

COMMITTEE ON FINANCE

Planning for the 2022-2023 Operating Budget

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Summary

The California State Constitution requires the submittal of the governor's budget proposal each year by January 10. To meet consequent deadlines of the Department of Finance, it is necessary to commence planning for the 2022-2023 California State University Operating Budget Request. The CSU Board of Trustees will be provided preliminary assumptions for the purposes of preparing the 2022-2023 budget request to the governor. The final budget request will be presented to the Board of Trustees for review and approval in November 2021.

State Budget Overview

Extreme fiscal lows and highs have gripped the state over the past two state budget cycles. As the state finalized its 2020-2021 budget plan in the depths of the pandemic, the forecast was dire—an immediate \$54 billion budget deficit and a bleak outlook into the future. But a year later and under an unexpected, far better economic situation, the state's 2021-2022 budget plan estimated an immediate \$75 billion budget surplus and a positive tax revenue forecast into the future.

As the 2021-2022 budget year begins, and the CSU looks ahead to the 2022-2023 fiscal year, the Department of Finance and the Legislative Analyst's Office project continuous state tax revenue growth through 2024-2025. The Legislative Analyst's forecast of about three percent growth per year is a touch more optimistic than the Department of Finance's forecast of about two percent growth. Together, the state's significant 2021-2022 surplus and these positive longer-term forecasts suggest that the state will be able to invest more in its many programs and functions including the CSU.

The past interests of the governor and the legislature could again be their interests in the future. As the Board of Trustees considers the components of its 2022-2023 operating budget plan, it

could choose to include those components of the budget that are both priorities of the trustees and state leaders.

Most recently, the governor has expressed interest in the CSU closing the equity gaps, better aligning student learning objectives with workforce needs, offering more online courses when compared to pre-pandemic levels, and reducing the overall cost of attendance for students—such as affordable student housing.

The legislature has emphasized enrollment growth and new academic facilities to support more of those California students. Student basic needs, mental health, financial aid, and faculty diversity are other legislative interests.

While many of these gubernatorial and legislative priorities are and could be funded through the operating fund—in other words, the core functions of the university, such as classroom instruction, student services, campus operations, and state university grants—several of those priorities are outside the scope of the operating fund. For example, student housing is a university enterprise activity funded by fees or financial aid sources.

With the potential for a more stable and optimistic state revenue picture for 2022-2023, it is reasonable to assume the governor and legislature will choose to support some proportion of the CSU's operating budget request with recurring new revenues in the next fiscal year.

Recent Funding of the CSU

Governor Newsom's third budget, in partnership with the legislature, showed their commitment to unwinding a significant 2020-2021 budget reduction and additional investments to the university when they provided \$550.2 million in new recurring funds. The CSU also received \$976.3 million in one-time funding mostly for the repair, renewal, and new construction of CSU academic facilities and infrastructure. The operating fund budget totals \$7.4 billion for 2021-2022. Recent CSU operating fund data is detailed in the following chart.

Fiscal Year	State General Fund	% Change	Gross Tuition & Fees	% Change	Total Operating Fund Budget	% Change
2017-2018	\$3,474,230,000	-	\$3,275,294,000	-	\$6,749,524,000	-
2018-2019	3,772,707,000	8.6%	3,277,627,000	0.1%	7,050,334,000	4.5%
2019-2020	4,021,849,000	6.6%	3,269,805,000	-0.2%	7,291,654,000	3.4%
2020-2021	3,722,806,000	-7.4%	3,277,002,000	0.2%	6,999,808,000	-4.0%
2021-2022	4,228,282,000	13.6%	3,167,899,000	-3.3%	7,396,181,000	5.7%

New Investment from the State

Over the last several weeks, Chancellor’s Office staff have met with many stakeholder groups to solicit feedback on the potential contents of the 2022-2023 Operating Budget Request. Based on that feedback, the preliminary 2022-2023 budget plan would allow the CSU to again improve compensation for all employee groups, again consider enrollment growth, provide the final round of investment in Graduation Initiative 2025 (with particular emphasis on eliminating equity gaps and student basic needs), cover mandatory cost obligations, and launch or continue initiatives that take lessons learned from the pandemic and move the university in more dynamic directions. Additionally, progress could be made on facility, infrastructure, and deferred maintenance needs. These align with the Board of Trustees’ standing and emerging priorities and the preliminary expenditure plan below reflects those priorities.

The 2022-2023 budget request will assume that the state continues to see positive state revenue growth for at least another 12 to 18 months and continues to invest in the CSU.

The state’s fortunes can rapidly change and the CSU must also be prepared with contingencies. If a recessionary event were to affect the state budget picture sooner than forecasted, the CSU would explore and implement some combination of the following strategies:

- Use reserves designated for economic uncertainty on a one-time basis;
- Limit investment in new budget priorities;
- Redirect existing campus resources toward significant priorities;
- Explore new revenue sources; and
- Discuss a possible increase in tuition.

If a recessionary event were to occur, the Chancellor’s Office would continue to engage with students, faculty, staff, campus executives, the state, and other CSU stakeholders to first garner state support then explore alternatives for balancing budget priorities and necessary resources.

2022-2023 CSU Operating Budget—Preliminary Planning Approach

It is very early in the budget development process and appropriate for the Board of Trustees to begin discussion of CSU priorities for the 2022-2023 Operating Budget Request. The planning approach presented below represents a range of funding levels that can be balanced to communicate the university's key funding needs. At this stage, it is important for the Board of Trustees to provide input on fiscal policy priorities for 2022-2023.

Preliminary Expenditure Plan - \$563 Million to \$754 Million

Graduation Initiative 2025 - \$75 million

As Graduation Initiative 2025 enters its sixth year, the CSU expects to invest \$75 million of the 2022-2023 operating budget request to meet the ambitious goals adopted by each campus. Launched in 2016, this initiative aims to increase graduation rates for first-time and transfer students, eliminate equity gaps for historically-underserved students and Pell Grant recipients, and meet California's workforce needs. Reducing time to degree means that students graduate and enter the workforce sooner positively impacting their future and producing additional graduates to power California.

Today, four- and six-year graduation rates for first-time students and two- and four-year rates for transfer students continue to increase and have reached all-time highs. Additionally, the CSU is on track to meet its systemwide graduation rate goals by 2025. These remarkable improvements represent the dedication of CSU faculty and staff, intentional action by campus leaders, and a systemwide focus on student success.

Closing equity gaps in higher education is the challenge of our time. CSU campuses are rising to that challenge, continuing university-wide efforts to eliminate equity gaps. While graduation rates continue to rise for students from all backgrounds, the persistence of the equity gaps underscores the need for an explicit focus at every level of the university.

Continuous state funding for Graduation Initiative 2025 is critical to maintain momentum. Campuses will continue to use these funds to partner with faculty to provide more courses, to hire additional tenure-track faculty, and to advance innovative student success practices with a focus on these six areas:

- Academic Preparation
- Enrollment Management
- Student Engagement and Well-Being
- Financial Support
- Data-Informed Decision-Making
- Administrative Barriers

These efforts ensure that all students have the opportunity to earn a degree, empowering current and future generations of Californians. To properly support the initiative, an incremental recurring investment of \$75 million in 2022-2023 is necessary. This would fund the sixth year of a six-year, \$450 million investment plan in support of Graduation Initiative 2025.

Employee Salary and Benefit Increases – \$199 million to \$245 million

The Unit 3 (California Faculty Association) contract is currently open for negotiation. Most other collective bargaining agreements expire at the end of 2021-2022 and discussions between bargaining units and the Chancellor's Office are underway or will commence in 2022 for successor agreements. Early estimates indicate that salary, health care premium, and pension cost increases for all employee groups will cost between \$199 million and \$245 million. This range includes an estimate of Unit 3 salary-only recurring costs for 2021-2022 and an estimate of all units (including Unit 3) salary and benefit recurring costs for 2022-2023. As CSU hires more faculty and staff in support of Graduation Initiative 2025, enrollment growth and other systemwide and campus initiatives, the cost to provide salary increases and cover benefit cost increases also grows. Chancellor's Office staff will have more precise figures from campuses and complete its analysis by the November 2021 meeting, but for conservative planning purposes, this estimate is a reasonable starting point.

Mandatory Costs – \$50 million

Chancellor's Office staff anticipate that mandatory cost increases for existing university commitments will be approximately \$50 million in 2022-2023.

Inflation impacts all areas of the university and, for the most part, salary and benefit cost increases are addressed through collective bargaining and state budgetary processes. However, over the past decade, the CSU operating budget request and the final state budget have not included funding explicitly dedicated to cost increases on variety of expenses such as technology, instructional

equipment, supplies, contracts, utilities, and any other non-personnel expenditure of the university. This inflationary adjustment should be considered. Other mandatory costs include increases to operations and maintenance of newly-constructed facilities and other compensation-related costs, such as minimum wage law changes.

If operating budget requests do not include these types of mandatory cost increases, campuses must redirect resources from existing programs, services and priorities to meet those cost increases.

*Facilities and Infrastructure Needs - \$50 million - \$135 million (recurring)
\$500 million - \$1 billion (one-time)*

Prior to 2014, the CSU was reliant on the voters and state to issue bonds and pay the debt service on CSU academic facilities and related infrastructure projects. A change in 2014 authorized the CSU to also issue bonds on these types of projects. It also allowed the CSU to restructure some of the existing state debt so the CSU could build new, and refurbish old, projects.

The CSU and the state have made strides in addressing academic facility and infrastructure needs. The CSU restructured some of that debt shortly after 2014, which since allowed the CSU to construct over \$2 billion in new and revitalized facilities. Additionally, the state has provided approximately \$650 million in one-time funding for deferred maintenance projects over the past decade. These funding streams have been important to addressing the most pressing capital needs on CSU campuses.

Even though a sizable portion of facility and infrastructure needs have been addressed recently, the university's facilities and infrastructure needs remain significant. The systemwide academic facility improvement needs, including deferred maintenance, totals approximately \$16.8 billion. Deferred maintenance alone grows annually by approximately \$300 million.

The CSU pursues multiple strategies to address facility and infrastructure needs. These include:

- The CSU regularly requests recurring funding from the state that is used to pay the debt service on CSU-issued bonds.
- The state recently approved \$2 billion in one-time funding to construct new academic facilities and support affordable student housing for public higher education segments. While the state has not finalized the details of this program, it is anticipated that a portion of that funding will support new CSU academic facilities.
- The CSU has been supportive of efforts for voter passage of higher education facility general obligation bonds, though voters last approved bonds in 2006.
- CSU also keeps capital outlay resources dedicated to those purposes. When older bonds mature, the CSU repurposes those debt service payments to support the next round of CSU bonds issued for new projects.

- The CSU continues to use one-time Total Return Portfolio investment earnings for capital improvement projects as required by law.
- The CSU regularly requests one-time funding from the state that supports deferred maintenance projects.

The 2021-2022 budget request of \$50 million recurring for academic facilities and infrastructure was not funded. In fact, the state's annual budget acts and related CSU decisions have resulted in no new recurring funding from the state being dedicated to annual debt service since 2015-2016. The CSU certainly appreciates the significant one-time investment of \$325 million provided by the state to help campuses with their deferred maintenance and infrastructure needs in the coming years.

The addition of \$50 million to \$135 million in recurring funds in 2022-2023 would finance approximately \$750 million to \$2 billion of needed facility and infrastructure projects that increase capacity for student growth and complement the plan to address deficiencies in existing facilities. Requesting between \$50 million to \$135 million recurring to pay the annual debt service on projects is an important fiscal strategy to help address facility and infrastructure needs. A second, complementary strategy would be to include a request between \$500 million and \$1 billion in one-time funds from the state to further address deferred maintenance.

Full-Time Equivalent Student Enrollment Growth – \$129 million

In 2015, the Public Policy Institute of California (PPIC) concluded that the state would fall about 1.1 million college graduates short of economic demand by 2030. The PPIC suggested then that to close the degree gap, there was a need for 480,000 more CSU graduates. Six years later, PPIC today reports that California is currently on track to close the degree gap and attributes that success to: (1) increases in state funding that supported significant enrollment growth at CSU and the University of California and (2) university programs, such as Graduation Initiative 2025, that have successfully improved student persistence and graduation rates. New enrollment and persistent enrollment are key to closing the anticipated degree gap.

Additionally, California has for decades encouraged generations of young Californians to pursue higher education. Despite the pandemic, demand for the CSU remains strong as more students graduate from high school having met the A-G requirements for admission to the CSU and more transfer students complete the Associate Degree for Transfer. To accommodate more students at the CSU, the legislature and governor committed to providing recurring funding to grow enrollment by 9,434 resident, full-time equivalent students beginning in 2022-2023. This would cost approximately \$129 million and would be equivalent to a 2.5 percent increase in funded enrollment growth principally for new two-year transfer and four-year first-time student seats and, to a smaller extent, growth in the average unit load for continuing students in support of graduation rate goals. Funding for this item would come from two sources: additional tuition revenue from

new students and state general fund. For planning purposes, each one percent increase in enrollment would cost approximately \$51 million and would allow for growth of approximately 3,740 FTES.

Bridging the Equity Divide Through Technology – \$50 million to \$100 million

Over the course of the past year, the CSU helped bridge the equity divide by increasing access to critical technology to ensure student success in a virtual learning environment. While the CSU is offering the majority of instruction in person this Fall term, some courses will be offered virtually, due to ongoing risks and challenges posed by the COVID-19 pandemic.

In July 2021, the CSU announced the launch of the first phase of the California State University Connectivity Contributing to Equity and Student Success (CSUCCESS) initiative, a bold effort to enhance student achievement and create more equitable opportunities for the CSU community by providing industry-leading technology. CSUCCESS will help provide students with tools to participate and succeed in a virtual learning environment. Eight campuses are participating in the initial phase this Fall 2021 and offered an iPad Air, Apple Pencil, and Apple Smart Keyboard Folio to all incoming first-year and new transfer students who register to participate in the initiative. Students will have this iPad bundle for the entirety of their undergraduate experience at the CSU. The new CSUCCESS initiative builds on previous efforts to address the issue at scale by partnering with a global technology leader at the university-wide level to provide a high-quality, reliable device for new students.

Next steps in bridging the equity divide through technology could include several approaches. The CSUCCESS initiative could be rolled out to more campuses and more students beginning in Fall 2022. Also, information technology capabilities could be expanded so that the educational experiences, lessons learned, and opportunities identified during the pandemic can be optimized now and in the future for course delivery. Another component of the request could be informational technology infrastructure that increases research opportunities and access to advanced cyberinfrastructure. At this early stage, Chancellor's Office staff estimate between \$50 million and \$100 million in new recurring costs.

Student Basic Needs – \$10 million to \$20 million

While the CSU's primary mission is educational in nature, the CSU recognizes that students cannot be fully engaged in, or out of, the classroom if they are preoccupied with hunger, housing insecurity, personal safety, or mental health concerns. As such, leaders across all 23 campuses have committed to enhancing and developing resources consistent with the CSU academic mission to reduce the negative impact of these basic needs gaps on student retention and graduation. From a Fall 2020 survey, campuses are investing \$92 million from all funding sources on basic needs support and services to students. Another survey this fall is underway to help determine if

additional funding should be included in the operating budget request. As a placeholder, the addition of \$10 million to \$20 million in recurring funds would provide the CSU more opportunities to support students experiencing food and housing insecurities, unanticipated financial distress, mental health concerns and overall health and safety challenges that have the potential to disrupt their timely pathways to degree.

Staff Salary Structure Study Results – PENDING

The Budget Act of 2021 included \$2 million for the Chancellor's Office to evaluate the existing salary structure, issues of salary inversion, and provide any recommendations for alternative salary models for CSU non-faculty staff. The Chancellor's Office, California State University Employees Union, Service Employees International Union, and Teamsters Local 2010 partnered this past spring to advocate for state funding for this purpose. Our organizations have long desired to find a mutually-agreeable solution to address issues of inversion and salary structure. The evaluation will be completed by April 30, 2022. The evaluation's recommendations could include solutions that could require additional funding. The Chancellor's Office, in partnership with these represented staff groups, could advocate for additional funding in the spring and summer of 2022 just prior to final enactment of the 2022-2023 state budget.

This item is time dependent and potential costs will not be known for many months. If the Board of Trustees were to agree with the strategy articulated above, this item could be included as a placeholder in the 2022-2023 Operating Budget Request.

Preliminary Revenue Plan

At this preliminary stage, the planning effort focuses on stating the CSU's budget priorities and needs. Accounting for enrollment growth revenue (approximately \$24 million per one percent increase in enrollment targets), the preliminary plan's range of new investments would require additional new ongoing revenues from the state ranging from \$504 million to \$695 million and would require additional new one-time revenue from the state ranging from \$500 million and \$1 billion for deferred maintenance.

Operating Fund Designated Balances and Reserves

Designated balances and reserves in CSU's operating fund are used in several ways to deal with non-recurring expenses by managing short-term obligations and commitments, providing funding for capital infrastructure repairs and maintenance, and helping to ensure that operating costs can be paid during times of catastrophic events and economic and budgetary uncertainty. Designated balances and reserves are determined and reported annually by the campuses and the system office and are published on CSU's financial transparency portal. Designated balances and reserves are not used to fund recurring expenses such as salary increases. The use of one-time monies to pay

recurring, permanent expenses can lead to structural deficits where recurring resources are insufficient to pay for recurring costs.

The CSU has prudently grown designated balances and reserves to meet certain strategic goals, one of which has been to prepare for possible economic uncertainty. In the first several months of the pandemic, the CSU drew upon these reserves on a one-time basis to maintain operations in programs impacted by COVID-19. More specifically and early in the pandemic, the Chancellor's Office estimated that 45 percent of all operating fund reserves for economic uncertainties would be used in 2020-2021 to cover COVID-related losses and expenses. The fortunate reality was that over the past 18 months with subsequent rounds of federal legislation, campuses used one-time federal funds in lieu of operating fund reserves for COVID-related losses and expenses. We no longer anticipate a use of reserves for COVID-related purposes over the next several years because the economy and state budget have rebounded sooner than expected.

As of June 30, 2021, designated balances and reserves in the operating fund totaled \$2.0 billion and are held for short-term obligations, capital needs, catastrophic events and economic uncertainties.

Designated Balances for Short Term Obligations

Amounts held for short-term obligations are designated for payments for open contracts and purchase orders, near-term debt service payments, financial aid obligations, and programs that are in development. Balances for short-term obligations totaled \$1.11 billion at the end of last year and cover expected needs, which are typically paid in the following fiscal year.

Designated Balances for Capital

Designated balances for capital are for new projects and to repair current buildings, as well as planning costs and equipment acquisition associated with those buildings. Balances for capital fall well short of the expected need, which is at least ten percent of the cost of academic projects approved in the most recent five-year capital plan. Capital designated balances totaled \$327 million.

Designated Balances for Catastrophic Events

These designated balances are to be used in the event of a natural disaster or other catastrophic event, including annual insurance premiums or self-insured retentions and total \$31 million.

Reserves for Economic Uncertainties

Reserves for economic uncertainties are designated to provide a prudent reserve to sustain operations during periods of economic uncertainty such as short-term recessionary cycles or state budget fluctuations. Operating reserves are intended to be used in the present and the future as one-time supplements to help manage the often-rapid decline in state resources, allowing time to appropriately adjust operating budgets to balance reductions and minimize disruptions to students' education as much as possible. Designated reserves for operations set aside for economic uncertainty total \$531 million and are less than one month of operating expenses, well below the need to maintain three to six months of operating expenses.

Conclusion

This is an information item presenting a preliminary framework for the 2022-2023 CSU Operating Budget Request to the governor and the Department of Finance. Using feedback provided by the Board of Trustees at the September 2021 meeting, Chancellor's Office staff will present an updated and detailed operating budget recommendation for Board of Trustees' approval in November 2021.