Thinking Strategically About University of California Finances

Presentation for UCLA Academic Senate

December 2, 2014
The Evolving Role of University Financial Leadership
Changes in the External Environment

**Legacy**
- Strong state funding
- Low tuition, low aid
- California-only student body
- State-funded professional schools
- Commuter campuses
- Growing federal research funding
- State funded capital investment
- Teaching hospitals
- Little or no fund raising infrastructure

**Emerging**
- Sharply reduced state funding
- Tuition discounting, aid packaging
- Strategic enrollment management
- Tuition-funded professional schools
- Residential campuses
- Declining federal research funding
- Debt & gift financed capital investment
- Complex health systems
- Complex development & investment infrastructure
# The Evolving Role of University Financial Leadership

## Changes in Leadership Focus

### Legacy
- Resource allocation
- Fund management
- General Funds
- None
- Fund balances
- Budget variance
- Capital budget
- None
- None
- Financial reporting
- Budgeting
- Financial losses

### Emerging
- Resource creation & entrepreneurship
- Central bank management
- All funds
- Investment returns
- Unrestricted net assets
- Operating margin
- Return on fixed assets
- Capital debt structure
- Working capital/liquidity management
- Managing P/L, balance sheet, cash flow
- Strategic resources allocation
- Enterprise risk management
University of California  
Statement of Net Position  
Year Ending June 30, 2014  
$ in millions

<table>
<thead>
<tr>
<th>ASSETS</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash &amp; Short Term Investments</td>
<td>$ 4,131</td>
</tr>
<tr>
<td>Other Current Assets</td>
<td>4,806</td>
</tr>
<tr>
<td>Investments</td>
<td>25,683</td>
</tr>
<tr>
<td>Capital Assets</td>
<td>27,645</td>
</tr>
<tr>
<td>Other Noncurrent Assets</td>
<td>2,754</td>
</tr>
<tr>
<td><strong>Total assets</strong></td>
<td><strong>$ 65,024</strong></td>
</tr>
</tbody>
</table>

| Deferred Outflows of Resources              | $ 3,705|

<table>
<thead>
<tr>
<th>Liabilities</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Current Liabilities</td>
<td>$ 9,340</td>
</tr>
<tr>
<td>Pension Liabilities</td>
<td>7,725</td>
</tr>
<tr>
<td>Retiree Health Liabilities</td>
<td>8,440</td>
</tr>
<tr>
<td>Long Term Debt</td>
<td>15,850</td>
</tr>
<tr>
<td>Other Long Term Liabilities</td>
<td>$ 1,453</td>
</tr>
<tr>
<td><strong>Total Liabilities</strong></td>
<td><strong>$ 42,809</strong></td>
</tr>
</tbody>
</table>

| Deferred Inflow of Resources                | $ 7,109|

<table>
<thead>
<tr>
<th>Net Position</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Net investment in capital assets</td>
<td>$ 12,167</td>
</tr>
<tr>
<td>Restricted balance</td>
<td>15,028</td>
</tr>
<tr>
<td>Unrestricted balance</td>
<td><em>(8,390)</em></td>
</tr>
<tr>
<td><strong>Total Net Position</strong></td>
<td><strong>$ 18,805</strong></td>
</tr>
</tbody>
</table>
University of California  
Statement of Revenue, Expenditure, and Change in Net Position  
Year Ending June 30, 2014  
$ in millions

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>OPERATING REVENUE</td>
<td>$23,589</td>
</tr>
<tr>
<td>OPERATING EXPENSES</td>
<td>28,413</td>
</tr>
<tr>
<td>OPERATING REVENUES (EXPENSES)</td>
<td>6,242</td>
</tr>
<tr>
<td>INCOME BEFORE OTHER CHANGES IN NET POSITION</td>
<td>$1,418</td>
</tr>
<tr>
<td>OTHER CHANGE IN NET POSITION</td>
<td>811</td>
</tr>
<tr>
<td>INCREASE IN NET POSITION</td>
<td>$2,230</td>
</tr>
<tr>
<td>Activity</td>
<td>Amount</td>
</tr>
<tr>
<td>-------------------------------------------------------------------------</td>
<td>----------</td>
</tr>
<tr>
<td>NET CASH USED BY OPERATING ACTIVITIES</td>
<td>$(2,087)</td>
</tr>
<tr>
<td>NET CASH PROVIDED BY NONCAPITAL FINANCING ACTIVITIES</td>
<td>$3,817</td>
</tr>
<tr>
<td>NET CASH USED BY CAPITAL AND RELATED FINANCING ACTIVITIES</td>
<td>$(1,553)</td>
</tr>
<tr>
<td>NET CASH PROVIDED (USED) BY INVESTING ACTIVITIES</td>
<td>$(221)</td>
</tr>
<tr>
<td>NET INCREASED (DECREASE) IN CASH</td>
<td>$(45)</td>
</tr>
</tbody>
</table>
## Strategic Financial Analysis

### Four Key Questions

<table>
<thead>
<tr>
<th>Topic</th>
<th>Question</th>
<th>Primary Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>Liquidity</td>
<td>Does the institution have sufficient unrestricted reserves to meet future operating and capital requirements?</td>
<td>Primary Reserve Ratio</td>
</tr>
<tr>
<td>Asset Performance</td>
<td>Are past investments providing adequate returns?</td>
<td>Return on Net Assets Ratio</td>
</tr>
<tr>
<td>Debt Management</td>
<td>Has the financial burden of debt outweighed its strategic usefulness to achieve mission?</td>
<td>Viability Ratio</td>
</tr>
<tr>
<td>Operating Results</td>
<td>Are operations generating a sufficient surplus to support liquidity and return on assets, and to limit debt?</td>
<td>Net Operating Revenues Ratio</td>
</tr>
</tbody>
</table>
Liquidity

Does the institution have sufficient unrestricted reserves to meet future operating and capital requirements?

Does the institution have sufficient cash to meet current operating requirements?

Primary Metrics

- **Primary Reserve Ratio (CFI)**
  - Numerator: unrestricted net assets + expendable restricted net assets
  - Denominator: total expenses
  - Benchmark:
    - .40x or better gives the institution maximum flexibility to transform the enterprise
    - UC in 2013-14: .25x
    - UCRP & OPEB obligations have huge impact on primary reserve ratio

- **Liquidity Ratio**
  - Numerator: sources of liquidity
  - Denominator: uses of liquidity

Strategies

- Increase cash generated from operations
- Grow unrestricted endowment
- Spend restricted balances first, preserve unrestricted funds
- Reduce unfunded pension liabilities
- Reduce unfunded retiree health benefit liabilities
- Operations
  - Revenue cycle management
  - Lines of credit
- Investments
  - Management of STIP/TRIP exposure
  - Management of endowment cash
  - Management of net capital redemptions
Asset Performance
Are past investments providing adequate returns?

Primary Metrics

Financial Assets
- Return on Net Assets Ratio (CFI)
  - Numerator: Change in net assets
  - Denominator: Total net assets
  - Benchmark: 3% to 4%
  - UC in 2013-14: (-7%)

Fixed Assets
- Physical Asset Reinvestment Ratio
- Age of Facilities Ratio
- Deferred Maintenance Ratio

Strategies

Financial Assets
- Establish campus treasury function to manage working capital and debt.
- Professionalize endowment management.
- Reduce unfunded pension liabilities
- Reduce unfunded retiree health benefit liabilities

Fixed Assets
- Improve utilization of existing buildings
- Optimize mix of owned and leased facilities
- Increase investment in deferred maintenance
- Consider full ownership cost when making new capital investment
Debt Management

Has the financial burden of debt outweighed its strategic usefulness to achieve mission?

Primary Metrics

- **Viability Ratio (CFI)**
  - Numerator: unrestricted net assets + expendable restricted net assets
  - Denominator: total plant-related debt
  - Benchmark: 1.00x or better indicates institution has sufficient net assets to satisfy obligations.
  - UC in 2013-14: .55x

- **Debt Burden Ratio**
  - Numerator: interest expense + principal payments.
  - Denominator: total expense
  - Benchmark: .07x viewed as upper limit for debt affordability.

- **Debt Service Coverage Ratio**
  - Numerator: net operating income + net nonoperating income + interest expense + depreciation expense
  - Denominator: interest expense + principal payments
  - Benchmark: 1.25x to 2.00x

- **Interest Burden Ratio**
  - Numerator: Interest expense
  - Denominator: total expenditures
  - Benchmark: No more than .05x to .07x

- **Portfolio Principal Duration Metric**
  - Numerator: par outstanding x principal duration term
  - Denominator: part outstanding
  - Benchmark: the shorter the duration, the greater the need for liquidity.

**Strategies**

- Establish debt management policies
- Expand debt capacity
- Manage within overall debt affordability
- Manage to an optimal capital debt structure
  - Principal maturity dates
  - Mix of fixed vs. variable
  - Mix of taxable vs. tax exempt
- Establish and manage a central bank
- Reduce unfunded pension liabilities
- Reduce unfunded retiree health benefit liabilities
Operating Results
Are operations generating a sufficient surplus to support liquidity and return on assets, and to limit debt?

Primary Metrics

- Net Operating Revenues Ratio (CFI)
  - Numerator: operating income (loss) plus nonoperating revenue (expense)
  - Denominator: operating revenues plus nonoperating revenues
  - Benchmark: 2 to 4%
  - UC in 2013-14: (-6%)
- Cash Income Ratio
- Net Tuition & Fee Contribution Ratio
- Net Tuition Dependency Ratio
- Demand Ratios

Strategies

- Develop and grow new revenue sources
- Consider substantive programmatic adjustments
- Re-engineering core business processes
- Outsource noncore operations
- Build unrestricted endowment
- Reduce unfunded pension liabilities
- Reduce unfunded retiree health benefit liabilities