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Subject: Message from President Casteen: Impact of additional state budget cuts

July 10, 2009

To the University Community:

As you know from the news, Virginia's collections of tax revenues are now so far below the predictions on which the General Assembly built the current year's state budget that state officials are planning for allotment reductions that will be even larger than those implemented in Spring 2009. In addition, unemployment in Virginia has almost doubled in the last year. The Virginia Employment Commission's chief economist predicted in a news story published today that unemployment in the state will continue to rise until, at earliest, the first calendar quarter of next year.

The state's revenues fell by 21.3 percent in April compared to the previous year. In June, they lagged another 8.8 percent. This is the largest drop in state tax collections in recorded history. Virginia's revenue crisis is not unique. California, New York, Florida, North Carolina, and another 20 or so states have reported similar or worse numbers.

This letter, and others that will come after it, reflects the best knowledge and judgment that Mr. Sandridge and I can bring to bear on this problem. It comes to you after Mr. Sandridge, Dr. Garson, and Mr. Howell have analyzed our options as carefully as possible. Dr. Garson met with the deans on Wednesday to disclose what we know, to deliver basic instructions on how to manage budget reductions, and to provide assurance that all of us understand that we are all in this together, that in this environment we must identify every option for saving and put available resources behind our most important priorities.

As the planning for this next round of reductions advances, we will provide periodic updates for you. As strategies are formed, we will let you know what they are and how they will work, and as we succeed or fail in these strategies, we will let you know what we know when we know it.

What this means to us, to the University, is that we must both (1) redouble efforts to attract non-state revenue to support current activities and (2) curtail spending and in every possible way, including wherever possible eliminating expenditures planned for the current year. Later in this letter, I will summarize the instructions going now to deans and other fundraisers for the kinds of support we must seek for the duration of this summer and for the upcoming fall. The following section, however, has to do with curtailing expenditures.

First, it helps that Mr. Sandridge and his colleagues who track state finance, anticipated more bad news, and that they directed all units to examine spending prior to the end of the last fiscal year. The instructions included new steps to reserve cash and early drafting of strategies to eliminate planned expenditures in 2009-10.

Second, some basic cuts have already been made. In June, the Rector and Visitors approved a \$2.25 billion budget for the new fiscal year. For the first time in recent history, the Academic Division's budget is smaller than it was in the preceding year. As you know, we are now in the second year of a general freeze on staff and faculty salaries.

Third, as he did previously, Governor Kaine has given timely warning of the state's latest budget problems. We received instructions earlier this week to prepare and submit by July 22 three different plans for absorbing additional reductions. These call for us to find ways and write plans to deal with cuts equal to 5 percent, 10 percent, and 15 percent of our state general fund (tax) appropriations for the current year (2009-2010). The order stipulates that whatever additional reductions the Governor orders in October, when the next state revenue report becomes available, may continue through the next biennium (2010-2012).

To say that sustaining the University and its people during and after this next round of state cuts will be a challenge is probably to understate the obvious. These next cuts come in addition to the \$32 million reduction in state tax support during the last three years. If the next cuts remain in place through 2012, the impact of the salary freeze, now in its second year, on family budgets may well have grown to crisis proportions.

I cannot speculate today on how the deans and unit managers will propose absorbing these new reductions. Mr. Sandridge and Dr. Garson will receive proposals from the deans and unit heads and decide what is acceptable and what is not. For now, it may be enough to say that all of us will have to change how we carry on business. If the next cut is the largest for which we are now planning (15 percent of the state tax appropriation), the cost will be an additional \$19 million. On average, a 15 percent cut will take some 6 percent of a typical departmental budget composed of state tax funds and tuition. Cuts of this size will also affect many non-general-fund units because academic departments will have to reduce further their spending for goods and services.

We remain convinced that we can manage these upcoming state cuts without layoffs, but all of us will need to understand how difficult this will be. All University employees who manage budgets and personnel will have to share in this work. Universities belong to a labor-

intensive industry. We spend most of every dollar on our people.

For the University to absorb these cuts, total employment (the total payroll) must shrink to sustainable levels. Using retirements, routine turnover, and transfers, administrative units (not counting those in the Medical Center) have let go more than 100 positions during the last year. Especially in activities that are not absolutely essential to our core business of offering and supporting academic programs, the coming year will bring reductions of at least this scale.

That is the bad news. The good news is that vice presidents, deans, and other unit heads have been engaged in this work for the last several months.

I am asked frequently what conditions might force us to use layoffs. The answer is: After all rational and all other remedies have failed.

Layoffs are bad business logic in universities because our chief investments are in people whose whole-career accomplishments add up to the University's net value. They are not compatible with an institutional culture in which the continuity of core business and perpetual innovation and reinvention matter because we aim to grow stronger, especially so in bad times. Layoffs cost money -- very possibly more than they might be said to save because most staff and faculty members work in teams

that have to be rebuilt from scratch if allowed to collapse during a recession.

News reports suggest that universities elsewhere have announced various plans to cut their costs of operation. Each university has its own reality. States, including North Carolina and Arizona, that pay very large shares of the total cost of education in their universities, are making larger cuts than Virginia. Endowment-dependent private universities are using layoffs and other mechanisms to deal with the income losses that go along with their investment losses. In California, public universities are cutting enrollments because their state appropriations no longer cover the cost of instruction.

We are probably better able than most to deal with cuts of the kind that Governor Kaine is requiring for at least two reasons.

First, management here has been rigorous about gaining top returns on whatever we commit and about predicting and controlling downturns before they are announced.

Second, a matter sometimes not fully appreciated, we rely not on one major source of funds (the state, the endowment, or whatever), but instead on a complex variety of sources: tuition set at a realistic level; patient fees calculated to cover the real cost of providing care; endowment payout set at levels that dampen the effects of

downturns; annual and capital giving systematically sought for all programs; auxiliary revenues that cover the full cost of non-core functions; ticket sales; and of course state funding.

Each kind of revenue has its job to do within the University. Each computation of price begins with the costs incurred to provide a service and tracks a carefully articulated plan to capture what each source owes to a specified University function.

For better or worse (generally worse in my own time here), state tax support has been our least reliable resource for a long time. The reasons for this anomaly -- and for the generally low level of state support in all of Virginia's public college budgets -- have varied from one era to another, but in any event, the state contribution to this year's budget has fallen to 6.9 percent, which is a record. In more normal times, we might simply protest this low level of support. In this year and in the other recession years that have come during the last two decades, the higher levels of support from other sources have protected our core functions when the state has cut its allotments.

On Monday, Mr. Sandridge met with the vice presidents to describe the pending cuts and to order these steps to be taken immediately:

1. Avoid new hires. Our first commitments are to core academic and support functions (including raising money to be spent now to relieve this year's budget pain), to safety, and to regulatory and legal compliance. Even in these areas, the standards for approving hires are now the toughest in our history. Beyond them, we simply cannot hire now. We will use reassignments and consolidations of duties whenever those strategies, which can also build careers, will save money without damaging core functions. Every new vacancy is now an opportunity to find innovative ways to do the work without filling the vacancy.

2. Identify non-core services that can be eliminated. This is not a time for small steps or for delays in hope that next month will be better. We cannot make these new budget reductions without eliminating services that are or may be good -- but not essential to -- our core mission.

3. Defer discretionary spending, eliminate non-essential travel, and encourage conference calls in place of meetings that would require travel. Capital improvements and renovations that require the use of operating funds have already been curtailed. When we have restricted or dedicated funds for projects of this kind, we will use them because the jobs created benefit the entire community, but we have no discretionary dollars for these purposes.

There will, no doubt, also be questions about raising money in the current environment. Perhaps contrary to

what anyone might expect, donor support has remained steady, and in some instances we have seen dramatic new gifts.

In addition to receiving firm instructions about hiring and spending, deans and others who work in fund raising are also receiving instructions about what kind of support to seek and what advice to give when donors ask what our priorities are now. We continue to work with donors and potential donors whose chief interest is in major new projects -- new buildings, one and perhaps two additional schools, and endowments to sustain need-based financial aid for students (AccessUVA), faculty salaries, endowed chairs, and other programs of the kind that the large capital fund campaigns of the last two decades have brought us.

Perhaps more seriously at this time, we are seeking funds to be placed in school and department budgets this year to sustain the core functions. The logic is straightforward. Offsetting all of the state cuts over three years using current cash would cost \$38.7 million. A new endowment fund to generate that \$38.7 million would be \$773 million.

Many of you know the hard work that has gone into building an endowment that continues to serve us well despite market losses. It serves us so well because the Rector and Visitors have exercised the authority to adjust payouts when that is the appropriate thing to do. They did

this last year, and virtually all academic programs, as well as our financial aid programs for students, benefited. I believe in the long-term value of both the endowment that we have built and the authority that the Rector and Visitors exercise over it.

Along with Mr. Sandridge, Dr. Garson, Mr. Howell, and the Rector and Visitors, I believe also in meeting current obligations. This is why the deans, Mr. Sweeney, our fundraising staff, and I will be working especially hard to seek gifts throughout the summer and fall.

Our experience in the early 1990s, when sudden and singularly vicious state cuts were even more common than they are now, was that persons who responded to the appeal for immediate gifts to support the core functions also responded in due course to the case made for the capital fund campaign of 1995-2000 and to the current campaign.

Economies run in cycles. In this cycle, our job is to focus large numbers of new donors on immediate needs. As times improve, we will make the University's quality and character visible enough and compelling enough to persuade those same donors to stay with us for the long haul, to do what their predecessors have done to build the strength that we have now.

Our volunteer and professional fund raisers are now the best in the country. Despite the recession and what may seem to be a daily deluge of bad news about Virginia's economy (for that matter, the national economy and the global economy), our fundraisers have just received a 2009 CASE Wealth Engine Award. CASE is the national professional organization for people who raise money. This award is CASE's recognition for the very best in that profession. This award places Mr. Sweeney and those who work with him, if not at the top nationally in raising private funds, very near it, perhaps among the top two or three. We need these people especially now.

In the near future, tuition and fees will almost certainly rise again, either permanently or by way of surcharges, as we distribute the cuts that will come to us this fall. My guess is that increases will come for in-state and out-of-state students and for undergraduate and graduate students. We will meet our students' demonstrated financial need: the Rector and Visitors' commitment to that purpose is as firm as any commitment I have seen here.

In the somewhat more distant future, probably after my time but well within the time of many of you who read this letter, we will learn to earn additional revenues through extended teaching by computer and other means and to feed this new money into the core budget, and perhaps in other ways to become increasingly self-sufficient.

This letter, however, is about what we do now.

No university is better equipped than we are to manage our way through the cuts that have come our way because we are a public enterprise. None is better equipped to do what we must do both to capitalize on large philanthropy when that is within reach and to attract the smaller gifts that we must find to keep the momentum that we have, this day and this month, as we become even more self-sufficient, more productive, perhaps leaner and tougher than we have ever before had to be -- even more the University that Thomas Jefferson dreamed of building.

John Casteen

President Casteen approved distribution of this message.