Comments to Budget and Finance about Budget Reductions:

As we think about the current economic environment and its impact on the University, let me try to put several things into a larger context, review where we are, and how things may evolve over the coming months. The University's fiscal environment is quite complex, and all of our various funding streams are impacted by this severe economic downturn. For 2006-07, the following is a breakdown of our sources of revenue:

State Appropriations, Contracts & Grants	31%	$2,543,060,697
Auxiliaries	13%	$1,058,544,036
Tuition & Fees	12%	$ 959,448,820
Federal Appropriations, Contracts & Grants	11%	$ 916,318,492
Hospital Sales & Services	10%	$ 787,795,559
Capital Appropriations, Grants & Gifts	10%	$ 838,787,149
Investment Income & Endowments	7%	$ 592,640,519
Gifts	2%	$ 173,481,473
Local Grants & Contracts	2%	$ 172,052,988
Other Revenues	2%	$ 161,456,264
	100%	$8,203,585,997

Right now, all of these revenue streams are subject to changes due to the changing fiscal environment, so we're working to get a clearer picture of the impact on each. As we work through the next few months, we'll begin to get a better understanding of the long-term picture and how to manage our way through this challenging time in the University.

On the state budget side, you've heard us talk about budget reversions for this year and potential reductions for next year. Let me further clarify those conversations.

- For this fiscal year (2008-09), or the state fiscal year that began on July 1, 2008 and will end on June 30, 2009 - the Governor has the responsibility to manage the budget so that the state ends the year at or above zero. What has happened is that revenues that the state counted on (primarily sales taxes, personal income taxes and corporate taxes) have not materialized in the way that was projected. Thus, the state's expenditures have to be reduced below what was expected so that the budget can be balanced. For the current year, we have to holdback, or return to the state, 6% of our alloted budgets. We can treat this as a temporary return, in other words, the campuses have been able

to ask – what can we do without between now and the end of the year in order to make ends meet? For us, most of our expenditures happen during the fall and spring semesters, so as the year goes along, it gets harder to manage. Remember that this started at a 2% holdback level, went to 4% and now is at 6%. Since we're not sure that the state will not require further reversions, we have instructed the Chancellors to plan for 7%. Since we anticipated this early on and the Governor was able to give us information early on, we feel like we are well-positioned, working with the Chancellors and the Governor, to manage through the end of this fiscal year.

- For next fiscal year and the biennial budget (2009-11) or the state fiscal year beginning July 1, 2009, the situation is much different. Just think about your business or personal budget. You can do without a lot of things in the short term to make ends meet, but having to do without those things forever is a much tougher decision.
- What we were asked, by the Governor, was to work with the campuses to develop scenarios to help project the impact of budget reductions at the 3%, 5%, and 7% levels for the upcoming biennium. The Governor's instructions allowed that up to 25% of each level could be recommended as a nonrecurring cut. These scenarios were done in a very short timeframe, and we did it to the best of our ability with the limited knowledge we had about the overall scope of the economy and environment we're in. The campuses were responsive to the Governor's request and we have provided the information to the Budget Office. <u>The responses are hypothetical, not definitive – solid plans cannot be determined until some things that are currently unknown become clearer.</u>
- Right now we can give you overall, general statements about the impact of the above issues on our operations, but our campuses will refine these over the next several months.
- There are several unknowns that will become clearer over the next few months:

    - Right now we do not know the ultimate impact of the federal stimulus package for North Carolina. This includes any funds that we can expect for the University, but it is broader than that. Any funds that help the state's budget, ultimately help our budget as well. For example, any assistance that the federal government can give to the states in Medicaid and education will help relieve some of the pressures at the state level. As that picture unfolds over the next couple of weeks we'll get a better idea of that part of the puzzle.

    - We do not have the final revenue picture for the state, for 2008-09 or for the upcoming biennial budget. Those numbers will begin to be finalized in the late March to mid-April timeframe.

    - We currently do not know what options the state will consider to address the budgetary issues on a statewide basis. (As an example, the controversial issue of furloughs.)

- Enrollment on our campuses and the need for financial aid will become clearer over the next few months. Campuses are right now in the process of reviewing applications for admission and getting some ideas about the choices that students are making. We expect that there will be increased enrollment on our campuses, but we do not know exactly how much. We expect that some of the families may have increased need, and that will become clearer over the spring and summer.

- This is not an exact science, and we have to work with our "managers in the trenches" - the Chancellors and their staffs . I am confident that we have good managers in place at our institutions that will make the best decisions that they can in order to manage our way through this.
- For context, I can tell you that our state funded budgets are very much focused on what the state expects us to do – educate students. Let me explain what I mean:
    - Personnel costs represent 75% of our campuses' state budgets. Therefore, in order to protect jobs and not eliminate faculty and staff positions at the 5% cut level, campuses would have to cut non-personnel costs (utilities, library books, physical plan operations, building upkeep, equipment) by approximately 20%. At the 7% cut level, it would require cutting those other areas by 28%.
    - Looking at it another way, 70% of our campuses' state budgets go towards instruction, academic support and student services. To protect these vital services at the 5% reduction level, campuses would have to cut other areas (research, public service, operations & maintenance of facilities and institutional support) by 16%. At the 7% reduction level, it would require a 23% cut to those other areas. Clearly, we can't completely protect the instructional areas while simultaneously allowing the buildings to degrade or having further weakening in our fiscal operations. From the above it is plain to see that while we will do everything that we can to minimize the impact on students, we simply cannot cut this magnitude of funds out of our budgets without students feeling some of the impact. There will be adjustments and changes that just have to happen, including job losses that will be painful.
- As the Chancellors put together these scenarios, we provided guidelines to them to consider and think about. This is not a "one size fits all" case, and each campus had to consider what was the best management strategy for its particular situation. Our guidelines were simply to provide suggestions and options for consideration:
        - Reduced administration
        - Increased faculty productivity
        - Areas funded by the state that could be funded from another source
        - State-funded activities not directly related to course delivery
        - Low productivity/ low enrollment programs
        - Appropriateness of staff sizing
        - Review of vacant positions
        - Middle management

    - Telecommunications
    - Program consolidation
    - Centers and Institutes
- At the 3% cut level, the estimates show that it would require the loss of 600-700 jobs, some of which would be vacant but others that may be filled. The breakdown of filled versus vacant is not exact at this point, since there is ongoing turnover and campuses will manage accordingly. At this level, about a third of the cut could also come from reductions in travel, supplies and materials, telephone services, postage, utilities, repair and maintenance of facilities and other operational line items.
- At the 5% cut level, estimates show that it would take a reduction of 1100-1200 jobs to meet the targets, again some of them vacant and some filled. At this level, a little less than a third of the total can come from travel, supplies and materials, telephone services, postage, utilities, repair and maintenance of facilities and other operational line items. A higher percentage of the overall total would unfortunately come from reductions in jobs.
- At the 7% cut level, still about 30% of the total cuts can come from non-personnel areas, since the bottom line total reduction has increased by another 2%, it would require cutting more than 1600 jobs, some filled and some vacant. At this level, unfortunately many more would be eliminations of filled positions.

Based on the Campus budget reduction scenarios:

	3% Cut Level	5% Cut Level	7% Cut Level
% of cut that is Personnel	66.9%	69.6%	70.2%
% of cut that is Non-Personnel	33.1%	30.4%	29.8%

- Overall the types of things we can expect to see are:
    - Larger classes
    - Higher workload for existing faculty
    - Lower retention and graduation rates
    - Less engagement
    - Less advising
    - Higher faculty/staff ratios
    - Fewer courses, less classes
    - Delayed classroom upgrades
    - Reduction in equipment & renovation of laboratories
    - Lower delivery of efficient and quality patient care
    - Less revenue generating research
    - Less junior faculty development

- Reduction in staffing and acquisitions in libraries
- Reduced support to local and state government
- Accreditation at risk due to major reductions in faculty
- Reduced enrollment in critical programs like nursing where there are workforce shortages
- Number of undergraduate class sections with over 100 students will reach an all time high
- Reduction of online course development and outreach because of unavailable faculty, support staff, technology upgrades
- Less able to recruit graduate students
- Elimination of faculty development programs
- Reductions in student enrollment
- Elimination of departments
- Reduction in hours of security personnel
- Reduction in accounting and internal control personnel
- Reduction in maintenance at all levels
- Elimination of pediatric clinics across the state that are supported by AHEC

We will keep the Board of Governors fully informed in this process as we go forward. We have discussed with your Chairman a possible statement of values concerning budget cuts that the Board may want to issue, as it did in prior recessions.