MINUTES

BOARD OF REGENTS COMMITTEE ON BUDGET AND FINANCE MEETING

AUGUST 6, 2020

Note: On January 30, 2020, the World Health Organization declared the outbreak of COVID-19 a public health emergency of international concern, subsequently declaring it a pandemic on March 11, 2020. On March 16, 2020, Governor David Y. Ige issued a supplementary proclamation that temporarily suspended Chapter 92, Hawaii Revised Statutes, relating to public meetings and records, "to the extent necessary to enable boards to conduct business in person or through remote technology without holding meetings open to the public."

I. CALL TO ORDER

Chair Jan Sullivan called the meeting to order at 10:45 a.m. on Thursday, August 6, 2020. The meeting was conducted virtually with regents participating from various locations.

Committee members in attendance: Chair Jan Sullivan; Vice-Chair Randy Moore; Regent Alapaki Nahale-a; Regent Michelle Tagorda; and Regent Robert Westerman.

Others in attendance: Board Chair Ben Kudo; Regent Simeon Acoba; Regent Kelli Acopan; Regent Eugene Bal; Regent Wayne Higaki; Regent Ernest Wilson (ex officio committee members); President David Lassner; Vice President (VP) for Administration Jan Gouveia; VP for Community Colleges Erika Lacro; VP for Legal Affairs/University General Counsel Carrie Okinaga; VP for Academic Planning and Policy Donald Straney; VP for Research and Innovation Vassilis Syrmos; VP for Information Technology/Chief Information Officer Garret Yoshimi; VP for Budget and Finance/Chief Financial Officer Kalbert Young; UH Mānoa (UHM) Provost Michael Bruno; UH Hilo Chancellor Bonnie Irwin; UH West Oʻahu Chancellor Maenette Benham; Executive Administrator and Secretary of the Board of Regents (Board Secretary) Kendra Oishi; and others as noted.

II. APPROVAL OF MINUTES

Regent Westerman moved to approve the minutes of the June 4, 2020, meeting, seconded by Regent Nahale-a, and the motion carried, with all members present voting in the affirmative.

III. PUBLIC COMMENT PERIOD

Board Secretary Oishi announced that the Board Office received written testimony expressing support for funding of student organizations from Ms. Ceslieanne Kamakawiwoʻole, and that no one had signed up to provide oral testimony.

IV. AGENDA ITEMS

A. Fiscal Year (FY) 2019-2020 Fourth Quarter UBS Legacy Endowment Fund Investment Performance Report

Kyle Yoneshige and Lori Hamano from UBS provided a report on the Legacy Endowment Fund (Fund) for the fourth quarter of the fiscal year ending June 30, 2020, reviewing both the asset allocation and investment performance of the Fund. It was noted that the markets continue to experience volatility as a result of the COVID-19 pandemic. Ms. Hamano stated that the Fund consisted of cash assets, fixed-income assets, and equity assets. Fund assets were allocated as follows: 2.76 percent cash, 30.26 percent fixed-income, and 66.98 percent equities. Ms. Hamano noted that UBS has had discussions with the administration and moved an additional $7 million into equities since March 2020 which resulted in substantial benefits to the Fund during these tumultuous times.

Mr. Yoneshige highlighted the overall portfolio performance as of June 30, 2020, noting that returns were up by 14.21 percent for the fourth quarter; 1.40 percent for the calendar year-to-date; 8.12 percent for FY 2020; and 6.88 percent over the last five-year period. He stated that the Fund had a strong performance for FY 2020 and experienced returns near or above the established benchmarks despite the COVID-19 pandemic. He highlighted that the bond portfolio and international growth portfolio have outpaced benchmark expectations which has also provided substantial benefits to the Fund.

Overall, the asset allocation and financial performance of the Fund is on par with the benchmarks. Internal compliance reviews conducted by UBS also confirmed that the Fund was compliant with its fossil fuel divestiture mandates, that there were no material changes or weaknesses in the management of the Fund, and that the Fund was in compliance with all investment policies.

Mr. Yoneshige and Ms. Hamano briefed the committee on the financial outlook of the Fund and the direction UBS was considering given the current market situation and market volatility. Although all indications are that the United States will experience a serious recession with an expected contraction of the Gross Domestic Product of 12 percent, UBS noted that stimulus moneys from both the federal government and the Federal Reserve totaled slightly more than $5 trillion with an additional $1 trillion in stimulus funding being considered. This unprecedented amount of infused liquidity has allowed the markets to continue to stabilize and show growth.

UBS continues to advocate for keeping the Fund's allocation in equities at its current level of a 66.98 percent even though this is slightly lower than where UBS would like the Fund to be with regard to its allocation in equities. It is anticipated that the markets will remain volatile for the foreseeable future, particularly due to fears about the economic impacts of COVID-19, trade issues with China, and the upcoming elections in the United States, and that it is important to maintain calm when making investment decisions. UBS will continue to closely monitor the financial markets and adjust its investment strategies as more information becomes available with the ultimate goal of maintaining long-term investment strategies.

Vice-Chair Moore asked for clarification with regard to the established benchmarks noting that it appeared that UBS was still using a 60-40 split of asset allocation between equities and fixed-income. Mr. Yoneshige replied that two sets of benchmarks were provided by UBS. The benchmarks currently being used were implemented in March 2020 and is equivalent to a 75-25 split in asset allocation between equities and fixed-income. The first benchmark, which is the 60-40 benchmark, is a placeholder and reference to how assets were allocated in the past. Regent Moore asked whether the 60-

40 split benchmark could be eliminated from the report as it is no longer being utilized. Mr. Yoneshige responded in the affirmative.

Noting that UBS indicated that it anticipates that the markets will remain volatile for the foreseeable future due to fears about the economic impacts of COVID-19, trade issues with China, and the upcoming elections in the United States, Regent Acoba asked how this affected UBS' strategy with regard to the Fund. Mr. Yonehige responded that UBS is not anticipating the markets to experience the severe declines it experienced in March 2020 as the markets have the backing of both the federal government and Federal Reserve. He reiterated that UBS continues to advocate for keeping the Fund's allocation in equities at its current level but will continue to monitor the markets closely and if an opportunity arises that would indicate an increase in equities would be prudent, UBS will discuss this matter with the administration.

Regent Acoba stated that the infusion of money into the economy appears to be based on borrowing large sums of funds that will eventually need to be paid back which will impact the economy. He asked how UBS plans to address this situation. Mr. Yoneshige replied that the borrowed money would be paid back through increased economic growth or through increases in tax rates for individuals and corporations. He repeated that UBS continues to advocate for long-term investment in equities to address any impacts this may have on the Fund's portfolio.

B. <u>Financial Outlook for FY 2020-2021</u>

A report on the fiscal impacts of the COVID-19 pandemic on both the economic condition of the State as well as the university was presented by VP Young who noted that the both the State and university would face unprecedented economic challenges in the near future and the most financially difficult situation since statehood. The COVID-19 pandemic will have significant fiscal impacts to the university's operations, particularly in light of an expected decline in revenues from all of the university's funding sources, including its two predominant revenue sources - the State General Fund (GF) and Tuition and Fees Special Fund (TFSF). Although extramural funding for research appears to be showing signs of fiscal positivity, the university expects severe fiscal shortfalls to be felt in all non-research, special, revolving, and enterprise funds which will have impacts on university operations. Some fiscal mitigation measures are available for FY 2021. However, the university is anticipating the financial impacts of the COVID-19 pandemic to be prolonged, requiring mitigation into the next fiscal biennium and beyond.

VP Young reviewed the four major sources of funding for university operations. He reiterated that the two primary sources of university revenues are the GF, which is dependent on general excise tax (GET) revenues, and the TFSF, which is dependent on enrollment. Together, these two funding sources account for more than 66 percent of the university's annual operating budget. The university also receives funding for operations through revenues generated by specific university programs and operations such as the athletics department, university housing programs, and parking fees, which are deposited into numerous enterprise services special funds and revolving funds. He stated that the university receives approximately $540 million annually in GF revenue appropriations. In FY 2019, the university also received approximately $479.4 million from all special funds including the TFSF and $83.4 million from its revolving funds.

An overview of revenue forecasts for both the State and the university was provided by VP Young. State tax revenues for FY 2020 were approximately $600 million lower than forecast with the State collecting approximately $6.7 billion of the projected $7.2 billion in tax revenues. As anticipated, the Council on Revenues (COR) expects tax revenues to be lower for FY 2021 due to the economic impacts of the COVID-19 pandemic and has projected that $5.845 billion in tax revenues will be collected by the State for the current FY. VP Young noted that the recently passed State Budget for FY 2021 included appropriations of $8.182 billion in GF revenues for operations which is approximately $2.3 billion more than the amount of general funds COR is forecasting will be realized by the State. He also cautioned, however, that COR's FY 2021 projections were based on several assumptions that were made in May 2020, including the gradual reopening Hawaiʻi's economy by July 1, 2020. As these assumptions have not been realized and the economic shutdown continues, it is expected that COR will revise its projections downward when it meets again in September 2020. COR has also forecasted that aggregate personal income growth will experience a 7 percent decline for the 2020 calendar year and no growth for the 2021 calendar year which is further indication of the economic crisis facing the State.

The university received approximately $507 million of the $518 million in GF revenues that it was appropriated in FY 2020, with about $11 million being restricted by the Governor and Department of Budget and Finance (B&F). While the Legislature appropriated approximately $526.5 million in GF revenues to the university for FY 2021, the amount of funds which will ultimately be allocated has yet to be determined.

VP Young reiterated that the State Budget appropriations exceed the amount of revenues COR has forecasted for FY2021. He explained the mechanisms the Legislature could use to cover the budget shortfall including drawing down $183 million from the Hawaiʻi Hurricane Relief Fund (HHRF)and approximately $1 billion from the Emergency Budget Reserve Fund (EBRF), and issuing General Obligation (GO) bonds through the municipal facilities lending provision contained in the federal Coronavirus Aid, Relief, and Economic Security Act (CARES Act) which affords jurisdictions the opportunity to sell GO bonds and ultimately use those proceeds to supplant tax revenues that would have been used to pay for operations. He cautioned that the issuance of GO bonds to generate funding to cover operational costs did have risks as these funds are obtained through a process that amounts to a loan and the funds would have to be repaid with interest which would impact later fiscal years.

Chair Sullivan requested VP Young to provide a brief update on the Governor's line item veto of provisions contained in the recently passed State Budget. VP Young replied that the Governor used his line item veto authority to reduce several appropriation amounts contained in the State Budget bill but that none of these items affected the university directly. He stated that all of the reductions made by the Governor were based on the amount of funding the Governor anticipated receiving through federal support and that these amounts may need to be adjusted as funding needs or funding sources may not materialize.

Similar to its significant impact on GF revenues, COVID-19 is also anticipated to have a measurable effect on headcount enrollment, and concomitantly TFSF revenues. VP Young reported that current headcount enrollment on all university campuses, with the exception of UHM, is below enrollment numbers experienced over the same time period last year. While the possibility exists that enrollment will increase as a result of the economic downturn, this will not necessarily translate to an increase in revenue. If considerable changes are experienced in the mix of resident versus non-resident students attending any particular campus, tuition revenues may decline even if enrollment increases since non-resident students pay higher tuition. The university will have a better idea of overall headcount enrollment numbers and actual TFSF revenues generated once the fall semester commences.

VP Young also noted that a significant portion of the university's total operating budget is funded via other non-general special and revolving funds which are almost all for specific programs, auxiliary services, or business activities, including areas such as parking, housing, and athletics. He noted that the university is forecasting that the revenues for the majority of the special and revolving funds will decrease due to the COVID-19 pandemic, with some experiencing significant fiscal shortfalls.

Since the impacts of the COVID-19 pandemic began in March 2020, the State and university have implemented a number of budget constraining measures including the initiation of hiring freezes, restriction of unnecessary travel, restrictions on equipment purchases, and cash preservation measures. All of these initiatives are intended to dampen the 16 percent reduction of GF revenues, a minimum of five percent reduction in TFSF revenues, and reductions in special fund and revolving fund revenues being anticipated by the university for FY 2021 and beyond.

Regent Bal noted that the administration presented a matrix in June regarding anticipated reductions in GF and TFSF revenues that indicated a deficit of $100 million if the university experienced a 15 percent reduction in GF revenues and a five percent reduction in TFSF revenues and asked if that was correct. VP Young replied in the affirmative. Regent Bal inquired whether VP Young was more assured now than he was two months ago regarding the accuracy of the anticipated revenue reductions. VP Young replied that the financial picture remains unclear. However, all indications are that the reductions on GF revenues will be closer to 16 percent which would account for a reduction in revenues of approximately $80 to $100 million.

Vice-Chair Moore commented that the State did not re-open as previously anticipated on July 1 or August 1 and it is still unknown whether it will re-open on September 1. He opined that this does not bode well for the economic condition of the State or the university.

Regent Acoba asked VP Young if he believed the Governor and Director of B&F had a plan to address the funding shortfall between the GF expenditures appropriated by the Legislature in the State Budget and the actual revenues that COR anticipates will be collected. VP Young responded in the affirmative but noted that it will be challenging. He repeated that there are actions that can be taken to attempt to reduce the impacts of anticipated budget shortfall including the use of monies from the HHRF and EBRF. Regent Acoba inquired whether the State was anticipating another round of stimulus from the CARES Act and whether that could be used to cover the budget shortfall. VP Young replied that it is uncertain whether there will be additional direct federal stimulus monies forthcoming to the State and counties. Debate on this issue continues on the federal level. However, should the federal stimulus monies for states and counties materialize, it could be another tool the Governor could use to address the budget shortfall.

Regent Acoba stated that the administration had previously mentioned that it expected the budget shortfall to be somewhere on the order of a 10 to 25 percent reduction in GF revenues for the near future and asked if the administration was able to forecast what the budget deficits might be beyond 2023. VP Young replied that the administration's last presentation provided information on the impacts of a number of revenue reduction scenarios for the next fiscal biennium. He briefly reviewed the scenarios, including estimated revenue losses and speed of depletion of campus reserves, for the three four year campuses, the community colleges, and system-wide administration. If the belief is that these conditions will be prolonged and continue beyond 2023, it is critical that the university begin planning and implementing multi-year budget containment measures to preserve operations beyond 2022 or 2023.

Stating that it was his understanding that funding of collective bargaining increases for university personnel has historically been the responsibility of the Legislature and not paid for with university funds, Regent Acoba inquired as to whether this was a correct assumption. VP Young replied that pay increases negotiated through the collective bargaining process are contractual obligations between the respective employees and the State and that the Legislature approves funding for these collective bargaining costs. However, it is incumbent upon the Governor and the departments, including the university, to determine how to fund the increases should the necessary revenues not materialize. He stated that the university generally receives approximately 83 percent of the general funds necessary to pay for all generally-funded employees of the university.

Regent Acoba inquired further as to whether the over $400 million received in extramural research funding was taken into consideration when determining the university's budget shortfalls. VP Young replied that only GF and TFSF revenue reductions were considered when determining the major budget deficits the university anticipates it will experience in the near future. He reiterated that all revolving and special funds are anticipating revenue reductions, with the exception of the Research and Training Revolving Fund.

Given that the anticipated GF revenue shortfall the university is expecting to realize is somewhere in the range of $100 million, Chair Sullivan asked how much of the general funds received by the university is for discretionary spending as opposed to non-discretionary spending. VP Young replied that nearly all of the GF revenues received by the university are used to pay for personnel costs although the community colleges do receive some GF revenues for operating costs. Therefore, reductions of GF revenues for the university will impact existing positions. While salaries are not generally considered to be non-discretionary costs, in the case of government, salary reductions are not easily achieved and thus can be considered as fixed costs. As the university does not use GF revenues to pay for other costs, such as debt service, it can be assumed that nearly all GF revenues received by the university are non-discretionary.

Chair Sullivan continued asking if a potential consequence of not receiving an adequate amount of GF revenues to cover payroll costs would be a Reduction-In-Force (RIF) scenario where seniority is a major factor in determining whether an individual is retained and can result in more junior employees being "bumped" from their positions. VP Young replied that that was his general understanding of the RIF process but noted that the collective bargaining contracts would contain a more detailed process.

Board Chair Kudo asked what the annual operating budget is for the university in a normal year. VP Young responded that in a given year the university's operating budget is approximately $1.1 billion when all funding sources are considered. Board Chair Kudo continued asking if it would be reasonable to divide this amount by 12 to get an approximation of the funding the university expends each month. VP Young replied that this would be correct in theory. Board Chair Kudo asked how much of these funds are discretionary in that it would not severely impact university operations if the funds do not emerge. VP Young responded that things such as travel and equipment purchase could be considered discretionary and the administration is currently reviewing what spending can be curtailed to help address the anticipated budget shortfall. Board Chair Kudo opined that he estimates that the university spends approximately $70 to $90 million a month and attempts to lower this amount will need to be made to preserve the university's reserve funding for as long as possible and ultimately preserve university operations. VP Young replied that the administration is currently assessing where cost savings can be realized using this approach including in areas such as hiring freezes, travel restrictions, attrition rates, and equipment purchases.

Board Chair Kudo questioned if utility costs have been reduced due to the COVID-19 pandemic. President Lassner replied that UHM utility costs average just around $30 million annually but that since the COVID-19 pandemic began the university has witnessed a decrease in utility costs of 15 to 20 percent compared to the same months the prior year.

Chair Sullivan expressed her concerns regarding the impacts on TFSF revenues that would be felt by the university in the event that the university was not able to begin some form of in-person instruction and had to maintain a completely online instruction model noting that this is beginning to occur in other jurisdictions such as California. President Lassner replied that the administration has not discussed this particular scenario from a purely financial perspective.

C. <u>Budget Planning Schedule</u>

President Lassner stated that the budget planning schedule was the administration's effort toward taking a longer term approach to address the fiscal crisis facing the university due to the COVID-19 pandemic. Based upon previous recessions and financial crises faced by the university, the expectation is that this financial crisis will last a minimum of four years and that the usual belt-tightening and across-the-board reductions used in the past will not be sufficient or appropriate to get the university through these difficult times. Even if the economy of the State were to immediately re-open, the prospects for rapid recovery of the general fund budget are dim. The university is essential to the economic and social recovery of the State. In order to focus on what the State needs, it is imperative that the university recognize that it can no longer be all things to all people, cannot continue to simply work to preserve the status quo, and must pivot and make strategic investments in areas that will allow the university to advance its mission in a more efficient and effective manner. He remarked, however, that implementing any major changes necessary to achieve this goal will take time and will be painful. Accordingly, the intent of determining a budget planning calendar is to lay out the administration's short- and long-term financial plans, incorporate timetables and milestones it hopes to achieve, and begin the process to achieve long-term structural changes that support economic stability and sustainability.

VP Young provided an overview of the immediate budget planning schedule the administration is currently contemplating. The short-term plan is to focus on addressing anticipated budget shortfalls with maximum preservation of capital for FY 2021. He noted that much of these actions were intended to build the foundation for achieving longer term financial goals. While the landscape of the financial condition and budget and fiscal forecasts and outlooks for both the State and university were presented at today's meeting, the administration intends to present more detailed fiscal scenarios for FY 2021, as well as fiscal and financial parameters for an FY 2021 expenditure plan, at the board's August meeting. The administration further intends to report on its FY 2021 expenditure plan, which will include COVID-impacted fiscal measures, at the committee's September meeting and request full board approval of the expenditure plan at the board's September meeting. Both the board and committee will be given updates throughout the rest of the calendar year as situations change or become clearer.

President Lassner gave an overview of discussions and planning for the longer term future of the university. He reiterated that the university must begin to reposition itself and determine what its priorities will be to help Hawaiʻi recover from the effects of the pandemic and beyond. This will require the university to recognize that it can no longer provide the myriad of programs and services it currently provides and must streamline its operations through organizational and programmatic changes that will enable the university to be more effective and efficient in all aspects of its mission and allow it to thrive in service to Hawaiʻi beginning in FY 2022 and for years to come. Increasing and diversifying revenue streams for the university that will let it carry out its core mission must also be part of the overall budget planning process. President Lassner also reviewed the administration's timetable for its longer term budget plans and briefly spoke on the milestones the administration intends to meet as well as anticipated dates for the administration to provide both the committee and board with updates on its plans.

VP Young concluded by noting that the budget planning process proposed by the administration will be conducted concurrently with the biennium budget process that normally occurs with regard to the university's budget request that is submitted to the Legislature. To date, neither the Governor nor B&F have indicated the process that will be implemented for submittal of the university's biennium budget request. This will play a role in meeting some of the proposed deadlines contained within the administration's budget planning timetable.

Board Chair Kudo remarked that the board will be faced with making difficult decisions in the near future. As it appears that a number of these decisions will need to be made in the fourth quarter of this calendar year and the first quarter of 2021 and will need to occur in an expeditious manner, he requested that Regents be available during this timeframe as the board may need to initiate special meetings to address any pressing issues.

Chair Sullivan remarked that it was her understanding that the administration's budget planning timetables call for several major milestones to be met including a presentation of an updated expenditure plan for FY 2021 for board review and approval in September; the initiation of intensive discussions and planning to reposition the university for FY 2022 and beyond in September; and the presentation of an updated biennium budget request for board review and approval for submission to the Executive Branch in November. She stated that it appears that the board would need to approve the biennium budget request before the administration has completed its strategic fiscal planning and asked if this was a correct assumption. VP Young responded in the affirmative. Chair Sullivan continued stating that she believed that if it was necessary to further amend the university's biennium budget request once the fiscal planning was completed that amendments would be made in the 2021 calendar year. VP Young replied that any augmentation of, or adjustments to, the biennium budget request to reconcile it with the university's completed strategic fiscal plan would more than likely be done through amendments made to the supplemental budget request in 2021. President Lassner added that some models have suggested that after addressing the fiscal shortfalls for FY 2021, biennium budgets in the upcoming fiscal years will need to be dramatically trimmed and new general fund appropriations may not be forthcoming for the foreseeable future.

Chair Sullivan asked if the administration would consider presenting a high-level budget policy paper to the committee in October outlining its plans with respect to budget instructions that will be presented to the various units of the university including issues such as directions that will be given to units with regard to the use of reserve funds. VP Young replied that the administration can present this information to the committee in October. He added that, specifically with regard to the use of funding reserves, the university is planning on providing direction to its units on the use of funding reserves for FY 2021 in the near future. Given the current fiscal situation facing the State and the university, it did not appear that the university would be able to completely fund operations for FY 2021 without the use of some of the funding reserves.

Vice-Chair Moore remarked that, historically, the board has looked at special funds in the aggregate. Given that special funds are expected to witness fiscal deficits that will affect university operations, he asked the administration if it could provide specific details regarding the major special funds or those that have debt service requirements to both the committee and the board in the fall. President Lassner responded that this information can be broken out and presented to the committee and the board.

Chair Sullivan noted that work on a draft of the committee work plan was postponed and asked that Regents submit suggestions for items to be included on the committee work plan to herself and the Board Office.

V. ADJOURNMENT

There being no further business, Regent Nahale-a moved to adjourn, seconded by Regent Westerman, and with all members present voting in the affirmative, the meeting was adjourned at 12:43 p.m.

Respectfully Submitted,

/S/

Kendra Oishi
Executive Administrator and Secretary
of the Board of Regents