rules Committee each appoint three public members. The President of the State Board of Education is an ex-officio member.

The Commission is the state's higher education planning and coordinating body. Its statutory duties include long-range planning for higher education across segments; participating in the executive and legislative budget processes; advising the Legislature and the Governor on proposals for new campuses, institutions, and programs of public higher education and for changes in eligibility pools for the public segments; acting as a clearinghouse for postsecondary education information and data in the state; and developing criteria to evaluate the effectiveness of higher education programs. The commission also administers a federal grant program to improve teacher quality.

Proposed Reorganization of CSAC. The Governor's proposal would establish a new executive branch department to administer financial aid and outreach programs. It would also establish an advisory board, with a composition and appointment process similar to those of the commission – but it would have no formal powers. The Governor would appoint a director and deputy director for the new department. The director would report to the Secretary of Education, and would "give great weight" to the advisory board's recommendations in administering and regulating statutory programs.

The CSAC's civil service staff would be transferred to the new department and the CCC Chancellor's Office. The director would contract with the Office of State Audits and Evaluations of the DOF for compliance audits of financial aid programs. The administration estimates that the reorganization would lead to the elimination of 30 positions between CSAC and CPEC from administrative efficiencies (in addition to the 30 positions described above related to financial aid decentralization).

Proposed Reorganization of CPEC. The Governor's proposal would transfer CPEC's function to the new executive branch department described earlier, under the supervision of the Secretary of Education. The advisory board would provide recommendations to the department director (and to the Governor, Legislature, other governmental officials, and institutions of postsecondary education), but would have no direct authority to perform policy analysis, planning, or coordination of higher education independent from the executive branch.

ISSUE 4: STUDENT LOAN OPERATING FUND (SLOF) (INFORMATIONAL ITEM ONLY)

The issue for the Subcommittee to consider is the uses of the California Student Aid Commission's Student Loan Operating Fund (SLOF) over time, including current revenue projections.

PANELISTS

- Legislative Analyst's Office
- California Student Aid Commission
- Department of Finance

PANELISTS

The California Student Aid Commission is the state's guarantor of student loans and administers the state's participation in the Federal Family Education Loan (FFEL) Program through its auxiliary EdFund. EdFund generates surpluses in the FFEL Program and federal law allows these surpluses to be used for financial aid-related activities "for the benefit of students," including awareness and outreach, in addition to administration of the FFEL program.

Student Loan Operating Fund (SLOF) monies vary from year to year depending on various factors, including loan volume from schools, collection revenue and the federal default fee provided to guarantee agencies for the guaranteeing of student loans. The Legislature and the Governor have at times used the SLOF to fund the Student Aid Commission's operations, California Student Opportunity and Access Programs (Cal-SOAP), and portions of the Cal Grant program.

In making use of the SLOF, the Legislature has been deliberate in its efforts to avoid making severe cuts to the Student Aid Commission's budget and programs choosing to preserve access to higher education for low-to-moderate income students and families. In addition, the Student Aid Commission, with the Legislature's support, has used the SLOF to fund financial aid-related activities to promote access to higher education and the availability of financial aid for this purpose. These efforts include funding support for the Cal Grant Public Awareness Campaign informing students and families of the availability of Cal Grants, the Cash for College Program providing hands-on FAFSA completion for students and their families, and other campus-agency partnerships, in-class instruction and technology services designed to inform students and families about the availability of financial aid and assist them in applying for financial assistance for college.

Examples of some of these latter programs includes support for enhanced "student friendly services" – the electronic portal to California higher education – by developing specific financial aid modules for families, educators, and students (now known as www.CaliforniaColleges.edu funded at $435,000) and support for in-class instruction through the Advancement Via Individual Determination (AVID) program funded at close to $2 million.

Funding for major non-loan related expenditures from the SLOF, including those appropriated by the Legislature to fend of earlier cuts to the Student Aid Commission, Cal-SOAP and to the Cal Grant program are summarized below by fiscal years.

California Student Aid Commission
Major Non-loan Program Expenditures from SLOF
($ in millions)

	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	Total
Administration - Grant Programs		1.4	10.7	10.9	11.1	13.5			47.6
Cal SOAP		8.6	8.6	8.6	8.6	8.6			43.0
Cal Grant Program				146.5	51.0			24.0	221.5
Public Awareness Campaign*			3.0	3.0	2.0	2.0	1.7		11.7
Cash for College*				0.3	0.5	0.6	0.5		1.9
Total	**-**	**10.0**	**22.3**	**169.3**	**73.2**	**24.7**	**2.2**	**24.0**	**325.7**

Cal-SOAP	General Fund	SLOF	Federal Funds (Challenge Grant)	Total All Funds	Schools Served	Students Served
2001-02	$8.6			$8.6		
2002-03		$8.6		$8.6	441	92,459
2003-04		$8.6		$8.6	462	103,353
2004-05		$8.6		$8.6	446	135,000
2005-06		$8.6		$8.6	523	119,777
2006-07		$8.6		$8.6	504	128,180
2007-08	$6.3			$6.3	401	111,347
2008-09			$7.3	$7.3	374	145,854
2009-10			$7.3	$7.3		
Total	$14.9	$43.0	$14.6	$72.5	3,151	835,970

Public Awareness Campaign	General Fund	SLOF	Federal Funds (Challenge Grant)	Total All Funds	Schools Served	Students Served
2003-04		$3.0		$3.0	N/A	N/A
2004-05		$3.0		$3.0	N/A	N/A
2005-06		$2.0		$2.0	N/A	N/A
2006-07		$2.0		$2.0	N/A	N/A
2007-08		$1.7		$1.7	N/A	N/A
2008-09				$ -	N/A	N/A
2009-10				$ -	N/A	N/A
Total	$ -	$11.7	$ -	$11.7	-	-

Cash for College	General Fund	SLOF	Federal Funds (Challenge Grant)	Total All Funds	Workshops	Students Served
2004-05		$0.3		$0.3		
2005-06		$0.5		$0.5		
2006-07		$0.6		$0.6	420	14,257
2007-08		$0.5		$0.5	500	22,000
2008-09			$0.3	$0.3	546	25,471
2009-10			$0.3	$0.3		
Total	$ -	$1.9	$0.6	$2.5	1,466	61,728

All Programs	General Fund	SLOF	Federal Funds (Challenge Grant)	Total All Funds		
2001-02	$8.6	$ -	$ -	$8.6		
2002-03	$ -	$8.6	$ -	$8.6		
2003-04	$ -	$11.6	$ -	$11.6		
2004-05	$ -	$11.9	$ -	$11.9		
2005-06	$ -	$11.1	$ -	$11.1		
2006-07	$ -	$11.2	$ -	$11.2		
2007-08	$6.3	$2.2	$ -	$8.5		
2008-09	$ -	$ -	$7.6	$7.6		
2009-10	$ -	$ -	$7.6	$7.6		
Total	$14.9	$56.6	$15.2	$86.7		

ISSUE 5: MIGUEL CONTRERAS LABOR PROGRAMS

The issue for the Subcommittee to consider is the restoration of funding for the Miguel Contreras Labor Programs of $5.4 million, which was not included in the 2009-10 Budget Act.

PANELISTS

- University of California
- Public Comment

BACKGROUND

The 2008-09 Budget Act passed by the Legislature included $5.4 million to support the labor and research education, a 10 percent reduction from the $6 million provided in 2007-08. The Governor vetoed the $5.4 million in the Budget Act and the funds were permanently withdrawn. In 2008-09, the UC Office of the President provided $4 million in temporary support from University funds ($2 million each for the Berkeley and Los Angeles campuses) on a one-time basis and suspended the multi-campus grants program.

History. The ILE was established in 2000 as a multi-campus research program devoted to studying labor and employment issues in California. It expanded upon the existing Institutes of Industrial Relations (IIRs) at UC Berkeley and UCLA, which were founded in 1945 to encourage interdisciplinary research in the areas of labor and industrial relations, and upon the two Centers for Labor Research and Education housed in the IIRs on those two campuses. In 2004, the ILE was restructured as a result of final budget negotiations. The $3.8 million in funding was divided in three ways. One third was allocated to the Labor and Employment Research Fund administered by the UC Office of the President for system-wide competitive research grants and it is overseen by a faculty Steering Committee drawn from all ten UC campuses. One third was allocated to the UC Berkeley campus and one third to the UCLA campus. The $5.4 million would be allocated in the same manner.

What do the Labor and Employment Research Programs do? These programs fund research on a wide variety of topics critical to the state's economy and workforce. Recent examples include a statewide employer survey of human resource and training practices, studies of the public cost of low-wage work, changes in job quality and how wages and benefits affect the quality of care in In- Home Supportive Services. The research findings included in the many reports produced by these programs have provided valuable information to policy-makers at the state and local level on issues of importance to California's working families, including paid family leave, health care access, and improving incomes for low-wage workers.

On January 18, 2007, the UC Board of Regents approved that the Labor and Employment Program be named the Miguel Contreras Labor Program.

ISSUE 6: UNIVERSITY OF CALIFORNIA RETIREMENT PLAN (UCRP) (INFORMATIONAL ITEM ONLY)

The issue for the Subcommittee to consider is the Governor's 2009-10 budget proposal to provide $20 million to help the University of California resume contributions to the UC Retirement Plan. This funding was removed from the 2009-10 Budget Act and language was added in the Education trailer bill that states that UC may not use any new General Fund monies to fund this proposal. The university system is asking for reconsideration.

PANELISTS

- University of California
- Public Comment

BACKGROUND

UC Has Long Had a Fully-Funded Pension Plan. Like most public employers, UC provides its career workers with a comprehensive package of retirement benefits, including health benefits and a pension. Unlike nearly all other major pension programs, however, the UC Retirement Plan (UCRP) has not required any new infusion of funding for nearly two decades. During this “funding holiday,” neither the state, UC, or employees have contributed to the plan. The funding holiday began in 1990. It has lasted so long because (1) over-funding by the state, UC, and employees prior to 1990 led to a substantial surplus in the pension fund at that time and (2) UCRP investments have benefited from a remarkable period of sustained investment gains since 1990.

Time for the Nearly Two-Decade Funding Holiday to Come to an End. For plans like UCRP, it is nearly impossible for a funding holiday to be sustained forever since this would require year after year of abnormally strong investment returns. Each year, existing and new employees accrue future pension benefits under existing pension formulas, but because of the continuing funding holiday, no new funds have been set aside and invested to cover these costs. This reduces the plan’s funded status over the long term. In addition, broad declines in stock and other investments during 2008 probably will result in further declines in the funded status. Without the resumption of employer and employee contributions, these declines will become apparent in future annual valuations of UCRP. It is expected that UCRP’s fall 2009 valuation will show that its funded status has dropped below 100 percent for the first time in over 20 years. Keeping the pension plan’s funded status near the 100 percent level – the state’s policy for its major pension funds – will require an end to the funding holiday soon.

The UC budget request assumed that employees would resume contributing 2 percent of their pay to UCRP beginning on April 15, 2010. This resumption of employee contributions would require – for rank and file staff – agreements with UC’s unions. The unions have strongly resisted resumptions of contributions in recent years.

ISSUE 7: CAPITAL OUTLAY PROJECTS

The issue for the Subcommittee to consider is the Governor's 2009-10 budget proposals of $774 million worth of higher education capital outlay projects funded with Lease-Revenue Bonds (LRB), which were removed "without prejudice" to be vetted in the Subcommittee process.

PANELISTS

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

BACKGROUND

The 2009-10 Budget Act adopted by the Legislature in February 2009, removed $774 million of Lease-Revenue Bonds (LRB) funded projects, of which $449 million would be appropriated to the University of California to fund 9 projects and $325 million to CSU to fund 6 projects.

The Budget Act appropriated $241 million from prior-year General Obligation Bonds to support 38 projects on the University of California (UC), California State University (CSU), and California Community Colleges (CCC) campuses. In all, but one case for UC and CSU, the dollars are being used to equip the buildings, thus finishing the projects. However, prior-year General Obligations bonds are being used to start 18 new projects at community colleges, though funding is not available to finish them.

The Governor’s proposal relies heavily on lease-revenue bonds for funding projects at UC and CSU because, without the passage of a new general obligation bond measure, existing General Obligation (GO) bond dollars are essentially exhausted. In the case of the proposal before the Legislature, the Administration proposes to borrow against the future General Fund "revenue stream" that would be appropriated to the university systems, the Community Colleges are excluded from the Administration's LRB proposal because their debt service payments would be deducted from their "share" of Proposition 98, thus putting their traditional education programs at risk.

About Lease Revenue Bonds

Lease Revenue Bonds are a form of long-term borrowing in which the debt obligation is secured by a revenue stream produced by the project. LRB's are subject to legislative appropriation and do not require voter approval.

For the segments, UC and CSU have the authority to issue their own LRB debt financing for projects that will generate revenue, such as student housing or parking. The cost of construction (including planning and equipment) is then borrowed from the marketplace using the future revenue stream of the facility as collateral. Further, financing projects with LRBs, is dependent upon the marketplace, and tends to cost slightly more than GO Bonds.

About General Obligation (GO) Bonds
GO Bonds are a form of long-term borrowing in which the state issues municipal securities and pledges its full faith and credit to their repayment. Bonds are repaid over many years through semi-annual debt service payments. The California Constitution requires that GO Bonds be approved first by a 2/3 vote of the Legislature, followed by a majority of the voting electorate.

The table below lists all of the projects for UC and CSU that were removed without prejudice.

Proposed University of California Lease Revenue Bond Projects 2009-10			
Phase	**Campus**	**Description**	**Cost**
C	Berkeley	Campbell Hall Seismic Replacement Building	$62,334,000
W/C	Davis	Music Instruction and Recital Building	$14,930,000
W/C	Irvine	Business Unit 2	$39,442,000
W/C	Merced	Science and Engineering Building 2	$75,204,000
P/W/C	Riverside	Engineering Building Unit 3	$64,984,000
P/W/C	San Diego	Biological and Physical Sciences Building	$81,156,000
W/C	Santa Barbara	Davidson library Addition and Renewal	$64,718,000
P/W/C	Santa Cruz	Coastal Biology Building	$45,875,000
W/C	Los Angeles[1]	Center for Health Sciences, South Tower Renovation	$123,276,000

[1] Added in April 1 Department of Finance Letter

Proposed California State University Lease Revenue Bond Projects 2009-10			
Phase	**Campus**	**Description**	**Cost**
P/W/C	Channel Islands	West Hall	$37,137,000
P/W/C	Chico	Taylor II Replacement Building	$57,185,000
P/W/C	Fullerton	Physical Services Complex Replacement	$23,781,000
P/W/C	Sacramento	Sciences II, Phase 2	$97,921,000
P/W/C	San Bernardino	Theater Arts Addition	$60,506,000
C	San Diego	Storm/Nasatir Halls Renovation	$48,453,000

Legend: (P) Preliminary Plans; (W) Working Drawings; (C) Construction; (E) Equipment

ADDITIONAL BACKGROUND INFORMATION

Lease-Revenue Bonds Cannot Be Used for the Segments' Highest-Priority Capital Projects. Due to requirements for selling the bonds, lease-revenue bonds are limited to funding new buildings, replacement buildings, additions, or significant renovations. Many of the segments' top priorities—such as seismic upgrades, minor renovations of older buildings, campus infrastructure, capital renewal (upgrades to building systems), and minor capital outlay—cannot be funded with lease-revenue bonds. Older buildings and outdated infrastructure typically represent the greatest safety risks on campuses. Lease-revenue bonds can be used to demolish and replace older buildings, but cannot be used for minor renovations of the existing structures, which is often more cost efficient. Capital renewal and minor capital outlay are also cost efficient because they maintain existing buildings, extending their useful life. The Governor's 2009-10 proposal for UC and CSU includes two replacement buildings and one extensive renovation, but otherwise proposes new buildings. Meanwhile, seismic renovations, infrastructure projects, and other priority projects in the segments' capital outlay plans remain unfunded.

DOF Concluded Equipment Cannot Be Funded With Lease-Revenue Bonds. As recently as the 2007-08 Budget Act, lease-revenue bonds were used to cover all phases of higher education projects—including equipment. However, DOF recently told state agencies that it will no longer allow lease-revenue bonds to finance the equipment phase of projects due to requirements in the underwriting process for the bonds.

The Governor proposes using lease-revenue bonds to fund the initial phases of 14 projects at UC and CSU, requiring that additional funds be made available for their equipment phases in subsequent years. The total estimated equipment costs for these 14 projects would be $32 million. The 2008-09 Budget Act also used lease-revenue bonds to fund 11 projects at UC and CSU that will require an additional $18 million for equipment. The UC indicated that some campuses would use gifts or other funds to cover their equipment costs. Since UC and CSU's general obligation bonds are depleted, the state voters would most likely need to approve additional general obligation bonds in order for the state to cover these equipment costs.

The LAO believes that the state should not invest in projects that lack sufficient funding for their completion. The LAO recommends that, should the Legislature approve LRB-funded projects, it require UC and CSU to commit to using nonstate funds for the equipment phases prior to appropriating lease-revenue funding for these new projects.

General Obligation Bonds Provide More Flexibility.
Relying on lease-revenue bonds to finance higher education capital outlay limits the range of projects which the state can support. In the long run, this financing method promotes costlier growth and replacement projects as opposed to renovations. Further, it also limits the ability of the state to support essential projects including seismic upgrades, campus infrastructure projects, and capital renewal. For these reasons, the LAO believes that, over the long term, the state would need the flexibility of general obligation bonds to continue meeting higher education's capital outlay demands. However, the LAO would note that in the current economic climate, moving projects forward on a short-term basis with LRB may allow the state to take advantage of low construction costs. This shorter-term method was employed by the Legislature in the 2008-09 Budget Act, whereby the state used LRBs for many UC and CSU projects in lieu of the Governor's original proposal to fund education projects with a new 2008 GO bond measure.

RELATED LEGISLATION

Related legislation includes Assembly Bill 220 (Brownley) which would place a Kindergarten through University GO bond for school facilities on the next statewide ballot, and Senate Bill 271 (Ducheny) which would place a Higher Education GO bond on the ballot.

QUESTIONS:

1. DOF/LAO: What are the pros and cons of using Lease Revenue Bond to finance higher education facilities?

2. DOF/LAO: Is this the best funding mechanism available?

3. How do Lease Revenue Bonds compare to General Obligation bonds?

4. What are the future implications of utilizing the segments' General Fund revenue stream to pay back these debt services?