MINUTES

BOARD OF REGENTS COMMITTEE ON BUDGET AND FINANCE MEETING

SEPTEMBER 3, 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, Hawaiʻi 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 10:33 a.m. on Thursday, September 3, 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 Benjamin 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 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

Vice-Chair Moore moved to approve the minutes of the August 6, 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 did not receive any written testimony, and no individuals signed up to provide oral testimony.

IV. AGENDA ITEMS

A. Presentation on the State Economic Forecast by University of Hawaiʻi Economic Research Organization (UHERO) Executive Director Carl Bonham

Dr. Carl Bonham, Executive Director of UHERO, provided a report on long-term budget trends and the macroeconomic outlook for the state in light of the COVID-19 pandemic but indicated that this report is based upon current economic conditions and that UHERO will be releasing a report using more recent economic data in the next few weeks. He indicated that national and local data shows a causal relationship between increases and decreases in economic activity and positive COVID-19 case counts and that fear and uncertainty about the impacts of COVID-19 have affected individual economic choices. As a result, preliminary indications are that the economy is continuing to weaken, particularly with the recent surges in positive case counts. Consequently, the key to long-term, sustained economic recovery is effective control of COVID-19.

UHERO used the most recently available local and national data, as well as information collected through businesses via surveys it conducted with the Chamber of Commerce of Hawai‘i, to develop a number of scenarios and economic forecasts based upon certain assumptions. Assuming the resumption of tourism in November 2020, the moderate scenario envisions visitor spending returning to 2016-2017 levels near the end of the fourth quarter of 2021 leading to continued economic recovery through 2024, while optimistic scenarios envision this timeline occurring more rapidly. However, he cautioned that restoring long-term fiscal balance to the state will take years and indications are that the State will continue to face budget deficits through 2026, although it is anticipated that 2021 will be the most difficult.

Noting that Dr. Bonham mentioned a $400 - $500 million underestimation in fiscal year tax revenue collections made by the Council on Revenues (COR), Regent Acoba questioned the cause of such a large miscalculation. Dr. Bonham stated that challenging and uncertain economic conditions are being realized globally and given these factors the forecast error is minimal. He noted that issues such as tax rule changes and extended deadlines for the submission of tax returns undoubtedly had an impact on forecast calculations, highlighting that there has been a surge in tax revenues realized during the first two months of fiscal year 2021.

Regent Acoba asked if military spending added stability to Hawai‘i’s economy and whether its impacts were included in UHERO’s scenarios and forecasts. Dr. Bonham responded in the affirmative and added that economic forecasts would be much more dire without federal defense spending.

Regent Acoba inquired as to what the University of Hawai‘i’s economic contributions were to the State. Dr. Bonham replied that UHERO has conducted several economic analyses in the past which determined that the university was an economic asset to the state and highlighted its contributions to the economy at both the system and individual campus levels. However, he believed these past analyses undervalued the university’s economic impacts to the state because they only took into account direct revenues generated by the university such as research dollars and tuition. They did not factor in the broader economic impacts of the university such as the increase in individual spending and tax revenue collections due to the escalation of lifetime earnings experienced by residents receiving a post-secondary education from the university.

Stating that the economic conditions caused by COVID-19 are having significant fiscal impacts to the small business sector, Regent Westerman asked whether the size of small businesses and their ability to quickly adapt to changing situations or reinvent themselves would impact their survivability and allow them to recover more quickly. Dr. Bonham stressed that due to the dynamic, complex, and ever-evolving nature of the COVID-19 pandemic and the numerous factors involved in attempting to address this public health crisis, economic recovery and sustainability is extremely uncertain for any business. He stated that the most entrepreneurial businesses capable of reinventing or redeveloping themselves will increase their chances of survivability and that some businesses have already begun to adapt and make adjustments. At present, those businesses that are barely surviving will either end up shuttering their doors or recover at a very slow pace. However, it does appear that current economic conditions have increased opportunities for individual entrepreneurship among those experiencing the greatest financial impacts of the pandemic which may result in an increase in the establishment of new small businesses.

Chair Sullivan asked for clarification about the amount of time it took for Hawaiʻi to restore fiscal balance during the last recession and UHERO's forecast for the return of fiscal stability for this economic crisis. Dr. Bonham responded that it took approximately three years to restore fiscal stability during the last recession and that UHERO forecasted fiscal stability to occur sometime around 2026 for this crisis. However, he cautioned that UHERO's forecast did not take into account measures such as budget cuts, furloughs, or the borrowing of funds since it is uncertain what actions would be taken by the State to lessen the economic impacts of COVID-19.

Chair Sullivan asked Dr. Bonham if he agreed with her assessment that COR will lower its economic forecast when it meets later this month which will impact the amount of general fund (GF) revenues the university will receive. Dr. Bonham agreed that a downward economic adjustment would impact university revenues but stated that it is very difficult to forecast what actions COR will take. He stated that with the data UHERO currently has, he would argue that economic conditions are not as severe as previously projected or COR may be anticipating. While the recent surge in cases and the secondary shutdown of Oʻahu may affect how COR will react, he did not have a strong sense that COR would lower its economic forecast.

Regent Wilson left at 11:00 a.m.

Chair Sullivan thanked Dr. Bonham and stated that the committee may request a subsequent update from UHERO after COR meets.

B. <u>Recommend Board Approval of Fiscal Year (FY) 2020-2021 Operating Budget</u>

VP Young presented the university's operating budget for FY 2020-2021 stating that the economic downturn caused by the COVID-19 pandemic is fiscally impacting the university. Revenues for all university funding sources are projected to decrease by $138.3 million, or 13.1 percent as compared to FY 2020 actual revenues. Expenditures are predicted to decrease by $17.7 million, or 1.7 percent, as compared to FY 2020 actual expenditures. Overall the university is anticipating a net operating loss of $66.9 million. However, he noted that campuses began taking actions in FY 2020, particularly in the 4th quarter, which will help mitigate the effects of this revenue loss for FY 2021.

The assumptions and factors considered in developing the proposed operating budget were reviewed with VP Young highlighting that the administration was anticipating the imposition of a 16 percent restriction on the use of GF revenues, a minimum decrease of five percent in Tuition and Fees Special Fund (TFSF) revenues, and revenues for the

Research and Training Revolving Fund (RTRF) to remain flat. However, he noted several caveats to these assumptions. Though the reduction in GF revenues is large, it equates to an approximately 13 percent decrease when compared to the level of actual GF revenues received in FY 2020. Additionally, smaller decreases in TFSF revenues may be experienced as some early indications are that headcount enrollment at some campuses have exceeded expectations, although this data continues to be analyzed. He also added that the university's fiscal situation remains challenging and the use of some portion of the budget reserves may be required for FY 2021 but that this use must be prudent. As such, the administration has directed campuses to limit the use of reserve balances to 50 percent of currently available balances that are above the five percent minimum reserve fund amount established by Executive Policy (EP).

VP Young reviewed budgeted, actual, and projected GF and TFSF revenues and expenditures, as well as revenues and expenditures for various special funds, for each of the four-year campuses, the community colleges, and the UH system-wide administration. He also provided an overview of beginning reserve fund balances and the projected balances of these funds at the end of FY 2021. While this is unsustainable for the long term, he noted that TFSF reserve balances to end FY 2021 are forecasted to be near the 16 percent reserve fund balance target set forth in board policy.

VP Young provided a brief historical perspective of the university's GF and TFSF revenue, noting that GF revenue support provided to the university peaked in 2009, just prior to the beginning of the last recession. He emphasized that, while the federal reserve determined that the recession ended in 2012, the university did not recover the level of GF revenue support it received in 2009 until 2017 and 2018 – an almost 10 year period. Assuming that UHERO's assessment of a slower economic recovery from this fiscal crisis as compared to the last recession is correct, the university could be facing a much more prolonged recovery period than what was experienced during the last recession if its forecasted 16 percent reduction in GF revenues holds true.

VP Young added that the university was still awaiting budget execution instructions and its GF budget allocation for FY 2021 from the State Department of Budget and Finance. Once this information is received, it will allow the administration to refine and imbed more certainty into the operating budget.

Regent Westerman asked what was considered "other special funds". VP Young explained that the university receives its revenues from four main funding classes: GF, TFSF, RTRF, and other special funds. He elaborated that "other special funds" included dozens of non-general special and revolving funds. The majority of these funds are used for specific programs, auxiliary services, or business activities, including areas such as parking, housing, and athletics.

Noting that certain fiscal parameters such as the allocation of GF revenues are still unknown, Regent Westerman inquired as to whether the university has already begun accounting for or identifying areas of expenditure reductions. VP Young responded that the administration had already begun implementing fiscal mitigation measures such as hiring freezes and travel restrictions and that each campus expenditure plan is accommodating reductions, although how each campus achieves these cost-savings may differ based upon their unique needs.

Regent Acoba asked whether the administration conducted an in-depth review of the UHM Athletic Department's (UHM Athletics) budget that accounted for any reductions in, or adjustments that needed to be made to, its revenues and expenditures. VP Young reiterated that each campus determines its own expenditure plan. UHM Athletics has accommodated for a 16 percent decrease in GF revenues in its expenditure plan but its implementation of mitigation measures to achieve cost-savings and may differ based upon a unique set of needs. In answer to Regent Acoba's specific question, VP Young indicated that there had not been an item-by-item review of the athletics budget.

Regent Acoba requested clarification on whether the anticipated reduction in GF revenues was 13 percent or 16 percent. VP Young replied that the administration was anticipating a 16 percent reduction (restriction) in GF appropriation for FY 2021 which equates to a 13 percent reduction of GF revenues that were allocated to the university in FY 2020. Regent Acoba also asked if it was correct that the administration believed the decrease in TFSF revenues it was anticipating may be smaller since overall headcount enrollment appeared to be improving. VP Young responded in the affirmative.

Noting that in previous presentations it was stated that RTRF revenues were increasing and had reached $450 million, Regent Acoba questioned the statement made by the administration that RTRF revenues were anticipated to remain flat and asked if there was any specific data to support this assertion. VP Young replied that this assumption was a conservative estimate based upon progress made in securing RTRF funds for this fiscal year. VP Syrmos responded that while RTRF revenues have remained relatively stable, it was anticipated that growth would slow in FY 2021, although he did not have specific evidence to indicate that this would occur.

Referencing statements made by the administration that TFSF revenues may be used to cover GF revenue shortfalls, Regent Acoba asked what specific GF revenue funded items would be funded by TFSF revenues. VP Young replied that the majority of TFSF funds would be used to address salary costs. Regent Acoba continued stating that in previous presentations it was asserted that the Legislature funded approximately 80 percent of GF revenue funded positions and asked whether the administration believed that this amount would be reduced. VP Young replied in the affirmative.

Board Chair Kudo questioned why there existed such a large range in budget reserve requirements established by EP and Regent Policy (RP). VP Young explained that the EP set a minimum reserve balance amount of five percent but that the RP established a target for operating reserves equivalent to approximately two months of operating costs, which amounts to approximately 16 percent. In view of this, Chair Kudo asked how the five percent requirement contained in the EP would achieve the intent of the board to maintain reserves in amounts that would allow campuses to remain operational for two months. VP Young stated that campuses began with differing amounts of reserve balances, with some having reserve balances well below the five percent amount, but that campuses have been building up their reserves over the years. As a result, all campuses presently have reserve balances that are at least five percent, with some campuses being closer to the 16 percent target. He noted that campuses with higher reserve balance amounts are in a better position to withstand fiscal challenges it may experience.

Board Chair Kudo inquired as to the university's average monthly operating costs in FY 2020. VP Young replied that approximately $70-$80 million per month was used to fund operating costs in FY 2020. Chair Kudo asked what the monthly amount of revenues being used for operating expenses were at present given that the administration had begun taking actions to mitigate expenses. VP Young responded that he did not have that information readily available but that a decrease in expenditures was realized for certain areas.

Discussions ensued on the parameters, limitations, and speed of the depletion of campus reserves with Regents expressing concerns with regard to the reasoning behind the established limitations on the use of these reserves; the apparent disconnect between the EP and RP with regard to reserve balance amount requirements and the restrictions on the use of reserve funds imposed by the administration; the course of action for the use of the reserves; and the effectiveness of reserve balances at the lower end of the spectrum in assisting campuses in maintaining operations given the limitations established. VP Young stated that, in developing its operational budget, the administration was attempting to triage the fiscal situation and develop restrictions on the use of reserve fund balances that would maintain the availability of a portion of these funds for fiscal years beyond 2021 as this is anticipated to be a prolonged fiscal crisis.

Noting the aforementioned discussion on budget reserves, Chair Sullivan reviewed the history of, and reasoning behind, the creation of the budget reserve policy and its established targets. She then went over information on total revenues, total expenses, net deficits, and minimum and maximum budget reserve amounts based on the respective EP and RP for each of the four-year campuses, the community colleges, and some of the larger university programs such as athletics and housing. Most alarming was that both UHM and UHH which would deplete there reserves within one to one-and-a-half years respectively under the current operating budget. She also expressed her concerns regarding the anticipated deficits for the larger programs noting that the operating budget, as currently presented, was unclear as to how these deficits would be addressed.

Chair Sullivan stated that she would be recommending deferral of action on the approval of the FY 2020-2021 operating budget. She explained the reasons for recommending deferral which included concerns regarding the anticipated amount of the budget reserves allocated for possible use to ensure continued university operations for FY 2021; the lack of clarity with, and a necessity to better understand, the administration's strategy and multi-year plan for the use of revenues and reserves for fiscal years beyond 2021; the lack of discussion or direction on making difficult cost-reduction decisions such as salary reductions, reductions-in-force, and furloughs, and the apparent shifting of funds to cover these operational expenses; the assumption that the State will continue to fund the costs of fringe benefits for university personnel in the same way it has in the past and the lack of planning to address this issue should the university be required to cover these additional costs; and the lack of certainty on the allocation in GF revenues the university will receive as well as the State's overall plan to address its own fiscal situation.

Regent Westerman expressed his concerns regarding the lack of clarity with the operating budget stating that, while budgets are often formulated with some assumptions, there are numerous unanswered questions and uncertainties within the proposed operating budget that require additional information and further discussion. He also noted that there were apparent conflicts with some of the data provided which would make it difficult to approve this budget as presented to the committee.

Vice-Chair Moore asked if funds received from the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) were accounted for in the operating budget under the category of "other special fund" revenues and if not, could a breakdown of the expenditure of these funds be provided to the committee. President Lassner stated that there were 30 individual grants awarded by the CARES Act to the university, with three grants being given to each of the 10 campuses, but reiterated that these funds would not provide extensive budget relief for the university as specific requirements have been established by the federal government for the use of these funds. Since CARES Act funds are still being used to address the university's COVID-19 related costs, the expenditure of these funds, as well as any new costs to the university associated with COVID-19, were not accounted for in the proposed operating budget. Vice-Chair Moore expressed his concern that CARES Act funds will eventually be depleted but expenses associated with COVID-19 will continue and this information needs to be reflected in the operating budget. President Lassner agreed with this assessment and stated that this information will eventually be included in reports to the committee and the board and that the administration will work on improving its functional reporting on this issue.

Vice-Chair Moore remarked that the historical figures presented regarding the timeframes for economic recovery were not adjusted for inflation and opined that the university probably never fully recovered from the last recession. Taking this into account, along with the fact that there are still numerous uncertainties with the current economic condition of the state and concomitantly the fiscal situation of the university, he conveyed his concerns regarding the use of reserve fund balances as contained in the proposed operating budget.

Regent Nahale-a stated that he supported deferral of the operating budget as currently proposed. While he commended the administration for its work on the budget given the information available to them and the amount of economic uncertainty facing the state, he also agreed with other Regents that more information needed to be obtained before moving ahead and that discussions and collaboration on the operating budget should continue so as to achieve a long-term fiscal sustainability plan for the university that is balanced against its immediate economic needs.

Vice-Chair Moore made a motion, seconded by Regent Nahale-a, to conditionally recommend approval of the FY 2020-2021 operating budget subject to the administration incorporating provisions that address the concerns raised by Regents and presenting these provisions to the full board.

Chair Sullivan explained that she could not support the motion due to the amount of uncertainty and lack of detail in the currently proposed operating budget noting that once the committee votes to recommend approval of a budget, even if the approval is conditional, it implies endorsement of the committee and by extension the board.

President Lassner stated that the administration was agreeable to deferral of the proposed operating budget until a more detailed spending plan could be crafted using additional fiscal data and information which it was expecting to receive over the next several weeks.

Board Chair Kudo remarked that he agreed with Chair Sullivan's recommendation to defer action on the proposed operating budget as there were too many unanswered questions that needed to be properly vetted, reiterating that this was not the fault of the administration but simply the result of a lack of credible information and economic data.

There having been a motion, and a second, Chair Sullivan requested that a roll-call vote be taken and the motion failed to carry with Vice-Chair Moore voting aye, and all other members present voting nay.

Regent Westerman moved to defer action on recommending approval of the FY 2020-2021 operating budget, seconded by Regent Nahale-a, and the motion carried with all members present voting in the affirmative.

C. <u>Recommend Board Approval of a Supplemental Resolution Authorizing the Issuance of Revenue Bonds for Refunding and University Projects</u>

VP Young reported that the university will be restructuring a bond transaction over the next 60 days to refund or refinance approximately $231 million in currently existing revenue bond debt of the university associated with bonds that were issued in 2010 for construction of the University of Hawaiʻi Cancer Center (Cancer Center) and other construction projects at the John A. Burns School of Medicine at the University of Hawaiʻi (JABSOM). He stated that under current bond financing provisions, the university has an opportunity to refinance the bonds after 10 years if interest rates are favorable, which they are at present. This transaction will generate net present value savings compared to the current debt service level. Additionally, the university will be issuing approximately $10 million in new bonds to finance the design costs and completion of renovations and repairs to existing parking facilities. Board approval of the supplemental resolution authorizing the issuance of revenue bonds in a principal amount not to exceed $250 million to fund the restructuring of bond financing for the Cancer Center and JABSOM projects, as well as the parking facilities repair and renovation project, is necessary to allow the administration to execute these transactions.

Board Chair Kudo recalled that the original bonds issued for the Cancer Center contained restrictions on the use of the facilities and asked if these restrictions would still be applicable after the execution of this action. VP Young replied that, due to the partial tax-exempt status of the original bonds, they contained restrictions on the use of facilities constructed with these bonds. The administration intends to restructure the bond financing in such a way that 50 percent of bonds issued will be conventional, taxable bonds and 50 percent will be tax-exempt bonds. While interest rates may be slightly higher on the conventional bonds, issuance of these types of bonds will afford the university greater economic opportunities due to the increased flexibility in the use of unoccupied Cancer Center facilities. Chair Kudo asked if that meant that the Cancer Center would be allowed to lease empty space in its facilities to private entities. VP Young responded that using the proposed bond restructuring model, up to 50 percent of available space at the Cancer Center could be leased for private activities.

Vice-Chair Moore moved to recommend board adoption of the supplemental resolution authorizing the issuance of revenue bonds for refunding and university projects, seconded by Regent Nahale-a, and the motion carried, with all members present voting in the affirmative.

Regent Wilson returned at 12:26 p.m.

D. FY 2019-2020 Fourth Quarter Financial Report

VP Young provided the financial report for the fourth quarter of FY 2019-2020, reviewing both budgeted and actual general fund revenues and expenditures, as well as revenues and expenditures for various special funds, for each of the four-year campuses, the community colleges, and the UH systemwide administration. Actual revenues through the fourth quarter were $14.7 million, or 1.4 percent lower than projected, largely due to the impacts of the COVID-19 pandemic, with all fund categories performing below expectations. It was noted that expenditures were significantly lower due to GF revenue restrictions, the decline of on-campus presence, the institution of a hiring freeze, travel restrictions, and other cash preservation strategies implemented by the administration. Actual expenditures were $94.7 million or 8.6 percent lower than expected with the exception of the RTRF which had expenditures that were $3.8 million, or 7.6 percent, higher than anticipated. As a result of the dramatic decrease in expenditures, net operating income experienced a $38.5 million gain as opposed to an originally projected shortfall of $41.5 million. VP Young stated that these additional resources will be critical given the current economic downturn and the administration's anticipation that the broader impacts of COVID-19 will be occurring on a long-term basis.

Chair Sullivan requested committee members to review the budget presentation materials and suggest ways to improve data presentations as she believed that, given the fiscal crisis the university will be facing, improved formatting for the reporting of budget-to-actual information will allow the committee to more effectively carry-out its fiduciary responsibilities.

E. Budget Policy Paper

Chair Sullivan suggested that the Budget Policy Paper be deferred to a later date.

V. EXECUTIVE SESSON

No Executive Session was held.

VI. AGENDA ITEMS (Coninued)

A. Committee Work Plan

Due to time constraints, Chair Sullivan deferred discussion on the Committee Work Plan to the next committee meeting.

VII. ADJOURNMENT

There being no further business, Vice-Chair Moore moved to adjourn, seconded by Regent Nahale-a, 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