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MARY S. CROUGHAN
Provost and Executive Vice Chancellor

OFFICE OF THE PROVOST AND EXECUTIVE VICE CHANCELLOR
ONE SHIELDS AVENUE
DAVIS, CALIFORNIA 95616-8558
TELEPHONE: (530) 752-4964

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DEANS, VICE CHANCELLORS, UNIVERSITY LIBRARIAN, ATHLETIC DIRECTOR and CHIEF INFORMATION OFFICER

SUBJECT: 2020-21 Mid-Year Budget Update and Mitigation Strategies

Dear Colleagues,

Under the leadership of former-provost Hexter, we began a five-year process of rebalancing core funds to address a projected deficit of $80-$100 million. This work is now more critical than ever, as the pandemic has brought significant financial consequences. Despite new challenges that emerged in the spring, $12.8 million in savings has already been implemented—that's more than we originally asked for. These savings have been accomplished by individual units using strategies including eliminating or consolidating vacant positions, streamlining administrative activities, shifting activities to other appropriate fund sources, or using one-time reserves. But, much more work remains and our efforts to achieve ongoing core fund savings must continue and accelerate.

The new state budget reduction to our campus is over $45 million and our enrollment is down modestly from what was expected, largely in new international students. We are now projecting a structural budget deficit of at least $67 million in core funds, just for this year alone, and questions remain in many areas. Due to the impact of the pandemic on our operations since March, we are expecting limited-term revenue losses and increased costs of at least $210 million across all funds for campus in the current fiscal year. This estimate includes the $45 million state budget reduction, approximately $13 million in lower than expected tuition and fees; pandemic-related net losses and extraordinary costs, of over $70 million through November with additional losses expected; $56 million in projected net losses to housing and dining operations, and at least $20 million in Campus Ready costs. In addition, the Medical Center's COVID 19-related loss is over $100 million. As we have all learned, this situation is dynamic and unpredictable. There will undoubtedly be changes requiring flexibility and creativity, and yet, we are actively meeting the current challenge.

I am working closely with campus leaders on mitigation strategies that identify and use one-time funding sources that can carry the university through the coming year and address extraordinary needs due to the pandemic. Mitigation requires shared sacrifice campuswide and locally. We will continue to make decisions collaboratively, following a principled process with focus on our strategic priorities. A document describing the mitigation strategies and guiding principles is attached. The budget framework website is another important resource.

Our top priority continues to be supporting our students' academic success and achieving equitable outcomes for all UC Davis students. We must also continue to advance key strategic initiatives addressing critical research and service needs of California and beyond. We maintain our commitment to faculty, academics, and staff. Our employees are key to our mission of providing a productive learning environment and performing research and service that matters.

Now more than ever, we must continue to engage our entire campus community to shift mindsets and find creative solutions that generate savings, create revenue generation, and streamline our work.

Though the financial pressures can be daunting, I assure you that we will see the university through these current financial challenges. Together, we have proven that we are able to adapt in challenging times. UC Davis will continue to outgrow expectations. And, we will soon refocus our efforts on the critical multi-year process of adjusting the core funds budget that began before the pandemic. We are urging all units to continue to work toward achieving *ongoing* savings whenever feasible, keeping an eye on the long-term goal of financial sustainability and continually aligning resources with our priorities.

This pandemic has disrupted the status quo. Now is the time for us to work together to find creative solutions, to help UC Davis become more resilient and achieve long-term financial sustainability.

Sincerely,

Mary Croughan

Mary S. Croughan
Provost and Executive Vice Chancellor

Attachment

c: Chancellor May
Davis Division Academic Senate Chair Tucker
Academic Senate Committee on Planning and Budget Chair Nachtergaele
Vice Chancellor Ratliff
Senior Associate Vice Chancellor Frace
Assistant Vice Chancellor Mangum
Assistant Deans and Chief Operating Officers

In March of 2020, as the COVID-19 pandemic unfolded, UC Davis began to experience lost net revenues and increased operating expenses. Due to the impact of the pandemic on our operations since March, a state budget reduction of $45 million, and lower enrollment than what was expected, we are expecting to address limited-term revenue losses and increased costs of over $210 million for campus in this fiscal year.

While many of the financial challenges are expected to be limited-term in nature, as the pandemic continues and the economy of the State of California is affected, the financial impacts will grow and additional risks are being identified. Financial risks and uncertainties include the following:

- Future enrollment shortfalls in both California and National/International students.
- Significant new operating expenses for public health and safety.
- Financial losses for auxiliary operations such as housing, dining, and parking where there are significant fixed costs, such as debt service, and drastic reductions in revenue.
- Impact on research through reduced ability to conduct in-person research and potential reductions in federal research funding.
- The potential for additional state budget reductions in fiscal year 2021-22.
- The potential for additional federal aid that would either mitigate the state budget reduction for one-year or provide additional direct aid to higher education.

The magnitude and timing of these risks and the potential for federal funding are currently unknown. Uncertainty will continue, so we must pause and reconsider all options. The campus must have mitigation strategies to address the immediate financial losses and risks with available one-time funds while, in parallel, continuing to implement and adjust the budget framework to align our structural budget to address larger shortfall. The mitigation strategies described in this paper provide short-term resources to address immediate needs and smooth the structural adjustments that will be needed. These strategies will be adapted as additional opportunities and needs arise.

BACKGROUND AND CONTEXT

In fiscal year 2019-20, prior to the COVID-19 pandemic, the campus identified a structural imbalance in state funds and tuition, largely due to growth in salary and benefit costs that exceeded new funds. The imbalance was estimated to reach $100 million by fiscal year 2023-24 if no action was taken. As a result, a multi-year budget framework was developed to address this structural deficit within five years. A first phase of budget savings targets was established and the central campus committed to identifying $25 million in savings. The new state budget reduction in 2020-21 and lower enrollment, largely in new international students, requires acceleration of additional core fund savings.

The framework is guided by core principles, including the following:

- Our commitment to students' success and experience will not be compromised.
- The good of the university as a whole drives the discussion of resource allocation adjustments.
- Administration and faculty have shared responsibility and accountability to support responsible financial management.
- We will continue to make progress on the strategic plan goals identified in "To Boldly Go."

We will add the following principles to guide the mitigation strategies:

- Protect, to the greatest extent possible, against COVID-related indefinite layoffs.
- Defer new permanent or one-time cuts in fall 2020 and winter 2021 quarters.
- Recognize the need for shared sacrifice including central campus and units.
- Deliver working capital options that partially and temporarily mitigate budget impacts, recognizing that repayment strategies are needed and will result in long-term tradeoffs.
- Investments to support the reopening of campus to meet public health guidelines are a high priority.

MITIGATION STRATEGIES

At the beginning of the pandemic, UC Davis quickly took action to ensure liquidity and accessed available federal funding sources. In addition, the UC system paused faculty ranges and merit programs for non-represented employees, reducing expected cost increases for fiscal year 2020-21. Over the past eight months, as the length of the pandemic grew, there has been significant uncertainty and frequent shifts in the fiscal landscape and guidance on allowable uses of external funds.

A number of one-time funding sources have been identified to address critical limited-term uses. Estimates included in this paper are a range based on the known information and planning underway at this time. These estimates will be refined and the range of options narrowed in coming months. Central budget actions will be managed to best fit solutions to needs.

One-Time Funding Source Highlights

Working Capital Loan and Internal Borrowing (up to $200 million one-time)

This plan proposes internal borrowing of up to $200 million backed by aggregate cash balances repaid over time. Available cash balances were bolstered by working capital bond sold by The University of California in July. These bonds were to support working capital needs, including backstopping operational shortfalls resulting from extraordinary losses in auxiliaries, uncertain enrollment results, and increased COVID response costs. It should be noted that the loan will require regular debt service payments, including interest. A strategy to support payment of the debt service obligation is built into this internal borrowing strategy.

We propose a two part plan for use and repayment of internal loans. First, we will identify opportunities to provide internal loans to units with repayment capacity. Therefore, primary targets for these loans are auxiliaries and revenue generating units. These loans will allow auxiliary units more time to recover losses and mitigate what would otherwise be significant rate increases to users. Units who have opportunities to increase net revenue that can be used to recover operational losses, but need initial investment could also receive a loan at favorable rates. In addition, the campus anticipates the need to bridge general operational costs that do not have a natural repayment source. In order to create a repayment stream for those central investments that does not create a further strain on the ongoing operational budget, we propose taking a portion of one-time investment gains discussed below and creating a Fund Functioning as an Endowment (FFE) that will mature sufficiently to pay off this debt in up to 20 years.

Federal CARES Act Institutional Funding and Other Future Federal Stimulus ($17 million one-time)

UC Davis received $17 million in institutional support from the federal CARES Act. The federal Department of Education guidance evolved and primarily allows support for lost revenues linked to refunds to students. For our campus, those costs were related to study abroad fees and housing and dining contract refunds and we have applied these funds to these programs, representing a fraction of expected losses. To the extent that there is additional federal stimulus approved, either directly to higher education or to the state, those funds will be incorporated into these mitigation strategies and allocated based on the applicable guidelines.

Federal Emergency Management Agency (FEMA) Reimbursement ($1 to $3 million one-time)

Current guidance for FEMA reimbursement limits funding to only those expenditures that are required to directly respond to the public health crisis to protect health and life. Along with other UC campuses, we have engaged a consultant to help us maximize and support our claim. We anticipate that although funding for this may be limited, we will successfully recoup some of our costs. FEMA reimburses 75% of approved claims costs and such reimbursement will offset the eligible expenditure. We are estimating $1-3 million in FEMA funds at this time.

Accessing Extraordinary Payouts from the Campus Enhancement Fund FFEs ($7 to $21 million)

University investment policies permit campuses to request up to an additional 5% payout on Funds Functioning as an Endowment (FFE) with the Chancellor's approval. UC Davis has the Campus Enhancement Fund (CEF), a FFE which was established to generate additional investment income to support critical capital investments. This strategy proposes taking an additional 2% payout annually from the CEF for 1-3 years yielding approximately $7 million annually. By limiting the extraordinary payout to 2%, this strategy maintains the FFE corpus, with some potential growth, to sustain the annual payout income.

Accessing Investment Gains ($45 to $60 million one-time)
At the end of FY 2019-20, campus sold Total Return Investment Pool (TRIP) funds to be able to recognize a sizeable appreciation in market value. We will use $15-$30 million to fund an FFE associated with the central campus portion of the internal borrowing strategy discussed above. The balance of approximately $45-$60 million is available for other mitigation or investment needs.

Unit Sources ($40 - $55 million one-time)
There is an expectation that units will use internal resources to cover a portion of COVID-19 losses. Potential mitigation funds in units include, but are not limited to:

- Operational savings resulting from the curtailment of operations
    - Reduced travel, entertainment, and meeting expenses
    - Faculty and staff vacancy savings
    - New one-time expense savings including delayed faculty start-ups
- Carryforward balances
- Extraordinary payout from unit-managed FFEs
- Revenue from increased 2020 Summer Session enrollment
- Resources from a one-time rebate of the UCOP Tax Assessment.
- Net revenue from increasing revenue generating activities

It is recognized that within units these savings and potential revenue sources may be distributed across operational units, faculty, and various fund sources. However, given these unprecedented times, it may be necessary for unit leaders to leverage and redistribute these resources to address COVID losses.

In addition, the Regents may take actions such as temporary furloughs, curtailments, salary reductions or other actions that could result in substantial one-time savings. Any such action will be subject to substantial discussion and deliberation and would likely not occur until sometime in calendar year 2021.

Units will be asked to develop mitigation plans to address pandemic-related losses that are not otherwise addressed through campus programs. An initial plan will be requested for losses through December 2020. A revised plan will be requested in the spring for losses through June 2021 with updates made to the prior plan as needed.

One-Time Funding Use Highlights

The primary use for centrally-identified revenues will be to mitigate known shortfalls to defer additional budget reductions in 2020-21 and support strategic, well-informed decisions. We will avoid short-term, draconian cuts. The budget framework had already envisioned reductions over the next five years, but the additional strain on core revenues requires an adjustment and acceleration of the framework.

State Budget Reductions and Enrollment (Tuition) Shortfalls ($58 million base)
The primary source for core fund support is state appropriations and student tuition. The state has reduced the appropriation for UC Davis by $45 million in the 2020-21 budget (base reduction). Total Fall undergraduate enrollment was almost 500 students below our target, of which, about 330 were national/international students. This results in a revenue loss of approximately $13 million compared to the budget.

Because the multi-year budget framework did not address the full pre-existing structural deficit in 2020-21, one-time bridging is needed to mitigate the accrued one-time debt. This was a known need prior to the pandemic and should be considered in the context of overall mitigation strategies.

COVID 19-Related Losses ($95 to $120 million one-time)
COVID-19 revenue losses and increased expenditures have not been evenly distributed across units. Auxiliary and other self-supporting units, along with certain research cores have experienced the greatest net losses and, in most cases, those losses are expected to grow. As noted in the principles above, any set of solutions requires a shared approach with both central and unit actions that will likely occur over multiple years for the units with the most significant impacts.

Solutions to the specific needs of units will need to be tailored to their individual mission, business model, and fund types. For example, solutions identified for auxiliaries or units that rely on internal recharge or self-supporting funds are likely to be different from those identified for academic units that rely largely on core funds and contracts and grants.

Campus Ready Operational Expenses ($20 to $50 million)
COVID-19 screening (testing), contact tracing, isolation and quarantine, cleaning and disinfection, and other campus responses are substantial and will likely continue throughout the academic year.

Supplemental Funding to Support Remote Instruction ($0.5 to $1.5 million)
The Provost authorized an investment of $500,000 in additional instructional support for undergraduate courses to provide the best possible remote experience during Fall quarter. These funds are expected to largely be used for additional TA and Reader support. The initial investment will be evaluated and if remote instruction continues could be expanded to Winter and Spring quarters.

COVID-Impacted Research Program (up to $1 million)
The Provost approved a COVID-Impacted Research Program that provides grants to early-career faculty to hire up to 2 quarters of GSR support to address lost research productivity. Program details are available from the Office of Research.

Scientific Recharge Mitigation ($5 to $10 million)
Although research activity was curtailed in early response to state and county directives, much of the expense associated with research infrastructure provided through research cores, vivaria, and similar operations that recharge extramural contracts and grants, continued. While some of the revenue may be recaptured as research continues to ramp up, certain revenue will be foregone. The estimated funding need for these facilities ranges from $5-10 million.

Capital, Deferred Maintenance and IT Infrastructure Investments ($75 to $150 million over 2-to-3 years)
Despite the emergent budget shortfalls, one of the greatest risks that continues for UC Davis is underinvestment in infrastructure and capital needs. This lack of state investment has been made up in recent years through campus funding actions, including bonding to support investment. Further, as part of budget actions for FY 2020-21, the state swept $11 million of previously authorized one-time deferred maintenance funds and new allocations are not anticipated. Capital and deferred maintenance investments must continue. Similarly, a number of critical enterprise systems are reaching the end of their useful life and investments must be maintained.

Net Losses from Course Materials and Service Fee Waivers ($0.6 to $1.2 million)
Campus leadership decided to waive Course Materials and Service Fees for students during the quarters instruction is primarily remote. However, in some cases departments provided materials to students that would have been funded with these fees, or will incur losses from materials bought prior to the quarter that expire (i.e., chemicals or biological materials). Funding has been set aside to cover net expenditures that would typically have been covered by course material fees, as well as shipping of materials beginning in the fall quarter. BIA is collecting data on these expenses from units.

Unit Losses and Increased Expenditures Due to COVID-19 (varies by unit)
As noted above under “One-time Funding Source Highlights”, central actions will not address all losses for all units. Units will be expected to address some losses and increased costs with internal savings, reserves, and revenue generation.

PROCESS

Information and analyses about various aspects of this plan was provided to key campus constituents for feedback and advice. Consultation will continue to occur with the Budget Framework Advisory Committee, Academic Senate Committee on Planning and Budget, Chancellor and Provost Leadership Councils, Deans, and Assistant Deans and Chief Operating Officers.

BIA will develop criteria for distributing central mitigation funding to address extraordinary unit needs. Units will be asked to submit proposals for various central campus funding opportunities including internal borrowing and scientific recharge mitigation. Units will be asked to submit mitigation plans for losses not addressed by central funding. BIA will communicate a process for submitting and evaluating individual mitigation plans and will seek input from the Budget Framework Advisory Committee.

The multi-year budget framework initiated this year will continue to address structural budget gaps. BIA will develop new estimates of this gap based on the current situation and work with leadership and the Budget Framework Advisory Committee to identify Phase 2 Budget Savings Targets consistent with new forecasts. While the Budget Framework and Mitigation Strategies have aspects that will overlap, especially as it relates to unit-level mitigation, it is critical that both processes move forward to ensure that UC Davis emerges from this crisis with a solid financial foundation so that we can continue to make progress toward our goals and meet our critical missions of education, research, and service.