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2009-10 Budget Analysis Series

Higher Education



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EXECUTIVE SUMMARY

The Governor's budget proposal includes \$11.5 billion in General Fund support for higher education in 2009-10. Another \$5.7 billion in student fee revenue and local property taxes also provide support for core higher education programs.

BALANCING THE 2009-10 BUDGET

Governor's Proposal

The Governor estimates that his higher education proposal will achieve \$1.5 billion of General Fund savings by the end of the budget year. Only about 30 percent of these savings result from actual General Fund reductions to higher education budgets. The majority of the savings come from withholding augmentations that had been built into the administration's workload estimates and from delaying state payments for some community college costs.

Although not part of his budget solution, the Governor assumes that students fees at the University of California (UC) and the California State University (CSU) will increase by about 10 percent in 2009-10. The Governor proposes no fee increase for the California Community Colleges (CCC).

Concerns With Governor's Proposal

Fails to Account for New Fee Revenue. The proposed fee increases at UC and CSU would generate almost \$300 million in 2009-10. The proposed budget identifies no specific purpose for this revenue, and it is not accounted for in the proposed budget solutions.

Relies Too Heavily on Financial Aid Cuts. The Governor proposes to reduce funding for the state's Cal Grant financial aid programs by \$87.5 million. We think this reduction undermines financial aid expectations that the state has carefully established, and on which students and their families have come to rely.

Continues Disconnect Between Budgeted and Actual Enrollment. The Governor establishes enrollment targets that are many thousands of students lower than the segments' own enrollment plans. The disconnect between budgeted and expected enrollment makes it impossible to determine how much of the universities' enrollment is supported by the state, thus undermining accountability.

Recommend a Better Approach for Achieving General Fund Savings

Reduce UC and CSU General Fund Support to Reflect Availability of New Fee Revenue. We recommend that the segments retain enough of the new fee revenue to expand their campus-based financial aid programs in order to cover increased fee costs for aid recipients. The remaining new fee revenue should be used to offset state costs for the universities.

Reject Proposed Cuts to Cal Grant Programs. The General Fund savings made possible by the universities' fee increases would be more than enough to substitute for the Governor's proposed financial aid cuts.

Increase University Enrollment. We think the universities should enroll many thousands of students more than is reflected in the Governor's budget. Increasing these enrollment targets would restore the link between budgeted and actual enrollment levels, lock in substantially higher enrollment levels than those proposed by the Governor, and ensure a level of enrollment capacity that upholds the Master Plan's promise of access.

OTHER ISSUES

Proposed Consolidation of Higher Education Commissions. We generally support the administration's proposed decentralization of financial aid administration and restructuring of the California Student Aid Commission (CSAC) as an executive department. We, however, recommend against including the California Postsecondary Education Commission (CPEC) in such a consolidation. The CPEC's role should be reformed, but it should remain independent of the executive branch.

Capital Outlay Proposals. We recommend changes to some of the capital outlay proposals in the Governor's budget in order to better target resources and ensure legislative oversight.

Community College Nursing Programs. We analyze the implementation of recent legislation, and recommend an additional change that would improve nursing program completion rates.

UC Retirement Program. We raise concerns about a looming shortfall in funding for UC's Retirement Program and recommend an alternative to the Governor's proposal.

BACKGROUND

The Governor’s budget proposal includes \$11.5 billion in General Fund support for higher education in 2009-10. This is \$561 million, or 5.1 percent, more than the Governor’s proposed funding level for 2008-09. The higher education budget includes funding for UC, CSU, CCC, Hastings College of the Law, CSAC, and CPEC. Funded activities include instruction, research, and related functions, as well as other activities, such as providing medical care at UC hospitals and managing three major U.S. Department of Energy laboratories.

Putting the Higher Education Budget In Context

Even though higher education would receive increased General Fund support under the

budget proposal, it would receive less than the “workload” levels that the administration assumes would normally be required in the budget year. The administration projects that higher education would thus contribute about \$1.5 billion toward closing the estimated \$41.6 billion budget shortfall by the end of 2009-10.

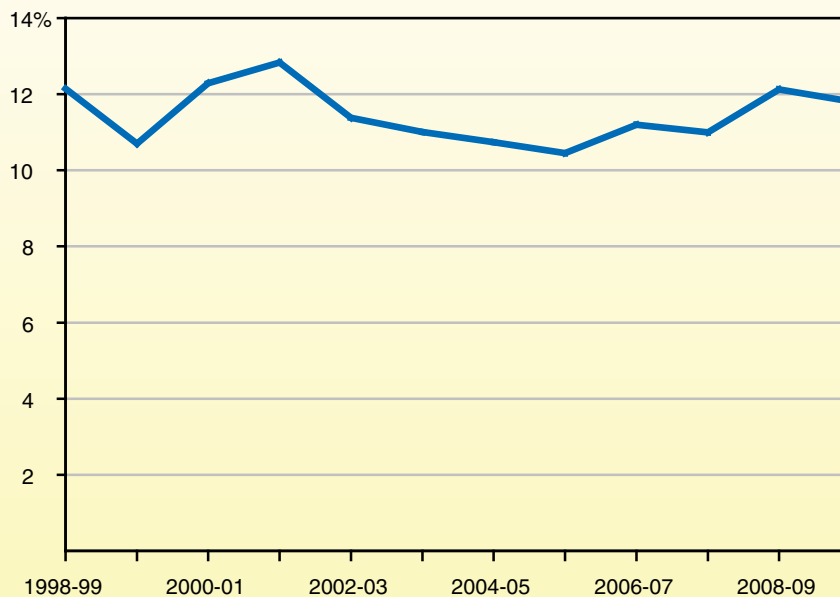
Higher Education’s Share of State Funding Same as a Decade Ago. Under the Governor’s proposal, higher education would receive about 11.8 percent of total state General Fund spending. As shown in Figure 1, higher education’s share of state spending has varied about one percentage point above or below this level over the past decade. Under the Governor’s proposal, higher education’s share would remain at about the same level as a decade ago.

Proposed Current-Year Reductions. The Governor’s proposed budget solutions include General Fund reductions to the three higher education segments in the current year. These include unallocated base reductions of \$65.5 million and \$66.3 million to UC and CSU, respectively. For CCC, the Governor proposes a current-year reduction of about \$270 million, although most of this amount (\$230 million) is simply a deferral of funding

Figure 1

Higher Education’s Share of General Fund Spending

Percentage of Total State General Fund Appropriations



from 2008-09 to 2009-10, and thus would have no programmatic impact.

All Except CSAC Would Receive More General Fund Support in 2009-10. Under the Governor's proposal, all higher education agencies except CSAC would receive increased General Fund support in 2009-10. In contrast, CSAC would receive about \$170 million less than its revised current-year funding. This net General

Fund reduction reflects a proposed \$87.5 million cut to financial aid programs, as well as workload adjustments and nonprogrammatic funding swaps.

Modest Programmatic Increases for the Universities and Colleges. As opposed to CSAC (and most other state agencies), the higher education segments would realize modest year-to-year increases in their programmatic funding. For example, as shown in Figure 2, UC and CSU

Figure 2

Governor's 2009-10 Higher Education Budget Proposal

(Selected General Purpose Funds in Millions)

	2007-08	2008-09 Proposed ^a	2009-10 Proposed	Change From 2008-09	
				Amount	Percent
University of California					
General Fund	\$3,257.4	\$3,135.0	\$3,240.2	\$105.2	3.4%
Fee revenue	1,593.1	1,734.7	1,903.1	168.4	9.7
Totals	\$4,850.6	\$4,869.6	\$5,143.3	\$273.6	5.6%
California State University					
General Fund	\$2,970.6	\$2,871.8	\$2,962.2	\$90.5	3.1%
Fee revenue	1,176.3	1,251.3	1,382.9	131.6	10.5
Totals	\$4,146.9	\$4,123.1	\$4,345.1	\$222.0	5.4%
California Community Colleges					
General Fund ^b	\$4,170.0	\$4,062.0	\$4,597.0	\$534.6	13.2%
Local property taxes	1,970.7	2,053.5	2,063.6	10.1	0.5
Fee revenue	281.4	299.4	308.4	9.0	3.0
Totals	\$6,422.4	\$6,415.4	\$6,969.1	\$553.8	8.6%
All Other Agencies^c					
General Fund	\$879.4	\$912.9	\$743.1	-\$169.7	-18.6%
Fee revenue	26.2	32.2	36.4	4.2	13.0
Student Loan Operating Fund	94.9	130.0	106.1	-24.0	-18.4
Totals	\$1,000.5	\$1,075.2	\$885.6	-\$189.5	-17.6%
Grand Totals					
General Fund	\$11,277.7	\$10,982.0	\$11,542.6	\$560.6	5.1%
Fee revenue	3,077.0	3,317.7	3,630.9	313.2	9.4
Local property tax	1,970.7	2,053.5	2,063.6	10.1	0.5
Student Loan Operating Fund	94.9	130.0	106.1	-24.0	-18.4

^a Reflects General Fund reductions the Governor ordered as part of his 2008-09 veto package and proposed midyear reductions.

^b Most, but not all, of this amount applies toward Proposition 98 appropriations.

^c California Student Aid Commission, Hasting College of the Law, and California Postsecondary Education Commission.

would receive substantial new revenue from fee increases in 2009-10. When fees and General Fund support are combined, UC and CSU would receive year-to-year increases of well over 5 percent. Even allowing that some new revenue would backfill other reductions (such as lottery income), the universities would experience net increases in general purpose funding. For CCC, the main sources of general-purpose support include General Fund, local property taxes, and student fees. These funds would increase by almost 9 percent year-to-year under the Governor’s proposal, although only about one-third of this increase would be available for programmatic needs (with the remaining increase primarily due to the proposed deferral and lottery changes).

Because the Governor’s proposals would affect the current and budget years, a fuller view of the combined effect can be achieved by compar-

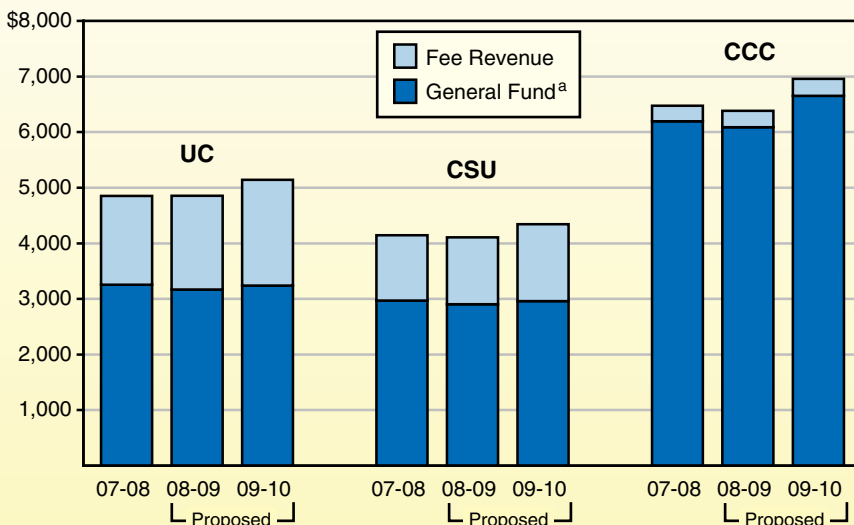
ing them to the prior year (2007-08). As Figure 3 shows, all three segments would receive more general-purpose funding in 2009-10 than they received in 2007-08.

Major Funding Proposals

Figure 4 (see next page) summarizes the Governor’s major funding proposals for higher education. It shows that virtually all General Fund reductions for UC, CSU, and CCC are confined to the current year, while CSAC would receive significant General Fund reductions in the budget year. The figure also shows that a number of the General Fund adjustments in higher education would not have any programmatic effect. For example, all three segments would receive General Fund augmentations to replace revenue they would lose under the planned securitization of the state lottery.

Figure 3
General-Purpose Funding Would Increase for Public Colleges and Universities

(In Millions)



^aProposition 98 funding for CCC.

Proposed Enrollment Total Is Below Current Level

As we describe in more detail in the “Enrollment and Access” section of this report, UC and CSU’s enrollment has grown in 2008-09, even though the budget provides no explicit augmentation for growth. The Governor’s budget for 2009-10 would once again provide no new funding explicitly for growth at the universities, and establishes enrollment floors that are

substantially lower than estimated current-year enrollment. Accordingly, both universities have expressed their intent to reduce freshman enrollment in 2009-10.

Unlike the universities, CCC would receive an augmentation specifically for enrollment growth in 2009-10, raising its funded enrollment to about 1,236,000 full-time equivalent (FTE) students. However, preliminary estimates sug-

Figure 4

Proposed Major Higher Education Funding Changes^a

University of California

2008-09: Net \$82.3 million General Fund reduction

- -\$65.5 million—Unallocated base reduction
- -\$16.8 million—Nonprogrammatic, technical adjustments

2009-10: Net \$105 million General Fund augmentation, plus \$166 million in new fee revenue

- +\$33.1 million—Restore one-time 2008-09 veto reduction
- +\$2.5 million—Nursing and medical program enrollment growth
- -\$5 million—Phase out UC Merced start-up costs
- +\$74.6 million—Nonprogrammatic, technical adjustments
- +\$166.1 million—Revenues generated by 9.3 percent student fee increase

California State University

2008-09: Net \$67.6 million General Fund reduction

- -\$66.3 million—Unallocated base reduction
- -\$1.3 million—Nonprogrammatic, technical adjustments

2009-10: Net \$90.5 million General Fund augmentation, plus \$130 million in new fee revenue

- +\$31.3 million—Restore one-time 2008-09 veto reduction
- +3.6 million—Growth in nursing enrollment
- +\$55.6 million—Nonprogrammatic, technical adjustments
- +\$130 million—Revenues generated by 10 percent student fee increase

California Community Colleges

2008-09: Net \$269.8 million General Fund reduction

- -\$39.8 million—Eliminate 0.68 percent cost-of-living adjustment
- -\$230 million—Deferral of state spending to 2009-10

2009-10: Net \$534.7 million General Fund augmentation

- +\$185.4 million—3 percent enrollment growth
- -\$4 million—Suspend state mandates
- +\$353.3 million—Nonprogrammatic, technical adjustments (including effect of deferral of 2008-09 costs and replacement of lottery funds)

California Student Aid Commission

2008-09: \$92.6 million General Fund augmentation

- +\$62.6 million—Growth in financial aid costs

2009-10: Net \$169.5 million General Fund reduction

- +\$87.5 million—Growth in financial aid costs
- -\$87.5 million—Reduce and restrict Cal Grant benefits
- -\$169.5 million—Nonprogrammatic, technical adjustments (swaps between General Fund and federal special funds)

^a General Fund, unless otherwise noted.

gest that CCC has already achieved this level of enrollment in the current year. Thus, the target envisioned in the Governor’s budget for 2009-10 would be about the same as estimated enrollment in the current year. Figure 5 shows the segments’ actual, estimated, and budgeted enrollment levels for the prior, current, and budget years, respectively.

Student Fee Increases

Figure 6 (see next page) shows student fee levels proposed by the Governor. The UC and

CSU would increase fees by 9.3 percent and 10 percent, respectively. The CCC’s fee level would remain unchanged at \$20 per unit. At the same time the Governor proposes fee increases at the universities, he proposes significant reductions to long-standing financial aid programs that normally would shield financially needy students from such fee increases. For example, the competitive Cal Grant program would be eliminated, while remaining Cal Grant programs would become more restrictive and would no longer fully cover UC and CSU fees.

BALANCING THE 2009-10 BUDGET

GOVERNOR’S BUDGET PROPOSAL FOR HIGHER EDUCATION

The Governor proposes about \$11.5 billion in General Fund support for higher education in

2009-10. The Governor attributes about \$1.5 billion of his General Fund solutions to the higher education budget. Savings are achieved through current- and budget-year reductions (including

**Figure 5
Higher Education Enrollment**

Full-Time Equivalent Students

	Actual 2007-08 ^a	Estimated 2008-09 ^b	Budgeted 2009-10 ^c	Change	
				Amount	Percent
University of California					
Undergraduate	166,206	170,942	160,824	-10,118	-5.9%
Graduate	24,556	25,482	25,400	-82	-0.3%
Health Sciences	13,144	13,392	12,445	-947	-7.1%
Subtotals	(203,906)	(209,816)	(198,669)	(-11,147)	(-5.3%)
California State University (CSU)					
Undergraduate	304,729	306,253	295,583	-10,670	-3.5%
Graduate/post baccalaureate	49,185	49,431	47,650	-1,781	-3.6%
Subtotals	(353,915)	(355,684)	(343,233)	(-12,451)	(-3.5%)
California Community Colleges (CCC)	1,182,771	1,236,127	1,236,446	319	—
Hastings College of the Law	1,262	1,250	1,250	—	—
Totals	1,741,853	1,802,877	1,779,598	-23,279	-1.3%

^a Reported by segments.

^b Latest available estimates of total current-year enrollment. Figures for CSU and CCC are Legislative Analyst’s Office estimates.

^c Governor’s 2009-10 budget proposal. Numbers for CSU reflect correction to Governor’s budget display.

Proposition 98 reductions), as well as foregoing some planned augmentations in the budget year. The components of these projected General Fund savings are shown in Figure 7.

About 30 percent of the proposed General Fund solutions in higher education result from actual General Fund reductions to higher education budgets. In contrast, the majority of the savings come from withholding augmentations that had been built into the administration’s workload estimates and delaying state payments for some community college costs.

Concerns With Governor’s Proposal

We have identified three overarching concerns with the Governor’s proposed budget solutions: (1) they fail to account for new student fee revenue, (2) they rely too heavily on cuts to financial aid programs, and (3) they exacerbate an emerging disconnect between budgeted and actual enrollment levels at the universities.

Fails to Account for New Fee Revenue.

The Governor’s budget proposal assumes that UC and CSU will enact fee increases that would generate almost \$300 million in 2009-10. Assuming that the segments continue their recent practice of diverting one-third of new fee revenue to campus-based financial aid programs, the proposed fee increases would generate almost \$200 million in general-purpose revenue. However, the

proposed budget identifies no specific purpose for this revenue, and it is not accounted for in the proposed budget solutions. For example, this fee revenue could be used to reduce the level of General Fund support needed for university programs. The Governor’s proposal also ignores an opportunity to create General Fund savings by increasing CCC fees, which cover less than 5 percent of total costs.

Relies Too Heavily on Financial Aid Cuts.

Alongside proposed fee increases of about 10 percent at the universities, the Governor proposes to reduce and restrict state financial aid programs. Given that student fees are low by national standards, we think increasing fees is a sensible way to provide resources to the segments in lieu of General Fund support. In order to ensure that fee increases do not prevent higher education access for financially needy students, however, the state would need to increase, rather than reduce, funding for its financial aid programs. Instead, the Governor proposes to

Figure 6
Annual Education Fees for Full-Time Resident Students
2007-08 Through 2009-10

	2007-08	2008-09	2009-10 ^a	Change	
				Amount	Percent
University of California					
Undergraduate	\$6,636	\$7,126	\$7,788	\$662	9.3%
Graduate	7,440	7,986	8,736	750	9.4
Hastings College of the Law	\$21,303	\$26,003	\$29,383	\$3,380	13.0%
California State University					
Undergraduate	\$2,772	\$3,048	\$3,354	\$306	10.0%
Teacher Credential	3,216	3,540	3,894	354	10.0
Graduate	3,414	3,756	4,134	378	10.1
Doctoral	7,380	7,926	7,926	—	—
California Community Colleges	\$600	\$600	\$600	—	—

^a Proposed.

reduce funding for the state's Cal Grant programs by \$87.5 million from the level that would be required under current program rules. We think this reduction is unwise, as it undermines financial aid expectations that the state has carefully established, and on which students and their families have come to rely.

There are better options for saving similar amounts of General Fund support in higher education. Using new university fee revenue to offset General Fund costs, as suggested above, is one such example. The Governor proposes modest, unallocated midyear base reductions to the universities equal to about 2 percent of their General Fund support. Other than this, the universities would receive no programmatic reductions under the Governor's two-year budget proposal. The CCC's current-year reduction would be less than 1 percent, with only a \$4 million programmatic reduction in the budget year.

Continues Disconnect Between Budgeted and Actual Enrollment. As part of his budget

solution, the Governor establishes enrollment targets that bear no relationship to actual enrollment patterns, and (at least for UC) would be many thousands of students lower than the segments' own enrollment plans. This problem builds on a similar divergence of budgeted and actual enrollment in the current year. As a result, it is becoming impossible to determine how much of the universities' enrollment is supported by the state. This undermines accountability, creates confusion for potential students about enrollment opportunities, and makes it difficult for the state to plan for future enrollment costs.

Recommend a Better Way to Achieve General Fund Savings

We recommend that the Legislature achieve General Fund savings in higher education using a different approach that better accounts for available resources, preserves affordability, and restores the link between the budget and enrollment levels consistent with the Master Plan.

Figure 7

Governor's Proposed Higher Education Savings

(In Millions)

	2008-09	2009-10	Two-Year Total
Unallocated reductions to UC, CSU, and Hastings	\$132.2	\$132.2	\$264.4
Forego 5 percent base increases for UC, CSU, and Hastings	—	299.9	299.9
Forego 2.5 percent enrollment growth for UC and CSU	—	127.8	127.8
Restrain new spending on UC Retirement Fund	—	75.5	75.5
Impose new limitations and reductions on Cal Grant programs	—	87.5	87.5
Consolidate CPEC and CSAC and decentralize financial aid	—	2.0	2.0
Defer some CCC apportionment costs from current year to budget year ^a	230.0	—	230.0
Eliminate 0.68 percent COLA for CCC in current year ^a	29.8	39.8	79.6
Forego 5.02 percent COLA for CCC in budget year ^a	—	322.9	322.9
Suspend CCC mandates ^a	—	4.0	4.0
Totals	\$402.0	\$1,091.6	\$1,493.6

^a Proposition 98 savings.

UC = University of California; CSU = California State University; CPEC = California Postsecondary Education Commission; CSAC = California Student Aid Commission; CCC = California Community Colleges; COLA = cost-of-living adjustment.

Specifically, we recommend the Legislature:

- ***Reduce Segments' General Fund Support to Reflect Availability of New Fee Revenue.*** We recommend that the segments retain enough of this new fee revenue only to expand their campus-based financial aid programs in order to cover increased fee costs for aid recipients. The remainder should be used to create General Fund savings.
- ***Reject Proposed Cuts to Cal Grant Programs.*** The General Fund savings made possible by the universities' fee increases would be more than enough to substitute for the Governor's proposed financial aid cuts.
- ***Rebench Budgeted Enrollment Based on Realistic Targets.*** This would restore the link between budgeted and actual enrollment levels by locking in more realistic (and higher) enrollment levels than those proposed by the Governor, and would ensure a level of enrollment capacity that upholds the Master Plan's promise of access.

We discuss the Governor's specific proposals and our recommendations in the following sections.

UC AND CSU ENROLLMENT AND ACCESS

One of the principal factors influencing the state's higher education costs is the number of students enrolled at the public higher education segments. The 1960 Master Plan of Higher Education expresses the goal that all Californians should be afforded the opportunity to receive a college education. This promise of universal access is achieved by guaranteeing university eli-

gibility to the top one-third of high school graduates and allowing all adults the opportunity to attend a community college. Below we analyze and make recommendations for budgeted enrollment at the public universities and then turn to CCC enrollment funding.

Enrollment Management and the Master Plan

The number of eligible applicants to UC and CSU fluctuates from year to year depending upon a number of factors—including population growth, demographic changes, economic conditions, and student preferences. Each year, the state and the segments take steps to manage the number of students who attend California's public universities. Such enrollment management is necessary since funding and campuses' physical capacity in any given year are limited. The state typically provides a fixed amount of funding for a specific level of enrollment in the annual budget. The state expects the universities to manage enrollment through admissions to achieve enrollment close to its targeted level. (See nearby box for examples of enrollment management techniques the universities use.)

Such enrollment management techniques are meant to keep enrollment growth from exceeding the state's resources for higher education or from falling below the state's enrollment goals. These tools are also meant to uphold the goals of the Master Plan—all eligible students who apply to UC or CSU are guaranteed a spot within the respective system, even though they may not be admitted to their first-choice campus. At UC, students may be redirected to a lower-choice campus. At CSU, students are guaranteed admission only to their local campus. Many applicants to either system reject opportunities to enroll at a

lower-choice campus. In this way, both segments can adjust their enrollment levels by increasing or decreasing the number of students they admit to first-choice campuses.

Budgeted Enrollment Levels in Recent Years

As stated above, the Legislature and Governor typically provide General Fund support in the annual budget act to support a specific number of students at each of the three segments. This usually includes an augmentation for enrollment growth, which is added to the previous year's base funding at a per-student funding

rate commonly referred to as the marginal cost of instruction. For example, the Legislature provided annual augmentations for 2.5 percent growth at UC and CSU from 2005-06 through 2007-08. The segments typically serve slightly more or fewer FTE students than budgeted because the number of eligible applicants choosing to enroll is difficult to predict and manage with precision. For example, CSU enrolled fewer students than budgeted in 2004-05, as did UC in 2005-06. As shown in Figure 8 (see next page), however, in more recent years the segments enrolled more students than budgeted.

EXAMPLES OF ENROLLMENT MANAGEMENT

California's universities employ the following tools to influence the number of eligible applicants who enroll:

- Redirect students to a lower-choice campus within the system (University of California primarily), or give priority to local-area applicants (California State University).
- Adjust application deadlines.
- Restrict lower-division transfers.
- Establish prerequisites for admission to upper-division status.
- Limit admission of those seeking second baccalaureate degrees (with some exceptions for high-demand fields).
- Require incoming students to attend orientation and/or pay enrollment deposits.
- Make offers of admission provisional on meeting conditions, such as completing courses in process at time of application, maintaining minimum grade point average, and providing supporting documents.
- Implement standards for academic disqualification (for example, do not permit students without good academic standing to re-enroll).
- Reduce the number of students admitted by exception (those students who do not meet regular admission requirements).

Universities Exceeded Enrollment Targets in 2007-08. In 2007-08, UC enrolled approximately 5,400 more students than budgeted and CSU enrolled approximately 11,000 more than budgeted. The enrollment was not even across campuses—some campuses exceeded their enrollment targets while others fell short.

No Enrollment Target Set for UC and CSU in 2008-09. In a departure from past practice, the 2008-09 Budget Act included no explicit augmentation for enrollment growth and did not specify any enrollment targets for UC and CSU. Instead, the segments were given the discretion to set their own enrollment levels for the 2008-09 academic year.

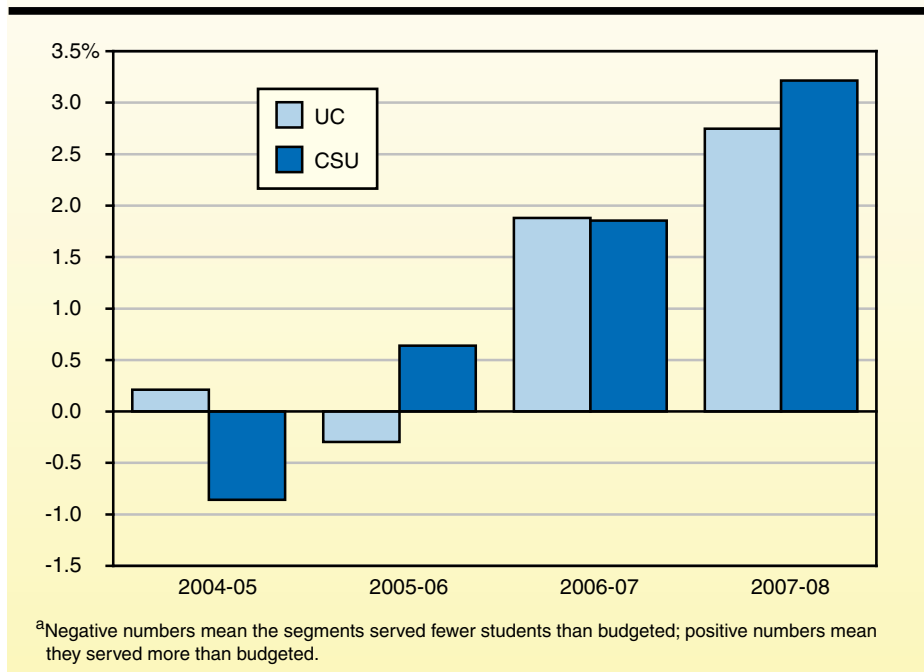
In order to hold the segments accountable for their decisions, the Legislature required the segments to report on any enrollment growth (as well as employee compensation increases) in the current year and how they were funded. These reports, submitted in mid-January, provide some detail on the segments' enrollment growth in the current year.

- **UC Estimates 2.9 Percent Growth in the Current Year.** The UC sought to increase its 2008-09 enrollment by about 5,000 FTE students, or 2.5 percent. The UC now estimates

it exceeded this target by approximately 1,000 FTE students. Combined with the 5,400 students UC enrolled above its budgeted level in 2007-08, UC currently has approximately 11,000 more students than its last budgeted level.

- **CSU Estimates Fall Enrollment Increased 1.3 Percent in the Current Year.** For the current year, CSU attempted to manage enrollment levels closer to its 2007-08 budgeted level by moving fall 2008 application deadlines earlier than normal. Despite this effort, CSU estimates enrollment increased by approximately 4,500 students in the fall 2008 term. Even with this increase in *fall* enrollment, CSU intends that enrollment management in the winter and spring terms will allow the segment to hold enrollment growth flat

Figure 8
Percentage Difference Between Budgeted And Actual Enrollment^a



in the current year. Depending upon the success of this effort, CSU's enrollment for the current year would still be 11,000 students to 15,000 students above its last budgeted level in 2007-08.

UC and CSU Use Various Means to Accommodate Additional Students. According to these preliminary estimates, both segments increased their enrollment in the current year without specific General Fund appropriations for this purpose. The segments did have growth in other revenues. For instance, most of these students paid a portion of their education cost through their fee payments. Moreover, both universities received additional unallocated revenue in 2008-09 from fee increases imposed on all students. The universities report, however, that this increased funding was not enough to cover all their cost increases. In addition to enrollment costs, other cost increases include employee compensation, energy, and the operation of new space. The segments, therefore, report that they have undertaken various cost-saving measures to cover their 2008-09 costs. These include:

- Increasing the size of classes.
- Hiring additional temporary faculty or part-time lecturers to teach courses, rather than tenure-track faculty.
- Asking faculty to teach more courses instead of engaging in their noninstructional responsibilities.
- Deferring the hiring of additional support staff in areas such as libraries, financial aid, and academic advising.
- Deferring maintenance of facilities.
- Drawing down campus reserves.

Governor's 2009-10 Enrollment Proposals

No General Enrollment Growth Proposed at UC and CSU for 2009-10. For 2009-10, the Governor proposes no new funding for general enrollment growth at UC and CSU. By not funding the 2.5 percent enrollment growth called for under the 2004 compact, the Governor assumes savings of \$56.2 million at UC and \$71.6 million at CSU.

Targeted Growth Proposed for UC and CSU Health Sciences Programs. At the same time, the Governor's proposal *does* include targeted enrollment growth funding for specific programs in health sciences at UC and CSU. The Governor would add \$3.6 million to CSU for an additional 340 undergraduates in nursing and \$1.1 million to UC for an additional 50 undergraduate and 42 master's level nursing students. The Governor's proposal also includes \$1.5 million for UC to enroll an additional 57 students in the Programs in Medical Education (PRIME)—designed to prepare physicians to address the health needs of underserved populations in the state.

The growth funding proposed for the additional nursing and PRIME students is much greater than the marginal cost funding normally provided for enrollment growth, reflecting the higher costs of education in health sciences. The Legislature included growth funding for these programs at the higher marginal cost levels in the budget acts between 2005 and 2007.

UC and CSU Plan to Reduce Enrollment Of New Students in 2009-10

The UC and CSU have already adopted enrollment plans for the budget year. Both segments plan to reduce enrollment levels for new students in 2009-10 based on expectations that

they will not receive enrollment funding augmentations due to the state’s budget shortfall.

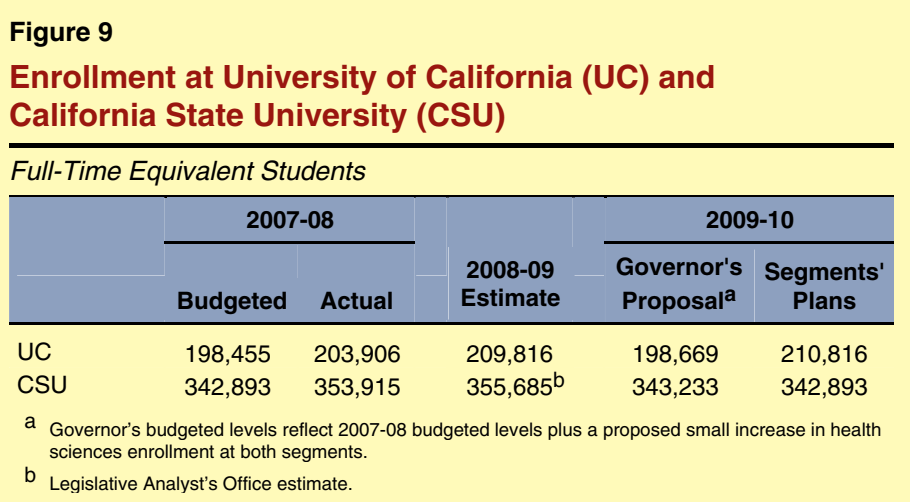
UC Plans to Reduce Freshman Enrollment From 2008-09 Levels. The UC Regents adopted a plan in January to reduce enrollment of new California resident freshmen by a total of 2,300 FTE students for 2009-10. This would represent a 6 percent reduction from the size of the 2008-09 freshman class. The plan would also increase enrollment of community college transfer students by 500 FTE students (a 3 percent increase) and maintain the same number of graduate students. As shown in Figure 9, UC expects total enrollment would still grow modestly in 2009-10, because the incoming freshmen and transfers would slightly outnumber the graduating class. The estimated total enrollment would still well exceed the budgeted level proposed in the Governor’s budget.

CSU Plans to Return to 2007-08 Budgeted Enrollment Levels. The CSU Trustees adopted an enrollment plan in November with the goal of reducing enrollment in the budget year to the last budgeted level in 2007-08. Depending upon the results of CSU’s efforts to constrain growth in the winter and spring of the current year, this would reduce the enrollment level by approximately 3 percent to 4 percent compared to 2008-09. The enrollment reductions would mainly affect incoming undergraduate and graduate students through a variety of the enrollment management measures described earlier.

UC and CSU Enrollment Plans Consistent With Master Plan

As described above, UC and CSU intend to reduce enrollments mainly through increased enrollment management efforts. These types of actions do not constitute a departure from previous policy, but rather reflect the expanded use of tools the segments regularly employ to align their enrollment with available resources.

Enrollment Plans Continue to Guarantee Admission for Eligible Students. It is important to note that the proposed enrollment plans are consistent with the Master Plan—all eligible students who meet application deadlines would be guaranteed admission to at least one campus within each university system. As regional institutions, the CSU guarantees that eligible applicants would be admitted to their local campus if they apply by the priority deadline. For 2009-10, the CSU has authorized all campuses to set eligibility criteria such as grade point average and test scores for nonlocal students that exceed the systemwide minimum criteria—referred to as impaction. For example, a high school senior from Pomona who meets the minimum eligibility criteria for admission to CSU would be guar-



anteed admission to CSU Pomona by applying before the priority deadline. However, this student potentially would not be admitted to some other CSU campuses as those campuses could use higher criteria for reviewing applications from other regions. Many popular campuses are regularly declared impacted to students from outside their region and have set higher eligibility criteria for years. Less popular schools that are unlikely to achieve their enrollment targets would continue to accept all eligible applicants.

The UC similarly guarantees admission to one of its campuses if an applicant meets the system's minimum eligibility criteria. As the university system charged with responding to state-wide needs, UC does not guarantee admission to a local campus, and instead redirects eligible students to campuses with available space. The UC's policy of redirection has been in place for many years, regardless of state funding levels. The more competitive UC campuses such as UC Berkeley have eligibility criteria that exceed the minimum criteria for admission to the system. If an eligible student applies to UC Berkeley and does not meet that campus' higher criteria, the student would instead receive an offer of admission to a campus with lower admittance criteria (such as UC Merced). In order to reduce freshman enrollment in 2009-10, UC expects to redirect more applicants than in the past to UC Merced. (There is an expectation that many of these redirected students will pursue other opportunities.) Due to increased redirection, UC expects freshman enrollment to increase at UC Merced in the budget year and decrease or remain flat at the other campuses.

Some Aspects of the Enrollment Plans Could Be Beneficial to Students and the State. Many of the enrollment management strategies

that the CSU Trustees directed its campuses to enforce would make sense even without a budget crisis. For example, campuses have been directed to make acceptance offers contingent on satisfactory completion of high school work in progress; accept transfer students only if they meet minimum requirements; and require continuing students to maintain good academic standing. Each of those proposals uphold academic standards the university should promote regardless of the state's budget situation.

Other enrollment measures under consideration could be beneficial to students. For example, mandatory orientations would introduce more new students to college-level expectations and raise awareness of support networks available on campus. Earlier application deadlines reward motivation and planning by potential students.

Funded Enrollment Level Unclear For 2008-09

The *2008-09 Budget Act* did not set enrollment levels for UC and CSU, but instead allowed the segments to decide how to accommodate unallocated reductions in state funding. Specifically, the Governor's 2008-09 budget proposal started with workload budgets for UC and CSU that included funding for enrollment growth and other cost increases, and then instituted unallocated General Fund reductions to the segments. By making these reductions unallocated, the Governor's budget proposal deferred to UC and CSU the task of reconciling their workload with reduced General Fund support. (The availability of new revenue from student fee increases aided this task.)

As a result of this approach, the 2008-09 funded enrollment base is not specified in the

budget. This has led to conflicting perspectives about what level of enrollment is funded in 2008-09. One interpretation (promoted by the segments) is that UC and CSU did not receive an augmentation for enrollment growth in 2008-09 and, therefore, their budgeted enrollment level for the current year is unchanged from the 2007-08 level. An alternative interpretation is that, by definition, UC and CSU found funding to pay for the students they enrolled in 2008-09. This view is based on the fact that the segments could have accommodated part of their unallocated reduction by reducing their 2008-09 enrollment from the Governor's workload levels. They also could have absorbed unallocated reductions in other areas, such as reducing research activities, public service, and administration. Other cost saving options included increasing class sizes or faculty course loads, implementing staff furloughs, and reducing travel and other variable expenses. As already described, UC and CSU did make some of these changes in the current year while also enrolling additional students. Under this interpretation, therefore, UC and CSU chose to allocate their General Fund reductions to other areas rather than enrollment growth.

Administration Inconsistent in Treatment of Enrollment. The Governor's 2009-10 proposal reflects both interpretations. For general enrollment, the Governor sets enrollment targets for both the current year and the budget year that are equal to 2007-08 budgeted levels. In this way, the Governor's proposal suggests that UC and CSU are *not* funded for the additional students they have enrolled beyond the 2007-08 level. However, the Governor's proposed augmentation for UC's PRIME initiative assumes that the additional PRIME students enrolled in the current year *are* funded—even though UC

has argued they are not. It is not clear why the administration has characterized funded and unfunded enrollment in this way.

The Legislature Should Adopt Specific Enrollment Targets in 2009-10

We believe it is important that the Legislature adopt specific 2009-10 enrollment targets for UC and CSU in order to clarify the state's goals for enrollment, set expectations for the segments, and provide a clear enrollment base to work from in subsequent years. As illustrated by the Governor's proposal, leaving specific enrollment targets out of the current-year budget has created confusion about which enrollment actions the state supported. Coupled with the Governor's abandonment of his compact and other budget turmoil in the current year, this has made it extraordinarily difficult to sort out "funded" and "unfunded" activities. We therefore recommend that the Legislature adopt language identifying specific enrollment levels that are funded for 2009-10. Establishing funded enrollment targets would provide a clear base from which to provide annual enrollment growth funding in the coming years.

Uncertainty about enrollment funding provided in the current year also makes it difficult to determine the amount of funding necessary to support the universities' enrollment targets in the budget year. Specifically, the lack of budgeted enrollment levels in the 2008-09 budget creates confusion about how much enrollment the state funded in the current year. Moreover, the segments' reports to the Legislature about how they are funding current year enrollment lack the detail necessary to determine whether current enrollment levels are sustainable at current funding levels. The reports do not, for example,

detail the extent to which the segments relied on one-time savings as opposed to ongoing savings to support enrollment growth in 2008-09.

Recommend Enrollment Be Re-Benched

We recommend the Legislature resolve this uncertainty by re-benching UC and CSU's funded enrollment for 2009-10, taking into consideration actual enrollment in the current year. (See nearby box for a description of how CSU's funded enrollment was re-benched earlier in this decade.)

Adopt UC's Enrollment Plan. In our opinion, UC has put forward a reasonable enrollment plan for 2009-10. While it would reduce the size of the incoming freshman class, it does so in a way that would not deny access to any eligible applicant. Further, the total number of enrolled students (at all levels) would increase slightly. We therefore recommend that the Legislature adopt budget language establishing UC's proposed enrollment total of 210,816 resident FTE students. We further recommend that the Legislature augment UC's budget to fund the enrollment growth this target would require above the estimated current-year level. We estimate this cost at about \$11 million.

Increase CSU's Proposed Target to Recognize Some Growth Funded in Current Year. As discussed above, the Governor's 2009-10 budget (and CSU's own plan) would return CSU enrollment to its 2007-08 budgeted level. We estimate this would result in a decline of more than 12,000 FTE students between the current and budget year. We believe this enrollment target is too low for two reasons:

- **It Is Unrealistic.** The CSU had earlier claimed it would reduce its enrollment by about 10,000 FTE students during the current year, but instead enrollment will almost certainly have increased slightly during the current year. We think it is unrealistic to expect that CSU will somehow be able to achieve an even larger reduction in 2009-10.
- **It Improperly Assumes Recent Enrollment Growth Was Not Funded.** As noted above, the *2008-09 Budget Act* does not specify how much enrollment it funds, instead deferring this decision to the universities. We would assume CSU's current-year enrollment is funded through

CSU'S ENROLLMENT RE-BENCHED IN 2004-05

The *2003-04 Budget Act* included funding for enrollment growth at the two university systems, raising their budgeted enrollment levels. However, the California State University (CSU) chose not to use its enrollment funding to enroll more students, and instead redirected this funding to other purposes (primarily restoring reductions the Legislature had made in other areas). In 2004-05, CSU enrolled still fewer students. Responding to the growing disconnect between budgeted and actual enrollment, the Legislature took two steps to restore transparency and accountability to CSU's enrollment funding. First, it re-benched CSU's budgeted enrollment downward to better match CSU's actual enrollment. Second, it adopted new language in the *2005-06 Budget Act* that prevented CSU from redirecting enrollment growth funding to other purposes. This approach was continued until the current year, when no enrollment targets were set.

some combination of revenue from its fee increase, cost savings from other areas of its budget, and drawing down budget reserves. While we recognize that a portion of this funding may be one-time in nature, we believe that some of the enrollment has been accommodated on an ongoing basis.

We recommend, therefore, that the Legislature establish CSU's 2009-10 enrollment target at 350,000 FTE students. While this target is somewhat arbitrary (given the confusion surrounding current-year enrollment), we think it is reasonable and appropriate. It is about 7,000 FTE students more than what the Governor proposes (recognizing that CSU has funded growth in the current year), and about 6,000 FTE students *less* than our estimate of CSU's current-year enrollment (recognizing that some of CSU's current-year enrollment was funded with one-time savings). In our view, this would require no additional funding.

Reject Targeted Enrollment Increases. Our proposed re-benching of budgeted enrollment levels does not include additional students in nursing and PRIME as proposed in the Governor's budget. We recognize that the Legislature has expanded these programs in recent state budgets, and they may remain a state priority. However, given the state's budget shortfall, we believe the state's resources should be focused on higher education's core responsibilities in fulfilling the Master Plan. Consequently, we recommend the Legislature delay the Governor's proposed augmentations in UC and CSU's health sciences programs in order to focus available resources on continuing to provide access—as we have proposed through augmentations to support UC's enrollment plan and financial aid programs.

Legislature Should Provide Enrollment Guidance for 2010-11 Academic Year

Our forecast of budgetary shortfalls over the coming years suggests that state support for all programs—including higher education—will continue to be constrained in 2010-11. Once again, the segments will need to develop enrollment plans for 2010-11 prior to state budget negotiations for that fiscal year. In order to help promote consistent enrollment and budget planning in this environment, we recommend that the Legislature include language in the 2009-10 budget indicating expected levels of enrollment growth in 2010-11. Based on expected demographic changes, we forecast that enrollment would remain flat at UC and increase modestly at CSU (0.5 percent). These enrollment targets would be appropriate given the state's fiscal condition. Due to a forecasted decline in the size of the state's high school graduating class, the effect of the relatively flat enrollment on university participation rates would be lessened compared to a typical year. Alerting the segments to the Legislature's enrollment growth expectations would allow them to plan for the upcoming year and inform students and parents of their enrollment management plans prior to enrollment deadlines. The segments would likely need to extend their current enrollment management approaches into the 2010-11 admissions cycle in order to achieve these targets.

CCC Enrollment Levels and Funding

What Influences Enrollment at CCC? The state's Master Plan and current statute require the community colleges to serve as "open enrollment" institutions. As such, community colleges do not deny admission to students. (Instead, students simply register for classes that have

available space, usually on a first-come, first-served basis.) Many factors affect the number of students who attend a community college. Changes in the state’s population, particularly among young adults, can be a major factor affecting enrollment levels. Factors such as state educational policies—relating to fees and financial aid, for example—and personal choices of potential students help determine the percentage of the population that enrolls in college (participation rates). Factors such as the availability of specific classes, local economic conditions, and the perceived value of the education to potential students also affect participation rates.

After Period of Decline, Enrollment Up.

As Figure 10 shows, after peaking in 2002-03, enrollment levels alternated between modest growth and decline for a few years. Community college enrollment has rebounded in recent

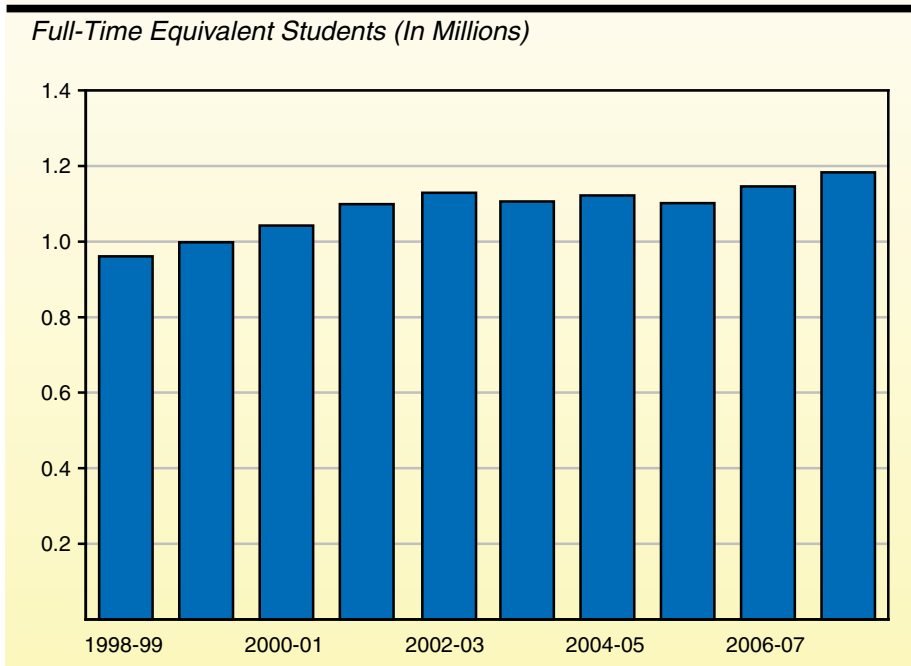
years—reaching an all-time high in 2007-08. (This is due in large part to individuals responding to a tight job market.) In fact, enrollment grew so rapidly in 2007-08 that systemwide growth exceeded the budgeted level by 1.3 percent, or about 15,000 FTE students. If funded, this excess enrollment would have required about \$65 million in additional apportionment monies. It is important to note, however, that the budget also provided a total of \$44 million in “stability” funding—representing almost 10,000 FTE students—for slots that became vacant in declining districts that year.

The 2008-09 Budget Act includes an augmentation of \$114 million to fund new enrollment growth of 2 percent, or about 23,000 FTE students. In addition, the base budget retained another \$44 million for the enrollment slots that became newly vacant in 2007-08. When these

new growth funds are combined with the unused slots from 2007-08, the 2008-09 budget provides CCC with enough funding to accommodate an additional 33,000 FTE students, or 2.8 percent of base enrollment. Based on enrollment in fall 2008, the Chancellor’s Office reports that the system is on track to grow over 4 percent in 2008-09.

Governor Proposes 3 Percent Augmentation for CCC Enrollment Growth. The Governor proposes a total of

Figure 10
Community College Enrollment Growing In Recent Years



\$185 million to fund 3 percent enrollment growth in 2009-10. This includes \$175 million for apportionments, as well as a total of \$10 million for three categorical programs that have historically received growth funding. With this augmentation, the Governor's budget would fund a total of over 1.2 million FTE students in 2009-10.

Recommend Smaller Growth Augmentation. The community colleges are currently facing strong demand for their services as adults seek job retraining and other skills at a time of weak state and national economic growth. For that reason, we recognize a need for additional enrollment funding. As described below, however, we recommend that the Legislature raise CCC fees as part of its budget-balancing solutions. This action would not affect financially needy students (because they are eligible to receive full fee waivers), while the vast majority of nonneedy students would qualify for a full or partial federal tax offset to their fees. It is likely, however, that some fee-paying students who would have attended when fees were \$20 per unit would choose not to attend when fees are higher. We therefore believe that such a fee increase would have some small impact on enrollment. Given this, we recommend the Legislature fund a smaller amount of enrollment growth to the extent that fees are raised. A growth rate of 1 percent for apportionments would cost \$58 million, for a savings relative to the Governor's proposal of \$117 million.

FEES AND FINANCIAL AID

Two of the most important determinants of higher education affordability are the level of fees charged to students and the availability of financial aid. Ideally, the state's policies on fees

and financial aid work together to maximize affordability for both students and the state.

Proposals Do Not Work Together to Maximize Access to Higher Education. Affordability and access depend on the interplay of fees and financial aid. For example, fee increases can provide revenue to maintain capacity at colleges and universities, while targeted aid increases can offset fee increases for needy students. The administration proposes significant fee increases at the universities for the third consecutive year, and financial aid *reductions* that fall disproportionately on university students. At the same time, the administration preserves the broad fee waiver program that covers fees for about 40 percent of community college enrollments, but misses an opportunity to maintain capacity at the colleges through increased fee revenues. In addition, the Governor proposes to reduce grants to students at private colleges at a time when public universities are planning to enroll fewer students. Moreover, the administration's proposal would eliminate grants for nontraditional students (mostly working or unemployed adults) at a time of high unemployment. Finally, rather than increasing aid for lower-income students to keep pace with fee increases, the Governor proposes several cuts to core financial aid programs. We discuss the specific proposals below.

Fee Increases at the Public Universities

Governor's Budget Recommends Fee Increases. For UC, the Governor's budget assumes an increase of 9.3 percent in systemwide fees and increases ranging from 5 percent to 24 percent in fees for specified professional school programs. These increases are projected to generate \$166 million in new fee revenue for UC. At CSU, the Governor's budget reflects a 10 percent

increase in fees for all students, generating an increase of \$130 million in fee revenues.

Current Fees Are Relatively Low. Current fee levels are relatively low at California’s public universities (and extremely low at the community colleges) by almost any state comparison measure. Figure 11 shows fees at UC and CSU compared with their national peer groups. Likewise, the share of educational costs paid by students in California, while growing in recent years, is still very low compared with other states.

Fees Are an Important Source of Support for Higher Education. Fee revenue works interchangeably with General Fund support to fund the core instructional mission of the public segments. A lower share of cost for students, as we have in California, necessitates higher costs for the state. The state’s portion (in the form of a general subsidy to the institutions) is paid for

all students, not only lower-income students. A fee increase has the effect of increasing non-needy students’ share of their college costs, thus reducing the state’s share. This can free up state resources that could be used to support higher education programs, including helping financially needy students, or to help balance the state budget.

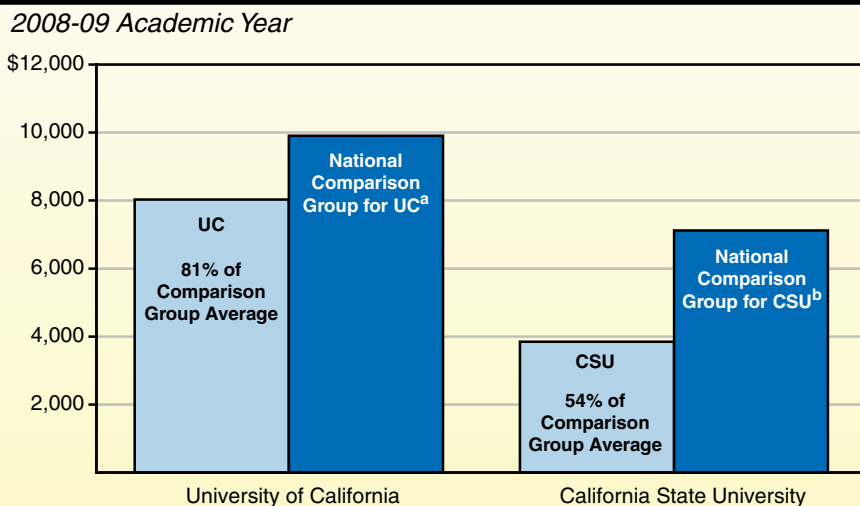
Governor’s Budget Does Not Address New Revenues. While the Governor proposes increased fees at the universities, he does not account for the new fee revenues in spending or savings proposals. Instead, he leaves it up to the institutions to determine how the new resources are to be used. In contrast, we recommend the Legislature take these new revenues into consideration as part of total funding for higher education.

Approve Fee Increases, and Use a Portion of New Revenues to Maintain Financial Aid

Programs. We recommend the Legislature combine fee increases with targeted aid for lower-income students. Specifically, we recommend the Legislature accept the Governor’s proposed fee increases at the universities, and reject the proposed reductions in Cal Grant programs (discussed below). The fee increases would generate about \$300 million in new revenue. This would be more than enough to supplement institutional

Figure 11

Average Tuition and Fees at California’s Public Segments and Their Public Comparison Institutions



^aState University of New York (SUNY) at Buffalo, University of Illinois at Urbana Champaign, University of Michigan at Ann Arbor, and University of Virginia.

^bRutgers, Illinois State University (Normal), University of Connecticut (Storrs), University of Maryland-Baltimore County, Wayne State University, Cleveland State University, University of Wisconsin at Milwaukee, University of Texas at Arlington, George Mason University, University of Colorado at Denver, SUNY at Albany, Georgia State University at Atlanta, Arizona State University at Tempe, North Carolina State University, University of Nevada at Reno.

financial aid programs and maintain Cal Grant programs intact.

Fee Increases at CCC: Federal Government Will Cover Costs for 90 Percent of Students

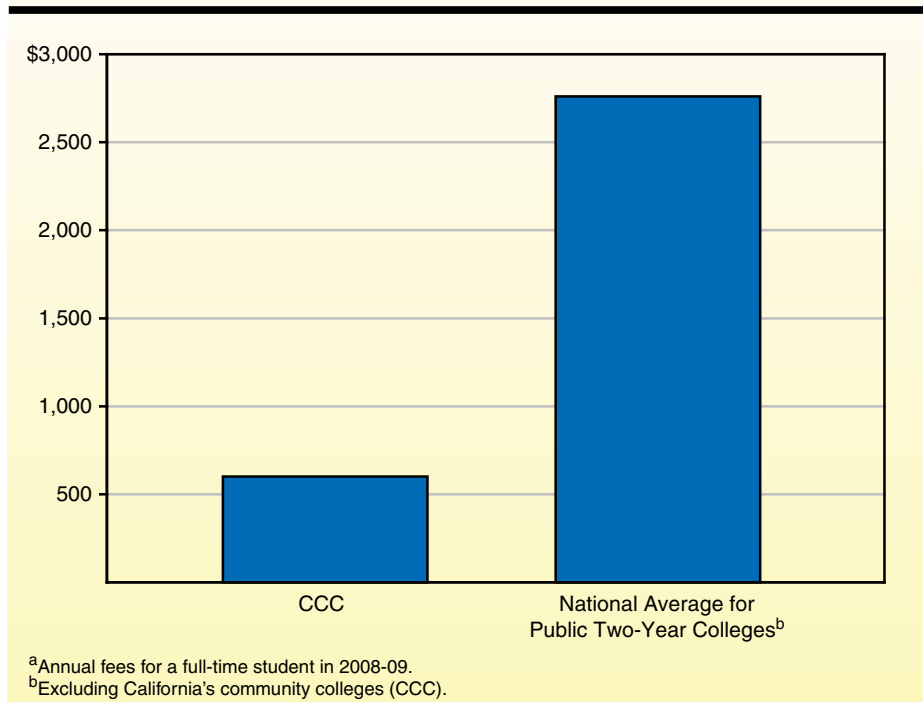
Fee Revenue Helps Colleges. Community colleges receive three main sources of general purpose funding: General Fund, local property taxes, and student fee revenue. In 2008-09, student fees are covering about \$300 million of CCC costs. If General Fund support for CCC were to be reduced (as we recommend in order to help close the state budget gap), the effect of General Fund reductions on CCC programs could be softened by increasing fee revenue. For the budget year, however, the Governor proposes no change to the current student fee level of \$20 per unit. As we describe below, various state and federal financial aid programs would minimize the impact of any fee increases on affordability and access.

CCC Fees Are Low by National Standards. Over the past decade, community college fee levels for credit courses have fluctuated between \$11 and \$26 per unit. (There continues to be no charge for noncredit courses.) The state currently has no official policy for setting CCC fees. Often, fees have been increased during fiscally challenging

periods, and reduced when budget situations improve. Despite this fluctuation, fees have consistently been the lowest in the country. Most recently, fees were reduced from \$26 to \$20 per unit in January 2007. As a result, a full-time student taking 30 units per academic year now pays \$600 a year. This is about one-half that of New Mexico (\$1,220, or about \$40 per unit), which has the next lowest fees among public two-year colleges in the country. Figure 12 shows that the average for all other public two-year colleges (\$2,760) is over four times the amount charged by CCC.

Fee Increase Would Not Affect Needy Students Since They Do Not Pay Fees. In considering any fee increase, the Legislature should consider how potential negative effects (primarily a reduction in affordability) could be mitigated or eliminated. For CCC students, affordability is pre-

Figure 12
CCC Fees Are Dramatically Below National Average^a



served through the Board of Governors (BOG) fee waiver program. The program, which functions as an entitlement, requires students to demonstrate only \$1 of need to receive full fee coverage. The program has relatively high income cut-offs. For example, a community college student living at home, with a younger sibling and married parents, could have a family income up to approximately \$65,000 and still qualify for a fee waiver. The family's income cut-off would increase to roughly \$80,000 if this same student lived away from home. An older, independent student living alone could have an income up to roughly \$45,000 and a student with one child could have an income up to roughly \$80,000 and still qualify for fee waivers. Currently, about 30 percent of CCC students receive fee waivers, accounting for over 40 percent of all units taken.

Federal Government Will Reimburse Most Fee-Paying Students. Most of the students who do not qualify for BOG waivers are still eligible for federal financial assistance that covers all or

a portion of their fees. Figure 13 provides basic information about the federal Hope tax credit, Lifetime Learning tax credit, and tuition and fee tax deduction. As the figure indicates, the Hope tax credit is designed for middle-income students during their first two years of college. Income requirements to qualify for the credit are relatively high. For example, students (or their parents) with a family income of up to \$96,000 in 2008 are eligible for a federal tax credit equal to their entire fee payment—up to \$1,200 per year—for their first two years of college. (The amount of the tax credit is gradually reduced between \$96,000 and \$116,000 for joint returns; \$48,000 and \$58,000 for single filers.) Therefore, while students have to pay their fees initially, they would be reimbursed for this cost as a federal income tax offset (so long as they have sufficient tax liability, which virtually all taxpayers at this income level do).

Students who do not meet the Hope tax credit's academic requirements (such as those

Figure 13

Federal Tax Benefits Applied Toward Higher Education Fees

2008

Hope Credit	Lifetime Learning Credit	Tuition and Fee Deduction
<ul style="list-style-type: none"> • Directly reduces tax bill for up to two tax years. • Covers 100 percent of first \$1,200 in fee payments. Covers 50 percent of second \$1,200 (for maximum tax credit of \$1,800). • Designed for middle-income students who: <ul style="list-style-type: none"> —Are in first or second year of college. —Attend at least half time. —Are attempting to transfer or acquire a certificate or degree. • Provides full benefits at adjusted income of up to \$96,000 for married filers (\$48,000 for single filers) and provides partial benefit at adjusted income of up to \$116,000 (\$58,000 for single filers). 	<ul style="list-style-type: none"> • Directly reduces tax bill for unlimited number of years. • Covers 20 percent of first \$10,000 in fee payments (up to \$2,000 per tax year). • Designed for middle-income students who: <ul style="list-style-type: none"> —Are beyond first two years of college. —Carry any unit load. —Seek to transfer or obtain a degree/certificate—or simply upgrade job skills. • Provides full benefits at adjusted income of up to \$96,000 for married filers (\$48,000 for single filers) and provides partial benefit at adjusted income of up to \$116,000 (\$58,000 for single filers). 	<ul style="list-style-type: none"> • Reduces taxable income. • Deducts between \$2,000 and \$4,000 in fee payments (depending on income level). • Designed for any upper middle-income student not qualifying for a tax credit. • Capped at adjusted income of \$80,000 for single filers and \$160,000 for married filers.

who already hold a degree or are only taking one course per term) can qualify for the Lifetime Learning tax credit. This program, which has the same income limits as the Hope credit, provides a tax credit equal to 20 percent of fees and is available for an unlimited number of years. Finally, those not claiming the credits may be eligible for a tax deduction of up to \$4,000 of the costs of tuition. Based on 2007 data from CSAC, we estimate that more than 90 percent of CCC students would qualify for either a fee waiver or a full or partial federal tax offset to their fees.

Recommend Raising Fees to Maximize Federal Aid. Maintaining very low fees is an inefficient strategy for preserving affordability. While needy students are already shielding from fees through the BOG waiver program, low fees deliver high state subsidies to middle-income and wealthy students—most of whom would receive substantial, if not full, fee refunds from the federal government. California, which charges only \$600 for a full-time student, is one of the only states that does not take full advantage of these federal funds. *In effect, the state is paying for costs that the federal government would otherwise pay and does pay for all other states.* Thus, a low fee policy actually works to the disadvantage of the state.

For these reasons, we recommend the Legislature increase CCC fees as part of its budget solution. An increase to \$30 per unit (from \$20 per unit) would mean that a full-time student taking 30 units per academic year would pay \$900. The annual cost to the same student at \$40 per unit would be \$1,200. Either way, students taking advantage of the Hope tax credit would qualify for a full fee refund. Higher fees, to be charged only to middle-income and wealthy students, would generate roughly \$120 million in additional revenue

for CCC at \$30 per unit, and \$225 million in additional revenue at \$40 per unit. (Even at this higher amount, CCC fees would still be the lowest in the country.) The federal government, in turn, would fully or partially reimburse fee-paying students. These additional fee revenues would effectively backfill a reduction in General Fund support for CCC, which would help mitigate the impact on student service levels.

We recognize that some students (probably less than 10 percent of total CCC students) do not qualify for any state or federal financial assistance due to their high-income level, and thus would have to pay the full fee. It is possible that some students who would have enrolled in community college courses at \$20 per unit will not enroll when the fee is raised. Because these students by definition are not financially needy, their decision not to enroll should not be considered a denial of access, but rather a choice they make about the benefit they will receive from community college classes. Consequently, affordability and access for CCC students is preserved even with a fee increase.

Funding to Educate Students About Federal Aid Opportunities. In 2003-04 and 2004-05, in conjunction with enacted CCC fee increases, the state provided CCC with significant new outreach funding to help educate students about federal and state financial aid. The Governor's 2009-10 budget proposal maintains this outreach funding at its current-year level of \$37 million. These funds are to be used explicitly for individual financial aid counseling and a statewide media campaign that makes students aware of financial aid opportunities available to them. Despite this funding, relatively few students take advantage of the federal tax credit/deduction programs. For example, according to the CSAC, only about

10 percent of CCC students in the 2006 tax year claimed the Hope or Lifetime Learning tax credits. The primary reasons given by students who did not take the credit is that they were not aware of the credit or did not know if they qualified. Recognizing that students need to be more aware of federal tax opportunities, and may require additional assistance in determining their eligibility for them, the Legislature may want to consider setting aside a small portion of funding generated by any fee increases (such as \$10 million) for purposes of outreach and technical assistance to students.

Financial Aid Program Reductions

As Figure 14 shows, the Governor’s budget includes four reduction proposals for Cal Grant programs. In total, these proposals provide an estimated \$87.5 million in savings, which would fully offset projected cost increases. Below, we describe each proposal and recommend the Legislature reject all of them.

Decoupling Cal Grants From Fees

Proposal Would Sever Link Between Fees and Cal Grants. The Governor’s budget pro-

poses to end the statutory requirement to raise Cal Grant awards to fully offset the cost of UC and CSU fee increases for grant recipients. This change would save \$16.6 million in 2009-10. Among the Governor’s financial aid proposals, decoupling Cal Grants from fee increases would have the greatest potential long-term effect on affordability. Chapter 403, Statutes of 2000 (SB 1644, Ortiz), restructured the Cal Grant programs into an entitlement for recent high school graduates and community college transfers, and established a competitive grant program for other needy students. For both programs, the statute sets the award amount for students attending UC and CSU equal to their systemwide fees (plus a subsistence award for Cal Grant B recipients).

Governor’s Proposal Fails to Protect Needy Students From Fee Increases. Holding Cal Grant recipients harmless from the effects of fee increases in this way has been a key part of the state’s affordability strategy in recent years. The Governor’s budget proposal breaks this link between Cal Grants and fees at UC and CSU. Proposed provisional language in the *2009-10 Budget Bill* overrides the statutory fee levels, replacing them with specified award amounts that cover

about 60 percent of proposed fee increases at UC and CSU. This modification would require Cal Grant recipients, who by definition are financially needy, to absorb a portion of fee increases (or find other aid). Over time, this could make the universities financially inaccessible to a number of qualified students.

Figure 14
Governor’s 2009-10 Financial Aid Proposals

(In Millions)

2008-09 Adjusted Base, All Financial Aid Programs	\$948.3
Routine program cost increases ^a	\$87.5
Eliminate new competitive awards	-52.9
Decouple grants from fee increases	-16.6
Reduce awards for private college students	-11.0
Freeze income eligibility ceilings	-7.0
2009-10 Proposed Costs, All Financial Aid Programs	\$948.3

^a Growth in number and size of awards.

Reject Proposal to Disconnect Cal Grants From Fees. We recommend, therefore, that the Legislature reject the Governor’s proposed savings of \$16.6 million in Cal Grants. Preserving the linkage of Cal Grants with fees will help to ensure that the fee increases do not limit access to higher education.

Eliminating Competitive Cal Grant Program

Governor Proposes to Eliminate Awards for Nontraditional Students. The Governor proposes to eliminate new competitive Cal Grant awards for a savings of \$52.9 million. The Legislature created the competitive award program in 2000 with the passage of Chapter 403, recognizing that not all needy students would be eligible for the Cal Grant entitlement. About 22,500 new grants are awarded annually under this program. Students served by the competitive program are older (generally several years past high school), and are more likely to attend a community college. Many have experienced challenges that make it more difficult for them to pursue education beyond high school. Award criteria include parents’ education levels, household status, and characteristics of the high school attended. Beyond that, competitive award recipients share many similarities with entitlement recipients. Both programs serve very low-income, financially needy students. Both serve academically successful students—in fact, competitive program recipients have higher average grades than those in the entitlement program (see Figure 15).

Maintain Competitive Awards. The Governor’s budget does not offer a programmatic rationale for eliminating the competitive program while maintaining the entitlement program. The competitive Cal Grant program serves a dis-

tinct population of college-going students not specifically served by other state financial aid programs, and is an important part of the state’s financial aid system. We recommend, therefore, that the Legislature reject the Governor’s proposed reduction of \$53 million in the competitive Cal Grant program.

Reducing Private College Cal Grant Awards

The administration’s proposal includes a reduction of about 14 percent (from \$9,708 to \$8,322) in the maximum Cal Grant amount for students attending private colleges and universities in California. This reduction would save about \$18 million.

Private University Cal Grants Increase Student Choice and Access. Private institutions in California—including independent nonprofit universities such as Stanford and the University of Southern California, as well as for-profit educational institutions such as the University of Phoenix—are an important part of the overall capacity of the state to ensure access to higher education. The State Constitution prohibits direct support to private entities. However, the state has long provided grant support to students who

Figure 15
Cal Grant Recipient Characteristics

2007-08 Award Cycle

Averages	Entitlement Program ^a	Competitive Program
Age	18	30
Income	\$28,771	\$14,895
GPA	3.10	3.27
Family size	4.1	3.0

^a High school component only.

Source: California Student Aid Commission.

attend private universities—promoting student choice and redirecting some enrollment demand away from the public segments. In fact, the original Cal Grants created in 1955 to accommodate students on the G.I. Bill were *only* for private college students—because there were no enrollment fees at the public universities.

Private Grants Cost State Less Than Public University Student Subsidies. Prior to 2001-02, the state had a longstanding statutory policy that linked the maximum Cal Grant for financially needy students attending private institutions to the average General Fund cost of educating a financially needy student at UC and CSU. When the Cal Grant entitlement was created in 2000, this policy was replaced with a new provision linking the maximum private-student award to whatever amount was specified in the annual budget act. Since then, the maximum award was maintained at its 2000 level (\$9,708) for three years, reduced to \$8,322 in 2004, and restored to \$9,708 in 2006.

In 2008–09, the maximum Cal Grant awarded to students attending private institutions is about 30 percent lower than the average subsidy the state provides to needy students attending public universities. As shown in Figure 16 (see next page), the reduced level proposed by the Governor would be about 40 percent below the average public-student subsidy. Yet, independent colleges, which serve most of the students with private college Cal Grants, serve students from relatively low-income families, and have relatively high degree completion rates, compared with UC and CSU.

Proposal Would Shift Enrollment Demand to Public Universities. Further reduction of support for students at private institutions is likely to result in more students seeking admission to the

public universities. This would cause additional enrollment pressure on UC and CSU, even as the administration’s budget proposal assumes a year-to-year *decline* in enrollment at the public universities.

Maintain Private University Cal Grants at Current Level. For the above reasons, we recommend that the Legislature reject the Governor’s proposed reduction of the maximum Cal Grant for students at private institutions.

Freezing Income Eligibility Level For Cal Grants

Governor Proposes to Freeze Income Ceilings for Cal Grant Eligibility. The Governor’s budget proposes to keep income eligibility limits for Cal Grants in 2009-10 at the current levels. This measure would save about \$7 million.

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. The current income ceiling for a family of four is \$76,400 for Cal Grant A, which provides fee coverage, and \$40,200 for Cal Grant B, which includes fee coverage and a subsistence award. The 2009-10 ceilings for a family of four would increase by 4.3 percent (to \$79,700 and \$41,900, respectively) with the statutory adjustment. Freezing income ceilings at current levels would reduce the number of grants awarded by about 2,000, or 4 percent, compared with the number the commission would award under adjusted limits.

Reject Proposed Change to Income Limits.

Earlier, we discussed how the state’s policies on fees and financial aid can work together to maximize affordability for both students and the state. This can be accomplished by maintaining existing financial aid programs to offset fee increases for needy students. The Governor’s proposal to reduce eligibility for grants while increasing fees, in contrast, would harm affordability for needy students. We recommend, therefore, that the Legislature reject the administration’s proposal to freeze income ceilings.

Other Options for Cost Savings

Options to Control Financial Aid Costs Are Limited. The primary Cal Grant program is an entitlement program, for which the state cannot specifically limit the number of available awards to reduce costs. Instead, it can reduce the award amount, as the administration proposes by decoupling awards from fees; or it can make it harder to qualify for awards by altering financial and academic eligibility criteria, as the administration proposes by freezing income ceilings. The criteria can be adjusted to strike a balance between ensuring that awards go to students with financial need and academic merit, while keeping the cost of awards in line with available funding.

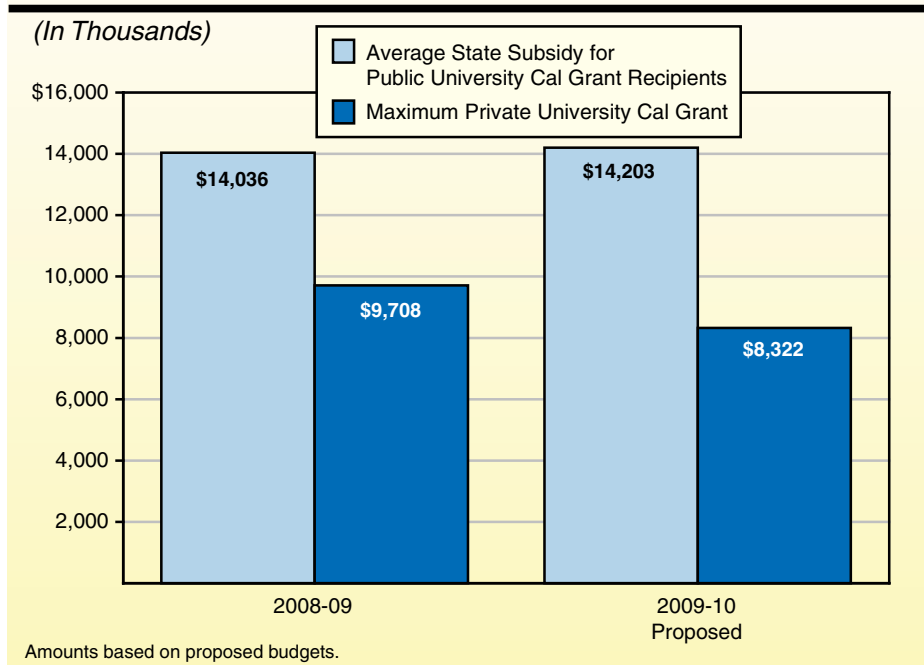
Adjusting Academic Eligibility.

In a list of budget savings options our office released in November, we included adjusting *academic* eligibility criteria for Cal Grants. We estimated that raising the minimum grade point average (GPA) requirement for Cal Grant B from 2.0 to 2.5 would save approximately \$11 million. The effect on college degree production would be minimal, because students with GPAs below 2.5 have markedly lower program completion rates. For example, of CSU students admitted to the university in 2001, less than one quarter of those with GPAs of 2.25 or less have graduated, compared to nearly one third with GPAs of 2.5, and over 70 percent of students with GPAs of 3.25 or higher.

Financial Needs Assessment. Other changes to eligibility criteria could better target aid to those with the greatest financial need. For ex-

Figure 16

Maximum Private University Cal Grant and Average State Subsidy for Public University Cal Grant Recipients



ample, a needs analysis process, such as the one used for federal aid programs, would account for factors other than income, such as the number of children in college, to determine financial need.

Savings Versus Reduced Affordability. Any combination of changes to eligibility criteria designed to generate savings will, by definition, reduce affordability for some students. There are trade-offs associated with different changes to the criteria. For example, the Governor's proposed income restriction would affect a limited number of students and families at the highest income levels of Cal Grant recipients, but would deny grants to some students with high academic merit. Likewise, our GPA restriction option may preserve aid to those most likely to remain in college and complete programs, but could disproportionately affect low-income or under-represented minority students. Replacing income criteria with needs analysis could result in better targeting to needy students, but may be more difficult for families to understand.

Maintaining Affordability

Students Face Increased Barriers to Higher Education. Students applying for college in 2009-10 face considerable uncertainty about access and affordability. Because of enrollment management strategies discussed elsewhere in this report, students are less likely than in recent years to be admitted to the campus of their choice. Affordability is a growing concern as fees continue to increase while ability to pay has diminished for many families. The value of home equity and college savings plans has declined due to a steep downturn in housing and financial markets. Federal education loans remain available, but the market for private loans, which many students use to supplement or replace

federal loans, is extremely tight. The proposed changes to Cal Grant amounts and eligibility add to the uncertainty. Many students will have to make their college decisions before the budget and related legislation are enacted, without knowing whether they will qualify for state financial aid programs.

State Should Maintain Affordability Strategy. It is especially important to preserve the structure of the state's financial aid system when many other factors that affect access and affordability are uncertain. If the Legislature decides to seek a greater contribution from higher education programs to balance the state's budget, we suggest that additional fee increases, combined with targeted financial aid increases, would best meet the objective of maintaining college affordability for students and the state. If the Legislature decides to reduce support for financial aid, we suggest that more targeted reductions, such as changes to eligibility criteria, are preferable to broad reductions, such as decoupling Cal Grant amounts from fees, or eliminating entire programs. Furthermore, we suggest that the Legislature consider adjustments other than income ceiling changes. Raising the GPA requirement and using a direct measure of financial need are two options that would link eligibility directly to state objectives—helping students with academic merit and financial need—and better target the state's investment.

CONTENDING WITH COST INCREASES

The Governor's 2009-10 budget includes no new funding specifically to cover cost increases at the three higher education segments. Moreover, for the current year the Governor calls for midyear base reductions of \$65.5 million at UC, \$66.3 million at CSU, and \$40 million at CCC.

Taken together, the Governor’s proposals would require the segments to make important choices about contending with new costs.

Segments Typically Receive Augmentations for Cost Increases. The higher education segments usually receive annual augmentations for the increased costs of labor and other operating expenses. For CCC, these costs are typically accommodated through the same statutory cost-of-living adjustment (COLA) formula that applies to K-12 schools. In contrast, statute provides no guidance for funding cost increases at UC and CSU. Since 1995, the universities have entered into nonbinding agreements with each governor, specifying multiyear funding targets that include base increases to account for inflation and other cost increases. The universities and the current Governor entered into the most recent compact in spring 2004. A few years later, however, the Governor abandoned the compact, proposing no funding for base increases or growth since 2007-08.

No Funding for General Cost Increases. The Governor’s 2009-10 budget does not provide General Fund augmentations for general cost increases at the three segments. (It does, however, include augmentations for some specific cost increases, such as retired annuitant benefits.) In contrast, the budget proposes a 3.2 percent inflationary increase for state departments’ operating expenses.

Rate of Inflation Likely to Slow. Due to falling inflation in many core areas, cost increases for UC, CSU, and CCC are likely to be significantly lower in 2009-10 than in recent years. Sharp decreases in energy prices and a weak labor market will likely offset rising health care costs, leading to low expected growth of less than 1 percent in 2009-10 for state and local

governments. We expect a similar decline for the rate of inflation for colleges and universities. Figure 17 compares some common measures of inflation in higher education. It shows, for example, that projected inflation for 2009-10 ranges from -0.1 percent (a decline in overall costs) to 0.8 percent (a slight increase in overall costs).

Segments Have Some Control Over Costs. In general, campuses face two kinds of potential cost increases for operating expenses. Some cost increases are largely unavoidable in the short term. For example, if utility companies increase their rates for electricity, campuses are generally obligated to pay those higher rates (although they can take actions to reduce their consumption). In addition, while retirement benefits for future employees can be negotiated, current law guarantees retirement benefits of current retirees. Thus, without new funding for these cost increases, campuses must reduce other items in their budgets to pay higher nondiscretionary costs.

There are other potential cost increases, however, over which the segments have more control. Key among these are salaries and other labor costs. In effect, the segments set the price

Figure 17

**Common Price Indices:
Low Inflation in 2009-10**

	U.S. Consumer Price Index	California Consumer Price Index	U.S. State And Local Deflator
2003-04	2.2	1.9	3.6
2004-05	3.0	3.3	5.6
2005-06	3.8	4.2	6.5
2006-07	2.6	3.4	4.6
2007-08	3.7	3.4	5.9
2008-09	0.7	1.7	3.3
2009-10^a	-0.1	0.8	0.4

^a Forecast.

for labor costs guided by the labor market and available funding. The segments have greater discretion to alter wages and benefits of non-union employees (including administrators, most UC faculty, and some support staff). Compensation for unionized employees (including CSU and CCC faculty, librarians, nurses, and campus police officers) is set through collective bargaining. The administration at each segment typically can reopen these contracts to renegotiate wages and benefits in the event the budget act does not include funding that had been assumed when the contract was negotiated.

Absorbing Cost Increases. Because most nondiscretionary cost increases are expected to slow or even decline, the segments should be able to absorb expected general cost increases in 2009-10. We acknowledge this may require difficult decisions on how to reallocate resources. Some common cost-savings approaches that the segments have used in the past include the following:

- No funding for salary increases for management.
- Reopen labor contracts and negotiate either freeze or reduced increase of faculty salaries.
- Delay purchases of capital equipment.

Weak Labor Market Will Help Universities Remain Competitive. Total compensation of faculty and administrators at both UC and CSU is competitive with their public comparison institutions. Studies commissioned by both UC and CSU in recent years show total compensation (salaries and benefits) of faculty and administrators to be above average compared to its public comparison institutions.

Because of the national recession, funding for many public universities has begun to decline. Many private universities have also reported declines in endowments and charitable giving. Universities across the nation have responded by announcing salary freezes and allowing for priority hires only. Similar to UC and CSU's announcement freezing salary for senior management, universities are making reductions in many administrative and support staff budgets. Because of the current labor market environment for faculty and administrators, even without funding for compensation increases for 2009-10, UC and CSU likely will remain competitive when recruiting and retaining faculty and administrators.

Recommend Accepting the Governor's Proposal for No New Funding for Cost Increases.

Given the state's budget shortfall, the projected low inflation rate, and the segments' ability to control costs, we recommend the Legislature adopt the Governor's proposal to exclude new General Fund augmentations for general cost increases at the three segments. (This is consistent with our recommendation for all state departments.)

CHANGING CCC FUNDING LEVELS FOR LOWER-PRIORITY CREDIT COURSEWORK

State Law Sets Educational Priorities for CCC System. The state's Master Plan for Higher Education and existing statute charge the community colleges with carrying out a number of educational missions. Figure 18 (see next page) summarizes those responsibilities. As the figure shows, the state has established a hierarchy that prioritizes the roles of the CCC system. The core mission of the community colleges is to provide academic and occupational programs at the lower-division (freshman and sophomore) level. Other key missions include providing opportuni-

ties for workers to update their job skills (such as by taking a computer class) and offering precollegiate basic skills instruction. In addition, the state allows CCC to perform two activities on a conditional basis if funding is available: offer community services courses (such as Art Appreciation and Pilates classes) and conduct research on student success.

Two Funding Rates for Noncredit Instruction. Community college courses can be either for credit or noncredit. Noncredit instruction, which is the equivalent of K-12's adult education program, does not assign grades, and students are typically permitted to join or leave a class at any point in the term. The state provides two rates of noncredit instruction: about \$3,250 per FTE student for courses that advance career development and college preparation (defined to include programs such as short-term vocational coursework and English-as-a-second-language classes), and \$2,750 per FTE student for regular noncredit courses (such as home economics and fitness classes for older adults).

Credit Courses Vary Significantly, Yet Receive the Same Funding Rate. The vast majority (over 90 percent) of CCC courses are categorized as for credit. There are several different types of credit instruction. Some credit courses (such as calculus) are transfer-

able to a four-year institution, while others (such as basic arithmetic) do not even count toward an associate's degree. Some credit courses (such as welding) are designed to train students for a trade, while others (such as golf and tennis) are primarily for students' personal enjoyment. Notwithstanding these differences, all credit courses receive the same per-student funding rate (about \$4,600 per FTE student in 2008-09).

Recreational Courses Are Popular at Community Colleges. The CCC system provides a variety of recreational courses to students. Credit physical education courses accounted for about 65,000 FTE students in 2007-08, or over 5 percent of total credit enrollment. (Although these courses are designed primarily for personal enrichment, some four-year institutions such as CSU allow students to apply one CCC unit of

Figure 18

California Community Colleges' Statutory Missions and Functions

Core Mission—Education Code Section 66010.4(a)(1)

“Offer academic and vocational instruction at the lower-division level.”

Other Missions and Functions—Education Code Section 66010.4(a)(2)

“A primary mission.”

- Provide education, training, and services that help to continuously improve California's workforce.

“Essential and important functions.”

- Provide remedial education for those in need of it.
- Provide instruction in English as a second language.
- Provide adult non-credit education in areas defined as being in the state's interest.

“Authorized function” to the extent it does not reduce CCC's ability to fulfill its main missions.

- Provide community services courses and programs.

“Permitted activity to the extent that state funding is provided.”

- Conduct research on student learning and retention.

physical education toward a bachelor’s degree.) In addition, the system served about 3,000 FTE students in credit courses that are neither transferable to four-year institutions, nor vocational, nor precollegiate basic skills. Figure 19 includes examples of such courses.

Recommend New Funding Rate for Lower-Priority Credit Enrollment. All CCC courses can be of value to students. Given resource limitations, however, the Legislature has established priorities for the CCC system that emphasize developing basic skills (such as communicating

in English) and preparing students for professional careers. Given the state’s fiscal condition, it is more important than ever to ensure that available resources are put to their highest use. We recommend, therefore, that the Legislature reflect its priorities in the way it funds CCC classes. Specifically, we recommend the Legislature reduce the funding for credit-bearing physical education courses and other enrichment classes to the regular noncredit rate. (Our recommendation excludes “adaptive physical education” courses, which are designed for individuals with physical disabilities.) Under our recommendation, these courses would continue to be classified as credit; only the funding rate would change. This action would result in savings to the state of up to \$120 million in 2009-10.

Figure 19
Examples of Credit Recreational Courses at California Community Colleges

2007-08

Physical Education	Other Personal Enrichment Instruction
Aerobic Exercise	Birds of Southern California
Badminton	Broadway Tap Dance
Bowling	Introduction to Ceramics
Weight Training	Painting for Pleasure
Yoga	Recording Your Autobiography

OTHER ISSUES

CONSOLIDATION OF HIGHER EDUCATION COMMISSIONS AND DECENTRALIZATION OF FINANCIAL AID

The Governor proposes consolidating two state higher education commissions and decentralizing financial aid administration. Below, we recommend that the Legislature accept two components of the proposal that are directly related to student financial aid—decentralization and placement of oversight activities in the executive branch. In contrast, we advise the Legislature to reject a third part of the proposal—moving higher education coordinating board activities

into the executive branch. In our view, this part of the proposal is incomplete and raises important questions that are left unaddressed. Finally, we encourage the Legislature to consider a more carefully planned reorganization of higher education support activities, including planning and coordination as well as other oversight functions.

Proposal Contains Three Distinct Initiatives

- The Governor’s proposal would:
- Decentralize administration of financial aid programs from CSAC to the higher education segments.

- Eliminate CSAC and move its remaining responsibilities to a new executive branch department.
- Eliminate CPEC and move its responsibilities to the same executive branch department.

The first two components are closely related, because decentralization would significantly alter CSAC's responsibilities. On the other hand, because there is minimal overlap between CSAC's and CPEC's activities, the transfer of CPEC's responsibilities is in many ways unrelated to the other two components. Each of the three parts, however, could be implemented independently from the others. For this reason, we address each component separately in our analysis, beginning with decentralization of aid programs. 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.

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 (see Figure 20). 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.

Authority in Proposed Legislation. Legal authority for decentralization (and other elements of the reorganization) is contained in trailer bill language proposed by the administration. In addition, the Governor's budget includes a new control section (Section 12.25) authorizing the Director of Finance to reallocate and transfer funding from CSAC and CPEC to other organizations as necessary to implement the reorganization.

Annual Savings Estimated at \$2 Million. The decentralization component of the restructuring proposal accounts for about half the savings anticipated by the administration. The Department of Finance (DOF) estimates that approximately 20 CSAC employees are performing tasks that are largely duplicative of work performed in higher education campus financial aid offices. Eliminating these positions, and another 10 support positions (such as accounting, personnel and business services), would save an estimated \$2 million annually.

Proposal Would Eliminate CSAC, Move Responsibilities to Executive Branch

CSAC Composition. 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 Assembly Speaker each appoint two public members. The other 11 members are appointed by the Governor and confirmed by the Senate.

CSAC Responsibilities. The CSAC administers Cal Grants and other state financial aid

programs for California students attending colleges, 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

Figure 20

Student Aid Commission's Financial Aid and Outreach Programs

Cal Grants

Entitlement Awards provide up to \$9,708 to cover tuition and fees, and stipends up to \$1,551 for books and other expenses. Awards are guaranteed for students who meet financial, academic, and other eligibility criteria and attend qualifying public or private institutions.

Competitive Awards provide grants up to the same amounts for students who do not qualify for the entitlement, often because they are older and have been out of high school longer. Grantees are selected based on financial need, academic merit, and other factors, such as parents' educational level and high school's college-going rate, for 22,500 new grants each year.

Cal Grant C provides 7,761 grants for eligible low-income students preparing for occupational or technical training. Grants cover tuition and fees up to \$2,592, plus \$576 for other costs.

Loan Assumption Programs

Assumption Program of Loans for Education (APLE) provides up to \$19,000 toward outstanding student loans for graduates who teach a total of four years in a qualifying school.

State Nursing Assumption Program of Loans for Education (SNAPLE) for Nursing Faculty provides up to \$25,000 toward outstanding student loans for graduates who teach nursing at eligible California institutions.

SNAPLE for Nurses in State Facilities provides up to \$20,000 toward outstanding student loans for graduates who work as nurses in eligible state-operated inpatient facilities.

Child Development Teacher and Supervisor Grant Program provides loan assumption for participants who teach or supervise in the field of child care and development in a licensed children's center. This program is funded from federal funds through an agreement with the State Department of Education (SDE).

Other Loan Assumption Programs include one for qualifying members of the National Guard, State Military Reserve, or Naval Militia and one for persons with graduate degrees who teach at eligible California colleges and universities. Neither of these programs is currently accepting new applicants.

Specialized Grant and Scholarship Programs

Law Enforcement Personnel Dependents Scholarship Program provides college grants equivalent to Cal Grant amounts to eligible dependents of law enforcement personnel who were killed or permanently disabled in the line of duty.

Robert C. Byrd Honors Scholarship Program provides \$1,500 federal scholarships to exceptionally able students who show promise of continued academic excellence. The SDE contracts with California Student Aid Commission to administer this program.

California Chafee Grant Program provides grants up to \$5,000 to eligible foster youth who are enrolled in college or vocational school. This program is supported by federal funds and the General Fund, through an agreement with the State Department of Social Services.

Outreach Programs

California Student Opportunity and Access Program provides financial aid outreach and tutoring services to disadvantaged K-12 students through consortia of school districts, community colleges, universities, and community groups.

Cash for College provides financial aid workshops to assist low-income students with the Free Application for Federal Student Aid (FAFSA) and the Cal Grant grade point average verification form, and provides other financial aid information.

also serves as the federal student loan guaranty agency for California.

CSAC Resources. The proposed 2009-10 budget for CSAC includes \$731 million from the General Fund, \$18 million in federal funds, and about \$1.5 billion in special funds for student loan operations. The budget includes 134.7 positions, excluding state positions related to EdFund, CSAC's not-for-profit auxiliary organization for administering federal student loan programs.

Proposed Reorganization. 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.)

Proposal Would Eliminate CPEC, Move Responsibilities to Executive Branch

CPEC Composition. 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 institution 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.

CPEC Responsibilities. 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.

CPEC Resources. The proposed 2009-10 budget for CPEC includes \$2 million from the General Fund and \$9 million in federal funds (mostly for grants to institutions). The budget includes 20.8 authorized positions.

Proposed Reorganization. The Governor's proposal would transfer CPEC's functions 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.

While transferring all statutory responsibilities of CPEC, the proposed trailer bill instructs the director to prioritize the essential functions (although these functions are not defined). It authorizes the director to contract with the CCC Chancellor's Office for data management and collection as necessary to facilitate accountability, planning, and policy development.

The three components of the Governor's restructuring proposal would provide about \$2 million in budgetary savings in 2009-10. In addition, some elements of the proposal would improve state services and responsiveness to students. In the next sections, we discuss the merits of each proposal on policy grounds and offer our recommendations.

Decentralizing Financial Aid

Campuses Provide Most Aid. Most student financial aid is awarded to students through campus financial aid offices based on a common, web-based application form (the Free Application for Federal Student Aid, or FAFSA). The federal Department of Education uses information from the FAFSA (including family income and assets, and number of children in college) to determine the expected family contribution (EFC). Campus financial aid officers use the EFC, in conjunction with information about the costs of attending their institutions—including books and living expenses—to determine each student's financial need. They then "package" various types of financial aid to meet as much of the financial need as possible.

Campus financial aid officers make awards for most categories of need-based gift aid. They

award Pell grants based on federal eligibility criteria, and invoice the federal government for just-in-time payment through electronic funds transfer. They award institutional funds, following campus or system policies and guidelines. The main exception is Cal Grants. Financial aid officers can estimate the amount of funding students are likely to receive from the Cal Grant entitlement program, but they are not authorized to approve the awards.

Cal Grants Require Many Extra Steps. The CSAC awards Cal Grants from its office in Sacramento. To determine eligibility for awards, CSAC uses information from the FAFSA, as well as a specially defined high school GPA. Most California high schools transmit GPA to CSAC electronically, but about 65,000 high school seniors file paper GPA verification forms to apply for Cal Grants. The CSAC determines eligibility for various types of grants, and awards the most advantageous grant to each student. For example, if a student meets the criteria for two types of grants, but would receive more funding over four years with one type, CSAC will award the grant that provides more funds to that student. After requesting supplemental information if needed, CSAC sends award letters (the California Aid Report, or CAR) to students by e-mail, offering the Cal Grant awards. To release awards, CSAC requires verification of high school graduation, which can be supplied by high schools or students. The actual payment of Cal Grants is made through the campuses. The campus financial aid offices confirm student enrollment and verify eligibility, and CSAC pays the campus for each eligible student. Campuses use the funds to pay the students' fees, and to pay stipends directly to students.

Process Is Fragmented. From the student's perspective, this process is fragmented and often confusing. Students may have to submit information to the CSAC office in addition to their campus financial aid office. They receive correspondence from CSAC, which sometimes duplicates information they have already received from the campus office, and sometimes contradicts it, when the campus communication is based on new information. In addition, a student's contact with the local financial aid office is usually face-to-face, with an individual counselor, whereas communication with CSAC is through a web application, mail, e-mail, or call center. From the campuses' perspective, the Cal Grant award process is duplicative and labor-intensive, and often creates additional work for financial aid counselors to resolve conflicting information.

Decentralization Would Improve Service Delivery to Students. Decentralization would improve delivery of Cal Grant awards to students by giving them a single point of contact—the campus financial aid office—for most financial aid matters. It would also streamline activities for campus financial aid offices.

Decentralization Could Increase Some Costs for Segments... Campus financial aid offices are already performing most of the tasks required to identify eligible students and make grant awards. They have systems in place to estimate Cal Grant eligibility as part of their financial aid packaging. They are also responsible for verifying student eligibility before disbursing grants. In some areas, decentralization will reduce the workload of financial aid offices and reduce administration costs.

There are some tasks, however, that could create new costs for the campuses. Currently, CSAC collects verification of GPA and high

school graduation centrally. Many high schools transmit the required data electronically for all students. Some, however, do not have the capacity to transmit the data, and must provide it manually or leave it up to students to submit. Students are ultimately responsible for ensuring that their information is submitted. The CSAC keeps track of submissions, and notifies students of missing or incomplete information. Most campus financial aid offices (and segment offices) do not have systems in place to assume tracking of these data, and developing the systems could be costly.

...But Options to Avoid the Higher Costs.

Part of the reason it may be costly to develop these systems is that the Cal Grant requirements do not match those for other financial aid or academic programs. For example, the methodology used for calculating the high school GPA for Cal Grant eligibility differs from that used for nearly any other purpose, such as college admissions.

There are several options for reducing compliance costs for the campuses for these requirements. These include:

- Aligning the statutory requirements with similar requirements for federal financial aid programs.
- Eliminating some of the requirements. For example, there is no added value in GPA verification for students attending UC, where the minimum GPA for admission (3.0) matches or exceeds the minimum GPA for Cal Grant eligibility (2.0 to 3.0, depending on the program). Likewise, Cal Grant eligibility criteria include income and asset ceilings, while most programs rely instead on the more comprehensive federal need analysis.

- Leaving some centralized functions with CSAC (whether or not the Legislature restructures the organization).

Some Functions Should Remain at CSAC.

The Governor's proposal recognizes that some financial aid functions, such as administering specialized programs and conducting compliance audits, should remain centralized. Another important function is tracking remaining eligibility for students. Because Cal Grants are portable, and can be moved from one institution to another, students may use a portion of their eligibility at several different institutions. Currently, CSAC tracks utilization, and campus financial aid offices—as well as grant recipients—can access this information on a web-based system. To maintain portability of Cal Grants and ensure that students do not exceed their maximum utilization periods, it would be important to maintain centralized tracking of utilization and remaining eligibility.

Funding Distribution Can Be Improved.

Under the administration's proposal, Cal Grant funds would be appropriated to the public higher education segments—and to the CCC Chancellor's Office for private institutions and competitive awards—based on current utilization patterns. (The Director of Finance could transfer unexpended funds among institutions.) The system offices would have to establish methods to distribute the grants to their campuses. While this model could accomplish some of the goals of decentralization, we believe there are important advantages to the federal aid distribution model. In that model, campuses make awards to students, and the federal government promptly transfers funds to the campuses based on invoices for approved awards. This process bypasses the system offices, and avoids extensive payment and reconciliation cycles required under the

current Cal Grant model. It would keep General Fund cash in the State Treasury until it is needed, and minimize overpayments and underpayments to the campuses. Another benefit of this model is that it would maintain a clearer distinction between state Cal Grant funds and institutional aid funds. It would also facilitate tracking of individual student utilization and remaining eligibility across institutions. Implementation of such a system, however, could take a year or more.

Competitive and Private Grants Should Be Centralized. Finally, the administration did not provide a rationale for its proposal to administer competitive and private college grants through the CCC Chancellor's Office. This proposal appears to acknowledge that these functions should be performed centrally (and there are good reasons for this), but fails to explain why these duties should not remain with CSAC or its successor organization. Administration of financial aid programs for non-CCC students is not within the CCC mission. The administration's proposal already leaves the smaller, specialized grant and loan programs within the purview of CSAC's successor organization, ensuring that it will still be involved in administering financial aid.

Recommend Legislature Decentralize Cal Grant Award Process. Our recommendations mirror several of the recommendations from a 2002 task force report on decentralization (see box on next page). We recommend that the Legislature approve the Governor's proposal to decentralize Cal Grant administration, with some modifications.

- Permit campus financial aid offices to approve Cal Grant entitlement awards for eligible students.
- Establish a just-in-time funding model for Cal Grants parallel to the federal grant distribution model.

- Maintain several functions in CSAC or its successor organization, including tracking of utilization and remaining eligibility, administration of competitive and private college grants, and administration of specialized aid programs. Do not transfer statewide functions unrelated to community college students to the CCC Chancellor's office.
- Consider statutory changes in requirements for Cal Grants to streamline administration of awards while preserving the intent of the financial aid programs. These could include changes to the GPA verification requirement and income and asset ceilings.

Restructuring CSAC

Although we have some specific concerns about the Governor's reorganization proposal for CSAC, we think it makes sense to move the commission's duties into an executive branch department. Most of CSAC's functions are ministerial and could appropriately be performed in an executive branch department. In addition, eliminating the independent governing board that oversees financial aid administration could resolve longstanding conflicts between it and the board of CSAC's auxiliary organization.

Program Implementation Is Executive Responsibility. The CSAC's primary responsibility is to administer programs governed by statute. While it also recommends changes to financial

2002 TASK FORCE RECOMMENDED DECENTRALIZATION

The Legislature adopted supplemental report language in 2002 directing the California Post-secondary Education Commission (CPEC) to convene a task force to examine alternative delivery systems for the state's Cal Grant programs. The CPEC submitted a report on the task force's recommendations in 2003. The main recommendations from the task force were:

- The state should undertake a transition toward a decentralized, campus-based model for the delivery of both Cal Grant entitlement and competitive awards, one that is more consistent with the federal student aid delivery system.
- The California Student Aid Commission should convene a task force to develop a new definition of and methodology for calculating the Cal Grant high school grade point average that is more commonly available from high schools and more readily used by colleges.
- The state needs to obtain complete and accurate information concerning the true costs of both the current Cal Grant delivery system as well as implementing the alternative decentralized model recommended.

Following submission of the report in 2003, Assembly Bill 1323 (Jackson), was introduced to implement the recommendations. The Assembly Higher Education Committee passed the bill unanimously, but the bill did not make it out of the Assembly Appropriations Committee.

aid programs, most of its attention has been focused on program implementation and organizational issues, rather than policy matters. Such implementation of laws is fundamentally a responsibility of the executive branch.

Independent governing boards are useful when there is a need to protect an agency's work from undue political influence, or when the primary audience for an agency's work products includes both the legislative and executive branches, as well as the public. For CSAC, the risk of undue political influence is minimal because it administers programs that are governed by eligibility standards established in statute and detailed in regulations. Moreover, the agency's main customers are students and higher education institutions, not the Governor or Legislature. For these reasons, it is not necessary for CSAC to have an independent governing board, and it could appropriately be constituted as an executive branch department. The placement of the department under the Secretary of Education, however, is problematic. The secretary's office does not exist in state law and has not managed programs or regulatory activities.

In addition, the name and structure proposed by the administration are confusing, at best. Proposed trailer bill language would give the same name—The Higher Education Accountability and Financial Aid Advisory Committee—to both the advisory board and the executive branch department that administers programs. It would be more accurate—and less confusing—to give the administering department a more descriptive title, such as *Department of Financial Aid Administration*, that is different from that of the advisory board.

The advisory board itself would have no formal powers. It would be up to the director, who is answerable to the Governor and not bound by

the recommendations of the advisory board, to carry out the department's functions. This brings into question why a strictly advisory body with no actual authority should be statutorily created. Instead, it would be a better management practice for the director to regularly convene one or more advisory panels representing the higher education segments and other stakeholders for regular consultation about entity activities. If it wishes to ensure that this takes place, the Legislature could require the director to convene and consult with such panels. This could be done without creating a formal advisory board in statute.

Restructuring Could Eliminate Conflict With EdFund. As noted earlier, EdFund is an auxiliary organization through which CSAC administers federal guaranteed loan programs in partnership with the US Department of Education. EdFund is a nonprofit, public benefit corporation, and is exempt from state hiring and procurement rules so it can compete in the financial services industry. It remains, however, under the ultimate control of CSAC, which appoints the members of its board of directors.

EdFund's twelve-year history has been marked by repeated conflicts between its board of directors and the Student Aid Commission. Underlying conflict may be inherent in a structure that includes two governing bodies with overlapping responsibilities working in two very different operating environments. Tensions may also result from differences in resources between the two organizations. EdFund generates considerable revenues from its loan activities and is able to provide executive compensation and employee rewards that are competitive in the private-sector financial services industry, while CSAC operates under the constraints of state budgets and stricter rules governing use of public funds.

On three occasions, CSAC has voted to remove the EdFund Board of Directors. In March 1999, the commission replaced all but one board member. In April 2005, CSAC removed the non-commission members from the board. In fall 2008, CSAC voted to remove the entire board and assume direct oversight of EdFund activities.

These conflicts have created tensions between the Governor's staff and CSAC. The DOF has been called upon to mediate numerous disputes between CSAC and EdFund. The Director of Finance, who has approval authority for decisions that may affect the value of EdFund (see nearby box), refused to approve CSAC's 2008 decision to dismiss the EdFund Board. Following the commission's fall 2008 action, the Governor removed the Chair of CSAC, who had not yet been confirmed by the Senate.

Tensions between CSAC and EdFund may be a short-term problem. As described in the nearby box, the state is attempting to sell or otherwise dispose of EdFund. The success of these efforts, however, is highly uncertain in the current credit market. In addition, changes to loan programs under the new federal administration are likely to further depress EdFund's value. It is possible, therefore, that the state will remain responsible for EdFund for the foreseeable future.

The proposed restructuring of CSAC could put an end to the ongoing conflict between the two organizations. It would eliminate one of the governing boards (CSAC), and replace it with an agency under executive branch control. The appointed advisory board, because it is only advisory, would not have authority over EdFund.

Accept Most Elements of Proposal to Restructure Student Aid Commission. The CSAC restructuring would appropriately place financial

aid oversight in the executive branch, and would solve longstanding problems in CSAC's relationship with EdFund. Some elements, however, are unnecessarily confusing and potentially misleading. For these reasons, we recommend the following:

- Approve the transfer of CSAC's responsibilities to a new department in the executive branch.
- Reject Governor's proposal to create a statutory advisory body. Instead, require the director of the new department to convene one or more advisory panels representing the higher education segments and other stakeholders for regular consultation about agency activities.

Restructuring CPEC

Growing Problems With CPEC. In recent years, there have been increasing concerns about CPEC's ability to effectively perform its responsibilities. In a 2003 white paper on this topic commissioned by the Legislature, a working group (convened by our office) identified three reasons for this.

- The scope of CPEC's statutory responsibilities is varied and broad.
- The CPEC's responsibilities are not matched to its resources.
- A tension exists between CPEC's coordination/advocacy responsibilities and its role as an independent fiscal and policy watchdog.

Other factors, such as the composition of the commission, may also contribute to its underperformance.

SALE OF EdFUND AUTHORIZED

Sale Authorized in 2007. The *2007-08 Budget Act* and Chapter 182, Statutes of 2007 (SB 89, Senate Budget Committee), authorizes the Department of Finance (DOF) to arrange a sale (or an alternative financial arrangement to a sale) of the state student loan guarantee program. (This is commonly referred to as the “sale of EdFund.”) No sale has yet been completed, and subsequent legislation extended DOF’s authority to January 2011. The enacted 2007-08 budget assumed sale proceeds of \$1 billion in 2007-08. The enacted 2008-09 budget package reduced the estimate to \$500 million and did not expect the sale until 2009-10.

Director of Finance Has Broad Authority. Chapter 182 authorizes the Director of Finance (Director) to act in consultation with the State Treasurer as the agent for the sale. The statute provides the Director broad authority to oversee loan program activities prior to the sale. For example, it:

- Authorizes the Director to take any actions deemed necessary to preserve the student loan guarantee program assets until a sale occurs.
- Declares that all of the actions, approvals, and directions of CSAC affecting the loan program shall be effective only upon the approval of the Director.
- Specifically prohibits CSAC from authorizing any new or expanded services at EdFund unless the Director deems them necessary for the operation of the loan program or to maximize the value of the loan program.
- Requires prior approval by the Director for any EdFund expenditures that are not directly related to (1) providing student loan guarantees, (2) providing support services for CSAC, or (3) accomplishing the sale of EdFund. The statute specifically prohibits several types of expenditures without prior approval, including increases in compensation or benefits for EdFund officers, and outreach and public awareness activities.
- Requires the Commission to cooperate fully with the Director and take all steps necessary to preserve student loan program assets.

Sale Is Uncertain. Since the Legislature authorized the sale in 2007, changes in the student loan guarantee business have weakened the estimated market value of the loan program. These changes include volatility in the credit markets and changes in the federal student loan programs that affect the revenue streams to guaranty agencies. Additional changes expected under the new federal administration—including increased direct lending from the government and reduced reliance on guaranteed private loans—are likely to further depress the market value of the loan program. These developments have raised doubt about whether a sale or alternative transaction will take place in the near term. Because of this high degree of uncertainty, the administration did not include any revenue gain from the sale of the loan program in its 2009-10 budget or multiyear forecast.

Recent Attempts to Change CPEC. Reflecting these concerns, support for CPEC has been declining among policymakers. In 2002-03, Governor Gray Davis' May Revision budget proposal sought to eliminate nearly all funding for CPEC. The Legislature rejected the proposal, but reduced CPEC's funding by one-third. In 2005, the Governor supported the California Performance Review proposal to eliminate CPEC and merge its functions into an executive office. In 2008, Senate amendments to the proposed budget would have begun a phase-out of the organization over three years.

Consolidation Could Create Conflict of Interest. The Student Aid Commission and Post-secondary Education Commission perform different types of functions. The CSAC is primarily an administrative body that implements policies and programs established in statute. The CPEC, in contrast, is a policy board. The majority of its attention is focused on collecting and reporting data and preparing policy reports and briefs. It also has programmatic duties, including (1) administering a federal grant program and (2) reviewing and making recommendations on new higher education programs, campuses, and sites. It is expected to base its recommendations on an analysis of how best to achieve the state's policy objectives for higher education, underscoring the importance of the policy analysis role.

If the functions of CSAC and CPEC were consolidated into a single organization, there could be a perceived conflict of interest in at least some of CPEC's analytical work. For example, readers might wonder whether a recommendation to expand a financial aid program is motivated by the results of objective analysis or by an interest in expanding the scope of the organiza-

tion. This could further diminish the credibility of CPEC's policy analysis.

Policy Analysis Role Requires Independence. As noted earlier, an independent governing board is useful when there is a need to protect an agency's work from undue political influence, or when the primary audience for an agency's work products includes both the legislative and executive branches. The CPEC meets both of these conditions. In our view, the interests of the state are best served when the Governor and Legislature can base their policy decisions on rigorous, unbiased analysis supported by thorough research and accurate data. If higher education policy analysis were conducted in an agency under executive control, the Legislature could reasonably be concerned about partisan or ideological bias. This could intensify existing concerns about the quality of CPEC's work products. Furthermore, a policy body in the executive hierarchy would not be free to critically appraise the administration's budget and policy proposals, further diminishing its usefulness to the Legislature.

Different Changes Could Improve Effectiveness. *In order to maintain policy independence, we recommend the Legislature reject the Governor's CPEC consolidation proposal.* In contrast to the Governor's proposal, other changes could preserve CPEC's independence and address specific problems and concerns about the agency's performance. Changes in structure and duties, for example, could address deficiencies identified in the 2003 white paper cited earlier.

- **Setting Priorities.** Recent legislation addresses some of these concerns. Chapter 514, Statutes of 2008 (SB 361, Scott), directs CPEC to give priority to campus and program reviews and recommenda-

tions, implementation of federal programs, and data management responsibilities when all functions and tasks cannot be performed within budgeted resources. The Governor's consolidation proposal also somewhat addresses these concerns, by instructing the director to prioritize functions to the most essential activities. In our opinion, the most important role for the organization is to protect the public's interests through oversight—including critical analysis of proposals from the segments, the administration, and the Legislature.

- **Changing Member Composition.** Changes in the composition of CPEC could also improve its effectiveness. As our 2003 white paper observed, the current composition of the commission is designed to facilitate planning and coordination by including segmental representatives. It is also designed to promote independence by including a majority of public representatives. These two factors can be at odds with each other, making it difficult for the commission to arrive at independent analysis and recommendations. Emphasizing the commission's watchdog role would require emphasizing public and independent members.
- **Changing Leadership.** Finally, an upcoming leadership change at CPEC (the current director is retiring) could provide an opportunity for the Governor and Legislature to focus the Commission on those functions most useful in advancing the state's higher education priorities.

Bureau for Private Postsecondary And Vocational Education (BPPVE)

The administration's proposal for restructuring higher education support functions does not encompass regulation of private postsecondary and vocational schools. The Governor's proposal, however, provides an opportunity for the Legislature to consider a broader reform that could include this function.

Institutions Not Currently Regulated. Historically, BPPVE has had regulatory oversight of private postsecondary institutions operating in California. (These are for-profit entities providing postsecondary educational services that, in most cases, are not accredited by the Western Association of Schools and Colleges.) The legal authority for BPPVE's regulatory activities expired in mid-2007, and a subsequent voluntary agreement expired in mid-2008. As a result, private postsecondary institutions are currently operating in an unregulated environment.

Regulation Remains Important. Private postsecondary institutions are an important part of California's broader system of higher education, especially in the area of career technical education and training. Most private institutions are legitimate and reputable, but a few make misleading or fraudulent claims and take advantage of students who may not know how to evaluate their quality. The Legislature created the BPPVE 20 years ago in response to concerns that the state was rapidly developing a reputation as the home of many of these "diploma mills."

Options for a New Framework. Should the Legislature approve a new regulatory framework for these institutions, it may wish to reconsider where best to place the regulatory functions. Currently, the bureau is in the Department of Consumer Affairs, emphasizing the consumer

protection aspect of private postsecondary school regulation. Placing it in a higher education agency could instead highlight the role of private postsecondary institutions in the state's system of higher education. In addition, there may be some overlap between the audit and data management activities required to regulate private postsecondary schools and similar activities required to monitor implementation of financial aid programs at public and private institutions (including many private postsecondary schools). For these reasons, the Legislature may wish to consider consolidating the functions of BPPVE with those of CSAC.

Summary of Approach to Reorganization

As summarized in Figure 21, we recommend that the Legislature accept with modifications some elements of the Governor's higher education restructuring proposal, and reject others. Specifically, we recommend decentralizing Cal Grants, while maintaining some centralized roles, and moving the functions of CSAC into an executive branch agency without creating a statutory advisory committee. In addition, we recommend that the Legislature reject the Governor's proposed consolidation of CPEC, and instead consider other reforms to the state's higher education planning and coordination board. Finally, we encourage the Legislature to consider consolidating regulation

Figure 21

LAO Recommendations on Consolidation of Higher Education Commissions and Decentralization of Financial Aid

- ✓ **Approve With Modifications Proposal to Decentralize Financial Aid Administration.**
 - Permit campus financial aid offices to approve Cal Grant entitlement awards for eligible students.
 - Establish a just-in-time funding model for Cal Grants parallel to the federal grant distribution model.
 - Maintain several functions in California Student Aid Commission (CSAC) or its successor organization, including tracking of utilization and remaining eligibility, administration of competitive and private college grants, and administration of specialized aid programs.
 - Consider statutory changes in requirements for Cal Grants to streamline administration of awards while preserving the intent of the financial aid programs.
- ✓ **Accept Most Elements of Proposal to Restructure Student Aid Commission.**
 - Approve the transfer of CSAC's financial aid administration responsibilities to a new department in the executive branch.
 - Reject Governor's proposal to create a statutory advisory body. Instead, require the director of the new department to convene one or more advisory panels for regular consultation about agency activities.
- ✓ **Reject Proposal to Restructure Postsecondary Education Commission, and Instead Consider Other Reforms.**
 - Reject the Governor's proposed transfer of California Postsecondary Education Commission's responsibilities to the executive branch.
 - Consider other reforms designed to address persistent concerns and improve the effectiveness of the organization. These could include setting priorities and changing the governing board composition.
 - Consider consolidating the functions of the Bureau of Private Postsecondary and Vocational Education with those of CSAC within the executive branch.

of private postsecondary institutions with other higher education oversight functions.

CAPITAL OUTLAY OVERVIEW

As shown in Figure 22, the Governor’s budget proposal includes about \$1 billion in new capital outlay funding for 2009-10. Most of the proposed funding for UC and CSU would come from lease-revenue bonds. The remaining capital outlay funding would come from the balances of general obligation bonds authorized by voters in previous years.

Most Capital Outlay Projects Suspended in December

Although the Governor’s proposal includes funding for continuing and new projects, the Pooled Money Investment Board (PMIB) in December 2008 suspended bond funding for most state-funded projects at the three higher education segments. (See the box on the next page for background information about PMIB and the suspension of bond funding.) The suspension affects approximately 400 projects in higher education. These projects range from \$30,000 capital renewal projects to \$50 million academic facilities.

Many of the projects were at convenient stopping points—such as the end of preliminary plans or preparing to go to bid. Others, however, were in the middle of construction, and thus incurred extra costs to close down and secure the construction sites. Additionally, projects under construction could incur extra costs through penalties paid to contractors if the suspension of work exceeds the terms allowed in the contract, usually 30 to 45 days.

These cost factors could cause numerous projects to exceed their budgets and require augmentations for completion. The segments, however, could cover the cost increases resulting from the suspension of projects without a new funding source in a number of ways. These include:

- **Contingency Funds.** A 5 percent to 8 percent contingency fund is allocated with each appropriation for state-funded capital outlay projects. The contingency funds are meant to cover unforeseen costs or necessary design changes. The contingency funds could offset cost increases resulting from the funding delay if these funds were not expended for other project costs.

- **Bid Savings.** State-funded projects are budgeted to allow for an annual 5-percent escalation of construction costs. Due to the economic downturn, costs have not escalated at this rate, and many projects could bid for less than budgeted. These bid

Figure 22
Governor's Proposed Higher Education Capital Outlay Appropriations

2009-10
(In Millions)

	Lease-Revenue Bonds	General Obligation Bonds	Total
University of California	\$449	\$31	\$479
California State University	325	16	341
California Community Colleges	—	194	194
Totals	\$774	\$241	\$1,014

savings would be available to cover cost increases related to delays from the suspension.

- ***Cancellation of Lower-Priority Projects and Reversion of Funds.*** The segments could also cancel lower-priority projects so that the projects' unspent funds revert to replenish the segments' bond fund balances. The balances could then be appropriated by the Legislature to cover the delay costs of other projects. The cancelled projects could be started again when additional general obligation bonds or other funding sources are available.
- ***Campus or Gift Funds.*** Campuses could raise funds to cover cost increases or to continue state-funded projects despite PMIB's suspension of state funding. Also, community colleges potentially could access local funds.

These options are not ideal. Projects would still be delayed and savings that would normally go toward funding additional projects would be spent on the rising costs of current projects. However, these options provide ways for the segments to cope with potential delays without further state funding.

Limitations of Lease-Revenue Bonds

The Governor's proposal relies heavily on lease-revenue bonds for funding projects at UC and CSU because their general obligation bonds are essentially exhausted. The *2008-09 Budget Act* also used lease-revenue bonds for many UC and CSU projects in lieu of the Governor's original proposal to fund education projects with a new general obligation bond. Financing with lease-revenue bonds costs slightly more than general obligation bonds, but in the current economic climate moving projects forward with lease-revenue bonds allows the state to take

THE STATE'S POOLED MONEY INVESTMENT ACCOUNT (PMIA)

What Is PMIA? The PMIA is the state's short-term savings account. Moneys in the General Fund and state special funds are held in PMIA and invested according to conservative guidelines. The PMIA is governed by the Pooled Money Investment Board (PMIB), which is chaired by the Treasurer and also includes the Controller and the Director of Finance.

How Does PMIA Fund Infrastructure Projects? The PMIA typically has a significant balance which allows it to provide short-term loans (known as "AB 55 loans") to jump start projects funded by the future sale of state general obligation and lease-revenue bonds. When the bonds are sold, the proceeds are used to repay the AB 55 loans and replenish PMIA.

Why Did PMIB Suspend Funding for Infrastructure Projects? On December 17, 2008, PMIB voted to begin the process of shutting down the AB 55 loan program, effectively halting most bond-funded projects. The deterioration of the state's cash cushion in PMIA and the state's inability to access the bond markets—due in part to its budget and cash crises—were the reasons cited for the action. Continuing to provide AB 55 loans would have drained cash from PMIA that would be needed to pay the state's other bills. The PMIB will be able to restart the AB 55 loan program once the state's budget and cash crises are addressed.

advantage of low construction costs. The exclusive reliance on lease-revenue bonds, however, creates capital-planning problems because the bonds are not appropriate for some types of projects.

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 has 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. In our view, the state should not invest in projects that lack sufficient funding for their completion. We therefore recommend that the Legislature require UC and CSU to commit to using nonstate funds for the equipment phases prior to appropriating lease-revenue funding to 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, it would promote costlier growth and replacement projects as opposed to renovations. It would also limit the ability of the state to support essential projects including seismic upgrades, campus infrastructure projects, and capital renewal. The segments hope that a federal stimulus package (see next section) would provide funds for these projects in the short term. However, over the long term, the state would need the flexibility of general obligation bonds

to continue meeting higher education's capital outlay demands. In the event additional general obligation bonds become available, the Legislature should consider reserving a large portion for renovations, renewals, and infrastructure as the other types of capital projects could continue to be funded with lease-revenue bonds when general obligation bonds have been spent.

Economic Stimulus

With the economic downturn, there has been added emphasis on the role of infrastructure spending in stimulating the economy based on the idea that the state or federal government's investment in capital projects would help to create jobs. For funding to provide an immediate stimulus to the economy, it would need to be directed to projects that are "shovel-ready"—meaning the projects have completed their environmental studies and design plans and are ready to start construction. Work could also begin on projects that do not typically require extensive environmental studies or design plans, such as equipment purchases, deferred maintenance, capital renewal, and energy-efficiency improvements.

State's Ability to Provide Economic Stimulus Through Higher Education Capital Outlay Spending Is Limited. The higher education segments do not have many shovel-ready projects ready for funding in the budget year. Due to many factors—most notably, planning funds from a 2008 general obligation bond did not materialize—the segments do not have many projects in advanced planning stages that could break ground soon. Additionally, many of the shovel-ready projects at UC and CSU—such as infrastructure, seismic upgrades, and capital renewal projects—are not eligible for funding

with lease-revenue bonds. As a result, less than 25 percent of the projects proposed in the Governor's budget could begin construction within the budget year.

Potential for Federal Stimulus. Given indications that the federal government is considering economic stimulus legislation that includes infrastructure funds for states, each of the higher education segments submitted a list of projects to the Governor's office to be considered for federal funds. The lists mainly include those shovel-ready projects that could not be funded with lease-revenue bonds and smaller maintenance projects. However, the size of a potential federal stimulus award, the procedures for its distribution, and any conditions attached to the funds are unclear. The availability of federal funds could provide additional options for funding higher education's capital outlay priorities. While relying on federal funds would be premature at this time, we believe the Legislature, if possible, should delay finalizing its 2009-10 capital spending plan for higher education to allow for the inclusion of any federal funds.

Evaluating the Governor's Capital Outlay Proposals

Although the Governor's proposal has limited potential for immediate economic stimulus, the construction climate makes it an appropriate time for the state to invest in capital projects. In our opinion, however, the Legislature should remain cautious in its funding decisions and only fund those projects which reflect state priorities, minimize costs, and for which funding is available. We offer recommendations in the next section on how the Legislature could apply this approach to the specific proposals in the Governor's budget. The Legislature might have addi-

tional options if federal stimulus funds become available, but at this time we confine our recommendations only to the Governor's proposals due to the uncertainty surrounding the federal stimulus plan. We summarize our recommendation in Figure 23.

CAPITAL OUTLAY— UNIVERSITY OF CALIFORNIA

The budget proposes to spend \$479 million on 12 UC capital projects by using various remaining general obligation bonds and issuing \$449 million in new lease-revenue bonds. The proposed funding would support additional phases of five projects previously funded by the

state and seven new projects. With the exception of the equipment phases of some projects (discussed above), each of the proposed projects would be fully funded in the budget year and would not require additional appropriations to complete in subsequent years.

Telemedicine Projects Need State Oversight

We withhold recommendation on the proposed telemedicine equipment purchases at the San Francisco and Davis campuses. The state's spending on telemedicine—approved by the voters in 2006 as part of Proposition 1D—is meant to improve communication between specialists

Figure 23

LAO Recommendations for Higher Education Capital Outlay Projects

University of California (UC)

- ✓ Require UC to commit nonstate funds to the equipment phases of proposed new projects funded with lease-revenue bonds.
- ✓ Withhold funding for telemedicine projects at Davis and San Francisco campuses until additional information is provided.
- ✓ Withhold funding for Telemedicine and PRIME Facilities Phase 2 at the Los Angeles campus due to potential changes in scope.
- ✓ Delete \$2.9 million from Biological and Physical Sciences Building at the San Diego campus due to unjustified cost increases.
- ✓ Delete \$10.2 million from Business Unit 2 at the Irvine campus by reducing excess meeting rooms from the proposed project.

California State University (CSU)

- ✓ Require CSU to commit nonstate funds to the equipment phases of proposed new projects funded with lease-revenue bonds.
- ✓ Withhold \$5.1 million in supplemental funding for sustainable design from five proposed projects.
- ✓ Reduce equipment funding for three replacement buildings to encourage the reuse of equipment.
- ✓ Delete \$7.3 million from Science II, Phase 2 at the Sacramento campus by removing excess capacity from the proposed project.
- ✓ Delete \$4.2 million from Taylor II Replacement Building at the Chico campus by removing excess capacity from the proposed project.

California Community Colleges

- ✓ Prioritize projects in order to provide funding to complete existing projects and key infrastructure projects.
- ✓ Reject remaining project proposals because there is insufficient funding to complete them in later years.

and general practitioners in remote locations by providing the infrastructure for UC hospitals and medical schools to support doctors and patients in underserved communities. The majority of the equipment funds requested in these two proposals would support the purchase of telemedicine equipment for the final phase of UC's efforts: the placement of telemedicine equipment in hospitals and community clinics mainly located in rural regions. At the time this analysis was prepared, however, UC was unable to provide sufficient detail on how these equipment funds would be utilized. The UC could not provide a list of the specific equipment that would be purchased, nor the locations where the equipment would be placed. The UC reports that the partnerships with local hospitals and clinics are still being developed. Until such time as these partnerships are solidified and the Legislature receives information on the type of equipment, its cost, and its ultimate location, we withhold recommendation on these two proposals.

**More Information Needed on
Telemedicine and PRIME Facilities Phase 2
Project at the Los Angeles Campus**

The Governor proposes \$23.5 million for the renovation of facilities to support PRIME and telemedicine. Although the project's title suggests it would fund improvements at UC Los Angeles (UCLA), it would actually support renovations at the Riverside campuses and provide equipment to facilities at Charles Drew University, as well as for UCLA renovations. The UCLA school of medicine operates collaborative programs with each of these schools. We withhold recommendation on this proposal until UC provides the Legislature with additional information regarding the following two concerns:

Renovation at UCLA Relies on Completion of Unfunded Project. The project would renovate 12,080 assigned square feet (asf) to provide additional medical education space in UCLA's Center for Health Sciences (CHS) South Tower. The project proposal indicates that these renovations would occur after seismic renovations of the CHS South Tower were completed. However, in the current year and the budget year, UC has requested \$123 million in state funding to seismically retrofit the CHS South Tower, but the project has not been funded due to its cost and the lack of general obligation bonds. According to UC, the 12,080-asf project would proceed in alternative space within CHS if the seismic upgrade of the South Tower was not complete. However, the project's costs and programmatic changes are based upon using specific space within the CHS South Tower. Until UC provides additional information about the potential changes to the scope of this project, we recommend that funding be withheld.

Legislature's Intentions for UC Riverside Space Should Be Made Clear. The project also proposes to renovate approximately 4,900 asf at UC Riverside to enhance and reconfigure space for the Thomas Haider Program in Biomedical Sciences. The Haider program is a partnership with UCLA's school of medicine in which students complete their first two years of medical training at UC Riverside, and then complete their final two years of medical school at UCLA. In July 2008, however, the UC Regents approved a new medical school at the Riverside campus with a tentative opening date of fall 2012. The Haider program's partnership with UCLA would be phased out at that time, as its operations would be absorbed into the new medical school. Consequently, the renovated space in this project

would ultimately support the capital plans of the new medical school, a proposal the Legislature has not formally endorsed. While the renovated space is justified for continuing the Haider program, we believe the Legislature should not approve any expenditures on a new medical school without formal hearings. Therefore, we recommend the Legislature specify that funding for this portion of the project provides support for continuing the Haider Program, but should not be viewed as an initial investment or implicit approval of the proposed UC Riverside medical school.

Cost Increases Not Justified for Biological and Physical Sciences Building at UC San Diego

The Governor proposes \$81.2 million in lease-revenue bonds to fund a new instruction and research building to support the biological and physical science departments at UC San Diego. The same project was proposed in 2008-09, but was not included in the enacted budget due to the lack of general obligation bond funding. Since submittal for consideration in 2008-09, the project's proposed costs have increased by 6.5 percent without justification—the rate of construction cost inflation during this time period was only 2.7 percent. We recommend, therefore, that the Legislature delete \$2.9 million from the proposed project so the cost increase accurately reflects inflationary increases over the previous year's proposal.

Scope and Cost Should Be Reduced For Business Unit 2 at UC Irvine

The Governor proposes to use \$39.4 million in lease-revenue bonds to fund a new building for UC Irvine's business school. The campus

would also contribute \$20 million in non-state funds to support the project—a departure from the business school's previous two buildings, which were entirely supported with non-state funds. The justification for providing the business school with expanded space is that UC Irvine decided to offer two new undergraduate majors in business that are expected to increase the business school's undergraduate population. However, the project—with the exception of an open-access computer laboratory and additional offices for new faculty needed to teach the undergraduate students—would not provide any additional instructional space, such as classrooms and instructional labs, to support the undergraduate students. Instead, the project provides numerous meeting and conference rooms for Masters of Business Administration (MBA) students, executive MBA students, doctoral students, faculty, and administration. Such space is either provided in the proposed new building or freed up in existing buildings by moving administrative functions into the new building. The new building would also include an auditorium to support speakers, research symposia, and business conferences.

Of particular concern in this proposal is that the amount of meeting room space provided for faculty and student meetings is far in excess of what the business school requires. We recommend, therefore, that the Legislature reduce the scope of this project by 11,000 asf (a 23 percent reduction) which would allow UC Irvine to maintain the core instructional functions of the building, but remove excess meeting space. We estimate that the reduction in scope would reduce the cost of the project by \$10.2 million for a total state appropriation of \$29.2 million.

**CAPITAL OUTLAY—
CALIFORNIA STATE UNIVERSITY**

The budget proposes to spend \$341 million on 12 CSU capital projects by using various existing general obligation bonds and issuing \$325 million in new lease-revenue bonds. The proposed funding would support additional phases of seven projects previously funded by the state and five new projects. With the exception of the equipment phases of the projects funded with lease-revenue bonds, each of the proposed projects would be fully funded in the budget year and would not require additional appropriations to complete in subsequent years.

Costs for New Projects Inflated to Support Sustainable Design

The five new projects proposed in the Governor’s budget include supplemental funding to support sustainable design. As shown in Figure 24, this supplemental funding represents approximately 3 percent of each project’s total cost. Sustainable building practices are meant to reduce the negative environmental effects associated with the construction and operation of buildings. Designing new buildings and renovating existing buildings to be more sustainable is one part of the state’s efforts to improve energy efficiency and meet the goals of AB 32. (See the nearby box for more background on the state’s actions concerning sustainable building practices.) Sustainable buildings typically have

higher upfront costs to accommodate alternative materials, new technologies and energy-efficiency upgrades. These costs are usually recovered over the life of the building through lower utility and operating costs.

In 2006, the CSU Board of Trustees adopted specific guidelines for sustainable building within the CSU system. Under these guidelines, CSU has constructed state-funded and nonstate-funded facilities to meet an internally developed standard for sustainability. The standards are similar to other certification standards for sustainable buildings, such as the Leadership in Energy and Environmental Design (LEED) certification administered by the United States Green Building Council. The CSU developed their own standards to better reflect the needs of California’s climate and individual campuses. However, a number of these buildings have qualified for LEED certification at its silver and gold standards.

Although CSU’s sustainable building policy appears consistent with state policy for decreasing energy usage and greenhouse gas emissions, it is not clear that additional funding is needed to meet those policies. Given that CSU has already completed sustainable buildings with state

Figure 24
Sustainable Building Measures at California State University

(Dollars in Millions)

Campus	Project	Total Cost	Sustainable Building Measures	Percent of Total Cost
Channel Islands	West Hall	\$37.1	\$1.1	3.0%
Chico	Taylor II Replacement Building	57.2	1.4	2.4
Fullerton	Physical Services Complex Replacement	23.8	0.7	2.9
Sacramento	Science II, Phase 2	97.9	3.4	3.5
San Bernardino	Theatre Arts Addition	60.5	1.9	3.1
Totals		\$276.5	\$8.5	3.1%

funds and has additional state-funded sustainable buildings under construction, we question whether additional augmentations are necessary for the proposed projects to meet sustainable standards. In fact, CSU proposed these same projects last year without supplemental funding for sustainable measures. Since that time, CSU has not changed its sustainable building policy—for example, it has not set higher certification standards—and UC, which has a similar sustainable building policy, has not requested augmentations for sustainability in its projects. Therefore, we recommend the Legislature withhold the supplemental funding for sustainable building in the Governor’s proposal unless CSU provides additional information that justifies the increases in cost.

Reduce Equipment Funding for Three Replacement Buildings to Encourage The Reuse of Current Equipment

The Governor proposes equipment purchases to fully furnish three replacement buildings. In each case, the existing departments or programs moving into the replacement buildings already have useable equipment in their current locations. Not all of the existing equipment will be transferable. Some of their current furniture could be worn and need replacement, and certain instructional or lab equipment could need replacement or be obsolete due to changing technology. The layout of the new facilities could also warrant new equipment—for example, new cubicle workstations or specialized lab equipment. However, we believe it would be

SUSTAINABILITY AND STATE BUILDINGS

A number of rating systems exist for certifying the “sustainability” (or environmental friendliness) of buildings. The nation’s leading green building rating system is the United States Green Building Council’s Leadership in Energy and Environmental Design (LEED) rating system. Like the other rating systems, LEED certifies the sustainability of a building based on a number of criteria including the use of environmentally friendly materials, energy conservation, and water usage. Buildings certified with LEED are ranked by their level of sustainability from lowest to highest: certified, silver, gold, and platinum.

The Governor, citing the environmental effects and energy costs of the state’s buildings, issued an executive order in December 2004 stating that all new and renovated state-owned facilities meet LEED silver standards. The order encouraged other state agencies not under executive authority, such as UC and CSU, to voluntarily participate. Although UC and CSU do not typically register their buildings with LEED and CSU developed its own rating system, both segments adopted policies that all new buildings and major renovations would be equivalent to a LEED certified building. The segments also adopted policies that each campus should strive to attain buildings equal to LEED silver if possible within budget constraints. The Legislature passed AB 35 (Ruskin) in 2007 which would have mandated that any state building constructed after 2010 meet LEED gold standards. The Governor vetoed the bill.

realistic to expect that some furniture and equipment could be reused in the new facilities. This would be similar to a CCC policy which does not provide state funding for equipment in renovation or replacement projects that support existing programs. Therefore, we recommend the Legislature reduce equipment funding for the following three replacement projects by 50 percent in recognition that a portion of existing equipment can be reused:

- ***Peterson Hall 3 Replacement Building, Long Beach.*** We recommend reducing the equipment costs by \$2.4 million.
- ***Science Replacement Building, Los Angeles.*** We recommend reducing the equipment costs by \$2.1 million.
- ***Corporation Yard and Public Safety, Los Angeles.*** We recommend reducing the equipment costs by \$383,000.

Reduce Scope and Cost for Science II, Phase 2 at CSU Sacramento

The Governor's budget proposes \$98 million for the planning and construction of a new science complex at the Sacramento campus. The facility would replace two existing buildings which would be demolished as part of this project and allow the biological sciences and chemistry departments to relocate into more modern laboratory space. While we agree that the existing buildings are in need of replacement or renovation, we have concerns that this project would add unneeded capacity to Sacramento's campus. Specifically, we take issue with the following space elements in the project:

Inclusion of Planetarium Results in Excess Lecture Space. The proposed project would

include a 100-seat lecture hall equipped with federally funded planetarium equipment. The hall would mostly be used as a lecture facility for the general campus since the astronomy department only offers three to four courses per semester. Due to its use as a planetarium, however, CSU classified the space as "other instructional space" rather than lecture space. This means that the proposed building includes excess lecture space—the lecture space CSU Sacramento normally would be allocated based on its forecasted enrollment *plus* the planetarium space. As a result, we recommend that the Legislature remove space for 100 lecture seats from the science complex to recognize that the planetarium would mostly serve as lecture space.

Increase in Laboratory Space Unjustified.

Replacing the existing buildings with the proposed science complex would create additional laboratory capacity for the campus. Additional capacity at the campus is not justified since facilities are currently underutilized in the summer. The campus reports it only enrolls about 1,200 FTE students in the summer compared with over 23,000 FTE students in the fall term. If campus instructional facilities were utilized year round, several thousand more students could be accommodated without the need to expand physical capacity.

Gallery Space Is Not a Programmatic Priority. In view of other statewide needs in higher education, we question the expenditure of limited funds on a science gallery and atrium for the entrance to the science complex. The proposed science gallery would provide space for students and visitors to view biological specimens. Although there is a programmatic need for storing and displaying specimens in the biological sciences department, the proposal already includes

1,500 asf of museum space in other sections of the building. The science gallery and atrium, on the other hand, appear more focused on providing public spaces for visitors to the planetarium, which is not consistent with the university's core mission nor the university's stated intention to use the planetarium space mainly for instruction as opposed to public performances. Rather than a building entrance consisting of an atrium and science gallery that is not suited to the needs of the university, we believe the students and the state budget's interests would be better served with traditional museum space—shelves and cabinets for storing specimens combined with a classroom for viewing. We recommend, therefore, removing the 2,400-asf science gallery from the scope of the project. Instead, we would recommend adding 1,000 asf to the already programmed museum space to offset the loss of the gallery space, resulting in an overall decrease of 1,400 asf.

These changes—reducing lecture space to account for the usage of the planetarium as lecture space, maintaining laboratory capacity at its current level, and eliminating the science gallery and atrium at the entrance—would reduce state spending on the project by an estimated \$7.3 million.

Reduce Scope and Cost for Taylor II Replacement Building at CSU Chico

The Governor's budget proposes \$57.2 million in lease-revenue bonds to construct a replacement building for the 42-year-old Taylor Hall on the Chico campus. Taylor Hall's mechanical systems are obsolete and the building requires renovations to meet current instructional requirements. While we agree with the need to replace Taylor Hall due to its physical condition,

we have concerns about the size of the replacement building.

Currently Taylor Hall and Yuba Hall (the two buildings being demolished) total approximately 26,000 asf, while the replacement building will be 67,000 asf and add instructional capacity for 751 FTE students. Some of this additional space may be necessary to move certain programs from off-campus leased space and to support programmatic changes—such as the recital hall and dance studios. However, even accounting for these necessary increases, the replacement building adds significant capacity above what is being replaced. Such additional capacity is not justified at Chico's campus since facilities are not being used in the summer. The campus reports it only enrolls 402 FTE students in the summer compared to over 15,800 FTE students in the fall term. If campus instructional facilities were utilized year round, several thousand more students could be accommodated without the need to expand physical capacity. We recommend reducing the scope of the project by 5,050 asf to limit the excess capacity in the facility and encourage greater use of campus facilities in the summer. This reduction in scope would reduce the state's costs for the facility by an estimated \$4.2 million.

CAPITAL OUTLAY— CALIFORNIA COMMUNITY COLLEGES

The budget proposes to spend \$194 million in previously approved general obligation bond funds for 28 CCC capital projects in the budget year. The proposed funding would support new phases of 10 projects previously funded by the state and 18 new projects. Of the 18 new projects, 16 would need additional state funds for completion in subsequent years at an estimated cost of approximately \$144 million.

Existing Funding Inadequate To Complete New Projects

We recommend the Legislature reject most of the new CCC projects in the Governor's proposal because the unappropriated balances in CCC existing bonds are not sufficient to complete these projects. The Governor's proposal would provide funding for the preliminary plans and working drawings for 16 projects, while construction and equipment costs would require additional funding in later years. However, there are insufficient funds available to complete all of the projects in later years. The CCC has approximately \$244 million remaining in existing bond funds, yet completing the proposed projects would cost approximately \$338 million. The Governor's proposal assumes that a new general obligation bond for higher education in 2010—proposed in the Governor's state infrastructure plan—would provide funds to cover these additional costs. A new general obligation bond would require approval from the Legislature and the state's voters—meaning its availability as a funding source is uncertain. In our view, the state should not invest in projects that lack sufficient funding for their completion. We therefore recommend that the Legislature target the available bond funds to projects which could be completed within the \$244 million available and that the remaining projects in the Governor's budget be delayed until a new funding source is secured. In allocating the available \$244 million, we recommend the Legislature prioritize projects in the following way:

- ***Construction and Equipment to Complete Previously Approved State Projects.*** This would account for \$224 million of the available bond funding: \$179 mil-

lion for ten previously funded projects included in the Governor's proposal as well as reserving \$45 million for a previously approved project scheduled for construction funding in 2010-11.

- ***Projects to Prevent Failure of Key Infrastructure.*** This would include \$5.2 million for critical infrastructure projects at Skyline College and Cañada College.

Funding these projects would leave an unallocated reserve of about \$15 million in CCC bond funds. At the time of budget hearings, this amount could be greater or less depending on any augmentations or reversions of previous appropriations that may be approved through administrative actions. In addition, as discussed above, unallocated bonds might be needed for additional capital costs related to construction delays from the PMIB's suspension of projects. Depending on the size of this unallocated balance, the Legislature may be able to fund additional projects.

COMMUNITY COLLEGE NURSING PROGRAMS

Chapter 712, Statutes of 2007 (AB 1559, Berryhill), sought to improve completion rates at community college nursing programs by permitting campuses to select students for these programs based on academic qualifications, as well as other skills and circumstances. Chapter 712 also requires the Legislative Analyst's Office to report on CCC's use of the new admissions process. This section fulfills this requirement.

Background on CCC Nursing Programs. As of fall 2008, 75 community colleges offer programs leading to an associate's degree in nursing. The number of programs has increased consid-

erably in recent years in response to concerns about a statewide nursing shortfall. In addition, the Legislature has funded a number of grants designed to increase the number of enrollment slots at existing programs, particularly in the CCC system.

Despite these expansion efforts, the number of applicants to nursing programs continues to far exceed the number of available slots. According to a 2008 Board of Registered Nursing study, for example, CCC nursing programs received a total of 18,530 eligible applications for just 8,135 first-year slots for the 2006-07 school year. (Eligibility is based on criteria such as applicants successfully completing certain prerequisite science courses.) This means there was capacity to accommodate less than 45 percent of applications.

About one-fifth of each year's incoming students fail to complete their degree. As we discussed in *Ensuring an Adequate Health Workforce: Improving State Nursing Programs* (May 2007), this is likely due in part to CCC's admissions policies. Prior to enactment of Chapter 712, CCC regulations prohibited programs from choosing from among eligible applicants based on merit (such as their grades in prerequisite classes). Instead, community colleges could use only nonevaluative admissions strategies (such as random selection) when selecting students for oversubscribed programs. (This policy stemmed from a decades-old lawsuit settlement.) As a result of this requirement, nursing programs could not choose the most qualified or best prepared students from among of the pool of applications they received.

New Law Allows Comprehensive Merit-Based Admissions Approach. Effective January 1, 2008, Chapter 712 changed this policy by permitting nursing-program admissions commit-

tees to select students based on multiple factors, including grades in prerequisite coursework, relevant work experience, and proficiency in languages such as Spanish. Alternatively, programs can continue using a nonevaluative process (or some combination of a merit-based approach and random selection). Pursuant to separate legislation, every program—regardless of its admissions process—also is permitted to administer a diagnostic assessment test to admitted students before they start a nursing program. Students who are unable to obtain a passing score must demonstrate readiness for the program by, for example, passing remedial courses (such as English or math) or receiving tutorial services from CCC staff.

Mixed Interest in Evaluative Admissions Option So Far. In fall 2008, a CCC nursing advisory committee surveyed all 75 nursing program directors on their admissions policies in light of Chapter 712. Twenty-nine campuses responded to the survey. Of this number, six indicated that they planned to implement a merit-based policy by spring or fall 2009. Another nine programs reported that their districts were still in the process of deciding which approach to use (but expected a decision to be made later this year). The remaining 14 programs indicated that they do not have plans to move to an evaluative system in the foreseeable future. For this final group, the most common reasons given were that the programs do not have the resources to evaluate applicants based on multiple criteria (random selection is less labor intensive) or that attrition rates were already relatively low using their current nonevaluative selection process. Others indicated that they had recently made changes to their admissions process (such as requiring students to take the diagnostic assessment test) and needed time to fully

evaluate the impact on student success before considering any further changes.

Recommend Linking Future Grant Funding to Attrition Rates and Admissions Process.

As noted earlier, systemwide attrition (drop out) rates at CCC nursing programs are about 20 percent. There is a large disparity among programs, however. For example, in 2006-07, there were 19 programs with attrition rates below 10 percent, and another 19 programs with attrition over 25 percent. Attrition rates ranged between 0 percent to 59 percent. Chapter 712 allows community colleges the authority and flexibility to use the admissions model of their choice. We are concerned, however, about nursing programs with high attrition rates that refuse to switch to a merit-based system. It is reasonable to believe that attrition rates would decline if these programs made the effort to select the most-qualified applicants. In order to create an incentive for these programs to change their admissions policy, we recommend the Legislature condition continued receipt of enrollment-expansion grant funding on a district either (1) keeping attrition rates below a specified level (such as 15 percent), or (2) implementing a multi-criteria selection process as authorized by Chapter 712. (Virtually all nursing programs receive this grant funding.) Under our recommendation, successful programs with relatively low attrition rates would continue to receive grant funding regardless of their admissions policy.

UC RETIREMENT PLAN

Pension Plan Will Need Money Soon... But Employee Contributions Should Resume First

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) overfunding 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. Figure 25 shows the recent history of UCRP’s funded ratio—that is, the actuarial value of its assets compared to the value of pension benefits accrued to date by UC employees and retirees. Since about 1987, UCRP’s assets have exceeded its liabilities. In pension policy, this sometimes is referred to as a “superfunded” pension plan. Few, if any, other major pension funds can boast such a long track record of being superfunded.

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 em-

ployee contributions, these declines will become apparent in future annual valuations of UCRP. We expect, as do UC’s actuaries, 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.

Governor Proposes \$20 Million Contribution—Much Less Than UC Requested. The Governor proposes that the state increase General Fund appropriations to UC by \$20 million in 2009-10 to help the university resume contributions to UCRP. The \$20 million figure appears to have been chosen arbitrarily. Keeping UCRP fully funded will eventually require total contributions (from all state, UC, and employee sources) of over \$1.3 billion per year. (This \$1.3 billion per

year figure will grow over time with inflation and payroll, among other actuarial factors. Additional increases will be needed for any unfunded liability that emerges due to a delay in resuming contributions or other reasons.)

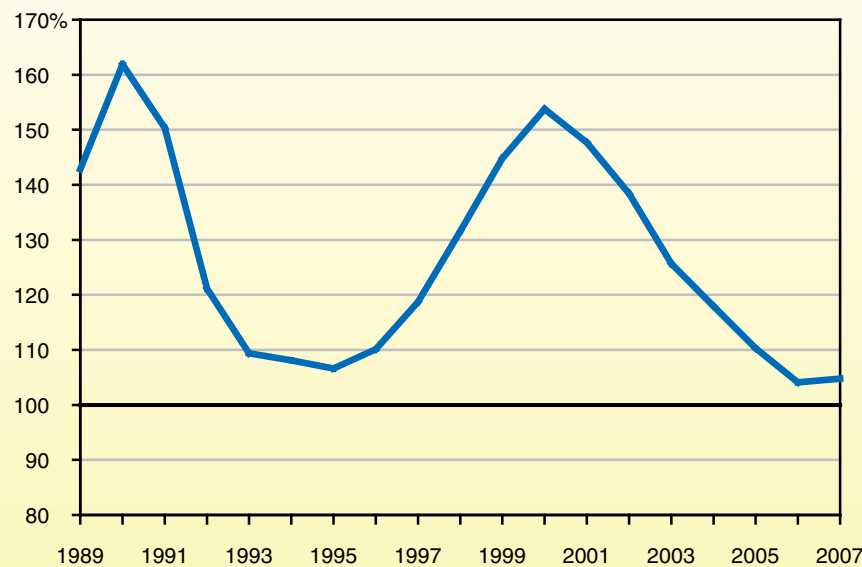
The Regents do not propose that the state contribute anywhere close to the full \$1.3 billion amount. First, the spending plan reflected in the Regents’ 2009-10 budget request does not ramp up contributions to UCRP to the full \$1.3 billion contribution amount immediately. Instead, the plan assumed total contributions to UCRP of only about \$875 million in 2009-10. Under the Regents’ actuarial policies, a ramp-up to the full contribution amount likely would occur over the next several years. Second, the Regents have proposed that, in any given year, the state pay only a share of UC’s total employer contribution—roughly equal to the portion of

university personnel costs that UC officials estimate is covered from state General Fund appropriations. In its 2009-10 budget request, for example, the Regents assumed that the “state General Fund and student fee share” of UCRP retirement contributions would be \$228 million in 2009-10—a number that would grow by tens of millions or hundreds of millions of dollars per year over the next few years as the university ramps up to the full con-

Figure 25

UC Retirement Plan Has Been Superfunded For Many Years

(Funded Ratio)



tribution level. The UC employer contributions—and, therefore, the state’s share of those contributions under the Regents’ proposed funding approach—would depend on what portion of the total UCRP contributions are deducted from employees’ paychecks. The greater the employees’ contributions, the less the total UC employer contribution would be. The UC budget request assumed that employees would resume contributing 2 percent of their pay to UCRP beginning on July 1, 2009. 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.

Recommend Rejecting Governor’s Proposed \$20 Million Appropriation. We recommend rejecting the Governor’s proposed \$20 million appropriation for UCRP at this time due in part to the state’s budget situation. Nevertheless, we believe that UCRP funding must resume soon in order to keep the plan relatively well-funded. In future years, therefore, the Legislature will need to consider the state’s role in providing additional General Fund money to UC to cover part of its employer contributions to UCRP. Failure to provide additional funds will mean that UC will have to identify other resources to cover the full costs of its employer contributions to UCRP—including, perhaps, reductions in services or increases in student fees.

Recommend Declaring State Policy That UC Workers Should Resume Contributions. Through its direct control of benefit levels and most employer and employee contributions to the two largest statewide public pension programs (the California Public Employees’ Retirement System [CalPERS] and the California State Teachers’

Retirement System), the Legislature already has established the state’s policy that *both* public employees and employers should contribute to public pension programs. In our view, when considering whether to appropriate funds to UC to cover its pension contributions, the Legislature also will need to consider whether UC workers have agreed to adhere to this long-standing state policy. The Legislature has the option of approving a formal statement of this policy concerning UCRP even before appropriating funds to UC for its pension contributions. We propose that the Legislature call on UC workers to cover approximately one-third of the total contributions needed to fund their pension benefits. Under our approach, UC workers would pay roughly the share of their total pension costs that the average state worker contributes toward the ongoing, or “normal cost,” of his or her CalPERS benefits. We would, however, suggest that the Legislature deviate from its existing state policy in one key way—require UC employees to cover a portion of the costs of any future benefit enhancements or unfunded liabilities that might emerge in UCRP. In the past, we have noted that employees’ fixed pension costs shield them from the financial tradeoffs of pension decisions. By maintaining a proportional share of all future costs, this can be avoided. Employees of UC would benefit under our approach if UCRP becomes superfunded again, which could allow total contributions—and, therefore, employees’ share of those contributions—to be decreased.

To implement this proposal, we recommend that the Legislature include in UC’s item in the *2009-10 Budget Act* the following budget bill language:

It is the intent of the Legislature that employees enrolled in the University

of California Retirement Plan (UCRP) contribute approximately one-third of the total contributions determined to be necessary for the plan on an annual basis, with the University of California (UC) contributing approximately two-thirds of these total contributions. It is the intent of the Legislature that, upon initiation of such contributions by UCRP members, consideration should be given as to whether and what amount, if any, of additional state funds should be appropriated to UC to assist it in making its share of the total contributions.

Recommend Report at Budget Hearings on Steps to Improve Communication With Employees Concerning UCRP. Discussions between UC and its unions concerning the resumption of contributions to the pension funds have been contentious, and in our conversations with various employee groups, we observe that there is much mistrust and misunderstanding concerning

the Regents' management of the fund. Under its constitutional authority, the Regents serve as the governing board of UCRP. The Legislature, however, has urged more cooperative governance of UCRP. Specifically, Resolution Chapter 126, Statutes of 2007 (SCR 52, Yee), asked the Regents to provide for "shared governance" of UCRP, including trustees representing both faculty and staff participants, similar to the way that CalPERS and other public pension systems are governed. Regardless of whether governance changes are implemented, in the future, as employees resume contributions to UCRP, it will be more important for employee groups to have an understanding with and comfort in the management of UCRP investments and other activities. Therefore, we recommend that UC officials be asked at budget hearings on the steps they have taken to improve communications and trust between the Regents and employee groups concerning the management of UCRP.

2009-10 BUDGET ANALYSIS SERIES

2009-10 BUDGET ANALYSIS SERIES

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