The Stanford University Budget Plan 1999/2000

Submitted for Action to the
Board of Trustees
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EXECUTIVE SUMMARY

To the Board of Trustees:

I am pleased to submit the 1999/00 Stanford University Budget Plan for your approval.

This Budget Plan is presented in two parts. It contains the Consolidated Budget for Operations, which reflects all of Stanford's anticipated non-capital revenue and expense. It also presents the University's Capital Budget for next year in the context of a three-year Capital Plan. (This Budget Plan does not reflect the budgets for UCSF Stanford Health Care, a separate corporation.)

The 1999/00 Consolidated Budget for Operations shows revenues and transfers of $1.647 billion and expenditures of $1.640 billion, resulting in a bottom line surplus of $7.0 million, or 0.4% of total expenditures. The projected surplus is the smallest forecast in several years, due primarily to transfers of funds from the Engineering, Medical, and Business Schools to the plant division in support of the Capital Budget.

The Capital Budget for 1999/00 reflects the completion of virtually all of the goals set forth in the first multi-year capital plan in 1993. This work has included the seismic strengthening of many buildings, the development of the Science and Engineering Quad, deferred maintenance and code compliance work, and the renovation of much of the student housing system. With the implementation of this Capital Budget, the physical renewal of Stanford's infrastructure will be nearly complete. Planning for the University's future physical facilities needs, however, cannot stand still. To respond to those needs we have developed a plan for projects beginning in 2000/01 and 2001/02.

This is my final budget submission to you as Provost. I would like to use this Executive Summary to briefly review the last six years of budgetary matters and to identify key issues of concern for the future.

A RETROSPECTIVE ON BUDGETING

From 1989 to 1993 the University had reduced operating expense by $42 million in the general funds budget. By the end of the academic year 1993/94, we still faced the need to cut an additional $18 million to free up funds for reallocation and to provide for a modest contingency reserve. There were other challenges identified at that time, as well, including:

- Facilities Renovation and Expansion – In 1993/94 a $700 million five-year Capital Plan was developed to address deferred maintenance, seismic retrofit, and expansion and improvements in science and engineering facilities, the libraries, and student housing.
- Investments in Undergraduate Education – The Commission on Undergraduate Education called for a number of enhancements to the undergraduate program, many with budgetary implications.
- Computing – Initial estimates indicated it would cost $60 million to replace aging administrative systems and to upgrade much of Stanford's networking capabilities.
- Regulatory and Compliance Issues – Regulatory burdens continued to grow.

In addition to these challenges, we also faced the ordinary budget issues that arise in the course of developing an annual budget: maintaining a competitive salary program, meeting the financial aid needs of our students, and providing support to the University's infrastructure. In addition, this has been a period of rapidly rising local housing costs and a local inflation rate that has outpaced national inflation.

In recent years we have made good progress in addressing many of those challenges, particularly in the following areas:

Program Initiatives – There have been a number of programmatic initiatives implemented:

- The budget for undergraduate education initiatives has grown from $4 to $14 million since 1994, with $6 million of that increment coming from unrestricted funds.
- Using school, department, and central funds, we have strengthened budgets for faculty support and graduate students. These initiatives include funds for faculty housing supplements, graduate student salaries and housing, recruitment, and lab set-up costs.
- The Stanford Graduate Fellowships program has been implemented and will enroll its third class of outstanding graduate students in the Fall.
- The Center for Research on Economic Development has been created.

Facilities – The Stanford campus has been largely renovated and rebuilt during the past seven years. The results are impressive and position us well for the future. These enhancements have, however, added $30 million in annual costs to the Consolidated Budget for Operations for debt service, planned maintenance, and maintenance on new facilities.

Compliance – As was anticipated in 1993, the cost of regulation has continued to grow. Since then our budgets have had to absorb the cost of removing tuition remission from the benefits pool, the addition of staff in the Health and Safety Office, and annual supplements to cover relentless government audit requirements.

Systems – From 1993-99 we have invested about $75 million in systems. About half has gone to new administrative systems, including financial, budget, financial aid, and development systems. The remainder went principally to academic and administrative infrastructure projects, including network upgrades, database products, and security.

Restructuring – We cut $18 million from the unrestricted budget from 1994 to 1996. In addition, there have been other important restructuring initiatives:

- We have budgeted an unrestricted base reserve against the possibility of future income shortfalls.
- We have merged the Alumni Association into the University and completed the merger of UCSF Stanford Health Care.
- Our method of budgeting has changed from an expense driven allocation model to one built from our best projections of revenue. Operationally, this has meant that the first dollars of revenue have been dedicated to the creation of the reserve, as noted above, and to the funding of several fixed cost categories (e.g., faculty salaries, undergraduate aid, and debt service). Remaining revenue has been allocated based on judgments of programmatic strength and the importance of the function to the university, as well as the units' abilities to contribute locally-controlled funds to their programs.

Our best managerial efforts at addressing these challenges have been helped considerably by strong investment markets and low inflation. In addition, the supplemental 1/2% increase in the endowment payout rate has permitted us to cover a portion of our facilities and infrastructure costs. Lastly, the friends of the University have supported us generously.

THE BUDGET PLAN FOR 1999/00

The Budget Plan for 1999/00 continues to address many of these issues and priorities that have been before us over the past six years. Its principal highlights include:

Consolidated Budget for Operations:

- As noted above, the bottom line surplus of $7 million reflects principally an excess of restricted revenue over expense. The surplus would be larger were it not for planned transfers to plant to support facilities renovations. Specifically, the Medical School will be transferring $53.4 million to plant to renovate the E.D. Stone Buildings and to pay for improvements to the library, student labs, and classrooms. The Graduate School of Business (GSB) will be transferring $5 million to plant to cover renovation costs of the GSB building. These transfers will create budget shortfalls and require these two schools to draw down reserves to fund their operations during 1999/00. In addition, the School of Engineering will transfer $5.5 million to the plant division but is not expected to draw down its reserves to cover this transfer.
- The Budget Plan continues the planned buildup of support for undergraduate education initiatives, including the creation of the freshman/sophomore college, further enhancement of the seminar programs, and expansion of research opportunities for undergraduates.
- Several new and renovated facilities, most notably the Science and Engineering Quad McCullough Annex and the Center for Clinical Sciences Research (CCSR) will become fully operational in 1999/00.
- One of our key priorities in this budget was to fund salary increases that exceeded the very modest increases of recent years. For the past several years, budgeted growth for continuing salary expense did not increase as fast as local inflation. Our salary program growth rate will exceed projected inflation next year and will target supplemental increases to employee groups that are significantly below market.
- Supplemental Endowment Payout for Infrastructure – In February, the Trustees approved a three year continuation of the 1/2% endowment payout supplement. This will provide the capacity to pay debt service on seismic strengthening and infrastructure. To preserve the long term purchasing power of the endowment while incorporating this 1/2% supplement into the budget, the Trustees stipulated that increases in continuing costs supported by the non-formula general funds component of the Consolidated Budget be held at 1% over inflation. Our planned expense growth for this component of the budget is 3.7%. National inflation is 2.3% and local inflation is 4.6% (April 1998 to April 1999). Given our local expense base, we are operating within the constraint.
- The Budget Plan includes an unrestricted budget base reserve of $13.2 million to provide a buffer against future income shortfalls. This has been an important priority in recent years, and I am pleased that we have been able to increase the size of the reserve from $12.2 million last year.

- In October, 1998, the Trustees voted to dedicate half of the income from the Stanford endowed lands (previously reinvested in the endowment) to support housing. This will generate approximately $30 million over a three-year period which will be used to help younger faculty and graduate students afford to live in this high cost area.
- The budget for undergraduate financial aid continues our policy of meeting the financial need of all admitted students. In February the Trustees approved—and we have included in this budget—$500,000 in additional financial aid to improve our ability to attract two groups of students: those at the lowest income levels, and those who are Presidential Scholars.

Capital Budget:

- The Capital Budget calls for $300.6 million for capital construction expenditures in 1999/00. The following are the key elements of the Capital Budget:
    - Construction Expenditures on Approved Projects – This category of projects, totaling $139 million, includes the remaining work ($41 million) on the Center for Clinical Science Research (CCSR), $40 million of construction on the $67 million Escondido Village graduate student housing project, and $20 million of construction on the $33 million Alumni Center project.
    - Infrastructure – The Capital Budget contains $39.7 million in infrastructure projects. This is split, approximately, into three equal amounts: renovation and expansion of our utility systems, information systems, and the Stanford Infrastructure Program, which includes landscaping, transportation, and parking projects.
    - Planned Construction Projects – A number of projects are in various stages of planning and are all subject to individual funding approval by the Trustees. We expect to spend $122 million on such projects in 1999/00, the largest of which is $79 million for the Stone buildings at the Medical School.
- The Capital Budget affects the Consolidated Budget for Operations by adding debt service costs and the costs of operating and maintaining the facilities. In addition to debt service for CCSR and the McCullough Annex, the Budget Plan reflects a full year of debt service for the Green Library and the Mudd Chemistry upgrade project, which are to be completed in 1999. Incremental debt service resulting from the Capital Budget totals $5.9 million for 1999/00 for academic, auxiliaries, and service center projects. These facilities will require $2.7 million in maintenance costs, of which $1 million was already budgeted in 1998/99. By Trustee policy, internal debt service repayment on capital projects (exclusive of SLAC, auxiliaries, and service centers) may not exceed 5% of unrestricted funds. For 1999/00 this figure stands at 3.1%.

FUTURE PROSPECTS

Stanford is well positioned as one of the best research universities in the world. Looking ahead, there are several issues to which we must pay particular attention. The first is the impact of market volatility on the endowment payout to the budget. A drop in the market, particularly a sustained one, could have a very negative impact on future budgets. While we have a diversified investment strategy, a conservative endowment payout smoothing formula, and a reserve to buffer the budget, we are not immune to the effects of a major or long-term drop in the market. We must be cognizant of our exposure and, where able, accumulate supplemental reserves in order to avoid the prospect of programmatic disruptions.

The second issue pertains to the various constraints on capital facilities. With the implementation of the Capital Budget and the three-year Capital Plan described in this document, we are pushing the limits of our debt capacity. By 2001/02, based on our Capital Plan, our debt service payments as a fraction of unrestricted revenues will rise to 4.2%. We are also constrained by Santa Clara County's General Use Permit. Given that it will be more difficult to build incremental space, we must continue to make better use of the space we have and seek to maximize the potential of existing facilities close to the campus.

Third, we need to build our budgets to provide adequate faculty support. Salary pressures, housing costs, and lab setup charges combine to make the cost of faculty recruitment and retention, particularly in Silicon Valley, very expensive. Yet providing adequate support to faculty is absolutely essential to the future of the University.

REQUESTED APPROVAL AND ORGANIZATION OF THIS DOCUMENT

This Budget Plan provides a university-level perspective on Stanford's programmatic and financial plans for 1999/00. We seek approval of the planning directions, the principal assumptions, and the high level supporting budgets contained here. As the year proceeds, we will make periodic reports, as necessary, on the progress of actual expenditures against budget. In addition, we will bring forward individually, for more detailed consideration, specific capital projects under normal Trustee guidelines.

This document is divided into three sections and two appendices. Section 1 describes the principal financial elements of the Plan, including the Consolidated Budget for Operations and the projected Statement of Activities for 1999/00. Section 2 addresses a number of programmatic issues in the academic and support areas of the University. Section 3 contains details on the Capital Budget for 1999/00 and the multi-year Capital Plan. The appendices contain the individual budgets of the major academic units and supplementary financial information.

CONCLUSION

I would particularly like to thank the deans and other faculty members who have advised me over the past six years and to acknowledge the considerable work of many staff members from across Stanford who work on budget issues. Without their commitment and goodwill, the management of this large and complex budget would not have been possible. I am delighted that John Hennessy will now bring his extraordinary talent to the Office of University Provost. Finally, I am grateful to you, the Trustees, for your commitment to Stanford. I have benefited from your advice and counsel and wish you well in your continuing service to the University.

Condoleezza Rice
Provost
June, 1999

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