NATHAN BROSTROM  
EXECUTIVE VICE PRESIDENT, BUSINESS OPERATIONS  
UNIVERSITY OF CALIFORNIA 

PATRICK LENZ  
VICE PRESIDENT, BUDGET AND CAPITAL RESOURCES  
UNIVERSITY OF CALIFORNIA 

Re: UC’s Capital Outlay Program 

Dear Nathan and Patrick: 

At its meeting on February 5, the Academic Council unanimously endorsed the enclosed letter submitted by UCPB outlining principles to guide the allocation of state general funds for capital projects. Council was convinced of the wisdom of UCPB’s principles and requests that you engage the Senate and other constituencies in a discussion of priorities for the program in 2014-15, as well as a more general discussion about the scope of the program. 

Please do not hesitate to contact me with any questions. 

Sincerely, 

Bill Jacob, Chair  
Academic Council 

Cc: Academic Council  
Martha Winnacker, Senate Executive Director
January 15, 2014

WILLIAM JACOB, CHAIR
ACADEMIC COUNCIL

Re: Capital Outlay Program

Dear Bill,

The University Committee on Planning and Budget (UCPB) has been discussing the new capital outlay process adopted in the 2013-14 state budget that authorizes UC to use up to 15% of its state general fund allocation to fund debt service for state-eligible capital projects on UC campuses. This represents a fundamental shift, not only in identifying a new source for funding capital projects but also for the first time setting up a tension between spending for capital projects and spending for operations. UCOP budget officials have been meeting with campus administrative leaders to discuss details about how the program should work, and have invited faculty to contribute to the discussion.

UCPB has identified some general principles that we wish to share with the Academic Council before engaging further with the administration. UCPB is also concerned that this program has already been adopted, is moving forward, and is being considered for a major increase in scope for 2014-2015 without sufficient consideration of its long-term impacts, including the possibility that this debt would be better used for UCRP liabilities or other critical university needs.

To review, the state agreed to shift to UC’s base budget approximately $200 million in state-funded debt service for UC capital improvement projects funded from general obligation (GO) bonds. One model would apply base budget increases resulting from this funds transfer to finance capital projects. A 5% increase to the GO bond portion of the base budget would generate a permanent increase of $10 million that could be used to finance a capital program of about $150 million in the first year. Subsequent 4% increases would generate $8 million that could finance about $120 million in each of the next two years.

The capital funding available through this mechanism represents only a small fraction of UC’s total capital facilities needs, which UCOP estimates to be about $2 billion over the next 4-5 years. UCOP proposes to use the program in an interim capacity to address a few of the most critical needs until the state returns to the general obligation bond mechanism to support UC’s larger needs.
All UC capital projects funded through the program must be approved by the Department of Finance (DOF). UCOP has already submitted to the DOF a list of capital projects for funding in 2013-14 and 2014-15. These projects were selected for each campus from previously submitted campus priorities. Specifically, the University has proposed and the Regents have approved $87 million in projects for 2013-14, and $202 million for 2014-15, most of which relate to infrastructure renewal or seismic safety. UC expects the state to approve the 2013-14 projects, and has set aside $15 million for debt service in the 2014-15 budget. In addition, UCPB recently learned that UCOP has identified an additional $182 million in projects for 2014-15 for which it plans to seek approval from the Regents. This would make the total size of the program proposed for 2014-15 nearly $400 million, requiring debt servicing of approximately $30 million/year in addition to the $10 million required for the 2013-14 program.

UCOP is also discussing whether a longer term program should allocate funding directly to campuses through Funding Streams to allow campuses to fund capital projects, or to a central program in which UCOP distributes funding for specific projects to campuses on a rotating basis.

This program raises a number of questions about the appropriate level of funding, the extent to which the program should be managed by UCOP or be campus-based, the type of projects the program should fund, and how particular projects should be identified and prioritized. UCPB has identified four broad principles that should guide future development of this project.

1. First, the University-funded capital projects program should be conservative and limited in its impact on the operating budget. Although allocating some or all of the base budget increase resulting from the transfer of state-funded debt service to UC’s budget does provide one way to address some urgent capital needs, it will not address the university’s total need for capital renewal and development, and does not substitute for the State’s obligation to maintain the infrastructure of its premier public university. Furthermore, the University has other unmet financial obligations such as UCRP, and other critical priorities to address the erosion of quality that has resulted from the cumulative cuts in state support that could be viewed as equally urgent, and must be viewed as competing with capital projects that are paid for out of funding from the operating budget.

UCPB is hesitant to support substantial long-term commitments of operating funds to new debt when the expected increase in the state contribution to the UC budget is inadequate to address UC’s mandatory cost increases, much less these other priorities. UCPB is also concerned that the program ramp-up now proposed for 2014-15 exceeds what is prudent, even if it is intended as a one-time expenditure that would not be matched in subsequent years. This expansion represents a change in the basis for judging the scope of University-funded capital projects, one that is no longer limited to increases resulting from the shift of debt service funds to the University. Further, a program that is not limited may create an additional incentive to the state to not return to capital funding. UC should do all it can to maximize the probability that the state will fund capital appropriately. These issues highlight the need for a comprehensive discussion about the appropriate level of funding for a self-funded capital program and the fraction of the state allocation that should be diverted from the operating budget to this purpose. UCPB recommends against implementing this program beyond 2013-14 until this discussion has taken place. We consider it important for UC to maintain the program as a strictly limited “emergency” measure, while it works with the state to address UC’s larger capital needs and pension funding obligations.
2. UCPB’s longstanding position, as noted in the “Choices Report,” has been that capital renewal investments that preserve educational and research quality, and the development of UC Merced, should be the highest priority capital expenditure areas for the system. We reaffirm this position in the sense that we believe that funds that are directed toward campuses with seismic and other safety issues must be utilized to address those urgent needs. However, we also urge that there be an equitable distribution of capital funding to all campuses (recognizing the special needs of UC Merced). On some newer campuses, the most urgent needs may be for new space to address critical space shortages for existing programs that support the core academic needs of California students. In the past, there has been concern that some campuses, particularly older and larger campuses with large seismic needs, have prioritized capital expansion over renewal, in using their own funds. In particular, if such funding decisions are made, it leaves large systemwide obligations to the system to that are shared by newer, smaller campuses, some of which chose to apply their own funds to some of their seismic needs. A UCOP-based process is more likely to balance critical capital renewal priorities on some campuses against critically needed new construction on others, and to mitigate the unintended consequences of funding decisions made on one campus that may affect other campuses.

3. For several reasons, including those discussed in (2), we believe this limited capital program should continue to be managed at the systemwide level in strong partnership with the campuses. UCPB views a campus-based process, with funding sent directly to campuses, as potentially more likely to divert funding to non-capital priorities or to priorities other than critical seismic (and other) safety issues when these exist. A central program, on the other hand is more likely to ensure funding for projects that support the greater good of the university, to fairly evaluate the campuses’ different financing needs and debt capacity, and to balance their differing capital needs in the context of the system. UCPB recognizes that while some campuses lack the resources to support capital development and renewal, cost sharing by campuses that do has the advantages of ensuring that the highest priorities are addressed and multiplying the system’s investment. UCPB also expects UCOP to provide a formal and transparent plan for the equitable distribution of capital funding to the campuses that accounts for the status of the campus’s infrastructure, the urgency of seismic retrofits/reconstruction, the expansion of education and research programs, and the campus’s ability to share costs.

4. Questions remain about how the projects previously identified as priorities by campuses were chosen and the principles that led to their selection for inclusion in the 2013-14 or 2014-15 plans. We recommend that before UCOP submits the expanded 2014-15 phase of projects to the state, it engage the Senate and other constituencies in additional discussion about the projects and principles that guide their assignment of priority, the plan for the equitable distribution between campuses discussed above, and a more general discussion about the desirability and appropriate size of this program.

Sincerely,

Donald Senear
UCPB Chair

cc: UCPB