MINNESOTA STATE COLLEGES AND UNIVERSITIES
BOARD OF TRUSTEES

Agenda Item Summary Sheet

Committee: Finance, Facilities and Technology **Date of Meeting:** January 19, 2010

Agenda Item: Fiscal Year 2011 Budget Outlook

- [ ] Proposed Policy Change
- [ ] Approvals Required by Policy
- [ ] Other Approvals
- [ ] Monitoring
- [x] Information

Cite policy requirement, or explain why item is on the Board agenda: The system is continuing budget planning for fiscal year 2011. The budget planning is incorporating the Governor's unallotment of $50 million which was announced in June 2009.

Scheduled Presenter(s): Laura M. King, Vice Chancellor - Chief Financial Officer
Judy Borgen, Associate Vice Chancellor Budget
Karen Kedrowski, System Budget Director

Outline of Key Points/Policy Issues: The purpose of this report is to provide the Committee with information on the state's most current economic forecast, the impact of the Governor's $50 million unallotment, and an outlook for the 2012-2013 biennium. Guidance will be sought from the Committee regarding tuition parameters and preliminary planning framework assumptions.

Background Information: The Committee was presented a preliminary outlook for fiscal year 2011 in June/July 2009. Several events have occurred since the last discussion including the Governor's unallotment and a new state budget forecast which impact the system's fiscal year 2011 budget outlook.

BOARD OF TRUSTEES
MINNESOTA STATE COLLEGES AND UNIVERSITIES

INFORMATION ITEM
FY 2011 Budget Outlook

BACKGROUND

The purpose of this report is to undertake a discussion with the Finance, Facilities, and Technology Committee regarding the budget outlook for fiscal year 2011. Preliminary budget planning for fiscal year 2011 began two years ago with development of the system's 2010-2011 biennial operating budget. At its June and July 2009 meetings, the Board of Trustees was presented a preliminary outlook for fiscal year 2011 at the time action was taken on the fiscal year 2010 operating budget. Several events have occurred since the last Board discussion of the 2011 outlook. Concurrent with the July 2009 board meeting, the Governor unallotted $50 million from the system's fiscal year 2011 appropriation. The November 2009 state budget forecast indicated a deficit for the fiscal year 2010-2011 biennium at $1.203 billion.

Information will be provided on the state's most recent economic forecast, impact of the $50 million unallotment, use of federal funds received under the American Recovery and Reinvestment Act of 2009, outlook for the 2012-2013 biennium, and the budget planning timeline. It is expected that discussion will generate further guidance for fiscal year 2011 operating budget planning. The Board will be asked to adopt the 2011 budget in April/May 2010.

State's economic forecast

The February 2009 forecast projected a budget gap of $4.570 billion for the 2010-2011 biennium. The 2009 legislative session reduced the deficit to $2.676 billion which was then addressed through the Governor's unallotment and executive actions. With the release of the November 2009 economic forecast on December 2, the state is now projecting an additional $1.203 billion general operating fund deficit for the current 2010-2011 biennium after the Governor's unallotment and executive actions. The deficit is comprised of a reduction in general fund revenues of $1.156 billion (3.7 percent), a small decrease of $44 million in general fund expenditures, and a $91 million reduction in the ending balance from fiscal year 2009. (Table 1) The forecast takes into account the national and state economic outlook, caseload, enrollment and cost changes in the state's entitlement programs (K-12, intergovernmental aids, health care, and family support), and actual fiscal year 2009 closing information. The forecast also takes into account the Governor's unallotment and other executive actions.

Table 1

State of Minnesota
General Fund Budget
Fiscal Years 2010-2011

($ in millions)	Legislatively Enacted Budget	Governor's Unallotments	End-of-Session	November Forecast	$ Change
Balance from FY2009	**$538**	**$0**	**$538**	**$447**	**($91)**
Revenues	$30,925	$217	$31,142	$29,986	($1,156)
Expenditures	$33,789	($2,459)	$31,330	$31,286	($44)
Budget Reserve	$0	$0	$0	$0	$0
Cash Flow Account	$350	$0	$350	$350	$0
Balance	**($2,676)**	**$2,676**	**$0**	**($1,203)**	**($1,203)**

Source: Minnesota Management and Budget, November 2009 Forecast.

An $827 million reduction in expected individual income tax receipts accounted for nearly three-quarters of the $1.156 billion revenue forecast decline. Job losses and wage declines throughout the state have been substantial. The average hours worked per week has reached a historic low. Fewer jobs and reduced hours worked result in a decrease in total wages paid and a significant impact to the individual income tax base and revenues to the state. (Minnesota Management and Budget, Press Conference, December 2, 2009)

The outlook for the 2012-2013 biennium has also worsened. The revenue forecast shows a $5.426 billion shortfall compared with $4.431 billion projected at end-of-session, a $995 million increase. (Table 2)

Table 2

State of Minnesota
General Fund Budget
Fiscal Years 2012-2013 Planning Estimates

($ in millions)	Legislatively Enacted Budget	Governor's Unallotment	End-of-Session	November Forecast	$ Change
Revenues	$34,406	($101)	$34,305	$33,218	($1,087)
Expenditures	$37,511	$1,225	$38,736	$38,644	($92)
Difference	**($3,105)**	**($1,326)**	**($4,431)**	**($5,426)**	**($995)**
Inflation			*$1,953*	*$1,179*	*($774)*

Planning estimates assume:

- Complete repayment of the K-12 aid deferral. Delaying repayment would save $1.167 billion.

- No repayment of the K-12 property tax recognition shift. Repayment would cost $562 million.

- No continued GAMC spending. Restoring the program would cost $928 million.

Source: Minnesota Management and Budget, November 2009 Forecast.

Expenditure projections do not include any adjustment for proposed inflation. Using the Consumer Price Index (CPI), inflation is projected at 2.1 percent for fiscal year 2012 and 1.9 percent for fiscal year 2013 for a cost of $1.179 billion in the next biennium. The planning estimates include the repayment of the K-12 aid deferral. However, the estimates do not include repayment of the K-12 property tax shift ($562 million) or restoration of the GAMC program ($928 million) which would have increased the deficit by an additional $1.490 billion.

The state is faced with a structural issue. Revenues are projected to grow slowly and spending pressures will be driven by issues of an aging population and health care services. As a result, state spending will likely shift from education, infrastructure and higher education to the care and support of the aging. With this shift, it is more than likely that the share of the system's budget from state resources will continue to decline.

Actions could be taken during the 2010 legislative session that would balance the fiscal years 2010-2011 deficit or that would begin to resolve the structural shortfall for the 2012-2013 biennium.

Budget planning

The system's budget planning for the 2010-2011 biennium has been guided by three principles:

- The Chancellor and system leadership will seek to make decisions in a way that best serves students;
- Decisions will strive to take into account the system's mission to serve the economic development needs of the state and its communities; and
- Planning will take a multi-year approach, positioning the system for long-term financial viability.

At the close of the 2009 legislative session, the higher education bill provided the Minnesota State Colleges and Universities with $1.28 billion of state resources during the 2010-2011 biennium. The funds were to be distributed as $614 million in fiscal year 2010 and $666 million in fiscal year 2011. The system's fiscal year 2011 overall budget outlook had a positive gap of $9.7 million before any programmed use of fund balance.

Since that time, the Governor has exercised his unallotment authority and recommended a $50 million unallotment for fiscal year 2011. This reduces the fiscal year 2011 funding level from $666 million to $616 million, virtually the same level as fiscal year 2006. A $50 million unallotment represents a 7.5 percent reduction in state appropriation from the approved level or a 3.2 percent reduction when evaluated on the basis of total general fund revenue including funds from the American Recovery and Reinvestment Act of 2009 (ARRA). After applying the $50 million reduction, the fiscal year 2011 budget outlook shifts from a positive budget gap of $9.7 million to a negative gap $40.3 million (2.6 percent of expenses) before the programmed use of fund balance or other budget reduction actions. (Table 3)

Table 3

Minnesota State Colleges and Universities
Summary Outlook – General Fund
Fiscal Year 2011

($ in millions)	Fiscal Year 2010 Proposed Budget	Preliminary Fiscal Year 2011 Outlook	Revised Fiscal Year 2011 Outlook
Revenues			
State appropriation	$614.2	$666.0	$616.0
Tuition*	$708.3	$740.5	$740.5
ARRA funds*	$26.7	$26.7	$26.7
Other revenues	$126.8	$124.5	$124.5
Total budgeted revenues	$1,476.0	$1,557.7	$1,507.6
Expenses			
Compensation	$1,085.9	$1,103.6	$1,103.6
Other operating costs	$404.7	$444.3	$444.3
Total budgeted expenses	$1,490.6	$1,547.9	$1,547.9
Gap	($14.6)	$9.7	($40.3)
Programmed fund balance	$16.3	$5.9	$5.9
Budget balance	$1.7	$15.6	($34.4)

*In fiscal years 2010 and 2011 approximately $12.9 million of ARRA funds were used to mitigate tuition increases. These resources are included in tuition revenue.

Colleges and universities have taken a multi-year approach to budget planning. Fiscal year 2011 budget planning began over a year ago within campus communities, in the Leadership Council and in the Office of the Chancellor. Budget planning and consultation will continue over the next several months with a focus on setting priorities and identifying budget balancing solutions.

Fiscal year 2011 guidance will be provided to the presidents and the campus communities in the weeks ahead. The preliminary planning framework suggests the following assumptions:

- Include a state support reduction of at least $50 million as announced by the Governor last spring;
- Assume tuition rate increases not to exceed 5 percent;
- Recognize modest compensation inflationary cost increases (insurance increase and steps for classified employees); and
- Expect the continuation of the already approved federal stimulus funds for one-time expenses.

The Chancellor and Vice Chancellor – Chief Financial Officer have directed the colleges and universities to reach structural balance at the beginning of fiscal year 2012 targeting the fiscal year 2011 funding level at the Governor's announced level which includes a $50 million reduction from 2009 session law. The Governor's 2011 unallotment announcement and the new 2011 state budget deficit place additional pressure on the colleges and universities to balance 2011 budgets while delivering services to record breaking enrollment levels.

Fiscal year 2011 unallotment

As previously outlined, the Governor has unallotted $50 million from the system's fiscal year 2011 state appropriation. With the state projecting an additional $1.203 billion general operating fund deficit for the current 2010-2011 biennium, it would be prudent for the system to plan for an additional reduction in appropriation above the $50 million unallotment. Because the state is receiving stabilization funds through the ARRA, there is a maintenance of effort that must be maintained in order to retain the federal funds.

The state must maintain the fiscal year 2006 level of funding to higher education which includes the Minnesota State Colleges and Universities and the University of Minnesota. Therefore, an additional reduction of $46.6 million could occur to higher education. If the maintenance of effort formula was carried through, the Minnesota State Colleges and Universities system could be reduced an additional $10.5 million above the $50 million unallotment. For the system, the fiscal year 2006 funding level was $605.5 million (adjusted for the Learning Network transfer in fiscal year 2010).

It would be the Chancellor's intent to distribute any reduction in state resources using the framework that was approved by the Finance and Administration Committee of the Leadership Council and the Finance, Facilities and Technology Committee of the Board of Trustees several years ago. The framework takes into account appropriation, tuition and the ARRA funds and distributes the impact of an appropriation reduction to the colleges and universities and the Office of the Chancellor.

The Chancellor will seek input and guidance from the Leadership Council regarding identifying state resources that could be redirected toward the unallotment. For example, $3.3 million of resources that were allocated to support college/university campus programs for fiscal year 2010 have been reserved to assist the colleges and universities in absorption of the unallotment. There is an additional $3.3 million allocated in fiscal year 2011 that could likewise be used to cover a portion of the unallotment. These resources are available during the 2010-2011 biennium due to the suspension of the awards of excellence and special initiative award programs.

Slightly more than 87 percent ($585.9 million) of the state resources the system receives are distributed to colleges and universities either as base or priority allocations. (Table 4) The Chancellor is committed to balancing the impact on the college and university base operations support with the need to advance the strategic priorities of the Board and support the system wide activities of the Office of the Chancellor.

Table 4

Minnesota State Colleges and Universities
Distribution of State and ARRA Resources

($ in millions)	Fiscal Year 2010	% of Total	Preliminary Fiscal Year 2011 (before unallotment)	% of Total
Institution allocations	$534.6	86.2%	$585.9	87.2%
- Basic allocations	$506.8		$558.1	
- Priority allocations	$27.8		$27.8	
Systemwide set asides	$38.1	6.1%	$38.6	5.7%
Office of the Chancellor/ Shared Services Division	$47.3	7.6%	$47.3	7.0%
Total state resources*	$620.1		$671.9	
ARRA resources	$39.6		$39.6	
Total state and ARRA resources	$659.7		$711.4	

*Includes state appropriation and invested treasury cash (interest earnings on tuition and misc. general fund revenue).

Tuition parameters

The colleges and universities are operating within the language of the Omnibus Higher Education bill that limits tuition increases for Minnesota resident undergraduate students to five percent each year of this biennium. It would be the interest of the Chancellor to apply the same method used in fiscal year 2010 which would set a maximum dollar per student rate increase for fiscal year 2011. This method provides the same amount of increased tuition revenue per full-year equivalent student and begins to address the disparity of rate based changes that results when maximum percentages are applied.

In keeping within the legislative language, tuition planning parameters at the colleges and universities will include a maximum fiscal year 2011 tuition increase for the colleges of $7.15 per credit and for the universities of $9.85 per credit. The total tuition increase for fiscal year 2011 will be borne by the students. In fiscal year 2010 ARRA funds have been used to mitigate two percent of the tuition increase so that students are charged no more than a three percent increase over prior year. The ARRA funds will be used again in fiscal year 2011 to pay for the mitigated two percent tuition increase from fiscal year 2010. Over the biennium, students will have experienced a maximum net increase of eight percent. In fiscal year 2012, students will be responsible for the mitigated two percent tuition increase before any new tuition increases.

The tuition cap language in the Omnibus Higher Education bill assumed that the system would be allocated $666.0 million in state appropriation for fiscal year 2011 which was an increase of $51 million over fiscal year 2010. With the system facing an appropriation reduction, the Chancellor and Vice Chancellor – Chief Financial Officer would like the Finance, Facilities, and Technology Committee to express its level of interest in pursuing removal of the tuition cap language during the 2010 legislative session. Removing the tuition cap language would provide some flexibility to colleges and universities at a time when state resources are being decreased by at least $50 million in fiscal year 2011 and some additional amount in 2012-2013.

Fund balance and reserves

There is an expectation that each college and university as well as the Office of the Chancellor will have a fund balance which is defined as budgetary cash balance at the close of a fiscal year. Maintaining a fund balance is an indication of responsible financial management and stability. A fund balance can increase/decrease year over year. A fund balance assists an organization to maintain operations for some period of time in spite of adverse financial conditions. It can be used to maintain continuity of operation in the face of revenue interruption (i.e., missed enrollment projections, unallotment of state resources, or other unforeseen expenses). Fund balances are built up in order to make large one-time investments such as instructional equipment, capital improvement projects, and repair/replacement projects.

Financial health is extremely important to the Higher Learning Commission (HLC). A Composite Financial Index (CFI) methodology is used by the HLC as a gauge of member institutions' financial health. The CFI calculation uses four financial ratios and assigns a specific weighting to each factor in computing a single, composite measure of financial health. Poor financial health can impact an institution's capacity to continue its mission and an institution's accreditation.

At the close of fiscal year 2009, the colleges and universities and Office of the Chancellor had a total general fund budgetary cash balance of $277.9 million. This represents 19 percent of total general fund revenues and is consistent with year end balances of the past five years. A portion of the budgetary cash balance ($32 million) is restricted in that it is reserved to cover obligations incurred but not yet paid prior to the close of the fiscal year. Board required reserves also represent a portion of the budgetary cash balance ($78 million). The colleges and universities programmed use of $17.2 million within their fiscal year 2010 general fund operating budgets.

The system's total general fund balance represents slightly more than 2 months of operating expenses for the Minnesota State Colleges and Universities. However, the range at the colleges and universities is from a low of .08 of a month (2.4 days) to a high of 3.8 months of operating expenses. Three months worth of operating expenses is a national standard minimum benchmark for a public college or university.

Beginning in the fall of 2009, the system began providing substantial cash flow assistance to the state's general fund. Minnesota Management and Budget (MMB) requested cash flow assistance to the state's general fund from the system as well as other participants in the state's general treasury. MMB has authority to move cash balances between the various funds in the statutory general fund as needed to meet cash flow needs. In the past with stable, performing revenue forecasts and a large rainy day fund and cash flow account, MMB only occasionally needed to shift monies between these accounts. Now with the state's general fund reserve gone and an underperforming revenue forecast, more shifting or lending activity between funds is required.

The system collectively maintains reserves and collects tuition and other revenues at the beginning of each term. Consequently, the system has excess cash available over daily expenses during certain portions of the year. The use of system cash avoids short-term borrowing by the state. The state's temporary use of system cash does not impact the day-to-day operations of the colleges and universities. College and university budgets are controlled by spending authority limits and those remain unchanged. The Office of the Chancellor manages the system's overall cash position.

The system has been assured by MMB that any funds lent will be repaid with interest in full before the end of the fiscal year or earlier if necessary to meet the cash needs of the system.

American Recovery and Reinvestment Act (ARRA) of 2009

The colleges and universities were allocated $79.2 million of one-time federal stimulus aid through the ARRA. The Board approved the designation of the federal stimulus funds for the following two purposes: (1) tuition mitigation (approximately $26 million) and (2) general operating budget support (approximately $53.2 million). The funds have been budgeted equally between fiscal years 2010 and 2011 and must be spent by September 30, 2011, which is three months after the end of the system's 2011 fiscal year.

To date, the colleges and universities have spent $12 million of federal stimulus funds which includes $6.9 million of tuition mitigation. Spending patterns are on track with the forecast. It is expected that 50 percent of the federal funds will be spent by the end of fiscal year 2010 and the balance by September 30, 2011. The funds are used to support the general operations of the colleges and universities as if they were a tuition or state support dollar. Almost 80 percent of the expenses (excluding tuition mitigation) have occurred within instruction and academic support. The funds have been used to support tuition mitigation for fall term, instruction and instruction-related salaries, supplies, and equipment, academic computing, faculty sabbaticals, and faculty and staff retirement costs.

2012-2013 Biennium

The 2009 Omnibus Higher Education bill established a base funding level for the system of $655 million of appropriation each year over the 2012-2013 biennium for a total of $1.31 billion. With the state now projecting a budget shortfall of $5.4 billion in the next biennium, it seems imprudent for the system to plan for that level of appropriation. The system represents 3.9 percent of the state's general operating budget. Depending on actions taken by the Governor and/or Legislature to solve the budget deficit (i.e., all in expense reductions or a combination of tax increases and expense reductions), the impact to the system could be from $105 million to $210 million reduction in appropriation over the next biennium.

The colleges and universities have been directed to begin the 2012-2013 biennium budget planning process assuming fiscal year 2006 level of funding at $605 million. Budget scenarios can be modeled to estimate the impact of any further reductions in the 2012-2013 biennium. The CPI referenced in the state's economic outlook will be used by the colleges and universities to estimate inflationary cost increases; 2.1 percent for fiscal year 2012 and 1.9 percent for fiscal year 2013.

Next steps

The Office of the Chancellor and the colleges and universities will continue with their multi-year budget planning process and with consultation with their campus communities. The Office of the Legislative Auditor is expected to release its study of the Office of the Chancellor services in late January-early February. That report will be carefully reviewed with the Board of Trustees and the Leadership Council for insight into future organizational planning and budgeting. Over the next several months, the Chancellor will also look to the Leadership Council for direction in identifying resources that could be reprogrammed toward the fiscal year 2011 appropriation reductions. The Chancellor will continue consultation with system constituents and will provide updates on the budget planning process to the Finance, Facilities, and Technology Committee. Action on the fiscal year 2011 operating budget is scheduled for the April and May 2010 meetings of the Board of Trustees.

The 2010 legislative session will begin in February, and three more economic forecasts will be released that impact the current and upcoming biennia - February 2010, November 2010, and February 2011.

Date Presented to the Board: January 20, 2010