EXHIBIT 4
DATE 2/3/2005
HB

Sub-Program Details

EDUCATIONAL UNITS -SP 01

Sub-Program Proposed Budget

The following table summarizes the executive budget proposal for this subprogram by year, type of expenditure, and source of funding.

Sub-Program Proposed Budget Budget Item	Base Budget Fiscal 2004	PL Base Adjustment Fiscal 2006	New Proposals Fiscal 2006	Total Exec. Budget Fiscal 2006	PL Base Adjustment Fiscal 2007	New Proposals Fiscal 2007	Total Exec. Budget Fiscal 2007	Total Exec. Budget Fiscal 06-07
Transfers	118,053,858	3,502,325	4,150,000	125,706,183	3,207,944	4,150,000	125,411,802	251,117,985
Total Costs	**$118,053,858**	**$3,502,325**	**$4,150,000**	**$125,706,183**	**$3,207,944**	**$4,150,000**	**$125,411,802**	**$251,117,985**
General Fund	105,818,858	2,352,324	4,150,000	112,321,182	1,763,944	4,150,000	111,732,802	224,053,984
State/Other Special	12,235,000	1,150,001	0	13,385,001	1,444,000	0	13,679,000	27,064,001
Total Funds	**$118,053,858**	**$3,502,325**	**$4,150,000**	**$125,706,183**	**$3,207,944**	**$4,150,000**	**$125,411,802**	**$251,117,985**

Sub-Program Description

Sub-program 01 includes the state appropriation for the university educational units and the colleges of technology (Montana State University campuses and University of Montana campuses).

Present Law Adjustments

The "Present Law Adjustments" table shows the primary changes to the adjusted base budget proposed by the executive. "Statewide Present Law" adjustments are standard categories of adjustments made to all agencies. Decisions on these items were applied globally to all agencies. The other numbered adjustments in the table correspond to the narrative descriptions.

Present Law Adjustments	Fiscal 2006 FTE	Fiscal 2006 General Fund	Fiscal 2006 State Special	Fiscal 2006 Federal Special	Fiscal 2006 Total Funds	Fiscal 2007 FTE	Fiscal 2007 General Fund	Fiscal 2007 State Special	Fiscal 2007 Federal Special	Fiscal 2007 Total Funds
DP 40 - Statewide - Educational Units	0.00	5,691,703	0	0	5,691,703	0.00	4,687,092	0	0	4,687,092
DP 41 - Base Year Equalization Adjustment - SB 407	0.00	(2,750,000)	0	0	(2,750,000)	0.00	(2,750,000)	0	0	(2,750,000)
DP 42 - Increase in O&M for New Space	0.00	86,097	0	0	86,097	0.00	115,641	0	0	115,641
DP 43 - Increased IT License and Maintenance	0.00	108,977	0	0	108,977	0.00	189,235	0	0	189,235
DP 44 - Resident Enrollment Growth --MUS	0.00	98,176	0	0	98,176	0.00	607,936	0	0	607,936
DP 45 - Water, Sewer, Elevator and Small Misc.	0.00	198,917	0	0	198,917	0.00	263,854	0	0	263,854
DP 49 - Off Campus Rental Increases-Ed Units	0.00	68,455	0	0	68,455	0.00	94,186	0	0	94,186
Total Other Present Law Adjustments	**0.00**	**$3,502,325**	**$0**	**$0**	**$3,502,325**	**0.00**	**$3,207,944**	**$0**	**$0**	**$3,207,944**
Grand Total All Present Law Adjustments					**$3,502,325**					**$3,207,944**

<u>DP 40 - Statewide - Educational Units -</u> The executive budget applies statewide present law adjustments for the educational units in the 2007 biennium, funding the state share of these adjustments at $10.4 million general fund.

LFD COMMENT The executive 2007 biennium budget uses a new formula to calculate the state share of both the statewide and other present law adjustments for the university educational units.

The statewide present law adjustments are determined through a calculation of global factors that include fixed costs, inflation/deflation rates, funding of personal services to capture annualization of 2005 biennium increases and full funding of positions, as well as vacancy savings rates. After these global factors are defined and approved by the legislature, they are allocated to each agency based upon agency usage of each expenditure factor.

For the university educational units, however, there is an additional calculation necessary to assign the total expenditure level for statewide present law adjustments. Specifically, the legislature determines what percentage share of these costs state government will pay, as opposed to the percentage share that the university educational units will fund with other revenue sources, including tuition.

This percentage share is then applied against both the statewide and other present law adjustments to determine the state funding level of these expenditures.

In the past, the state share calculation has been the ratio between state funding revenue versus other current unrestricted revenue in the university operating budget. In the FY 2004 base year that ratio is 43 percent, so that following past practice the 2007 biennium state share calculation for statewide and other present law adjustments would be that same 43 percent. This reflects past policy that the state should fund university unit expenditures at the same ratio that state funding revenue comprises total unrestricted revenue (it is the current unrestricted fund that serves as the formula base because this is the fund account that supports actual education costs, as opposed to research costs, housing, food service costs, and other non-education costs that are part of the university units).

The 2007 biennium executive budget, however, uses a different formula to determine the state share calculation that is applied to determine the funding level for present law adjustments. This formula change reflects a change in policy, which the executive budget states is intended to help minimize tuition rate increases.

These adjustments reflect the fixed costs of operating the university units so that these expenses are independent of student enrollment fluctuations. Thus, the fixed cost increases in the current unrestricted fund must be funded by either state appropriation or other revenue sources, which is primarily student tuition. So this change in executive policy, intended as a means to minimize tuition increases, shifts more responsibility for fixed cost increases to state funding.

The new executive calculation, therefore, is a ratio between Montana resident students versus non-resident students at the university educational units. This state share funding calculation essentially supports that portion of statewide and other present law adjustments that apply specifically to support Montana resident students. For the 2007 biennium that ratio is approximately 80 percent, derived from the actual FY 2004 enrollment at the university educational units, whereby some 80 percent of total enrollment is Montana resident students.

Therefore, DP 40 funds approximately 80 percent of the university educational units' costs of statewide present law adjustments allocated to the current unrestricted fund in the 2007 biennium. This shifts policy to one where state funding is allocated specifically to support Montana resident student costs at the university educational units. This policy shift and formula change has the following fiscal impact in the executive budget:

- DP 40 at 80 percent formula = $10.4 million (executive budget formula)
- DP 40 at 43 percent formula = $5.6 million (historical budget formula)
    - Total = $4.8 million increase

As a context, each 1 percent increase in tuition in FY 2006 would be equal to $1.49 million of revenue.

<u>DP 41 - Base Year Equalization Adjustment - SB 407 - -</u> In this adjustment to base year expenditures, the executive budget reduces general fund by a total of $2.75 million each year of the 2007 biennium.

LFD COMMENT

HB 2 in the 2005 biennium included a biennial appropriation of $5.5 million general fund to the university units from the revenue derived from SB 407 (the limited sales tax legislation). These funds were not designated as a one-time-only (OTO) appropriation.

As a biennial appropriation, the university units have the authority to expend these funds in either fiscal year of the biennium. Since the $5.5 million was part of the lump-sum appropriation, however, there is no certainty when, during which fiscal year, the funds were spent. Therefore, the total appropriation of $5.5 million is annualized over the biennium, leaving half this amount ($2.75 million) that must be removed from the base in order to make this adjustment.

<u>DP 42 - Increase in O&M for New Space -</u> The executive budget adds $202,000 general fund in the 2007 biennium to fund the state share calculation of increased operations and maintenance costs for new space coming online at MSU Northern (an applied technology center classroom/lab building) and at UM-Missoula (chemistry building renovations). These new facilities were approved by the legislature.

<u>DP 43 - Increased IT License and Maintenance -</u> The executive budget adds $298,000 general fund in the 2007 biennium to fund the state share calculation of increased information technology licenses and maintenance costs at MSU-Bozeman, UM-Missoula, MSU- Billings, Montana Tech, UM-Western, and the Helena College of Technology.

LFD COMMENT

In both DP 42 and DP 43, the executive budget uses the new state share calculation formula that is the ratio of Montana resident students versus non-resident students. Thus, in each of these adjustments, the state share of the present law adjustment costs is approximately 80 percent. Under the historic state share calculation formula the state share cost would be 43 percent.

This policy shift and formula change has the following fiscal impact in the executive budget:

- DP 42 and DP 43 at 80 percent formula = $.50 million (executive budget formula)
- DP 42 and DP 43 at 43 percent formula = $.27 million (historical budget formula)
    - Total = $.23 million increase

<u>DP 44 - Resident Enrollment Growth --MUS -</u> The executive budget increases general fund by $706,000 in the 2007 biennium to support projected resident enrollment growth at the university education units. Figure 9 illustrates the enrollment projections and subsequent funding allocation:

Figure 9
University Education Units - Present Law Adjustment (DP44)

				Growth From 2004 Budgeted	
	FY 2004 Budgeted	FY 2006 Projected	FY 2007 Projected	FY 2006	FY 2007
Resident FTE Students	26,866	26,918	27,188	52	322
	Enrollment Growth State Funding (@ $1,888 per student)			$98,176	$607,936

LFD COMMENT The executive budget carries forward the marginal cost per student calculation that was used to determine the funding level for resident student enrollment growth in the 2005 biennium (though this formula was never implemented, as budget reductions eliminated the adjustments for resident enrollment growth in the 2005 biennium budget). The executive budget proposes no change to this formula calculation for the 2007 biennium, and uses this to allocate $1,888 general fund per resident FTE student reflected in enrollment growth projections.

The marginal cost per student formula essentially combines the actual expenditures of the university units for instruction and for student services, then divides this expenditure total by the number of FTE students. The result is a number intended to reflect the average cost to educate each additional student. The average tuition level is then removed from this cost of education calculation, since students fund this portion of costs. This leaves the unfunded expenditure level for educating students that has historically been funded by the state appropriation, the so-called marginal cost per resident FTE student.

A mathematical anomaly of this formula, however, is that each time tuition rates or enrollment levels increase during a base year, these increases drive the subsequent marginal cost per student calculation down in the next biennium. During the 2005 biennium, the Board of Regents approved significant tuition increases, averaging 11 percent, while enrollment increased 3.4 percent. As a result, the marginal cost per student calculation starting from the actual FY 2004 base would result in a general fund allocation of $1,599 per resident student, a decrease of fifteen percent. The cost for instruction and student services, on the other hand, increases by 6.4 percent during the 2005 biennium.

Therefore, the executive budget carries forward the 2005 marginal cost per student calculation and funds resident student enrollment increases at the $1,888 per resident student level, rather than at $1,599 per student that is derived from the actual FY 2004 base. The executive narrative expresses concern about decreasing the state funding level per resident student to this lower level (concern about the impact on tuition) in order to justify this budget policy decision.

The executive budget then applies this marginal cost per student calculation against projected enrollment increases to determine the funding level. Enrollment growth projections for the 2007 biennium are dramatically lower than previous biennia, as FY 2006 resident growth is projected at 52 FTE and FY 2007 resident growth is projected at 322 FTE (see table above for specific projections).

This policy decision and marginal cost per student calculation difference has the following fiscal impact in the executive budget:

- Resident Student Enrollment Growth Adjustment at $1,888 per student = $706,000
- Resident Student Enrollment Growth Adjustment at $1,599 per student = $598,000
    - Total = $108,000 increase

<u>DP 45 - Water, Sewer, Elevator and Small Misc. -</u> The executive budget adds $463,000 general fund to the 2007 biennium budget as an adjustment to increase the state share for reported water, sewer, and other small miscellaneous items reported by the educational units.

<u>DP 49 - Off Campus Rental Increases-Ed Units -</u> The executive budget adds $163,000 general fund in the 2007 biennium for the state share of increased off campus rental costs at MSU-Bozeman and the Helena College of Technology.

DP 78 - Equipment - 2 Year Programs - OTO - The executive budget adds $5 million general fund in the 2007 biennium to fund the purchase and update of equipment for two-year degree programs within the Montana University System and Community Colleges. The executive budget intends that this proposal must be matched dollar for dollar from other non-state sources of funding to be identified by the Board of Regents. This proposal is for a one-time-only (OTO), biennial appropriation.

LFD COMMENT

For discussion of the Shared Leadership project initiatives see the LFD Comment and LFD Issue under the Program Highlights section above. For discussion of the non-state match requirement of the Shared Leadership DP's, see the LFD Issue below, under sub-program 01.

LFD ISSUE

All of the Shared Leadership initiatives at the university educational units as well as the $5 million equipment initiative include a match requirement that would be the responsibility of the Board of Regents, either to fund directly with university funds or to deliver funding from a non-state partner.

In order to provide maximum fiscal oversight for any Shared Leadership initiatives that are approved, the legislature may want to include specific additional HB 2 language relative to the match provision to address the following issues:

- Who specifically qualifies as a non-state partner for matching funds (e.g. federal government, local government, etc.) and what the expectations are of this partner
- What mechanism or action will be sufficient to verify the match (e.g. commitment letter, actual receipt of the funds, etc.), in particular if the university units use lump-sum funds as the match
- Must the match be specifically dollars or will equipment and/or services (in-kind) be allowed
- Will spending state funds be contingent upon first spending the matching funds
- Will the general fund appropriation be subject to reversion at the end of the biennium in the event that the Board of Regents is unable to secure a match partner or provide a match with university funds

Assuming that the intention of adding the funding match restriction to the executive budget is to leverage additional funding for the university system that will actually increase the total budget above the state funding level, the legislature may want to consider amending the executive budget language in some of these initiatives to require that some portion of the matching funds must be "nonstate money." Some potential sources of nonstate money would include:

- Federal government grants
- Private sector grants and contracts
- Private foundation grants
- Local government or economic development authority grants and contracts

Given that many of these initiatives add value not only to the university system but also to specific industries and sectors of the economy, it seems that there may be opportunities to use the match requirement to leverage nonstate funding as the match, essentially using state funding to leverage private sector funding to support the Shared Leadership initiatives.

Other Issues

Tuition Rates

In part due to state budget cuts resulting from revenue shortfalls, the university educational units and the Board of Regents have implemented tuition increases at or above 11 percent in each of the last four academic years. Figure 10 illustrates annual tuition changes over the past 10 years:

Figure 10
Annual Resident Undergraduate Student Tuition Rates
Tuition Only - Mandatory Fees Not Included
Fiscal Years 1996 - 2005

Fiscal Year	UM Missoula	UM MT Tech	UM Western	MSU Bozeman	MSU Billings	MSU Northern	System Average	Annual % Change	Cumulative % Change
FY 1996	1,731	1,795	1,703	1,711	1,708	1,656	$1,717		
FY 1997	1,822	1,892	1,745	1,831	1,778	1,739	$1,801	4.89%	4.89%
FY 1998	1,940	2,016	1,859	1,954	1,901	1,859	$1,922	6.68%	11.89%
FY 1999	2,066	2,146	1,979	2,086	2,033	1,988	$2,050	6.67%	19.35%
FY 2000	2,156	2,240	2,025	2,177	2,122	2,030	$2,125	3.67%	23.73%
FY2001	2,250	2,337	2,072	2,272	2,214	2,072	$2,203	3.67%	28.26%
FY 2002	2,543	2,641	2,267	2,567	2,502	2,262	$2,464	11.84%	43.45%
FY 2003*	2,873	2,984	2,483	2,900	2,827	2,472	$2,757	11.90%	60.52%
FY 2004	3,125	3,343	2,700	3,256	3,168	2,769	$3,060	11.01%	78.18%
FY2005	3,390	3,743	2,930	3,654	3,548	3,101	$3,394	10.92%	97.64%
Average Annual Growth	7.75%	8.51%	6.21%	8.80%	8.46%	7.22%	7.86%		

*Not include tuition surcharge

Source: OCHE /Board of Regents Annual Operating Budgets

LFD COMMENT

In FY 2004 state funding comprises an average of 43 percent of the funding for the university educational units in the current unrestricted operating budget. This average of the eight university and college of technology campuses ranges from the high of 58 percent state funding at MSU-Northern to the low of 37 percent state funding at UM-Missoula.

For some historical perspective, according to the university operating budgets, state funding as a percentage of the educational units current unrestricted operating budget has been decreasing as follows:

- 48 percent in FY 2002
- 50 percent in FY 2000
- 54 percent in FY 1998

At the same time, the average tuition rate at the university educational units has been increasing as follows:

- $2,235 in FY 2002 (5 percent increase over 2000)
- $2,011 in FY 2000 (4 percent increase over 1998)
- $1,851 in FY 1998

Therefore, the trend indicates that there is some correlation between the reductions of state funding as a percentage of university educational units unrestricted operating budget and increasing tuition rates.

The executive budget for the 2007 biennium proposes that the present law and new proposal increases included in the HB 2 components of the budget, together with the 3 percent proposed salary increase included in the executive HB 13 proposal, taken as a whole, should only require a tuition increase at about the 2 percent level, consistent with anticipated inflation rates. This is based upon the executive assumption that university educational units operations would only change in the areas addressed in the present law adjustments and the new proposals.

LFD COMMENT CONT.

The Board of Regents operating budget projections for the 2007 biennium, on the other hand, project tuition rate increases that range from 4.3 percent to 11.7 percent, depending on the state level of funding in HB 2, the state share calculation that is used in HB 13 (state employee pay plan), and the actual level of funding the Board of Regents allocates to specific university level new initiatives. For more detail on the Board of Regents tuition projection, see the LFD Comment and LFD Issue in the introductory section of this analysis.

In light of the historical, statistical relationship between state funding levels and tuition, the legislature may want to monitor the percentage share that state funding comprises of the university current unrestricted fund as a means to anticipate tuition changes going forward. Such a monitoring process could be done during budgeting by comparing the impact that each decision package would have on the total university budget and compare that to the percentage share that amount represents in the university system project operating budgets.