

Postsecondary Education Budget and Policy Subcommittee

Alternative State Funding Models for Higher Education

Staff Presentation

Thursday, February 23, 2006

Presentation Outcome Goal:

As part of PEPB Project #2, subcommittee members are interested in **reviewing** the current funding formulas that drive state funding levels for higher education (specifically the university educational units) and then **looking at alternative models** for state funding in order to determine if the PEPB would like to consider other funding models or mechanisms for higher education funding. In the prior staff report “The Mechanics of House Bill 2 (HB2)” all of the current funding formulas in the Montana budget are presented. It is the intention of **this report** to review other models for PEPB discussion and consideration.

If the PEPB determines that any of the model options presented in this report have the potential to present preferred outcomes compared to the existing model, PEPB may want to instruct staff to conduct additional research and report back with specific action options.

If PEPB is interested in making budget model recommendations to influence the 2009 biennium budget, that recommendation would be forwarded to the Governor’s Budget Office for consideration as the executive initiates the budget process and prepares the Executive Budget that is then submitted to the legislature.

Why Spend Time On This Issue Report:

To look at funding models in other states to see if there is a “best-practices” model or other funding mechanism that may demonstrate advantages or other public policy distinctions to the Montana funding model. The goal of this review is to either identify a model for consideration or stimulate thinking that leads PEPB to devise other models or mechanisms.

Brief Review:

In Montana, the state budget funds the university educational units using the following model:

University Educational Units

- $\text{Base Year} + (\text{Present Law} \times \text{State \% Share}^1) + (\text{Marginal Cost Per Student} \times \text{FTE Growth}) + \text{New Proposals} = \text{BUDGET}$

State Also Funds the State Pay Plan →

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

Funding Models from Other States:

Attached to this report is an inventory of data and narratives received from other states from a national request by the National Conference of State Legislatures and by the Legislative Fiscal Division (LFD). Using this inventory as a starting point, the following are some of the responses received regarding funding models for higher education from other states.

Arizona - No data received on their specific funding model, but the legislature does build performance measures into the general appropriations act for each campus in order to make clear what they seek to “purchase” with state funds. This process may lead to incentive funding in the future, which would provide additional state funds if targets are met/exceeded.

Arkansas – No data received on their specific funding model, but the legislature has created a \$1 million incentive funding pool and provides additional funds when specific accountability measures are met.

Idaho – Same model as Montana: **Higher education budget = Base + Adjustments + New Proposals**
Enrollment change funding is determined by looking at 3-year rolling averages of student enrollment levels (Montana enrollment funding uses projections for each year).

Kansas – No data received on their specific funding model, but starting with Fiscal Year 2006 any **new** state funding shall be contingent upon that campus achieving the goals set in an accountability measures agreement with the state.

Michigan – Allocates funding with a formula based on three components:

- **Enrollment-based component (37.5% of total funding)** ... as universities receive a base funding amount per FTE student, with resident students funded at a higher level than non-resident students
- **Degree-based component (37.5% of total funding)** ... as universities receive a base funding amount for the different types of degrees conferred, with higher cost degrees funded at a higher level (e.g. science and engineering)
- **Research-based component (25% of total funding)** ... as universities receive state matching funds for federal research grants in science and engineering

Nebraska – Same as Montana: **University Budget = Prior Year Base + Adjustments + New Initiatives**

New Jersey - No data received on their specific funding model, but each campus can earn up to 1 percent additional state funding if they meet accountability measures for graduation rates, transfer and articulation, efficiency and effectiveness, and diversified revenues.

North Carolina – Same model as Montana: **University Budget = Base Year + Inflation Adjustments** ... in addition, enrollment change funding uses a complex model that looks at the cost of each program, the instructional level, and student enrollment projections.

North Dakota – Same as Montana: **University Budget = Base Year + Inflation Adjustments** ... but also ties funding level to the state’s sustainable revenue growth so that if the state economy improves and state revenue increases, the university system gets a fixed percentage increase correlating to that growth.

South Carolina - No data received on their specific funding model, but approximately 3 percent of state funding for the campuses is tied to their performance in 9 “critical success areas” as measured by 37

performance accountability measures. State expects to increase the amount of funds that are appropriated in this manner.

Washington – Same as Montana: **University Budget = Base + Increment Adjustments + Initiatives**

Legislative Options for Consideration:

Should the PEPB decide to consider alternative funding mechanisms in order to influence the state funding level for the Montana University System, the following are options to consider:

*[Sidebar – in the one area where state government has codified a budgeting formula for the university system, in the community college program, the legislature identifies (in the 1981 funding study that led to the formula) that an underlying policy goal of that formula is to be **Transparency**; that the formula be clear, concise and easy to understand. In the options below, that legislative policy goal has been considered by LFD staff]*

COST OF EDUCATION MODELS

Three-factor funding formula model to establish the base-year budget (currently used by the community college funding program):

Stated mathematically, this funding formula looks like the following:

- **Student Enrollment x Cost of Education x State Percent Share = General Fund Budget Base**
(e.g. 100 Students x \$100 Cost Per Student x 53% State Share = \$5,300 General Fund Base)

Requires that the executive, legislature and the Board of Regents can reach agreement on a method to calculate the cost of education that all will trust and accept.

In this model, base-year funding is established as a direct function of the policy decision on what the **State Percent Share** level will be. That policy decision would be made in the original executive budget and then reviewed by the legislature in the HB2 process. Thus, each budget would determine what percent of the costs of education that state government would be able to fund; based upon public policy and available revenue.

Recall that in the current funding model, the state percent share is based on a mathematical formula that inherently decreases if universities raise tuition or spend more than state expenditure projections. So the primary change in this model is that the state percent share becomes a conscious policy decision rather than a pre-determined mathematical outcome. This would make the budget much more transparent and make it more subject to clear public policy goals rather than a function of confusing mathematical formulas.

Fixed and variable costs of education model (variation of the three-factor funding formula above):

Stated mathematically, this formula would look like the following:

- **[(Student Enrollment x Variable Cost of Education) + Fixed Cost of Education] x State Percent Share = General Fund Budget Base**
e.g. [(100 Students x \$40 Variable Cost Per Student) + \$6,000 Fixed Cost] x 53% State Share = \$5,300 General Fund Base)

This model is essentially the same as above, in terms of the exercise of public policy and the need for an acceptable cost of education factor.

But this model accounts for the fixed cost base that university units experience...as not all costs are driven by the number of students who enroll.

This model would require that the executive, legislature and the Board of Regents could reach agreement on a method to calculate the ratio of fixed to variable costs in each campus budget so that all will trust and accept that calculation. Of course, once again, the ultimate funding level is determined by the public policy decision on the State Percent Share level.

BASE PLUS ADJUSTMENT WITH STATE PERCENT SHARE POLICY DECISION

Current model, but for the state percent share is purely a legislative policy decision:

- $\text{Base Year} + (\text{Present Law} \times \text{State \% Share}) + (\text{Marginal Cost Per Student} \times \text{FTE Growth}) + \text{New Proposals} = \text{BUDGET}$

This model only changes the State Percent Share factor by making it purely a public policy decision, rather than a mathematical formula. It would operate such that the executive budget would recommend a percent level based upon policy goals and revenue affordability, and the legislature would consider that and make a decision that is stated in HB2.

This would make the budget much more transparent and make it more subject to clear public policy goals rather than a function of confusing mathematical formulas.

Current model but for the state funding level is a function of targets set as a policy goal of the “proper” state funding/tuition mix (that target mix could be based upon a peer institution average or norm):

- $[\text{Base Year} + \text{Present Law} + (\text{Marginal Cost Per Student} \times \text{FTE Growth})] \times \text{State \% Share} + \text{New Proposals} = \text{BUDGET}$

Under this model the state budget would identify the total cost of the university system budget and then determine the State % Share factor by setting a target, based upon a public policy decision, for the desired ratio between state funding/student tuition, so that the level of the state percent share decision would be a policy decision driven by a target ratio of state/tuition funding. Such a ratio could be determined and based upon peer institution norms.

This model would require that the executive, legislature and the Board of Regents could agree on appropriate peer institutions.

The targets would not require absolute agreement but could be target goals that each branch (executive and legislature) defines somewhat differently.

Once again, this model would be transparent and would shift the State Percent Share factor from a mathematical outcome to a public policy decision, but in this model that public policy decision is couched within a specific target range, that being a ratio from peer institution norms.

FUNDING THE PAY PLAN FOR THE UNIVERSITY SYSTEM

As stated above, the current practice for pay plan funding for the university system is that the pay plan bill calculates the total impact of salary/benefit changes on the university units budget, and then funds the pay plan at the State Percent Share level. Thus, in the 2007 biennium budget the university units received approximately 39 percent of the total funding they would need to meet the state pay plan.

An alternate model could be to fund the pay plan using a different calculation for the State % Share:

- ◆ The State Percent Share calculation for the pay plan could be purely a public policy decision so that the statute states the specific percentage of the total funding that the state would provide, based upon available revenue and policy goals.
- ◆ The State Percent Share calculation for the pay plan could be based upon a desired ratio between state funding/student tuition, with that target ratio derived from a comparison with peer institutions to identify a norm level of state/tuition funding levels.

INCENTIVE FUNDING POOL

Current model but tie additional funding level increases to successfully achieving policy goals and accountability measures

- State the accountability measures in HB2 for the first year of the biennium that trigger incentive funding
- If targets are met by the end the first year then incentive funds are available in the second year of the biennium
- The incentive funds could be appropriated as unrestricted funding or targeted/restricted for certain purposes

CONCLUSION

If the legislature is interested in affecting the state budget for the Montana University System at the base rather than just in the area of new proposals, legislators may want to consider selecting one or more of these model options for further investigation, including potential scenarios and comparatives to prior budgets. Based upon that additional investigation and modeling, subsequent PEPB action options may include the following:

1. Discuss with the Office of Budget and Program Planning a package of changes to the higher education funding model for the 2009 biennium budget, perhaps advocating for a specific model
2. Recommend pilot implementation of an alternative funding model(s) to the Office of Budget and Program Planning for a specific component of the higher education budget
3. Request a bill draft for a comprehensive funding study during the 2007-2008 interim

A decision about these action options does not need to be made at the February meeting, but they are listed here to provide “sideboards” for the process going forward in the June 2006 PEPB meeting.

FEBRUARY MEETING DECISION POINTS

The following are decision options, based upon the alternative funding model options, for PEPB consideration at the February 2006 meeting:

1. Do nothing at this time on alternative funding models for the Montana University System
2. Select one or more alternative models for further investigation and development of illustrations, to be presented to PEPB at the June meeting
3. Invite the Office of Budget and Program Planning to the June meeting and request a briefing on the status of the postsecondary education budget for the 2009 biennium, with particular attention to the funding models for the university units

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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 (the 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 for the basic costs of educating students was state funding) and so the Present Law Adjustments, updating 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 state budget adopted in the 2005 legislative session, the State % Share is now about 39%, which is 4% less than going into the session.