

# **SUBCOMMITTEE NO. 1**

# **Agenda**

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**Senator Anthony J. Portantino, Chair**  
**Senator Hannah-Beth Jackson**  
**Senator John M. W. Moorlach**



**Thursday, March 2, 2017**  
**9:30 a.m. or upon adjournment of session**  
**State Capitol - Room 3191**

Consultant: Anita Lee

## **PART B**

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**6440 UNIVERSITY OF CALIFORNIA****Issue 1: Overview of the Governor's 2017-18 Budget Proposal – Information Only****Panel**

- Christian Osmena, Department of Finance
- Jason Constantouros, Legislative Analyst's Office
- Kieran Flaherty, University of California

**Background**

The 1960 Master Plan for Higher Education designates the UC as the primary state-supported academic agency for research. In addition, the UC is designated to serve students at all levels of higher education and is the public segment primarily responsible for awarding the doctorate and several professional degrees, including in medicine and law.

There are ten UC campuses: Berkeley, Davis, Irvine, Los Angeles, Merced, Riverside, San Diego, San Francisco, Santa Barbara, and Santa Cruz. Nine of these are general campuses and offer undergraduate, graduate, and professional education. The San Francisco campus is devoted exclusively to the health sciences. The UC operates five teaching hospitals in Los Angeles, San Francisco, Sacramento, San Diego, and Orange counties. The UC has more than 800 research centers, institutes, laboratories, and programs in all parts of the state. The UC also provides oversight of one United States Department of Energy laboratory and is in partnerships with private industry to manage two additional Department of Energy laboratories.

The UC is governed by the Board of Regents which, under Article IX, Section 9 of the California Constitution, has "full powers of organization and governance," subject only to very specific areas of legislative control. The article states that "the university shall be entirely independent of all political and sectarian influence and kept free therefrom in the appointment of its Regents and in the administration of its affairs." The Board of Regents consists of 26 members, as defined in Article IX, Section 9, each of whom has a vote (in addition, two faculty members — the chair and vice chair of the Academic Council — sit on the board as non-voting members)

- 18 regents are appointed by the Governor for 12-year terms.
- One is a student appointed by the regents to a one-year term.
- Seven are ex officio members — the Governor, Lieutenant Governor, Speaker of the Assembly, Superintendent of Public Instruction, president and vice president of the Alumni Associations of UC and the UC president.

The Governor is officially the president of the Board of Regents; however, in practice the presiding officer of the regents is the chairman of the board, elected by the board from among its members for a one-year term, beginning each July 1. The regents also appoint its officers of general counsel; chief investment officer; secretary and chief of staff; and the chief compliance and audit officer.

The following table displays the budgeted expenditures and positions for the UC, as proposed in the Governor's budget. Of the amounts displayed in the table, \$3.26 billion in 2015-16, \$3.54

billion in 2016-17, and \$3.53 billion in 2017-18 are contributed by the General Fund. The remainder of funding comes from tuition and fee revenue and various special and federal fund sources.

**University of California  
Budgeted Expenditures and Positions  
(Dollars in Millions)**

|                                  | <b>2015-16</b>  | <b>2016-17</b>  | <b>2017-18</b>  |
|----------------------------------|-----------------|-----------------|-----------------|
| Personal Services                | \$12,314        | \$13,332        | \$13,330        |
| Operating Expenses and Equipment | \$18,258        | \$18,588        | \$19,429        |
| <b>Total Expenditures</b>        | <b>\$30,573</b> | <b>\$31,920</b> | <b>\$32,759</b> |
| <b>Positions</b>                 | <b>100,312</b>  | <b>103,322</b>  | <b>103,322</b>  |

**Governor's Proposal**

- **Unrestricted Base Increase.** Provides an \$82.1 million unrestricted base increase, plus \$50 million in funds from Proposition 56 (Cigarette and Tobacco Products Surtax Fund) for graduate medical education.
- **Enrollment.** The budget does not provide additional funds for enrollment growth, however, it does assume UC meets enrollment expectation set forth in last year's budget. Specifically, the Administration assumes UC will (1) enroll 2,500 more resident undergraduates in 2017-18 and (2) receive an \$18.5 million ongoing augmentation in 2016-17.
- **One-Time Funding.** The budget provides \$169 million, funded from a one-time Proposition 2 payment, for the third and final installment to help pay down the UC Retirement Plan's unfunded liability.
- **Assumes No Increase in Resident Undergraduate Tuition.** The budget's only assumed increases in systemwide charges for resident undergraduate students is a \$54 (five percent) increase in the Student Services Fee, and a five percent increase in nonresident supplemental tuition. However, the regents voted in its January board meeting to increase tuition by 2.5 percent, or \$282.
- **Eliminates Academic Sustainability Plan Requirement.** As with CSU, the Governor proposes to eliminate budget language that directs UC to develop an annual Academic Sustainability Plan. Under this plan, UC sets performance targets for eight specific measures, including graduation rates and degree completion. Additionally, the plan also includes revenue and expenditure assumptions, and enrollment trends.
- **Eliminates Sunset Dates for Two Programs.** Trailer bill legislation propose eliminating sunset dates for the California Health Benefits Review program (sunsets July 1, 2017)

and Umbilical Cord Blood Collection program (sunsets January 1, 2018). Both programs are funded from special funds.

- **Capital Outlay.** Trailer bill legislation proposes to include deferred maintenance as an eligible capital expenditure for UC's capital outlay process. UC will have the ability to pledge its state support appropriations to issue bonds for eligible projects, as well as use general fund to pay for debt service of these projects.

The Legislative Analyst's Office developed the following chart that displays UC's spending plan based on the Governor's General Fund proposal, as well as other core funds, such as tuition and fee revenue, and nonresident enrollment growth, available for the UC to spend.

**UC's Spending Plan for 2017-18<sup>a</sup>**  
(Dollars In Millions)

|   | <b>Increase</b> |
|---|-----------------|
| <b>Compensation</b>   |                 |
| General salary increases <sup>b</sup>   | \$112           |
| Faculty merit increases   | 32              |
| Health benefit cost increases   | 19              |
| Pension cost increases  | 18              |
| Retiree health benefit cost increases   | 8               |
| Subtotal  | (\$189)         |
| <b>Undergraduate Enrollment Growth</b>  |                 |
| Resident students (1.4 percent)   | \$45            |
| Nonresident students (3 percent)  | 16              |
| Subtotal  | (\$62)          |
| Academic Excellence   | \$50            |
| Financial Aid   | \$49            |
| <b>Facilities</b>   |                 |
| Deferred maintenance  | \$15            |
| Debt service for previously approved projects   | 15              |
| Subtotal  | (\$30)          |
| <b>Other</b>  |                 |
| Operating expenses and equipment  | \$27            |
| Student mental health   | 5               |
| Subtotal  | (\$32)          |
| <b>Total</b>  | <b>\$412</b>    |
| <sup>a</sup> Excludes spending items that assumed additional state funding above the Governor's proposal.<br><sup>b</sup> Includes a 3 percent increase for faculty and unrepresented staff and a 3.9 percent increase for represented staff. |                 |

**Capital Outlay.** Prior to 2013-14 for UC, the state funded construction of state-eligible projects by issuing general obligation and lease-revenue bonds and appropriated funding annually to service the associated debt. General obligation bonds are backed by the full faith and credit of the state and require voter approval. Lease-revenue bonds are backed by rental payments made by the segment occupying the facility and only require a majority vote of the Legislature. The debt service on both is repaid from the General Fund. State eligible projects are facilities that support the universities' core academic activities of instruction, and in the case of UC, research. The state does not fund nonacademic buildings, such as student housing and dining facilities.

AB 94 (Committee on Budget), Chapter 50, Statutes of 2013 and SB 860 (Committee on Budget and Fiscal Review), Chapter 34, Statutes of 2014, revised this method by authorizing UC and CSU, respectively, to pledge its state support appropriations to issue bonds for state eligible projects, and as a result the state no longer issues bonds for university capital outlay projects. The authority provided in AB 94 and SB 860 is limited to the costs to design, construct, or equip academic facilities to address: (1) seismic and life safety needs, (2) enrollment growth, (3) modernization of out-of-date facilities, and (4) renewal or expansion of infrastructure to serve academic programs. UC and CSU are required to manage its capital program so that no more than 15 percent and 12 percent, respectively, of its General Fund support appropriation, less general obligation bond payments and State Public Works rental payments, is used for its capital program. SB 860 also included the costs to design, construct, or equip energy conservation projects for CSU. Additionally, the state allows each university to pay the associated debt service of academic facilities using its state support appropriation.

Under the new authority, UC and CSU are required to submit project proposals to the Department of Finance (DOF) and the budget committees of the Legislature by September 1 for the upcoming fiscal year. By February 1, DOF is required to notify the Legislature as to which projects it preliminarily approves. The budget committees then can review the projects and respond to DOF. The DOF can grant final approval of projects no sooner than April 1 for the upcoming fiscal year.

SB 81 (Committee on Budget and Fiscal Review), Chapter 22, Statutes of 2015, revised UC's capital outlay authority to allow them to enter into contracts with private partners to finance, design, construct, maintain and operate state-eligible facilities. SB 81 also expanded the eligible uses of state support funds to include availability payments, lease payments, installment payments, and other similar or related payments for capital expenditures. For the Merced project, SB 81 requires UC to use its own employees for routine maintenance, meaning the partner only would perform maintenance on major buildings.

On February 3<sup>rd</sup>, DOF submitted its list of preliminarily approved capital outlay to the Legislature. The list includes six projects which would correct seismic and life safety deficiencies for academic facilities, one project would entail construction of a new science facility at the Irvine campus. Additionally, UC requests \$35 million in bond funding for deferred maintenance, and \$15 million to conduct an assessment of the conditions of academic facilities. For 2017-18, UC is requesting \$161 million in bond authority for capital outlay and deferred maintenance projects. UC estimates that the maximum projected percentage will be approximately 5.5 percent of UC's General Fund support (less general obligation bond payments

and State Public Works rental payments), based on all prior projects approved and this request. Moreover, the Administration is proposing trailer bill language to include the cost of deferred maintenance of academic facilities as a part of the allowed capital expenditures under the AB 94 process.

Due to a lack of resources, UC notes that campuses have not performed a comprehensive facility condition assessment as a part of their ongoing maintenance programs. Instead, campuses have only been able to collect limited deferred maintenance information as it is encountered during preventative and corrective maintenance visits. According to UC, this approach only identifies emergency and critical items, rather than providing for the systematic and comprehensive approach that a new facility conditions assessment would require.

### **Staff Comments**

**Access.** Whereas the state traditionally has set enrollment targets for the budget year, it recently began setting UC's enrollment target for the subsequent academic year. This change was intended to give UC more time to respond to legislative direction. In the 2015-16 budget, the state set a goal for UC to enroll 5,000 more resident undergraduate students by 2016-17 (than the 2014-15 level) and allocated an associated \$25 million in ongoing funding for the growth. The state continued this practice in 2016-17, setting an expectation that UC enroll 2,500 more resident undergraduate students in 2017-18 than in 2016-17. It provided an associated \$18.5 million, contingent on UC providing sufficient evidence by May 1, 2017, that it would meet this goal. The funding also is contingent on UC adopting a policy by the same deadline that limits nonresident enrollment. The Governor's 2017-18 budget assumes UC will meet these requirements and includes these funds. Because the amount provided in 2016-17 would be released to UC in May or June 2017, UC intends to carry forward this amount into 2017-18.

While the Governor's 2017-18 budget does not specify funding for enrollment growth, the UC's budget spending plan notes that they would increase resident undergraduate enrollment growth 1.4 percent. The Legislative Analyst's Office (LAO) recommends the Legislature continue its recent approach and set enrollment expectations now for 2018-19, however not fund the enrollment until 2018-19. Additionally, the LAO recommends the Legislature use upcoming reports on UC's degree production and freshman eligibility study to inform enrollment decisions.

**Tuition.** In 2015-16, the Administration and the UC developed a multi-year budget framework to hold tuition flat for two years. By 2017-18, tuition will have remained flat for six consecutive years, and in the 2015-16 May Revision, the Administration noted that it is reasonable to expect that tuition will begin to increase modestly and predictably at around the rate of inflation. The CSU did not have such an agreement.

In January 2017, the UC Regents again voted for a tuition increase of 2.5 percent, or \$282, for a total annual tuition of \$11,502. Additionally, the UC Regents voted to increase the student services fee by five percent, a \$54 increase for a total of \$1,128 annually, and nonresident supplemental tuition by five percent, or \$1,332, for a total of \$28,014. Though the Administration does not assume tuition increases for resident students, the budget reflects five percent increases in both the Student Services Fee and the undergraduate nonresident supplemental tuition charge.

**Capital Outlay.** The LAO notes that it is unclear UC could not regular assess the condition of facilities, and why it cannot use staff in existing plant and facility divisions, and that knowing facility conditions and system life spans seems a key responsibility of these divisions. The LAO and staff also question using bonds, which are intended to spread major infrastructure costs over many years, for a one-time facility assessment. Moreover, existing law does not provide UC with authority to use bond financing to conduct such an assessment. The subcommittee may wish to request additional information regarding the one-time assessment, prior to the Department of Finance's final approval, and whether \$15 million is an appropriate amount for such an assessment.

Staff notes that in the Administration's preliminarily approved list of capital outlay projects, UC and the Administration are proposing \$35 million of General Fund supported financing for deferred maintenance; however, existing law does not provide UC with such authority. However, the Administration is proposing trailer bill language to provide UC with this authority. Staff notes that it may be premature for the state to provide approval of the deferred maintenance proposal, with trailer bill still pending in the Legislature.

The LAO notes that UC lacks a plan to eliminate its \$3.17 billion backlog and improve ongoing maintenance practices. The LAO recommends the Legislature to require UC to develop a comprehensive maintenance plan to include (1) an estimate of the backlog based upon available data; (2) a multiyear expenditure plan for eliminating the backlog of projects, including proposed funding sources; and (3) a plan for how to avoid developing a maintenance backlog in the future.

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**6610 CALIFORNIA STATE UNIVERSITY****Issue 2: Overview of the Governor's 2017-18 Budget Proposals – Information Only****Panel**

- Christian Osmena, Department of Finance
- Paul Steenhausen, Legislative Analyst's Office
- Ryan Storm, California State University

**Background**

The CSU system is comprised of 23 campuses, consisting of 22 university campuses and the California Maritime Academy. The California State Colleges were brought together as a system by the Donahoe Higher Education Act of 1960. In 1972, the system became the California State University and Colleges; the name of the system was changed to the California State University in January 1982. The oldest campus, San Jose State University, was founded in 1857 and became the first institution of public higher education in California. Joint doctoral degrees may also be awarded with the UC. The program goals of the CSU are to:

- Provide instruction in the liberal arts and sciences, the professions, applied fields that require more than two years of college education, and teacher education to undergraduate students and graduate students through the master's degree.
- Provide public services to the people of the state of California.
- Support the primary functions of instruction, public services, and student services in the University.
- Prepare administrative leaders for California public elementary and secondary schools and community colleges with the knowledge and skills needed to be effective leaders by awarding the doctorate degree in education.
- Prepare physical therapists to provide health care services by awarding the doctorate degree in physical therapy.
- Prepare faculty to teach in postsecondary nursing programs and, in so doing, help address California's nursing shortage by awarding the doctorate degree in nursing practice.

The CSU Board of Trustees is responsible for the oversight of the system. The board adopts rules, regulations, and policies governing the CSU. The board has authority over curricular development, use of property, development of facilities, and fiscal and human resources management. The 25-member Board of Trustees meets six times per year. Board meetings allow for communication among the trustees, chancellor, campus presidents, executive committee members of the statewide Academic Senate, representatives of the California State Student Association, and officers of the statewide Alumni Council. The trustees appoint the chancellor,



who is the chief executive officer of the system, and the presidents, who are the chief executive officers of the respective campuses.

The following table displays the budgeted expenditures and positions for the CSU, as proposed in the budget. Of the amounts displayed in the table, \$3.01 billion in 2015-16, \$3.32 billion in 2016-17, and \$3.37 billion in 2017-18 are contributed by the General Fund. The remainder of funding comes from tuition and fee revenue and various special and federal fund sources.

**California State University  
Budgeted Expenditures and Positions  
(Dollars in Millions)**

|                                  | 2015-16        | 2016-17       | 2017-18       |
|----------------------------------|----------------|---------------|---------------|
| Personal Services                | \$4,357        | \$4,598       | \$4,598       |
| Operating Expenses and Equipment | \$5,091        | \$4,964       | \$5,017       |
| <b>Total Expenditures</b>        | <b>\$9,449</b> | <b>9,562</b>  | <b>9,616</b>  |
| <b>Positions</b>                 | <b>46,014</b>  | <b>48,093</b> | <b>48,093</b> |

**Governor's Proposal**

- **Unrestricted Base Increases.** The Governor's budget proposes a \$157.2 million increase as follows: (1) a \$131.2 million unallocated augmentation and (2) an additional unallocated \$26 million increase associated with savings from changes to the Middle Class Scholarship program made in 2015-16.
- **Other Allocations.** The proposed budget provides (1) a \$5.1 million increase to CSU's support budget for lease-revenue bond debt service and (2) an additional \$22.6 million above revised current-year levels for CSU retiree health benefit costs, which is budgeted separately from CSU's support budget.
- **Assumes No Increases in Tuition.** While the budget does not assume any increases in tuition levels, the Chancellor's Office has proposed increasing resident and nonresident tuition charges for 2017-18. The trustees are expected to vote on this proposal during their March meeting, after concluding a statutorily required consultation process with students. In March, the CSU Board of Trustees is also scheduled to vote on an up-to five percent tuition increase, or \$270, for a total annual tuition price of \$5,742. Additionally, tuition for nonresidents and resident graduate students would increase by about 6.5 percent.
- **Eliminates Sustainability Plan Requirement.** The Governor proposes eliminating budget language pertaining to academic sustainability plans, which requires CSU to develop an expenditure plan and set performance targets under revenue assumptions developed by the Department of Finance.

**CSU's Spending Plan.** CSU proposes to spend the vast majority of its unrestricted base increase on compensation commitments. Of the \$157 million unrestricted base increase proposed by the Governor for 2017-18, CSU indicates that it intends to spend \$139 million (88 percent) for collective bargaining agreements ratified by the CSU Board of Trustees in spring 2016. CSU indicates that the remaining \$18 million would fund basic cost increases, such as higher medical and dental premiums for current employees and additional pension costs (on payroll exceeding the 2013-14 level).

**Capital Outlay.** Similar to UC, SB 860 (Committee on Budget and Fiscal Review), Chapter 34, Statutes of 2014 revised the CSU's capital outlay procurement method, which authorized CSU to pledge its state support appropriations to issue bonds for state eligible projects, and as a result the state no longer issues bonds for university capital outlay projects. Details regarding this legislation and process are described in the previous section.

CSU's 2017-18 capital outlay request includes 27 projects totaling \$1.6 billion. Of these 27 projects, 17 were previously approved by the state but have not yet been funded by CSU. The other 10 requests are new submissions. At its November 2016 meeting, the Board of Trustees approved a multi-year plan for CSU to finance up to \$1 billion of the \$1.6 billion in submitted capital projects using university revenue bonds. Using this bond authority, the Chancellor's Office would fund 12 of the previously approved capital projects. The associated annual debt service is estimated to be about \$50 million. CSU indicates it would support this associated debt service using existing core funds. This is possible because a like amount of monies were "freed up" from expiring debt from former projects as well as restructuring of outstanding State Public Works Board debt.

### **Staff Comments**

**Access.** According to a recent PPIC report, in 2030, 38 percent of all jobs will depend on workers with at least a bachelor's degree, but only about 33 percent of workers will have one. As a result, California will have a shortage of 1.1 million workers holding a bachelor's degree. The 2016-17 budget sets an expectation for CSU to increase resident enrollment by 1.4 percent (an additional 5,194 FTE students) over 2015-16. Based on preliminary data from CSU, fall 2016 FTE student enrollment is about 1.3 percent higher than the previous fall, and the LAO states that campuses appear to be on track to meeting the enrollment expectation. However, the past several years CSU has reported denying admission to some eligible transfer students. Given this development, together with statute that requires CSU campuses to prioritize eligible transfer applicants over freshman applicants, the LAO suggest that the Legislature may want to consider targeting enrollment growth funding for transfer students in 2017-18. Additionally, given that a freshman eligibility study is currently underway, and that CSU must report by March 2017 on recommended budget or policy changes to produce more bachelor's degrees, the LAO recommends that any decision on freshman enrollment growth should wait till May Revision.

**Tuition.** While CSU resident tuition charges have been flat for the past six years, the LAO notes that a five percent increase might be considered high for one year. In addition, a five percent increase in 2017-18 would be notably higher than anticipated inflation. If the Legislature were to

consider tuition increases, LAO suggests it signal to CSU that a more modest rate increase would be acceptable.

**Graduation Initiative.** The state and CSU currently are funding a Graduation Initiative to boost graduation rates for freshmen and transfer students, as well as eliminate achievement gaps for low-income and other traditionally underrepresented students. Currently, the CSU's four-year graduation rate for freshman entrants is 19 percent, and six-year graduation rate of 57 percent. Similarly, the two-year graduation rate for transfer students is 31 percent, and the three-year graduation is 62 percent. CSU reports spending \$48 million of its base funds on the Graduation Initiative strategies, these strategies include, increasing the faculty-to-student ratio, and enhancing student support services. CSU maintains it will need additional resources to carry out campus plans and achieve the segment's performance goals.

While the Graduation Initiative may be assisting students graduate in a more timely manner, LAO notes that CSU could improve its assessment and placement policies. Currently, CSU primarily uses placement tests to assess college readiness. Based on these test results, CSU deems more than 40 percent of its admitted freshmen are unprepared for college-level math, English, or both. Students who do not demonstrate college-level skills are required to enroll in remedial coursework. A growing amount of research is finding that a better way to assess college readiness is to use multiple measures (including data from students' high school records) to place students. Additionally, CSU continues to have a problem with excess unit-taking by both freshman entrants and transfer students. Students who accrue more units than their degree requires generally take longer to graduate, generate higher costs for the state and themselves, and crowd out other students. LAO believes that CSU would make more progress in student success if it were to modify its assessment methods and placement policies as well as address the issue of excess units.