



USTAR BUDGET ISSUES FOR FY 2014

BUSINESS, ECONOMIC DEVELOPMENT, AND LABOR APPROPRIATIONS SUBCOMMITTEE
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ISSUE BRIEF

Introduction

This issue brief provides a summary of USTAR’s budget history and expounds on the reasons for the Fiscal Analysts recommendation of \$3 million in one-time funding, and these issues include: operations and maintenance, performance and accountability, salary obligations, and nonlapsing balances.

On June 30, 2013 USTAR will complete its seventh year of operations. As of year-end FY 2012, USTAR has expended approximately \$117 million for operational costs. FY 2008 was the high-water mark for USTAR’s ongoing General Fund appropriation, totaling \$19,324,500. During the 2009, 2010, and 2011 General Sessions, the state implemented budget reductions across the board in response to the great recession. During this time, USTAR’s ongoing General Fund appropriations were reduced to \$13,952,700 in FY 2012 – a 28 percent decrease. During these years, however, federal funding of \$33 million, mostly in the form of American Recovery and Reinvestment Act (ARRA) appropriations, was authorized by the Legislature. These federal appropriations were made in FY 2010 and FY 2011 and will have been expended by end of FY 2013. In addition to General Fund and federal fund appropriations, the Legislature approved a set of fees for USTAR to be able to recover the cost of administering grants through its Small Business Innovation Research Program (SBIR). These fees were first approved during the 2009 General Session and have provided about \$6,000 in dedicated credit revenue each fiscal year since then.

The tables below show the actual amounts in funding and expenditures for USTAR through FY 2012 and estimated totals for FY 2013. State funding and ARRA appropriations for the operations of USTAR are estimated to reach approximately \$148 million by the end of FY 2013. When counting the operational costs plus appropriations and general obligation bonding for construction of USTAR buildings, total state investment in USTAR since inception in FY 2007 reaches approximately \$333 million.

Sources of Funding	2007	2008	2009	2010	2011	2012	2013 Est.	Totals	% of Total
General Fund	19,250,000	19,324,500	16,397,800	15,296,100	14,501,300	13,952,700	16,990,300	115,712,700	78%
General Fund 1x	50,000,000	-	(1,947,700)	(5,072,900)	-	540,500	3,000,000	46,519,900	31%
Federal Funds	-	-	-	-	1,654,200	-	-	1,654,200	1%
ARRA	-	-	-	15,884,400	15,461,400	-	-	31,345,800	21%
Dedicated Credits	-	-	6,300	9,600	4,800	3,100	5,000	28,800	0%
Beginning NLB	-	58,328,300	11,269,700	12,165,000	16,744,900	21,702,000	10,923,700	131,133,600	89%
Closing NLB	(58,328,300)	(58,695,800)	(12,165,000)	(16,744,900)	(21,702,000)	(10,923,700)	-	(178,559,700)	-121%
Grand Total	10,921,700	18,957,000	13,561,100	21,537,300	26,664,600	25,274,600	30,919,000	147,835,300	100%

Uses of Funding	2007	2008	2009	2010	2011	2012	2013 Est.	Totals	% of Total
Personnel Services	485,300	1,546,600	2,030,400	1,587,800	1,638,800	1,394,900	1,135,100	9,818,900	7%
In-state Travel	8,900	35,300	36,400	22,100	18,500	14,200	5,100	140,500	0%
Out-of-state Travel	5,400	20,400	22,500	19,900	15,800	18,000	20,100	122,100	0%
Current Expense	9,440,600	15,491,400	1,015,900	769,400	737,900	1,028,700	1,325,500	29,809,400	20%
DP Current Expense	23,500	196,300	152,400	132,400	71,800	60,500	69,600	706,500	0%
DP Capital Outlay	-	51,200	-	-	-	-	-	51,200	0%
Other Charges/Pass Thru	25,200	301,700	10,303,500	19,005,700	24,181,800	22,758,300	28,363,600	104,939,800	71%
Transfers	932,800	1,314,100	-	-	-	-	-	2,246,900	2%
Grand Total	10,921,700	18,957,000	13,561,100	21,537,300	26,664,600	25,274,600	30,919,000	147,835,300	100%

USTAR Budget

Operations and Maintenance Costs for USTAR Buildings (O&M)

A key issue on hand with O&M is the apparent contradiction between statutory language directing USTAR to build research buildings at the University of Utah (U of U) and Utah State University (USU), and the absence of provisions for O&M costs in the statutory language of the bonds for these buildings.

The statute is written in a way that could indicate the buildings are state-funded and therefore are eligible for O&M funding, or are non-state funded and are therefore ineligible for O&M funding. This condition in statute has created a gap in the interpretation of who should pay for the O&M of the buildings – the state or the universities?

These issues were formally presented in a May 2012 audit from the Office of the State Auditor:

The Utah Science Technology and Research Initiative (USTAR) has not entered into any formal agreements with either Utah State University or the University of Utah related to the research facilities on those university campuses. USTAR partnered with those universities to construct facilities on each campus for the purpose of facilitating research programs, as established in Senate Bill 75 from the 2006 General Legislative Session. The facility at Utah State University was completed and placed into service in September 2010. The facility at the University of Utah was completed and placed into service in April 2012. Because of the lack of formal agreements, it is unclear what rights, responsibilities, and obligations USTAR and the universities have related to the facilities. It is also unclear who owns and should account for the facilities. Formal agreements between USTAR and the universities would eliminate these ambiguities and help prevent future disputes that could result from these ambiguities.

USTAR has responded to this audit report and has committed to resolving the issue by March 31, 2013.

Who should pay for O&M of USTAR buildings – The state or the universities?

The State

In the statutory language that created USTAR, the Legislature laid the framework for the construction of up to three USTAR buildings at Utah State University and two buildings at the University of Utah. USTAR was granted bond authorization for the first two buildings (one constructed on each of the two research university campuses) in the initial bill. The bill also establishes that the universities will provide the land for the buildings, but the buildings will be owned by the USTAR Governing Authority who will be able to lease the buildings back to the universities. This provision would seem to indicate state ownership of the buildings and this is the main point of the universities.

The Universities

In higher education, buildings constructed through private donations (non-state funded buildings) are rarely appropriated funds for O&M so as to not obligate the state for additional funding because of the actions of the institutions.

Funding for O&M was not included in the bond authorization of the current USTAR buildings. The statute identifies private funds that need to be raised by each of the universities in order to proceed with construction of the two buildings. The building at the University of Utah required \$30,000,000 to be raised by the school before the building could be constructed. The building at Utah State University was required to have \$10,000,000 in committed funds from the university.

Furthermore, when the vision of USTAR was presented to the Legislature, a key selling point was that the buildings would become self-funding, which would eliminate the need for the state to pay O&M. The reason for this is that through federal grant awards to research teams, commercialization revenue, and

royalties from patented technologies developed through research, the universities and research teams would cover the O&M costs of the buildings.

In summary, two main questions are presented below.

1. Should the USTAR buildings be funded as:
 - a. State buildings where O&M funding is provided, or
 - b. Non-state buildings where O&M is not funded?
2. If O&M funding is to be funded (either long-term or short-term), what incentive structure should be in place to encourage the research teams to generate enough revenue to cover these costs?

O&M BREAKDOWN SINCE FY 2007

Totals for O&M by university are provided in the table below. The FY 2014 budget request for O&M is \$3 million. The “2007 – 12” column is cumulative O&M charges through FY 2012. The “2013” column represents USTAR’s estimate for FY 2013.

Building O&M	2007 - 12	2013
U of U	1,743,711	2,826,215
USU	1,839,047	309,750
Total	3,582,757	3,135,965

Summary

The current practice for funding O&M is through General Fund appropriations from the state. This practice diverts funding from the research teams for doing their research. O&M costs are rolled up into the funding requests for “New Research Teams” and influence the amount of money being requested by USTAR. This in effect slows progress towards the ultimate purpose of USTAR: creating new technology-based businesses that provide high-level paying jobs for Utah citizens.

The Fiscal Analyst recommends the Business, Economic Development, and Labor Appropriations Subcommittee consider this issue during the 2013 General Session during its appropriations discussions.

Possible options to express Legislative intent include:

1. **Lease.** USTAR negotiate a lease with the universities to arrange for the payment of O&M through normal operations of the research teams and universities.
2. **Legislation.** Pass legislation to clean up statute and clarify its intent for payment of O&M costs at USTAR buildings.
3. **Intent Language.** Accompany any appropriations to USTAR with intent language describing the use of the funds.

Salary Obligations

A contributing factor in USTAR’s funding requests for “New Research Teams” during the 2013 General Session is the O&M cost for the two current USTAR buildings and existing salary obligations it has committed to pay for existing USTAR faculty members. While the O&M issues have been discussed preceding this section, USTAR has provided an explanation about its salary obligations to existing professors below:

USTAR has been successful in attracting world-class talent to join the research teams. These individuals sign research contracts for 5-year periods. However, at the end of the contracted term, monies appropriated for the research teams are still used to pay the salaries for these researchers, even though the additional research expenses are no longer an obligation. This results in a situation where USTAR

continues to pay for the salaries of researchers beyond the 5-year research agreement. Since USTAR is still a young agency, the ongoing salary obligations represent only 4 percent of the FY 2013 research team budget. As more researchers reach the end of their 5-year agreements, this amount is expected to grow.

USTAR is currently in the process of drafting new Memorandums of Understanding (MOUs) with the universities. Salary obligations is an area where USTAR would like to transition these ongoing costs to the university departments where these researchers are housed. While these expenses could continue to grow, it is USTARs intent to limit the impact to the state and allow the universities to determine ongoing salary obligations based on research and commercialization performance of the researchers.

The FY 2013 combined total for salary obligations is approximately \$1.2 million. The FY 2014 projected total is approximately \$2.7 million for both universities combined. The salary obligations are broken down by fiscal year and by university in the table below.

	U of U	USU	
FY 2013	920,208	285,000	1,205,208
FY 2014	2,390,415	285,000	2,675,415
	3,310,623	570,000	

Performance and Accountability

BACKGROUND

USTAR is a unique state agency and can be described as a hybrid agency. The USTAR Governing Authority is a board consisting of 10 members; eight of these members are appointed, and two are set in statute; USTAR is used in place of the USTAR Governing Authority for simplicity, but it is understood that whenever the acronym USTAR is used, it is a reference to the Governing Authority.

USTAR is authorized in statute and is overseen by the Legislature. Statutorily, as a state agency it is positioned between the Legislature and institutions of higher education and the private market as a de facto legislative body that determines funding levels to the participating universities. Through its Tech Outreach Program, USTAR leverages state funds in the private sector by offering grants and providing start-up services to entrepreneurs and businesses. By statute, all funds appropriated to USTAR are nonlapsing.

Typically, nonlapsing authority is not statutory for an agency, but is granted through intent language by the Legislature and is a temporary authority, usually for one fiscal year. This is significant because in practice, any appropriations made by the Legislature to USTAR are completely under USTAR’s discretion.

63M-2-302 GOVERNING AUTHORITY POWERS

This section of the “Utah Science Technology and Research Governing Authority Act” outlines multiple facets of the USTAR initiative.

Duties:

- Ensure funds are used appropriately, effectively, and efficiently in accordance with the intent of the Legislature
- Make rules for allocating money appropriated to it for research teams...
- Monitor all research plans that are part of the project...to determine that appropriations are being spent in accordance with legislative intent...
- Develop methods and incentives to encourage investment in and contributions to the project from the private sector...

Reporting and Recommendations to:

- The Governor
- The Business, Economic Development, and Labor Appropriations Subcommittee

By November 1 each year, report on the achievement of the objectives and duties outlined in this section, its annual expenditure of funds, and nonlapsing balances retained by the Governing Authority to:

- The Business, Economic Development, and Labor Subcommittee; and
- The Executive Appropriations Committee

SUGGESTIONS FOR PERFORMANCE MEASURES

A recommendation for intent language concerning USTAR’s annual reports to the Legislature is contained in the budget brief entitled *Utah Science Technology and Research Initiative (USTAR)*. These suggestions are targeted at the two main programs carried out by USTAR and can be considered further detail about the intent language recommended in that budget brief.

1. USTAR Research Teams

Because USTAR was created as an economic development initiative, the best metrics are those that directly measure commercialization of the technologies developed by USTAR research teams: 1) companies created and 2) jobs created. Employee earnings and state taxes paid are also measures of economic development but they cannot be tracked as readily or reported as specifically as companies and jobs. Although the University of Utah and Utah State University should continue to track patent disclosures, patents filed, private investments, and federal grants received, they are not direct measures of commercialization. Because the commercialization cycle takes years between the hiring of researchers and the hiring of employees at the new technology-based companies and because these companies and jobs may be short lived, USTAR should track companies and jobs created since USTAR's inception in 2006 and those companies and jobs still in existence at point-in-time.

2. USTAR Technology Outreach Innovation Program (TOIP)

This program is designed to promote regional commercialization activities from outreach centers located throughout Utah. The centers serve as a resource for transferring ideas and new technology from state universities to entrepreneurs and businesses in the respective regions. USTAR should track the number of projects conducted and entrepreneurs/businesses served in each region. TOIP also includes the Technology Commercialization Grant Program, which links higher education institutions with local entrepreneurs to commercialize unique ideas. USTAR should track and report the number of projects, product prototypes, companies, and jobs created via the grant program.

Nonlapsing Balances

A unique aspect of the USTAR budget is its nonlapsing balances. A contributing factor to USTAR’s nonlapsing balances are federal grants awarded to the universities. When a research team run by a USTAR professor receives federal grant money, a portion of that money is earmarked for administrative expenses and can be used to pay a portion of the O&M costs of the USTAR buildings. As a result, General Fund appropriations made by the Legislature and allocated to USTAR research teams is saved; every dollar of federal grant money spent, is a USTAR General Fund dollar saved. UCA 63M-2-302(3) grants USTAR nonlapsing authority for all funds appropriated to it, so any savings USTAR realizes through this medium is an increase to its nonlapsing balances.

For an example of how uncertain nonlapsing balances are for USTAR, refer to the table below:

	2012 App	2012 Est.	2012	2013 App	2013 Est
Beg. NLB	12,966,000	21,702,000	21,702,000	5,215,600	10,923,700
Close NLB	(1,777,800)	(5,756,100)	(10,923,700)	-	-

When USTAR’s FY 2012 budget was appropriated during the 2011 General Session, it estimated beginning balances would be \$12.9 million and closing balances would be \$1.8 million. During the 2012 General Session USTAR provided an estimate of what it expected its FY 2012 final budget to be. Beginning balances had grown to \$21.7 million, with closing balances increasing to \$5.8 million. For the 2013 General Session, USTAR has provided FY 2012 actuals of \$21.7million in beginning balances, with an increase in closing balances of \$10.9 million.

This circumstance with USTAR’s nonlapsing balances is a consistent pattern since it began operations in FY 2007. USTAR has provided the following explanation for its \$5.2 million increase in nonlapsing balances from FY 2012 to FY 2013:

1. USU USTAR restructuring: In FY12, USU put in place a USTAR Exec Cmte in response to a USU strategic planning process that occurred in FY11 (at USTAR's request). The USU USTAR Exec Cmte made difficult decisions about divesting USTAR programs and about re-organizing their emphasis for USTAR around the newly opened USTAR building and around three strategic innovation areas that are aligned with the President's strategy for USU as an institution. This re-structuring, coupled with accelerated performance on external grant funding saved USU \$2.2 Million in FY12. All of these savings are committed in FY13 to the re-organized program emphasis.

2. Uof U performance on grant funding: In FY12, U of U outperformed their business plan relative to grant funding bringing their total grant funding to date up to \$85.6 Million. As a result of their outstanding performance on grant funding, they spent only \$14.3 Million of their FY12 USTAR funds vs the \$16.6 Million they had budgeted to spend. The \$2.3 Million U of U carryover from FY12 is committed in FY13.

3. USTAR HQ and TOIP reorganization and limited spending on grant funding: In FY12, the USTAR team reorganized the HQ team for increased efficiency and effectiveness with GOED HQ that resulted in cost-savings. The TCG program was also restructured for increased efficiency and for alignment with the GOED TCIP program, resulting in savings. These savings have been committed to the USTAR Go to Market program in FY13, intended to be a catalyst for small business creation in the technology sector in FY13.

The condition of USTAR’s nonlapsing balances has had an impact on the Fiscal Analyst’s recommendations for the FY 2014 budget. With the uncertainty of nonlapsing balances for USTAR between general sessions, and the pattern of increasing nonlapsing balances from one fiscal year to the next, the fiscal analyst has assumed a similar pattern for FY 2014.