

The Budget Situation for FY2004 at the University of Maryland, College Park

Introduction

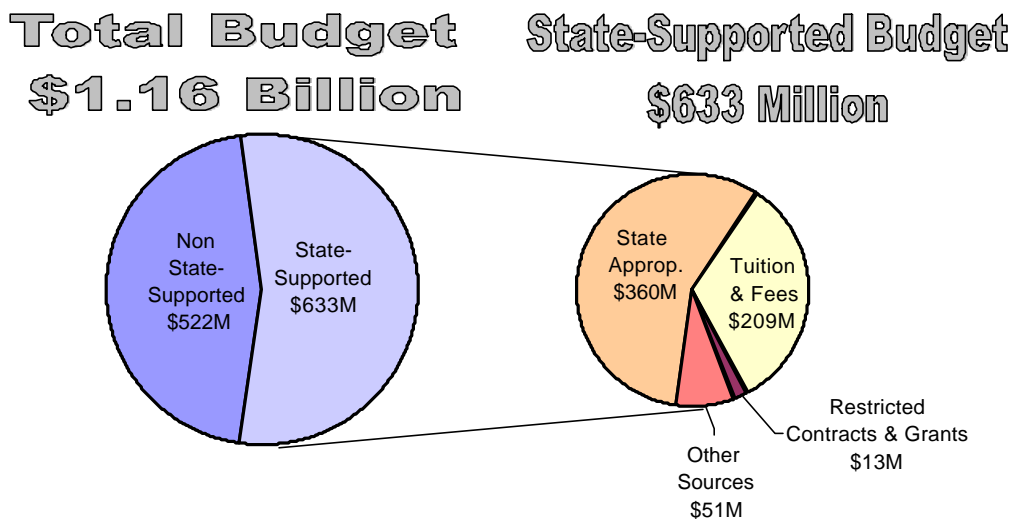
The University is facing a shortfall of approximately **\$81 million** in funds available to support our academic and statewide missions for FY2004 (starting July 1, 2003). This is the severest budget deficit the University has experienced since its designation as the flagship campus. Although the exact magnitude of this deficit and all of its implications are not yet fully determined, and because the problem will continue to affect us in FY2005, it is essential that all members of the campus community understand its scope so that we can work together to develop appropriate responses. The following is meant to explain the University's budget structure, the nature and origin of the deficit, and the University's strategies for dealing with this crisis.

The Budget Structure

The initial FY2003 budget before any major funding cuts serves as a useful reference point. It was already an austere budget, including no funds for merit or cost of living raises.

Revenue Sources

Chart 1: UMCP Revenue Budget FY2003



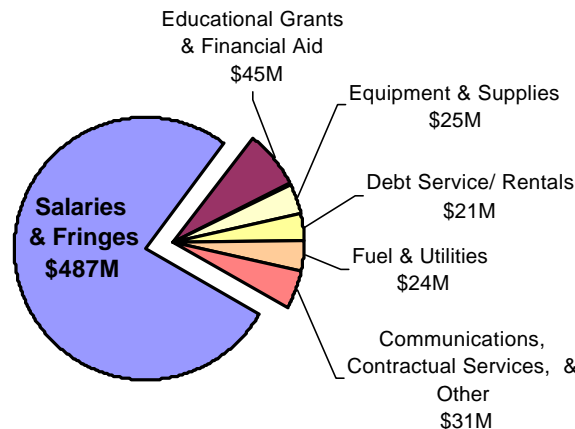
- On July 1, 2002, The University's FY2003 original budget **totaled \$1.16 billion** (Chart1).
- The University relies on the **state-supported** portion of the budget, which is **\$633 million** or a little over half of the total budget, to fund salaries, programs, and services supporting our core academic mission, service objectives, and main operations. The majority of the state-supported budget is funded from state appropriations and tuition & academic fees.
- Of the **\$209 million** in tuition and fees academic revenue, \$190 million supports the general operation of the campus, and \$12 million derives from and supports graduate professional programs. The remaining \$7 million is from fees that are used to cover specific laboratory and academic program costs.

- The remaining **non state-supported** portions of the budget are funds earmarked for specific purposes and **cannot be reallocated** to fund the campus' state-supported activities. The University has very limited discretionary authority over how these funds are spent. The two largest categories are:
 - Fees charged by self-supporting units for services such as: Residential Facilities, Dining Services, Transportation Services, Stamp Student Union, Recreation Services, and Intercollegiate Athletics. These units do not benefit from state appropriations or tuition revenue, and income received goes into salaries, facilities, and commodities used to provide these services.
 - Revenue from 'restricted gifts, grants, and contracts' is dedicated to specific tasks, usually research projects. Sources external to the University provide the funding and dictate how the money is to be spent.

Expenditure Categories

**Chart 2: UMCP State-Supported Budget - FY2003
Categorized by Type of Expenditure**

Total = \$633 Million



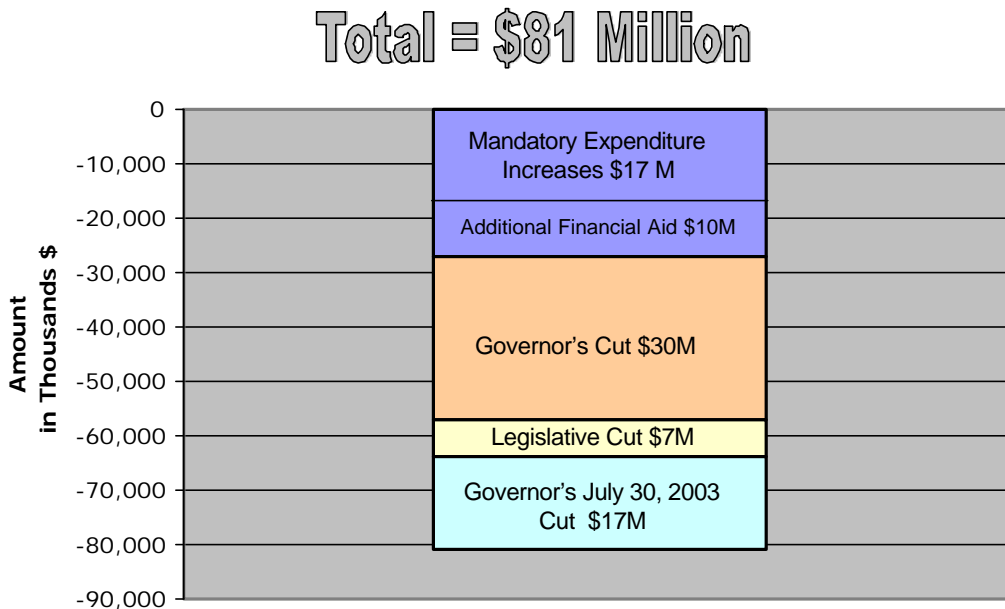
- The FY2003 state-supported budget is broken down into expenditure categories (Chart 2) based on how the funding is spent. Over three-fourths, or **\$487 million**, of the state-supported budget goes towards salaries, wages, and fringe benefits. Mandatory fringe benefit costs account for **\$95 million**.
- Items such as fuel & utilities and debt service are generally **fixed costs** for the University, and are not dependent on the number of employees or students using the facilities. There is limited capability for the University to adjust these expenditures.

The Budget Shortfall in FY2004

Total Budget Shortfall

- An increase of **\$17 million** in mandatory expenditures (see below) over the previous year and a reduction of **\$54 million** in state appropriations result in a **\$71 million** deficit in the University's *state-supported budget*.
- Currently, the University projects that a **\$650 million** state-supported budget is required in FY2004 to operate at the same level as FY2003. Before any tuition revenue increases, the total state-supported budget for FY2004 was only **\$579 million**. As stated above, this is a *gap in funding* of \$71 million.
- As a result of recent tuition rate increases, the University will commit an additional \$9 million to financial aid. Additionally, **\$1 million** in aid will be set aside for students who are financially most at risk. These additions to financial aid will increase our mandatory expenditures for financial aid by **\$10 million**. Therefore, the *total budget deficit is \$81 million* (Chart 3).

Chart 3: UMCP Budget Shortfall - FY2004



Mandatory Expenditure Increases

- Even if the University adds no new initiatives or programs, certain costs continue to increase each year. These 'mandatory expenditure increases' occur in costs such as: fringe benefits, student financial aid, insurance, debt service, and utilities.
- For FY2004, the Governor proposed a reduced state-supported budget which did not accommodate the University's expected increases in mandatory expenditures. To cover these mandatory costs, the University is forced to cut costs in other program areas.

- The University's mandatory expenditure increases are currently estimated at **\$17 million** (top of Chart 3).

Reductions to the FY2004 State-Supported Budget

- The **Governor's proposed budget** reduced the state appropriation to \$330 million, **\$30 million** less than the original FY2003 budget. In effect, a FY2003 mid-year reduction was carried forward into FY2004. The timing of the FY2003 mid-year reduction necessitated the use of primarily one-time measures. Now, the University must deal with the \$30 million reduction with **permanent** measures in the FY2004 budget. During the Spring 2003 session, the **Maryland General Assembly** took actions which resulted in a reduction in the University's allocation by another **\$7 million** relative to the Governor's proposed budget.
- The University System office, in response to a request from the Governor, has notified the University to put into reserve another **\$17 million** from state appropriations. The reserve became a permanent budget reduction on July 30, 2003.

Solutions for the Budget Shortfall

Since the University relies almost exclusively on state appropriations and tuition & fees revenues to support its primary missions, the unpleasant but necessary actions required to address the budget shortfall must include a delicate balance between raising revenue through tuition increases and reducing expenditures across the campus.

Why Raise Tuition?

- Severe reductions in the State's appropriations to the university, coupled with nearly 10 years of modest tuition increases, have forced university officials to consider tuition increases higher than normal in order to continue to enhance the quality of our educational programs. Maryland residents in particular have traditionally benefited from a considerable state subsidy.
- Cuts of this magnitude simply cannot be achieved entirely through expenditure reductions without negatively affecting the high quality of education our students have come to expect.

Tuition Increases

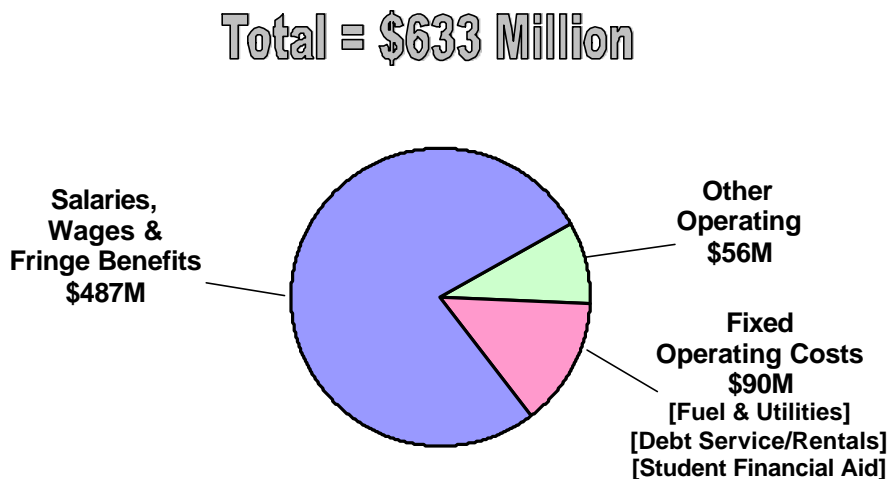
- The Board of Regents approved increases in the undergraduate tuition rate of 5% for Spring 2003 and 16% for Fall 2003. These two increases will generate a total of approximately **\$39 million** in revenue (\$5 million from the Spring 2003 increase and \$34 million from the Fall 2003 increase) that will be put towards the budget deficit.
- The University ensures that the revenue from tuition increases will be used to support the academic mission of the university and will not subsidize any activities not directly related to academic affairs.
- The tuition rate increase will be a burden for our students who are least able to afford their education. The University is committed to assisting as many of these students as possible through financial aid.

Expenditure Reduction Actions

- Of the \$81 million shortfall, the University will be able to cover approximately **\$42 million** through expenditure reductions, and redirection of revenue from modest growth in indirect cost recoveries and tuition increases from off-campus graduate programs. The magnitude of the expenditure reductions is a definite challenge to the campus community and will require stringent cost cutting efforts.

Expenditure Reduction Challenges

**Chart 4: UMCP State-Supported Budget - FY2003
By Expenditure Area**



Why are Personnel Reductions Necessary?

- The University's position count was reduced by 75 during FY2003. In FY2004, the Legislature imposed a personnel ceiling on the University of Maryland System. The position ceiling resulted in the elimination of an additional 208 campus positions.
- Expenditure reduction efforts are complicated by the fact that **fixed costs** make up about 14% of the budget (Chart 4). There is no flexibility to reduce expenditures in this category. Moreover, there are not enough funds in the remaining 9% of Other Operating costs to cover the enormous cuts the University has received for FY2004. Therefore, many campus units have no choice but to take a substantial reduction in the **Salaries, Wages and Fringe Benefits** category.
- Workforce reductions will be accomplished primarily by not filling vacant lines made available through resignations and retirements. Regrettably, some staff layoffs will be necessary to cover the position reductions and balance the University budget.

Guidelines for Expenditure Reductions

- The University continues to place the highest priority on maintaining the quality and availability of instructional programs, and these program areas must be sheltered from expenditure reductions to the extent possible.

- Protecting the instructional area will require that other University activities absorb a greater share of the reductions. In turn, this may result in major restructuring or elimination of some service and outreach programs.
- The campus is also committed to ensuring the safety of its students and employees on the campus, and public safety areas will be protected from budget reductions.

Net Assets: The Financial Position of the University

Net assets, formerly known as “fund balances,” are defined as the cumulative difference between revenues and expenditures. At the end of each year, the revenue in excess of expenditures, if any, for that year is added to the net assets on hand at the beginning of the year. Net assets fall into three categories:

Net Capital Assets – Resources already expended to acquire University land, buildings, and equipment, less related debt.

Restricted Net Assets – Gifts and Grants restricted to particular purposes. Examples include scholarships, student loans, construction or renovation of buildings, and research activities.

Unrestricted Net Assets – These include Current Funds that may be spent for any purpose in performing the primary objectives of the University; Unrestricted Quasi-Endowments that the Board of Regents has determined are to be retained and invested; and Plant Funds set aside for the acquisition, renewal, and replacement of University property including the payment of related debt service charges.

Why Can't Net Assets be Used to Cope with the Budget Cuts?

At the end of FY2002, the University's net assets totaled \$832 million. Over 80% of these net assets are either net capital assets or restricted assets, as stated above. Unrestricted net assets, which include plant funds and quasi-endowments, totaled \$139 million. *Of the unrestricted net assets, only \$44 million are available to support the primary objectives of the campus and most of these funds have already been committed.*

The \$44 million in Current Funds represents 4% of the total \$1.16 billion initial budget for FY2003. Current funds are comprised of hundreds of smaller savings accounts belonging to academic units, student services, and administrative departments throughout the University. Unlike operating revenues, which flow in to support budgeted expenditures year after year, once net assets are spent, they are gone. *Net assets cannot be used as a solution to permanent reductions in State support, and they must be maintained for the following reasons:*

Continuity of Operations – Many projects and activities continue beyond a single fiscal year. The University must be able to carry over a reasonable level of unexpended funds from year to year. This practice encourages units to use funds wisely and to engage in multiple-year efforts to improve the quality of the University.

Facilities Renewal and Replacement – Plant Funds are owned primarily by the self-supporting units. Residential Facilities, Dining Services, Transportation Services, Stamp Student Union,

Recreation Services, and Intercollegiate Athletics are required to set aside funds each year for renewal and replacement of their facilities. Given the relatively large cost and intermittent timing of such projects, it is necessary to save funds year-by-year for this purpose.

Credit Worthiness – The University cannot provide quality academic programs and student services without constructing and renovating buildings and other facilities from time to time. Therefore, the University must be able to borrow funds by issuing tax-exempt bonds. A good “credit rating” is an essential measure to minimize the interest expenses associated with such debt. More importantly, it is a requirement imposed on the University by the state. Officials at the credit rating agencies look very hard at the level of unrestricted net assets when determining a bond rating. As of June 30, 2002, the University fell \$4.7 million short of achieving the level of unrestricted net assets needed to assure an acceptable rating. To protect our state-mandated credit rating, the University is required to restore unrestricted net assets to an acceptable level over the near term.

Contingency Funds – It would be risky and irresponsible to neglect carrying forward funds for a “Rainy Day” to absorb any unexpected volatility in revenues and any unexpected, urgent expenditures.