Stanford University Budget Plan

2003/04

Submitted for Action to the
Board of Trustees
June 12-13, 2003

This publication can also be found on the World Wide Web at:
http://www.stanford.edu/dept/pres-provost/budget/plans/plan04.html

Executive Summary

To The Board of Trustees:

I am pleased to submit Stanford University's 2003/04 Budget Plan for your approval. The Budget Plan has two parts. The first is the Consolidated Budget for Operations, which includes all of Stanford's anticipated operating revenue and expense for next year. The second is the Capital Budget, which is set in the context of a multi-year Capital Plan.

Stanford's 2003/04 Consolidated Budget for Operations reflects an anticipated deficit of $19 million on $2.423 billion of revenues, $2.343 billion in expenditures, and $99 million of transfers. The entirety of this deficit reflects the planned use by schools and academic support units of expendable reserves, which are projected to drop from $882 million to $863 million during 2003/04.

$674 million of Stanford's Consolidated Budget is categorized as general funds. These funds can be used for any university purpose. General funds of $554 million are allocated directly by the Provost, while the remaining $120 million flow to units in accordance with previously agreed-upon formulas with the Graduate School of Business, the School of Medicine, the Hoover Institution, and the Continuing Studies Program. The general funds component of the Consolidated Budget has a projected $2.9 million surplus for 2003/04.

The Capital Budget calls for $151.6 million in capital expenditures next year, down from $266 million in 2002/03. These expenditures are in support of a three-year Capital Plan that, if fully completed, would require $837 million in total project expenditures (down from last year's $1.068 billion Capital Plan).

The budgets for the Stanford Hospital and Clinics (SHC) and the Lucile Packard Children's Hospital at Stanford (LPCH), both separate corporations, are not included in this Budget Plan.

CONTEXT

The budget for 2003/04 reflects our best efforts to balance the needs of a great university with the difficult financial realities brought on by continuing weakness in the national and local economies. In building the budget we are faced with several challenges—a more than 20% increase in health care costs, the first reduction in support from the endowment in recent years, a difficult environment for fundraising, and increased need for financial aid among our students (a second-order result of the weak economy). Despite these obstacles, this budget incorporates the support needed to sustain the excellence of our teaching and research programs. It also supports the completion and operation of several important new facilities, including the Clark Center and the Lokey Laboratory.

We anticipate a small deficit in the Consolidated Budget for Operations. This deficit is centered principally in the School of Medicine and the School of Humanities and Sciences. These schools will be drawing down reserves, which have been built up over the past decade, for capital projects and important non-recurring faculty recruitment and support costs.

When we last reported on the budget outlook to the Trustees and the Faculty Senate in December 2002, we projected a $25 million shortfall in the general funds component of the Consolidated Budget. Since that last public report, several additional factors worsened the outlook, including:

– Reduced investment income projections	($8.7 million)
– Increased employee benefits costs	($3.8 million)
– Additional debt service and insurance costs	($2.0 million)

Without any offsetting improvements or corrective actions, these changes would have yielded a $40 million general funds deficit. Through the budget development process, however, we were able to eliminate the projected shortfall entirely, through the following actions:

– Eliminating the merit salary program for one year	$8.0 million
– Increasing undergraduate and graduate tuition	$5.0 million
– Revising the Medical School formula	$7.2 million
– Miscellaneous revenue enhancements	$4.1 million
– Reductions in general funds allocations to the schools and administrative units	$23.4 million
– Selected general funds additions to the schools and administrative units	($5.3 million)

Together these actions resulted in a general funds budget with a modest surplus of $2.9 million.

One of the most important factors in achieving the slight surplus was the elimination of the merit salary raise program. The decision to forego raises was not taken lightly. But the university's business does not slow down in response to a weak economy. Implementing a salary freeze will allow us to minimize layoffs and avoid increased workloads for the remaining staff. We have been gratified by the support and good will shown by both faculty and staff in response to the announcement of the salary freeze.

The largest budget adjustment was the $23.4 million cumulative reduction taken by the academic and support units across the university. We asked all units to develop plans for 5%, 7.5%, and 10% reductions in their general funds allocations. All of the schools and administrative support areas took this charge very seriously and produced creative and responsible options for review by the University Budget Group. After careful study, we have built into next year's budget a set of general funds adjustments (cuts and central revenue enhancements) averaging 6.1% of these units' applicable general funds base. These reductions were not achieved through "across the board" cuts: reductions in individual units ranged from 3% to a full 10%.

As this is the second consecutive year of budget reductions in the general funded units, the impact of these cuts goes beyond belt tightening. Because schools will have fewer general funds to allocate to their departments, some departments are cutting support staff or relying on restricted funds until they can restructure their operations. Inevitably, there will be service reductions in a number of the administrative areas. For example, library hours will be trimmed modestly, and the growth in the library materials budget will not keep pace with inflation; there will be fewer computer training classes and technical consultants; and there will be some reductions in services at Vaden Student Health Center. Moreover, there will be layoffs as a result of these reductions. While we will not know the final number until later in the summer, there will be approximately 100 layoffs. We will be working with human resources officers around the university to find ways to accommodate the affected individuals.

In order to mitigate their budget reductions, two schools will be adding a modest number of incremental masters students. Many departments have recently seen a large increase in the number of applicants to their graduate programs, and so a moderate expansion can be achieved without compromising the quality of the students admitted or the quality of the education delivered. Other revenue enhancements include the renegotiation of the contract with General Electric to operate the co-generation plant located on campus, increasing the amount we collect in ground rent.

Although the budget process focuses primarily on achieving a balanced general funds budget, we did address several important issues that affect the entire Consolidated Budget for Operations:

- Fringe Benefits – The benefits rate is budgeted to increase from 24.8% to 29%, an increase of more than $40 million to the Consolidated Budget. This increase is due principally to the rise in employee and retiree healthcare costs. Another significant factor is the cost of transferring most bargaining unit employees from the defined benefit retirement plan to the defined contribution plan. Benefits costs have been a major expense in recent years, increasing by an average of 15% per year from 2000/01 to 2003/04 and growing from $178 million to $269 million. In response to these continuing increases, we are now exploring ways to hold down future growth in the benefits rate, although the budgetary impact of any resulting changes to the benefits package will not be felt in 2003/04.

- Undergraduate Financial Aid – Stanford's financial aid program will continue to be among the strongest in the country. While we are not adding any enhancements to the aid program for next year, this budget does provide funds to meet the demonstrated financial need of all undergraduates. It is important to underscore that for those families whose financial circumstances do not keep pace with the cost of attending Stanford, we will meet their increased need through our financial aid program. General funds (including the Stanford Fund) supporting financial aid is expected to increase next year by 12.4%, from $23.4 to $26.3 million. Since 1999/00, support for undergraduate financial aid from general funds (including the Stanford Fund) has increased by 67.5%. We expect this trend to reverse as the endowment support from the Campaign for Undergraduate Education increases.

- Support for New Buildings – There are several new and renovated buildings coming on line in the remainder of this year and next year whose operating and debt service costs will affect the budget. These include three important new facilities: the Clark Center, the Lokey Lab, and SAL III, the off-site library storage facility in Livermore. Incremental costs of $19.5 million for debt service and operations of new and renovated buildings are included in the Consolidated Budget for Operations.

- Systems – For the past several years Stanford has been engaged in an extensive effort to replace its administrative systems and to upgrade the infrastructure supporting both academic and administrative computing. That effort will be nearly finished in 2003/04 with the completion of the Oracle financial systems. We are budgeting $12.7 million for system development projects and the infrastructure to support them in next year's budget.

- Targeted Allocations of General Funds – As noted above, about $554 million of Stanford's $2.4 billion in revenue consists of general funds under the direct control of the Provost. Within this portion of the budget we are reducing base budget funding allocations to academic and administrative units by approximately $23.4 million. However, we are also allocating $5.3 million to support incremental expense. The largest expense increases are $1.7 million for software maintenance agreements on the new administrative systems and $1.3 million to the Office of Research Administration to build into its base budget salaries that had previously been supported with one-time funds.

- MEDICAL SCHOOL FORMULA – In the Fall of 2002, the Provost and the Dean of the School of Medicine reached an agreement on a new budget formula for the School of Medicine. The formula was designed to allow the central university more accurately to recover the costs of the services provided to the school, while allowing the school to benefit from revenue streams that more accurately reflect its various activities. The new formula lets the school retain all of its income and applies differential charges on various revenue streams to reimburse the university for central services related to that revenue. For example, tuition revenue is charged a rate that captures the cost of student services, while indirect cost recovery is charged a rate that covers central research administration. Whereas the old budget formula imposed a tax only on sponsored research, the new formula applies appropriate charges to all of the revenue streams in the school. This formula is more equitable and better reflects the diversity of activities in the school. The net result of the new formula is a reduction of $7.2 million in the general funds allocation to the School of Medicine.

CONSOLIDATED BUDGET FOR OPERATIONS

The table on the following page shows the main revenue and expense line items for 2003/04 and compares those numbers to the reprojection of actual results for the current year. These figures include the incremental costs for the programs and initiatives noted above. Some highlights of both income and expense follow.

REVENUE

STUDENT INCOME – This figure is the sum of tuition and room and board income. Tuition is projected to grow 7.3% over the projected 2002/03 actuals, the result of a 5.0% increase in the undergraduate tuition rate, a 9.7% increase in the 8-10 unit rate for part-time graduate students, a 50% increase in the terminal graduate registration rate, and the addition of 75 incremental masters students. Room and board income is projected to increase by 9.5%, due to a 4.25% increase in the standard undergraduate room and board rate, the reopening of Branner Hall, and the impact of a full year of rent on the new Escondido Village graduate student apartments.

SPONSORED RESEARCH – The 4.2% growth in sponsored research results from: 1) an anticipated growth in direct research costs of 6.5%, 2) a reduction in direct costs at SLAC of 3%, and 3) an 8% increase in indirect cost recovery, due to volume growth plus an increase in the indirect cost rate from 58% to 60%.

EXPENDABLE GIFTS – The Office of Development anticipates that revenue from non-capital gifts available for current expenses will remain flat at $105 million for 2003/04. (This line does not include gifts to endowment or for capital projects.) In addition, net assets released from restrictions—primarily payments made on prior year gift pledges—are also expected to remain constant at $50 million.

INVESTMENT INCOME – This category consists of income paid out to operations from the endowment and from the expendable funds pool (EFP). Income from endowment is expected to decrease next year by 1.0%, including payout from new gifts to the endowment. (Excluding new gifts, endowment income would drop by 2%.) The spending rates approved by the Board of Trustees in February 2003 yield a smoothed payout rate of 5.24% compared to our target rate of 5.05%. Other investment income is expected to grow by 9% over the projected 2002/03 year-end actuals. This return is in accord with a new EFP policy proposed to the Board at this meeting. Under this policy approximately 87.5% of the EFP will be invested in the merged endowment pool and the

Projected Consolidated Budget for Operations, 2003/04

[in millions of dollars]

2001/02 Actuals	20002/03 Projected Year-End Acts		2003/04 Projected Current Funds
		Revenues and Other Additions	
411.5	435.6	Total Student Income	469.3
801.6	850.1	Total Sponsored Research Support	885.6
195.8	208.1	Health Care Services	225.8
104.3	105.0	Expendable Gifts in Support of Operations	105.0
446.2	450.8	Investment Income	453.2
233.7	233.7	Special Program Fees and Other Income	233.7
39.8	50.0	Net Assets Released from Restrictions	50.0
2,232.9	2,333.4	Total Revenues	2,422.6
		Expenses	
1,084.0	1,169.1	Salaries and Benefits	1,233.0
227.8	230.0	SLAC	223.0
110.6	114.9	Financial Aid	123.6
704.4	740.6	Other Operating Expenses	763.5
2,126.8	2,254.6	Total Expenses	2,343.0
106.1	78.8	Revenues less Expenses	79.6
(84.4)	(105.0)	Transfers	(98.6)
21.8	(26.2)	Surplus/(Deficit)	(19.0)

remainder in money market instruments. Unspent endowment income funds will be invested in a segregated, but merged, investment pool, 100% of which will be invested in money market instruments.

Expense

Salaries and Benefits – We anticipate total salaries and benefits expense to increase 5.5% over the projected year-end actuals. Although there will not be a merit raise program next year, there are several factors causing this increase. First, the rise in the benefits rate from 24.8% to 29.0% accounts for 3.1 points of the 5.5% increase. Second, there will be funds dedicated to bonuses, reclassifications, and market adjustments. These account for 1.5 points of the increase. Finally, the remaining 0.9 points reflects headcount increases anticipated in the auxiliaries and on sponsored research projects. Benefits costs are anticipated to increase by 21% from the 2002/03 budget (8.9% from the projected 2002/03 year-end actuals). The largest increase is in healthcare benefit costs, which are increasing 27% from the 2002/03 budget.

Other Operating Expenses – These line items are comprised principally of operations and maintenance (O&M) costs, utilities, capital equipment, materials and supplies, travel, library materials, subcontracts, and professional services. We are budgeting a growth of 3% for these items.

THE OUTLOOK FOR 2004/05

While it is speculative to look at Stanford's financial situation beyond next year, we have developed a general funds forecast for 2004/05 that projects a $15-20 million shortfall. This is an "unconstrained" forecast at this time, since it does not contain any specific corrective actions. The forecast does include a merit salary program increase. There are two major reasons for the shortfall. The first is a further increase in the staff benefits rate, due to the escalating cost of healthcare. The second is the assumption of continued slow growth in endowment returns. At this point it is too early to suggest what our plan of action might be to address this projected shortfall. However, we will be monitoring the situation closely and will update the Board of Trustees and the Stanford community in the fall as the outlook becomes clearer.

CAPITAL BUDGET AND PLAN

The Capital Budget for 2003/04 has been developed in the context of a three-year Capital Plan. The three-year plan includes projects that were initiated prior to, but will be completed during or after, 2003/04, as well as projects that will be started during the three-year period from 2003/04 to 2005/06. Since some projects in the plan will not be complete by the end of 2005/06, the "three-year" plan actually provides a rolling window of approximately five to six years of construction projects at the university. The Capital Budget represents those capital expenditures in the three-year Capital Plan that are expected to occur in 2003/04.

CAPITAL PLAN, 2003/04 – 2005/06

This year's Capital Plan has been significantly affected by affordability constraints, debt capacity limits, and challenging fundraising prospects. This was also true last year, but is even more strikingly evident now. The three-year Capital Plan forecasts $837 million in construction and infrastructure projects and programs that are currently underway or planned to begin over the next three years. For comparison, last year's three-year Capital Plan included $1.068 billion in projects, while the previous year's plan listed $1.329 billion in projects.

Although this year's $837 million plan is a far more realistic view of our near-term construction outlook, I do not expect that all of the projects included in the three-year plan will be completed, or will be completed in the envisioned timeframe. The projects included in the plan can all be accommodated within the constraints of the General Use Permit, and we are reasonably certain that the debt funding assumptions are realistic. But many of the projects assume substantial amounts of unidentified gift or reserve funding. These projects will only move forward when the stated funding goal is met with gifts or school reserves in hand.

The three-year Capital Plan includes 25 major projects and numerous infrastructure projects and programs. Most of these projects are multi-year efforts and all are scheduled to be completed by the end of 2008/09. The three-year plan will be funded from $122 million in current funds; $84 million in gifts and pledges; $36 million in auxiliary and service center debt; $123 million in academic debt; and $472 million in other resources yet to be identified, including gift funds not yet raised.

The three-year plan includes:

- $173 million for projects currently in Design & Construction,
- $567 million for Forecasted Projects, those anticipated to be presented to the Trustees for approval during the three-year period, and
- $97 million for Infrastructure Projects and Programs.

At plan completion, incremental annual internal debt service is expected to be $14 million, of which $5.7 million will be serviced by auxiliary or service center activities and $8.3 million will be paid for by unrestricted funds. Incremental O&M costs are expected to total $12.8 million per year, of which $9.5 million will be paid for by unrestricted funds.

Capital Budget, 2003/04

The Capital Budget for 2003/04 has also seen a substantial reduction over last year's Capital Budget. It represents anticipated expenditures for the year, including both committed and planned projects. The 2003/04 budget totals $151.6 million, compared to last year's total of $266 million. We categorize the projects in the 2003/04 Capital Budget in two ways:

- By Use: 43% for academic/research facilities; 24% for infrastructure; 16% for housing; and the remaining 17% to athletics, student activities, and academic support.
- By Type of Space: 52% for new projects (Law Student Housing, Lucas Center Expansion, and the School of Medicine Information and Learning Environment buildings); 24% for renovation projects (Maples Pavilion); and 24% for infrastructure programs.

The 2003/04 Consolidated Budget for Operations includes incremental internal debt service and operations and maintenance expenses for projects completing in 2003/04 and for projects completed in 2002/03 that were operational for less than twelve months. The projected impact of the additional internal debt service and O&M expenses is $13.7 million and $5.8 million, respectively.

REQUESTED APPROVAL AND ORGANIZATION OF THIS DOCUMENT

This Budget Plan provides a university-level perspective on Stanford's programmatic and financial plans for 2003/04. We seek approval of the planning directions, the principal assumptions, and the high-level supporting budgets contained herein. As the year unfolds, we will make periodic reports on the progress of actual expenses against the budget. In addition, we will bring forward individual capital projects for approval under normal Board of Trustees guidelines.

This document is divided into three sections and two appendices. Section 1 describes the financial elements of the plan, including details on the Consolidated Budget for Operations and the projected Statement of Activities for 2003/04. Section 2 addresses program issues in the academic areas of the university. Section 3 contains details on the Capital Plan for 2003/04 – 2005/06 and the Capital Budget for 2003/04. The Appendices include budgets for the major academic units and supplementary financial information.

CONCLUSION

In presenting last year's budget plan, I remarked that Stanford was entering a period of modest retrenchment. That retrenchment has both continued and become significantly less modest. Where many units achieved last year's budget reductions by trimming and saving, this year has required, for almost all units, a much more searching analysis of expenditures. Many administrative units reluctantly reduced or eliminated services; several academic units restructured their funding models to tap school and department funds to cover expenses previously funded with general funds; some sought ways to enhance revenues. Centrally, we struggled with decisions about the salary program, ultimately deciding that a salary freeze, with opportunities for one-time bonuses and isolated market corrections, was worth the savings. We continue to struggle with the benefits package, which may have to be changed to dampen future increases in the benefits rate. Though many challenges remain, I think the budget plan we have arrived at achieves the required reductions without harming the university or decreasing the quality of the education we provide and the research we perform.

I am continually impressed by the cooperative and positive attitude brought to the budget process by everyone involved. I want to thank everyone who participated in the difficult budgeting process in the schools and administrative units. Their care and thoughtfulness was apparent in the budget documents that were ultimately presented to and studied by the Budget Group. This is also a sign of the outstanding leadership we have in place in the schools and administrative units: I am grateful to all the deans, vice provosts, vice presidents, and directors who were responsible for their unit's budget process.

The budget and capital plan would not come together without the extraordinarily dedicated work of two advisory committees: the University Budget Group and the Capital Planning Group. The Budget Group this year consisted of Keith Baker, Mike Hindery, Charles Kruger, Randy Livingston, Channing Robertson, Dana Shelley, Bob Simoni, Buzz Thompson, and Tim Warner. This year's Capital Planning Group consisted of Chris Christofferson, Megan Davis, Margaret Dyer-Chamberlain, Stephanie Kalfayan, Randy Livingston, Sandy Louie, David Neuman, Tim Portwood, Bob Reidy, Gary Rotzin, Craig Tanaka, Jeff Wachtel, and Tim Warner. I am grateful to all of these individuals for their hard work and good humor along the way to the final plans presented here.

A huge amount of work is performed behind the scenes to support the efforts of these two advisory committees. In the Budget Office, Steve Olson and Dana Shelley do this work, under the able direction of Tim Warner. In the Capital Planning Office, Megan Davis and Margaret Dyer-Chamberlain lead the process, with guidance from Bob Reidy. I am extremely lucky to have the support of all of these dedicated and capable individuals. Tim Warner, in particular, is behind every page of this document.

Finally, this year a special thanks is due to the team that worked many hours on the design of the new School of Medicine general funds formula. This effort was led by Paul Goldstein in the Budget Office, who collaborated with Mike Hindery and Carole Buffum to arrive at a fair and practical model for allocating central expenses to the school's complex revenue streams. Again, this was a potentially divisive topic, but was approached with good will and cooperation on all sides.

Thank you all.

John W. Etchemendy
Provost
June 2003

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