

Postsecondary Education Budget and Policy Committee

The Mechanics of House Bill 2 (HB2)

Staff Presentation

Thursday, December 1, 2005

Presentation Outcome Goal: That PEPB subcommittee members understand how to achieve and implement potential legislative options related to Project #1 (Budgeting through the use of Policy Goals/Accountability Measures as budget drivers) and Project #2 (Funding Formula Changes).

Why Spend Time On This: To clarify the technical mechanisms that are used in House Bill 2 (HB2) to provide state funding to the MUS so that work plan projects and potential PEPB legislative options are formulated properly and may be considered for implementation in the HB2 budget for the 2009 biennium.

Brief Review:

The state budget and HB2 for the Montana University System (MUS) is organized by Program:

Commissioner of Higher Education Functions

Program 1 = Administration

Program 2 = Student Assistance (Financial Aid)

Program 3 = Improving Teacher Quality

Program 6 = Talent Search (Student Support Programs)

Program 8 = Workforce Development

Program 12 = Guaranteed Student Loan

Program 13 = Board of Regents Administration

- **Base Year + Present Law + New Proposals = BUDGET**

Community Colleges

Program 4 = Community College Assistance

- **FTE Students x Cost of Education x State % Share (policy decision made each biennium) = BUDGET**

Medical and Workers Comp Insurance

Program 5 & 7 ... these are proprietary funds (rates are approved based on fee for service basis)

University Educational Units

Program 9 = Distribution to University Campuses and Research/Public Service Agencies

- **Research/Public Service Agencies** (Extension, Ag. Experiment, Bureau of Mines, Forestry, Fire School):
Base Year + Present Law + New Proposals = BUDGET
- **University Education Units**
- **Base Year + (Present Law x State % Share¹) + (Marginal Cost Per Student x FTE Growth) + New Proposals = BUDGET**

Tribal Colleges

Program 11 = Tribal College Assistance

- Actual Budget Formula → Typically no specific formula is applied...rather an appropriation level is determined based on budget affordability that remains below the statutory ceiling...while historical guidance is considered based upon the average FTE enrollment of 311 per year

State Also Funds the State Pay Plan → House Bill 447 (in the 2007 biennium budget)

For the Montana University System, the state pay plan funds **only** the state % share of the cost of the pay plan at the university units (recall that the state % share in the 2007 biennium is 39%), which leaves the remaining 61% of the costs of the state pay plan to be paid by other sources, primarily tuition.

Therefore...to effect change in HB2 funding for the MUS related to either Project #1 or Project #2 PEPB must:

1. Change the method/calculation to determine the Base year funding level
2. Change the calculation method for the State % Share that determines many funding levels, including the Present Law Adjustments and the Pay Plan
3. Change the method of calculating and implementing Present Law Adjustments
4. Implement New Proposals

Let's consider these in reverse order, which also leads from simplest to most complex:

- **New Proposals:**

These are Decision Packages² (DP's) that provide new funding, above the Base and Present Law Adjustments, to support either existing program goals/objectives at a higher service level with new funding or to support new programs to achieve new goals/objectives. New Proposal DP's may simply state an amount given for a general purpose, or the DP can list specific goals/objectives to be achieved with the funding (see examples below). These DP's may be restricted to spending only for that specific purpose, they may be approved as One-time-only (OTO) so that the funds do not "roll into the base" for the next biennium, etc. Thus, to affect change in HB2 funding for New Proposals is a function of how the DP's are written (e.g. setting measurable goals, incentive funding, restricting the funding, OTO's, etc.). For example:

- **An actual from HB2**... DP 78 - Equipment/Program Development - 2 Yr Programs-OTO - The legislature approved a restricted, biennial, one-time-only appropriation of \$4.46 million general fund in the 2007 biennium to fund the purchase and update of equipment and program development for two-year degree programs that is to be distributed in two blocks as follows: (1) \$1.4 million must be allocated equally (\$200,000 per unit) to the seven university units' 2-year degree programs to be used for either program development or equipment acquisition; and (2) \$3.06 million must be distributed entirely by a competitive grant process administered by the Office of the Commissioner of Higher Education. These equipment grants will be available to both the seven university units' 2-year degree programs and the three community colleges (Dawson, Miles, and Flathead Valley). The equipment portion of this appropriation must be matched from non-state funds identified by the Board of Regents.
- **An actual from HB2**... DP 1011 - Distance Learning Initiative - OTO - The legislature approved \$300,000 general fund in the 2007 biennium to support the development and implementation of a statewide distance learning plan across the university system and partnering with education providers at all levels. This was approved as a biennial, one-time-only appropriation.
- **A potential from policy goals**... DP 4 – Promote Access and Affordability for Montana Students as Compared to Median Family Income – The legislature approves an annual appropriation of \$_____ to each of the university system educational units for each year of the biennium that each unit is able to keep tuition rates at or below a level that represents _____ percent of the median

family income of Montana residents, up to a maximum appropriation of \$ _____. This will be a one-time-only (OTO) appropriation.

- **A potential from policy goals...** DP 3 – Increase Responsiveness to Workforce Development Needs in High-Demand Occupations – The legislature approves an annual appropriation of \$ ____ to each of the university system educational units for each year of the biennium that each unit is able to increase by ____ percent or by ____ number the level of degrees or certificates awarded in high-demand occupational fields.

- **Present Law Adjustments:**

These are DP's that provide funding, above the Base, in order to maintain "current law" programs at their required level of service (not new services). Typically present law adjustment DP's reflect inflationary cost increases or student enrollment increases, where additional funding is required to maintain the current level of service. Once again, Present Law DP's may simply state an amount given for a general purpose, or the DP can list specific goals/objectives to be achieved with the funding. These DP's may be restricted to spending only for that specific purpose, they may be approved as One-time-only (OTO) so that the funds do not "roll into the base" for the next biennium, etc. Thus, to affect change in HB2 funding for Present Law Adjustments is a function of how the DP's are written, as well as how the adjustment calculations are made (e.g. which inflation index is used, the State % Share level, etc.).

- **An actual from HB2...** DP 21 - Additional Federal Funds for Student Assistance - The legislature added \$73,574 additional federal authority in the 2007 biennium for anticipated increases in federal funds for student grants. These funds will be used as the federal match portion in the state matched Baker Grant program.
- **An actual from HB2...** DP 43 - Increased IT License and Maintenance - The legislature approved \$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.
- **A potential from policy goals...** DP 2 – Make Higher Education More Affordable by Offering Need-based Student Financial Aid to More Students – The legislature increases the _____ student assistance program by \$ _____ to increase the percentage of students in the MUS who receive need-based financial aid by at least ____%. This appropriation is restricted to the _____ student assistance program and will be an OTO appropriation.
- **A potential with new state % formula...** DP 3 – Present Law Adjustment for Operations and Maintenance – The legislature approved \$ _____ general fund to support inflationary increased cost adjustments for building operations and maintenance at the university educational units at the state percentage share of ____% (which represents a formula based upon ____).

- **State % Share:**

Currently this percentage represents the ratio between the total cost of education for Montana resident students and the portion of those costs paid by state funds (as opposed to tuition). This calculation model is NOT driven by statute but is a budget policy decision, so that to effect change, the legislature has the policy authority to change the calculation model without a bill draft and statute change.

- **As a ratio between Montana resident students vs. Non-resident students...** this calculation model was used for some present law adjustments in the 2007 biennium budget. The result is a state % share at the 80% level...which is the current percentage of resident students attending the university educational units.

- *As a pure policy decision by the legislature...* this calculation model is used by the legislature (since 1982) to determine the state funding level for the community college assistance program. The legislature states, in HB2, the percentage of the cost of education that state policy goals determine as the level to support Montana resident students. Currently the legislature has set that level at 53% for the community colleges.

- **Base Funding Level:**

Currently, the base funding is determined by taking the actual expenditures from the last completed fiscal year, removing OTO's and budget amendments, and that calculation sets the "base funding level" upon which the budget is built. Barring any extraordinary cost increases during a base year or any economic crisis affecting state revenue, the executive and legislature typically accept base year funding levels as determined from past expenditures.

In the university educational units budget, that base combines expenditures for fixed costs (such as utilities and other operations and maintenance costs that are not truly correlated to student enrollment) together with expenditures for variable costs (such as consumable supplies and adjunct faculty costs that fluctuate as a function of student enrollment). Under the current formula, there is no calculation that attempts to distinguish fixed vs. variable costs so that base year expenditures in total become the "base" for the next biennium budget.

At that point, the Present Law Adjustments and the New Proposals, in the form of DP's, build up from the base to become the budget. This model is essentially an "Incremental Budget Model"... change to the past expenditure level, the Base, is the focus of the budget process through specific DP's that essentially adjust the Base for inflation and to fund new proposals.

Other Base budget calculation models could include the following:

- Zero-based budgeting...starting with a zero budget each fiscal year and require that all expenditures be justified in budget detail
- Three-factor funding formula...used for the community colleges...could be used to establish Base funding level for university units then add new proposal DP's. The three factors are:
 - **FTE Students x Cost of Education x State % Share (policy decision made each biennium)**
 - Then legislature sets a specific % share of the base that it will fund...may want to fund differently for 4-year vs. 2-year, for fixed vs. variable, etc.
 - Fixed vs. Variable Cost model...base funding level could be determined using two categories of expenditures, fixed and variable, and then use separate calculations to make incremental adjustments to each type of expenditure. This base calculation formula could more accurately portray the costs.

Effecting change to base funding becomes much more complex than any of the above, both in term of complexity of details and complexity of making calculations.

Conclusion:

Therefore, in the event that PEPB decides to move forward to implement budget initiatives in HB2 that come out of workplan projects #1 or #2 the mechanisms to move these initiatives forward include:

1. **New Proposal Decision Packages (DP's)**...to create new programs and add new funding...and these may be written to include goal setting and measurable objectives that are intended to be achieved. In addition, the funding may be restricted for spending only on these specific programs, and made one-time-only so that continued funding would be subject to subsequent evaluation of progress/success against the measurable objectives that are written. Incentive funding could also be written into new proposal DP's.
2. **Present Law Adjustment Decision Packages (DP's)**...to fund existing services at levels required under present law...just as with New Proposals, the present law adjustment DP's could be written to include policy goals or they could be calculated with different adjustment formula (perhaps a specific inflation index specified). In addition, change can be affected to present law funding by changing the calculation of the state % share, as that calculation is a multiplier that determines the funding level of present law adjustments.
3. **State percentage (%) share**...the state share of funding to pay a proportion of the costs of education at the university units...this is used to determine funding for Present Law Adjustment DP's and the State Pay Plan...this percentage may be calculated in various ways...or it may be a purely public policy decision that is made by the legislature based upon policy goals and available state revenue.
4. **Base funding level**...currently this is the ongoing expenditures from the most recently completed fiscal year...affecting change to the base is more complex but it could be done by adopting alternate formula models.

This presentation was not intended to be advocating for any of the models discussed but merely to provide an understanding of the budget mechanisms that are used in HB2 so that PEPB, and by extension the legislature, will have to tools needed to implement any budget options that come out of these workplan projects.

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¹ Recall that the "state % share" in the budget for the University Educational Units is **NOT** driven by a stated legislative policy decision, as it is in the Community College budget. Rather, "State % Share" is the ratio of state funds as part of the Current Unrestricted Operating Fund (that fund which pays the basic costs of educating students) ... thus, going into the last budget, the "State % Share" was 43% ... meaning that 43% of the funding to pay for the basic costs of educating students was state funding...so that the Present Law Adjustments, the updating of the budget for cost changes, would be funded by the state at 43%. There are some mathematical anomalies to this formula, however, so that it is on a mathematical trend downward, independent of public policy decisions...for example, coming out of the last state budget adopted in the 2005 legislative session, the state % share is now about 39%...which is 4% less than coming into the session...

² Decision Packages (DP's) are specific, discreet funding amounts to be appropriated by fiscal year in the HB2 biennium budget to provide funds a specific program, purpose, etc. To be approved by the legislature, each DP must be subject to a vote, as DP's are stated separately from the budget base.