Stanford University Budget Plan

2004/05

Submitted for Action to the
Board of Trustees
June 10–11, 2004

This publication can also be found on the World Wide Web at:
http://www.stanford.edu/dept/pres-provost/budget/plans/plan05.html

Executive Summary

To The Board of Trustees:

I am pleased to submit Stanford University's 2004/05 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 2004/05 Consolidated Budget for Operations reflects an anticipated surplus of $6.7 million on $2.7 billion of revenues, $2.6 billion in expenditures, and $62 million of transfers. The Consolidated Budget is shown on a modified cash basis and reflects the legal restrictions of fund accounting. The Consolidated Budget is our primary tool for managing the financial operations of the university.

General funds comprise $706 million of Stanford's Consolidated Budget. These funds can be used for any university purpose. General funds of $584 million are allocated directly by the Provost, while the remaining $122 million flow to units in accordance with formula funding agreements 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 is balanced for 2004/05.

As has been our practice in recent years, we also show a projected Statement of Activities for the university, which is displayed in the format consistent with Generally Accepted Accounting Principles (GAAP), as reflected in the university's Annual Financial Statements. Under the GAAP structure we are projecting a $3 million deficit. The difference in the two results is primarily the inclusion of non-cash items in the Statement of Activities. (These adjustments are detailed in Section 1).

The 2004/05 Capital Budget calls for $168.9 million in capital expenditures. These expenditures are in support of a three-year Capital Plan that, once fully completed, would require $976.8 million in total project expenditures.

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

A year ago, when we proposed the budget for 2003/04, Stanford had just concluded a second year of budget reductions, implemented a salary freeze across the university, and made only minimal investments in new programs and support services. Moreover, we forecasted a deficit of $19.0 million for 2003/04. It was clearly the most challenging budgetary environment we had faced since the early 1990s. Although 2004/05 was two years away at that time, we forecasted continued, albeit less severe, financial pressures. Over the summer of 2003 and into the fall, however, the university's financial picture brightened as the financial markets improved. Stanford finished the last fiscal year, ending in August 2003, with a surplus, and we are now projecting a surplus of $18.5 million in 2003/04.

As we began planning for the 2004/05 budget, we were still forecasting a modest deficit in the general funds portion of the Consolidated Budget for Operations. The projected deficit was due, in part, to our commitment to include a competitive salary program in the budget and to include funding for program and facilities commitments made several years ago. After the past two years of cuts we also recognized the need for financial capacity for important new programmatic investments.

In developing budgets for the prior two years we relied on a process in which budget reductions were identified at the school and administrative unit level. Decisions were then made, with the advice of the Provost's Budget Group, on the magnitude of cuts in each area. After two years of this unit-focused reduction process, we felt another strategy was in order. Consequently, we identified six areas that cut across organizational lines and offered the potential for cost reduction or income enhancement. They were: benefits costs, the infrastructure charge on restricted funds, residence-based student advising, graduate student housing subsidies, human resources, and technology licensing income. We recognized, however, that to implement reductions or increase income in these areas could take more than a single year, given the lead time required to study each issue and implement a change. So in order to have the capacity to balance the budget we also asked each school and administrative unit to identify potential cuts of 3% and 5%. Our goal was to minimize reductions to individual unit budgets while achieving an overall balanced general funds budget.

Key Priorities

As we worked on the university-wide structural changes and with the budget units to identify cuts, I consulted with the Provost's Budget Group to identify the most critical priorities for 2004/05. They were:

- Providing a competitive salary program for faculty and staff – our highest priority,
- Implementing a benefits package that was fiscally responsible while meeting the core needs of our people,
- Maintaining our capacity to make selective academic investments in such important areas as bioengineering and graduate student support,
- Maintaining our long-standing commitment to a financial aid program that is among the very best in the country,
- Implementing a plan to fund our physical plant renewal needs, and
- Completing—and then sustaining—Stanford's significant investment in administrative and academic systems and computing infrastructure.

The 2004/05 Budget Plan reflects considerable progress in addressing these priorities.

- Compensation – This Budget Plan includes a competitive merit salary program for faculty and staff. The program also provides special market adjustment funding for those faculty and staff groups who are below their relevant markets. We believe this program will help restore our competitive position for faculty compensation and position us at the local mid-market target for staff.

- **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 our financial aid program will address the increased need for those families whose financial circumstances do not keep pace with the cost of attending Stanford. General funds (including the Stanford Fund) supporting financial aid will increase next year by 15.7% from $25.5 million to $29.5 million. Funding for undergraduate aid from all Stanford sources will increase by 10.4% from $56.0 to $61.8 million.

- **Facilities Support** – Over the past 15 years, Stanford has made significant investments in its facilities. During this period we have largely rebuilt the campus and have substantially avoided the accumulation of deferred maintenance. To preserve this strong position, we have analyzed the on-going cost of renewing our facilities and have begun to provide incremental funds for that purpose. Next year's budget includes an increment of $1 million for planned maintenance, the first of what will likely be additional incremental allocations over the next five to ten years. We will have an extensive report on the subject at the October 2004 board meeting.

- **Systems** – For the past several years Stanford has been engaged in a major 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 implementation. We are budgeting $19.1 million for system development projects and the infrastructure to support them in next year's budget.

- **General Funds Reductions and Incremental Allocations** – As noted above, in an effort to achieve a balanced budget and provide capacity for new investment in the general funds component of the Consolidated Budget, we adopted a two part approach: university-wide structural initiatives, and unit-specific budget reductions. Each of the structural initiatives holds promise for cost reduction or revenue enhancement, although major impacts will probably take a year or two to realize. We achieved immediate savings in the off-campus graduate student housing subsidies by renegotiating leases with local apartments complexes, and have implemented a change in the funding of the Office of Technology Licensing. We will also propose a modification in the infrastructure charge on restricted funds. The other areas are still under study, and several, such as residence-based advising and staff benefits, will require additional faculty and administrative consultation. To balance the budget and make needed investments, we relied again this year on unit-based cuts within the general funds portion of the Consolidated Budget. Specifically, we are reducing base budget funding allocations to academic and administrative units by $5.3 million. However, we are also allocating $13.1 million for incremental programs and support. On a net basis, after accounting for the salary and benefit program adjustment and non-salary inflation, the School of Humanities and Sciences will receive the largest increase at $2 million, $1 million will go to raise the planned maintenance budget for facilities, $1.3 million will provide increased support to Development and the Alumni Association to enhance further the university's fundraising and alumni relations capacity, and a $700,000 increase will go to the Libraries. (Details on the allocations are included in Section 1.)

CONSOLIDATED BUDGET FOR OPERATIONS

The table on page vi shows the main revenue and expense line items for 2004/05 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.

PROJECTED CONSOLIDATED BUDGET FOR OPERATIONS, 2004/05

[IN MILLIONS OF DOLLARS]

2002/03 Actuals	20003/04 Projected Actuals		2004/05 Projected Consolidated Budget	2003/04 to 2004/05 Percent Increase
		Revenues and Other Additions		
434.0	467.0	Student Income	491.4	5.2%
860.3	916.0	Sponsored Research Support	964.8	5.3%
227.6	249.6	Health Care Services	274.5	10.0%
112.6	115.0	Expendable Gifts in Support of Operations	120.0	4.3%
507.8	480.8	Investment Income	506.4	5.3%
227.9	241.9	Special Program Fees and Other Income	248.0	2.5%
54.2	50.0	Net Assets Released from Restrictions	50.0	0.0%
2,424.4	2,520.3	Total Revenues	2,655.1	5.3%
		Expenses		
1,175.0	1,282.0	Salaries and Benefits	1,361.1	6.2%
219.7	228.0	SLAC	260.0	14.0%
123.5	132.0	Financial Aid	141.9	7.5%
723.3	798.2	Other Operating Expenses	823.8	3.2%
2,241.5	2,440.2	Total Expenses	2,586.8	6.0%
182.9	80.1	Revenues less Expenses	68.3	
(113.4)	(61.6)	Transfers	(61.6)	
69.5	18.5	Surplus/(Deficit)	6.7	

REVENUE

Student Income – This figure is the sum of tuition and room and board income. Tuition is budgeted to grow 5.7% over the projected 2003/04 actuals, as the result of a 4.5% increase in the undergraduate tuition rate, a 50% increase in the terminal graduate registration rate, and a modest increase in the number of Masters students. Room and board income is projected to increase by 3.3%, due to a 4.7% increase in the standard undergraduate room and board rate and a reduction in off-campus subsidized housing for graduate students.

Sponsored Research – The 5.3% growth in sponsored research is driven by a 14% increase at SLAC. Direct cost growth in the rest of the university is expected to be 3.2%, which reflects a 5.5% growth rate before the impact of a significant reduction in funding for the Gravity Probe B project, which was successfully launched on April 20th. Indirect cost recovery is expected to be flat in 2004/05, due an anticipated reduction in the indirect cost rate.

Health Care Services – At a 10% rate of increase, this area is the fastest growing revenue source in the Consolidated Budget. It is dominated by $203.8 million from the clinical operations of the School of Medicine, which are projected to increase by 11.8% in 2004/05 due to the planned recruitment of Medical Center line faculty and clinician educators.

Expendable Gifts/Net Assets Released from Restrictions – The Office of Development anticipates that revenue from non-capital gifts available for current expenses will grow by 4.3% in 2004/05 to $120 million. (This line does not include gifts to endowment or for capital projects.) In addition, net assets released from restrictions—payments made on prior year gift pledges and prior year gifts released from restrictions—are 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). Overall, investment income is expected to increase by 5.3%. Income from endowment is expected to increase next year by 5.1%, including payout from $250 million in projected new gifts to the endowment. The spending rates approved by the Board of Trustees in February 2004 yield a smoothed payout rate of 4.67% compared to our target rate of 5%. EFP income is expected to grow approximately 6% over the projected year-end actuals.

Expense

Salaries and Benefits – We anticipate total salaries and benefits expense to increase 6.2% over the projected year-end actuals. Academic salaries are expected to increase by 6.0%, due to a competitive salary program, a 6.5% increase for RA/TA salaries, and a 10% growth in clinical academic salaries (driven by both headcount increases and a competitive salary program). Staff salary growth is expected to be 4.5% as a result of our merit program and a slight increase in staff headcount. Benefits and other non-salary compensation expense are expected to increase by 8.3%, due principally to an increase in the benefits rate from 29.0% to 30.5%. This increase is the result of continued growth in health insurance costs. For 2004/05, health insurance costs are expected to rise by 15%.

Other Operating Expenses – This line item is composed principally of internal debt service, 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 3.2% for these items.

CAPITAL BUDGET AND PLAN

The Capital Budget for 2004/05 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 not be completed by, 2004/05, as well as projects that will be started during the three-year period from 2004/05 to 2006/07. Since some projects in the plan will not be complete by the end of 2006/07, 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 2004/05.

Capital Plan, 2004/05 – 2006/07

This year’s Capital Plan has been significantly affected by affordability constraints, debt capacity limits, and challenging fundraising prospects. The three-year Capital Plan forecasts $976.8 million in construction and infrastructure projects and programs that are currently underway or planned to begin over the next three years. This is an increase over last year’s $837 million due to the inclusion of several projects from the ambitious Science, Engineering and Medicine Campus (SEMC) plan.

Although the $976.8 million plan presents a 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 in the envisioned timeframe or at the currently projected scale. Nevertheless, 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. It should be noted that many of the projects assume substantial amounts of unidentified gift or reserve funding. These projects will only move forward if and when the stated funding goal is met with gifts or school reserves in hand.

The three-year Capital Plan includes 29 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 2009/10. The three-year plan will be funded from $110 million in current funds, $134 million in gifts and pledges, $68 million in auxiliary and service center debt, $107 million in academic debt, and $558 million in other resources yet to be identified, including gift funds not yet raised.

The three-year plan includes:

- $257 million for projects currently in Design and Construction,
- $595 million for Forecasted Projects, those we anticipate presenting to the Trustees for approval during the three-year period, and
- $125 million for Infrastructure Projects and Programs.

If all the projects in the plan are completed, the incremental annual internal debt service will be $15.1 million, of which $6.1 million will be serviced by auxiliary or service center activities, $7.4 million will be paid for by unrestricted funds, and $1.6 million will be paid by the formula schools of Business and Medicine. Incremental O&M costs will total $12.9 million per year, of which $7.5 million will be paid from unrestricted funds.

Capital Budget, 2004/05

The Capital Budget for 2004/05 represents $168.9 million of capital expenditures for the upcoming year. Most of these expenditures reflect only a portion of the total costs of the capital projects, as most projects have a duration exceeding one year. We categorize the projects in the 2004/05 Capital Budget in two ways:

- By Use: 37% for academic/research facilities; 26% for infrastructure; 20% for athletics and student activities; and the remaining 17% for housing and academic support, and
- By Project Type: 42% for new projects (Law Student Housing, Varian 2, and the Arrillaga Family Recreation Center); 32% for renovation projects (Maples Pavilion); and 26% for infrastructure programs.

The 2004/05 Consolidated Budget for Operations includes incremental internal debt service and O&M expenses for projects completing in 2004/05 and for projects completed in 2003/04 that were operational for less than twelve months. The projected impact of the additional internal debt service and O&M expenses is $2.4 million and $792,000, respectively.

REQUESTED APPROVAL AND ORGANIZATION OF THIS DOCUMENT

This Budget Plan provides a university-level perspective on Stanford's programmatic and financial plans for 2004/05. We seek approval of the planning directions, the principal assumptions, and the high-level supporting budgets contained in the plan. As the year unfolds, we will make periodic variance 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 2004/05. Section 2 addresses program issues in the academic areas of the university. Section 3 presents the Capital Plan for 2004/05– 2006/07 and the Capital Budget for 2004/05. The appendices include budgets for the major academic units, along with supplementary financial information.

CONCLUSION

Although Stanford's financial outlook has improved markedly over the past year, we did not take this welcome development as license to stop looking for budget savings. For the third year in a row, we asked the schools and administrative units to propose possible budget reductions, many of which were then adopted. But unlike last year, most of the dollars freed up were used to finance important new university priorities rather than to offset a shortfall in revenue. Such internal reallocation is essential to maintaining a vibrant university with adequate resources to pursue new academic directions as they present themselves. Still, I recognize that identifying areas to reduce, following on the heels of two years of prior reductions, is a demanding task that places great pressure on both the leadership and the budget offices in the schools and administrative units. Once again, everyone involved in the process approached the effort with energy and equanimity. I thank our outstanding leaders—Deans, Vice Presidents, Vice Provosts and Directors—as well as their excellent budget officers, for all their hard work on this year's budget. Your efforts will result in a stronger university.

This year's budget process also demanded more of the Provost's Budget Group, thanks to our decision to examine, in addition to unit-based cuts, a set of more global, cross-cutting expense reductions and revenue enhancements. Although many of these efforts are ongoing, I am enthusiastic about the potential savings that will result from this additional work: it will serve us in good stead both in the current budget year and into the future. The Budget Group this year consisted of Artie Bienenstock, Stephen Hinton, Randy Livingston, Kären Nagy, Channing Robertson, Bob Simoni, Dana Shelley, Buzz Thompson, and Tim Warner. This is one of the hardest working committees in the university and we are all in their debt.

Each year the Capital Planning Group tackles a constraint-satisfaction problem of daunting complexity. After surveying the host of building needs and desires presented by the schools, this group must design a plan that satisfies the multiple constraints imposed by the General Use Permit, our limited debt capacity, the reality of gift prospects, the impact on General Funds, and the University's academic priorities. This process was led by Margaret Dyer-Chamberlain and Megan Davis. The remaining members of the Capital Planning Group were Charles Carter, Chris Christofferson, Jack Cleary, Stephanie Kalfayan, Howard Leung, Randy Livingston, Sandy Louie, Tim Portwood, Bob Reidy, Gary Rotzin, Craig Tanaka, Jeff Wachtel, and Tim Warner. I am grateful to this group, particularly to Margaret and Megan, for their insight and advice.

Finally, let me again thank Tim Warner and Bob Reidy for overseeing these two efforts, and Dana Shelley and Steve Olson for conjuring the behind-the-scenes magic required to bring the process to a close.

Thank you all,

John W. Etchemendy
Provost
June 2004

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