Brief Overview of Budget Shortfalls and Possible Responses

Financial Policies Committee (6/2/2020)

This document provides background for the June 3 Senate that will focus on the university’s financial difficulties related to the COVID-19 pandemic. The numbers given are estimates chosen to communicate order of magnitude. The budget for FY21 (July 1, 2020- June 30, 2021) will largely be shaped by the reopening committee reports that are due June 15 and a special June 26 meeting of the Board of Trustees.

The Broad Impact of the Crisis

Drivers

The key drivers for the FY21 deficit include a projected increase in undergraduate financial aid, anticipated decrease of undergraduate and graduate tuition revenue due to lower student enrollment, and a reduction in state appropriations. Roughly speaking,

- each one percent increase unemployment typically means a financial aid increase of about $7M.
- each one percent increase in the number of ugrad gap years means a loss of about $5.5M.
- each one percent decline in professional masters enrollment means a loss of about $2.3M.
- each one percent reduction in dorm occupancy means a loss of about $1.1M.
- each one percent decline in NYS appropriations means a loss of about $1.3M.

Mitigations

Measures already announced will save around $100M in FY21. These actions include a reduction of capital spending of $35M, elimination of the salary improvement program valued at $25M, and anticipated salary and non-personnel savings of $30-$40M resulting from a hiring freeze, travel restrictions and a reduction in discretionary spending. A senior leadership voluntary pay cut of $1M is also factored in.

Budget Shortfall

There will be a significant budgetary shortfall in FY21 even after the mitigation measures. The shortfall beyond these measures will depend upon the chosen format of undergraduate instruction. There will also be increased operating expenses for virus testing, contact tracing, protective gear, etc.

University administration is currently modeling 3 possible budget scenarios for FY21—Full Residential/Hybrid Instruction, Limited Residential/Hybrid Instruction, and Online Fall. The projected deficits for these range from approximately $98M, through $218M, to $314M.

Further deficits are projected totaling $48M in FY22 and $38M in FY23 due to continued increase in undergraduate financial aid cost.
Core Values

Going forward, Cornell must continue to be the place where any person can afford instruction in any study. To ensure this goal, there must be an equitable distribution of sacrifice across the university with the intention of preserving jobs and sustaining the community in which the University operates, protecting of financial aid, and maintaining our greatness as a research university through investing in and retaining excellent Faculty and staff. We also believe in the value of shared governance in discussing and evaluating the tradeoffs in involved in the University’s financial decisions. It is essential that these principles be front and center at all times.

Closing the Gap

For FY21 the incremental cost of Financial Aid accounts for the major part of the budgetary gap. The FPC concurs with the University that protecting Financial Aid is a core value. But if this route to closing the gap is not available, other sources must bear the burden.

Our understanding is that the University is considering meeting the shortfall through the following major line items:

- Faculty/Staff Salary/Retirement
- Organizational Reduction/Furloughs
- Other Cost Reductions, Reduced Faculty Hiring, Additional Use of Reserves
- Borrowing
- Tapping the Endowment

In the first scenario of a shortfall of $98M, the burden would be borne by the first three items. The University’s net financial asset position would be protected by not increasing borrowing and by leaving the endowment untouched. As between the first three items, the projection is that the round figure of $100M would be divided as follows: $60M from Salary/Retirement, $20M from Organizational Reduction and $20M from Other Cost Reductions/Reduced Faculty Hiring and Additional Use of Reserves.

It is further our understanding that for the second scenario of a shortfall of around $200M, the Salary/Retirement burden would remain unchanged. The incremental burden would be spread across the other items, except that the endowment would still be protected.

Finally, in the third scenario of a $300M shortfall in round numbers, the Salary/Retirement burden would still be held unchanged. The incremental burden would be spread across the other items, including now bringing in the endowment.

A Table at the end of this document summarizes our understanding of the broad numbers. The FPC has discussed the various tradeoffs involved in this pattern of sequencing of cuts. A summary of the issues raised is as follows.
To Tap or Not to Tap the Endowment

This is a contentious issue on which the FPC did not find full consensus. Drawing on the University’s net financial assets, through increased tapping of the endowment, will reduce the financial resources available in future years for University programs. One calculation is that drawing down $30M from financial assets in one year will lead to a reduction in flow of $1.5M every year into the future. In addition, if the endowment is to be made whole for the benefit of future generations, the $30M will have to be paid back into the endowment, leading to a further reduction in flows in the coming years. The question is how should we reason about this tradeoff between present needs and future generations of Cornell faculty, staff and students?

Those in favor of touching the endowment only as a last resort make these observations:

1. The annual payout is a renewable resource that, if managed successfully, can help sustain many types of essential university operations in perpetuity including faculty/staff salaries and financial aid.

2. It is not a simple bank account; it is comprised of hundreds of separate accounts that often carry restrictions for use made by donor intent.

3. Cornell has (by far) the lowest endowment-to-student ratio among its peers and cannot take additional hits.

Those who argue for a modest increase in endowment payout in the first scenario make their case as follows:

1. It will create a tolerance for sacrifice. Employees who are asked to make a sacrifice through salary and retirement cuts need to see the institution doing a measure of sacrifice.

2. Faculty and staff are also an asset, perhaps the major asset, of the University. There is an argument for protecting that asset from a sharp negative shock.

3. The political consequences of being seen to protect a multi-billion dollar net financial asset position. A rigid stand against even a modest increase in endowment payout will be read negatively in the political arena.

The committee also considered a scenario where the endowment payout was not increased but the existing payout was taxed to a small extent so as to generate funds to reduce cuts in other items. While there are pros and cons of this policy as well (for example, a unit or program which relies on its endowment payout to employ Faculty, staff and graduate assistants would have to cut back on these), this is an option worth examining.

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Footnote:

1 As an illustration, consider assets of $1M whose rate of return adjusted for inflation is 5% and whose payout is also 5%. This will generate a flow of $50K in perpetuity. If, in the face of an immediate crisis, the payout is increased to 6% for one year, this will generate an additional $10K that year, but the flow from that year onwards will be reduced to $49.5K per year in perpetuity. If the assets were $6B, these numbers would be that a $60M additional draw in one year would lead to a reduction of $3M per year in perpetuity. If the additional draw was $30M (payout increased to 5.5% for that year), the impact on future flows would be $1.5M per year.
To Borrow or Not to Borrow

The committee also considered the pros and cons of borrowing. Just as the cost of tapping the endowment is reduced flow of funds in the future, the cost of borrowing is the need to repay with interest in the future. In either scenario, the financial burden is being shifted from the present to the future. The present low rates of interest could be an advantage for borrowing, but there are limits to borrowing, and the extent of borrowing relative to assets can affect the University’s credit rating. The Committee does not have the detailed information to take a view on the tradeoffs involved in borrowing, but the University should clarify the basis on which no borrowing is contemplated in the first scenario of a $100M shortfall, with salary/benefits and employment bearing the lion’s share of the cuts.

Salaries and Retirement Benefits

On Salary/Retirement, the FPC concurs with the administration that cuts to salary and retirement contributions in FY21 should be scaled progressively, protecting those with the lowest incomes.

However, there are a number of complications in implementing the policy. For FY21, salaries can be cut for employees throughout the university. However, retirement benefits can only be cut by Cornell on the endowed side because NYS handles retirement benefits on the statutory side. Thus, a benefits-only cut is an option that is only possible for endowed employees. As we understand it, the University is considering graduated salary cuts for the contract side but across the board retirement contributions hiatus for the endowed side. This leads to a number of issues:

1. Should not the retirement contributions cut on the endowed side also be progressive? As we understand it, that is permissible as long as the differing rates of contributions don’t favor the highly paid.

2. If endowed employees take a benefits-only cut, what is an equitable salary cut for statutory employees? The requirement of progressivity across income levels further complicates the cross-University equity consideration.

3. Giving endowed employees a choice as to whether they want a salary cut or a pause in retirement contributions would give individuals the opportunity to factor in their personal situation. However, offering that flexibility poses problems for the University².

² From the Office of Human Resources: The Cornell University Retirement Plan (CURP), with its 10% salary contribution, has historically been granted ‘non-discriminatory’ status in our routine compliance testing. This is due to the fact that the Cornell contribution has been applied without regard to earnings level, age, length of service, etc. Because Cornell can state, in advance, that the benefit is being consistently and objective applied, we have been able to meet our compliance requirement by using a 3yr testing approach, with the last testing results on file for 2015 and 2018. We passed easily in both years. If we were to change the eligibility model to be a ‘choice’ model (i.e. reduction in pay vs. reduction in Cornell contribution) and the choice was an individual, voluntary one, we would no longer have the assurance that the plan was not primarily benefiting the higher-paid. We would be required to test for non-discrimination on an annual basis, and should we fail the non-discrimination test, we would be required to remove Cornell contributions from participant accounts within the same tax year, and potentially could face a penalty/fine in addition. If we ‘failed’, we would need to change the go-forward approach of contributions immediately.”
Other Ideas

FPC discussions have surfaced ideas for relieving the burden on Faculty/Staff employment, salary and retirement, which go beyond the avenues currently being considered. These include, for example, (i) a tax on the endowment payout to fund recurrent items in FY21 (as already discussed), (ii) the possibility of constructing salary/retirement cuts as a zero interest loan from the Faculty/Staff, to be paid back over time; (iii) work sharing rather than employment cuts in organizational reduction, using currently available Federal and State funds for this purpose; (iv) cuts should be done for six months in the first instance and then evaluated. These need to be scrutinized to test for feasibility and desirability. The FPC urges the administration to consider these and other ideas and to think creatively in addressing the current crisis.

Future Engagement

The Senate Financial Policies Committee has been meeting regularly, to discuss the implications of the Covid-19 crisis for the University. Provost Mike Kotlikoff and Vice President Budget Paul Streeter have also met with us to provide information and discuss planning.

There is understandable concern and uncertainty among Faculty and Staff on the handling of the crisis. We urge the University Administration to share broadly the up to date information on which financial decisions are being based, and to be open and transparent with Faculty and staff on the tradeoffs we face in meeting our values.

From a longer-term perspective, the crisis highlights the need for closer Faculty and Staff engagement in shared governance on financial matters, including the health of the endowment, developing contingency plans for downturns, and the values which underpin the University’s expenditure choices. To that end, the FPC believes that having one of its members, and a staff representative, serve on the Provost’s Budget Planning Committee is important, as is greater faculty and staff involvement on the Provost’s Administrative Costs Committee.

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3 For example, as we understand it from the University: “Workshare is not permanent – an employee can be on only for the maximum duration of UI benefits – generally 26 weeks. It is a strategy that can be used to put people on part time (reductions of 20% to 60% time) status and have them collect unemployment to support their lost wages. The UI amount is prorated (based on the reduction) and weekly UI is generally half of weekly wages up to the state max of $504/week. So if someone was reduced to 50% time, their weekly UI benefit under workshare would not exceed $252/week. However, until the end of July there is an additional $600/week available to support those on UI, including those on workshare. After July, that additional $ will/may go away.....And the person has to certify every week in order to stay on it.”
Alternative Ways to Close the Gap  
(Current University Thinking)

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*Our understanding is that this will be accomplished primarily by staff reduction, e.g., by further permanent job losses.

**However, our understanding is that there have been some furloughs already—over 100 Cornell staff.