MINNESOTA STATE COLLEGES AND UNIVERSITIES
BOARD OF TRUSTEES

Agenda Item Summary Sheet

Committee: Finance and Facilities **Date of Meeting:** September 14, 2010

Agenda Item: Minnesota State Colleges and Universities System and State Economic Outlook for FY2011-2013

☐ Proposed Policy Change ☐ Approvals Required by Policy ☐ Other Approvals ☐ Monitoring

☒ Information

Cite policy requirement, or explain why item is on the Board agenda: The system is continuing budget planning for the 2012-2013 biennium. The budget planning is incorporating a set of assumptions about appropriation reductions, tuition rate increases, and inflationary cost increases.

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 continue discussion regarding the budget planning framework and the 2012-2013 budget outlook as it relates to a biennial operating budget request.

Background Information: The system has taken a multi-year approach to budget planning, positioning the System for long-term financial viability. Budget planning for 2012-2013 is well underway. The Committee was presented a budget planning framework earlier this year that colleges and universities are using to model 2012-2013 operating budgets.

BOARD OF TRUSTEES
MINNESOTA STATE COLLEGES AND UNIVERSITIES

INFORMATION ITEM

Minnesota State Colleges and Universities System and State Economic Outlook for FY2011-2013

BACKGROUND

The purpose of this report is to continue a discussion with the Finance and Facilities Committee regarding the state and system outlook for the 2012-2013 biennium. The system and the colleges and universities have taken a multi-year approach to budget planning. The planning 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.

The Board approved the fiscal year 2011 operating budget and has provided a planning framework to colleges and universities in modeling 2012-2013 operating budgets. Discussion today will center on the system's budget outlook for 2012-2013 as a result of applying assumptions for appropriation, tuition and inflationary cost increases.

Fiscal year 2011 operating budget update

The Board approved the fiscal year 2011 general operating fund budget of $1.5 billion at its May 2010 meeting. The operating budget was built on a state appropriation level of $605.5 million, modest tuition rate increases and enrollment growth (slightly less than 1 percent), modest compensation inflationary cost increases (insurance rate increase and steps for classified employees), and the continuation of one-time federal American Recovery and Reinvestment Act of 2009 (ARRA) funds. (Table 1) The system is projecting a positive budget balance of $9.1 million.

Table 1 **Minnesota State Colleges and Universities**
Summary – General Operating Fund
Fiscal Year 2011 Approved Budget

($ in millions)	**Fiscal Year 2011 Approved Budget**
Revenues	
State appropriation	$605.5
Tuition	$777.4
ARRA funds	$39.6
Other revenues	$128.0
Total budgeted revenues	$1,550.5
Expenses	
Compensation	$1,127.3
Other operating costs	$421.4
Total budgeted expenses	$1,548.6
Gap	$1.8
Programmed fund balance	$7.3
Budget balance	$9.1

Although some colleges and universities have programmed the use of fund balance ($7.3 million), the $9.1 million budget balance means that the system in total is projecting an increase in its year-end fund balance. There is an expectation that each college and university as well as the Office of the Chancellor maintain a fund balance which is defined as budgetary cash balance at the close of a fiscal year. A portion of the fund balance is designated as reserves per Board Policy 5.10. A fund balance can increase/decrease year over year and affords the organization the ability to maintain operations for some period of time in spite of adverse financial conditions or to make large one-time investments such as instructional equipment or capital improvements. The Chancellor has directed colleges and universities and the Office of the Chancellor to reach structural balance by the end of this fiscal year.

As the academic year is just beginning, it is premature to presume that the fiscal year 2011 operating budget approved in May 2010 will hold. The enrollment increase built into the budget is an estimate. Key dates are the 30th day enrollment for fall term (available early October) and spring term (available early March 2011). The Board will be kept apprised of the enrollment outlook and the overall impact on the operating budget.

The legislature allocated to the system $79.2 million in one-time federal ARRA funds. The system divided the funds evenly between fiscal years 2010 and 2011 - $39.6 million each year. ARRA spending is on plan with $36.4 million spent in fiscal year 2010 and the balance to be spent 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.

A portion of the ARRA funds were programmed to mitigate the fiscal year 2010 tuition rate increase so that the student was charged no more than a three percent increase over prior year. The cost was originally estimated at $13 million but actual cost for fiscal year 2010 was $12 million. The fiscal year 2010 mitigation would be paid for again in fiscal year 2011 for a total biennium cost estimated at $24 million. With the cost of the tuition mitigation coming in under budget, the remainder of the ARRA funds is available for one-time operating costs. Table 2 provides a comparison of Board-approved annual average tuition rates to annual average tuition rates charged to students – showing the impact of the tuition mitigation. The $83 tuition difference at the colleges and the $110 tuition difference at the universities are the mitigated amounts. In fiscal year 2012, students will be responsible for the mitigated amount in addition to any new tuition rate increases approved by the Board.

Table 2

Minnesota State Colleges and Universities
Comparison Tuition Rates:
Board-Approved and Charged to Students

	Colleges		**Universities**	
	Fiscal Year 2010	**Fiscal Year 2011**	**Fiscal Year 2010**	**Fiscal Year 2011**
Average Annual Tuition (Board-Approved)	$4,277	$4,480	$5,901	$6,196
Average Annual Tuition (Charged to Students)	$4,194	$4,397	$5,791	$6,086
Mitigated amount	($83)	($83)	($110)	($110)

Preliminary budget decisions will be made later this fall by the colleges and universities and the Office of the Chancellor in preparation for the 2012-2013 biennium. The budget decisions will include faculty and staff layoff notifications and academic program closures. The impact of these preliminary decisions will be picked up by local media. The decisions being made are based on the best information available and on a set of assumptions (adjusted for local conditions) that the Vice Chancellor previously shared with the Committee. To date, only a few colleges and universities have publicly announced their preliminary budget decisions for the 2012-2013 biennium. By early to mid-October the remainder of the colleges and universities will release their preliminary budget decisions. Information related to preliminary budget decisions for 2012-2013 will be shared with the Committee later this fall.

State economic outlook 2012-2013

At the end of the 2010 legislative session, the state was projecting a budget balance of $6 million and a cash flow account of $266 million for the 2010-2011 biennium. The July 2010 Economic Outlook released by Minnesota Management and Budget stated that fiscal year 2010 general fund receipts are projected to be $99 million less than the February 2010 forecast. Individual income tax receipts are $188 million less than projected, offset by modest increases in corporate income and sales taxes. The revenue shortfall directly impacts the state's budget balance, and its ability to respond to any further revenue shortfalls during fiscal year 2011.

Based on 2010 end-of-session legislative action, the projected deficit for the 2012-2013 biennium is $5.766 billion. (Table 3) If general expense inflation was added to the planning estimates, the deficit would widen by an estimated $1.2 billion (based on information provided in the February 2010 Economic Outlook). It is anticipated that the 2012-2013 budget deficit will more than likely increase when the November 2010 forecast is released. Two main drivers impacting the deficit are (1) the decrease in real GDP growth from a projected 3.5 percent to 2.9 percent, and (2) a decreasing income tax and sales tax revenue base. (Minnesota Management and Budget, July 2010 Economic Outlook)

Table 3 **State of Minnesota**
FY2012-2013 Planning Estimates

($ in millions)	**End-of-Session May 2010**
Revenues	$33,179
Expenditures	$38,945
Difference	**($5,766)**

Planning estimates assume:
- Complete repayment of the K-12 aid deferral. Delaying repayment would save $1.173 billion.
- No repayment of the K-12 property tax recognition shift. Repayment would cost $576 million.

Source: Minnesota Management and Budget, General Fund – Fund Balance Analysis, End of 2010 Legislative Sessions, June 11, 2010.

The state's economist has stated numerous times that the state has a structural issue. Revenue growth will be slow, and spending pressures will be driven by issues of an aging population and health care services. State spending pressure will shift from K-12 and higher education and infrastructure to services for the aging. The state's economic outlook has a significant influence on the system's financial condition. Taking into consideration the spending pressures and the looming deficit, the Chancellor and Board have included in the framework for multi-year budget planning an assumption of appropriation reductions for the 2012-2013 biennium.

There are two more economic forecasts (November 2010 and February 2011) that will determine what action will need to be taken by the 2011 Legislature ultimately impacting the system's 2012-2013 funding level.

System outlook 2012-2013

A budget planning framework for the 2012-2013 biennium was shared with the Finance and Facilities Committee and provided to presidents and the campus communities in January 2010. The planning framework included the following assumptions:

- Assume governor's supplemental budget recommendation of $594.4 million (which is $11 million below the system's fiscal year 2011 appropriation level of $605.5 million);
- Model further reductions in state appropriation from the governor's budget recommendation;
- Recognize inflationary cost increases at the CPI referenced in the state's economic outlook, modified for local conditions. In the July 2010 Economic Outlook, the state revised the CPI downward to 1.5 percent for fiscal year 2012 and 1.4 percent for fiscal year 2013 (compared to 2.1 percent and 1.9 percent respectively);
- No cap on tuition rate increases but an expectation of reasonableness; and
- No federal stimulus funds.

Appropriation. With the state's projection of a significant budget deficit in the 2012-2013 biennium, modeling reductions in state resources seems more appropriate than planning for increased funding. The difficulty is in choosing which appropriation level to use when beginning to model further reductions in state resources. Early in the budget planning process there were a few options available that could serve as the base for further modeling. Those options were:

- Omnibus Higher Education Bill from the 2009 session: $654.9 million ($1,309.8 million biennium);
- Governor's supplemental budget recommendation released in January 2010: $594.4 million ($1,188.8 million biennium); or
- Fiscal year 2011 funding level: $605.5 million ($1,211 million biennium).

The Chancellor and Vice Chancellor-Chief Financial Officer sought input and advice from the Leadership Council early in the planning process to determine which appropriation level to use as the starting point for 2012-2013 budget modeling. In order to recognize the extreme uncertainty in the 2012-2013 forecast base outlook, it was determined that the system should take a more conservative approach and start from the governor's supplemental budget level of $594.4 million recognizing that differences exist. To add further complexity to the appropriation outlook, 2010 legislative action in mid-May 2010 reduced the forecast appropriation base from $1,309.8 million to $1,260.7 million ($630.4 million each year). As a point of reference, both the governor and legislature will begin the 2012-2013 operating budget planning process using the forecast base of $1,260.7 million and any reductions in state resources for the system will be from that funding level.

Appropriation planning scenarios were provided to presidents this past spring. The planning scenarios provide the "bookends" to appropriation reductions. One assumption was that half of the state's $5.8 billion deficit would be solved with spending reductions and the other assumption was that the entire deficit would be solved with spending reductions. Currently, the system represents 3.9 percent of the state's general operating budget. The system's share of the reduction would be from $105 million to $210 million over the biennium and that reduction would be applied against the system's planning estimate of $594.5 million. Information was shared with presidents that compared the system's planning estimates to the forecast base.

Table 4 below displays reduction scenarios against 2012-2013 forecast base. It also shows the system's planning assumptions compared to current level funding as well as the forecast base. The system's "bookend" planning assumptions seek to illustrate the degree of risk to the system depending upon the starting point for the discussions between the governor and the legislature.

Table 4 Minnesota State Colleges and Universities
2012-2013 System Planning Assumptions
Compared to Forecast Base and Current Funding Level

	Fiscal Year 2012	**Fiscal Year 2013**	**Biennium Total**	**Change 2012**	**Change 2013**	**Biennium Total**
Fiscal year 2011 funding level	$605.5	$605.5	$1,211.0			
Supplemental Omnibus Higher Education Bill (2012-2013 forecast base)	$630.4	$630.4	$1,260.7			
change from fiscal year 2011				*$24.9*	*$24.9*	*$49.7*
If 50% of state deficit solved with reductions ($105 million from forecast base)	$595.4	$560.4	$1,155.7			
change from forecast base				*($35.0)*	*($70.0)*	*($105.0)*
If 100% of state deficit solved with reductions ($210 million from forecast base)	$560.4	$490.4	$1,050.7			
change from forecast base				*($70.0)*	*($140.0)*	*($210.0)*
System planning assumption (bookend 1)	**$559.4**	**$524.4**	**$1,083.8**			
change from fiscal year 2011				***($46.1)***	***($81.1)***	***($127.2)***
				-7.6%	***-13.4%***	***-10.5%***
change from forecast base				***($71.0)***	***($106.0)***	***($176.9)***
				-11.3%	***-16.8%***	***-14.0%***
System planning assumption (bookend 2)	**$524.4**	**$454.4**	**$978.8**			
change from fiscal year 2011				***($81.1)***	***($151.1)***	***($232.2)***
				-13.4%	***-25.0%***	***-19.2%***
change from forecast base				***($106.0)***	***($176.0)***	***($281.9)***
				-16.8%	***-27.9%***	***-22.4%***

Using the different appropriation planning scenarios, colleges and universities are estimating their share of the reduction and incorporating the results into their local budget planning process. There is variability around the estimates each college and university is developing. Factors that influence appropriation reduction scenarios at any one college or university are the level of appropriation being modeled, historical outcomes of base allocation framework, and funding levels for other Board priorities and systemwide expenses (i.e., debt service, serving the underserved, centers of excellence, etc.). Colleges and universities have highly variable enrollment estimates resulting in more/less elasticity in tuition revenue. Although the overall “system” annual appropriation reduction being modeled ranges from 7 to 13 percent, colleges and universities are more than likely modeling different percent reductions due to the factors noted above.

In addition to appropriation, there are other revenue and expense variability that colleges and universities are managing. Some of those include:

Revenue variability

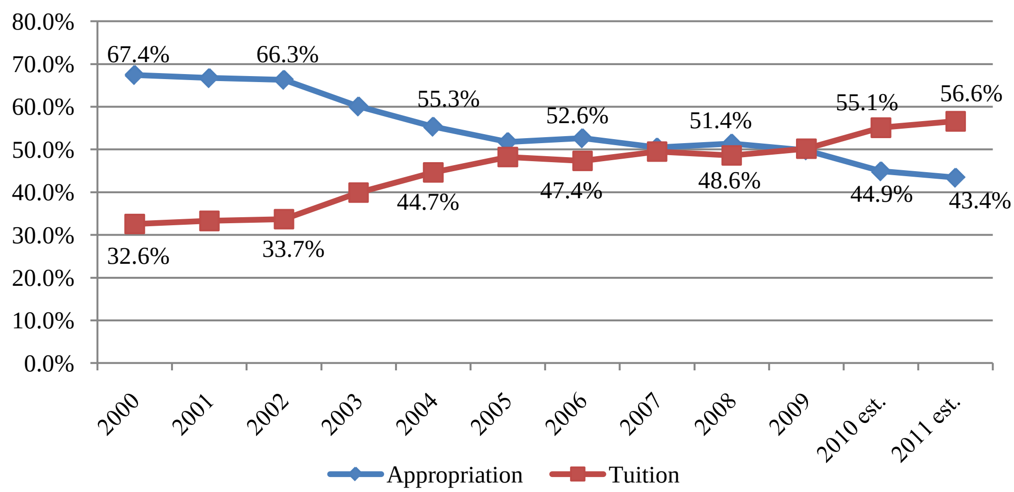
- Appropriation – balancing state outlook, legislative action, funding decisions of Board priorities, impact of allocation framework
- Tuition - rate increase and impact of enrollment volume increase/decrease

Expense variability

- Compensation costs – impact of fixed cost increases and potential impact of negotiated new costs
- Other operating costs – utilities, debt service obligation

Tuition. State appropriation has been a primary revenue source for the system. With diminishing support from the state, the system’s reliance on tuition to support basic education activities has increased dramatically. This has resulted in a trend where tuition currently is estimated to comprise 56.6 percent of total appropriation and tuition revenue. (Graph 1)

Graph 1 **Minnesota State Colleges and Universities**
Percent of Total State Appropriation and Tuition Revenue



The planning framework provided to colleges and universities includes no cap on tuition rate increases for 2012-2013; however, there is an expectation of reasonableness. Tuition revenue for fiscal year 2011 is estimated at $790.3 million. On average a one percent tuition rate increase would yield an estimated $7.9 million. As a point of reference, a one percent increase in enrollment would yield about the same amount of revenue as a one percent rate increase – an estimated $7.9 million. Table 5 shows the estimated tuition revenue realized with varying tuition rate increases.

Table 5

Minnesota State Colleges and Universities
2012-2013 Estimated Tuition Revenue Yielded
From Varying Tuition Rate Increases

($ in millions)	3% Rate Increase / Year	5% Rate Increase / Year	10% Rate Increase / Year
Fiscal year 2011 tuition revenue base = $790.3 million			
Fiscal year 2012	$23.7	$39.5	$79.0
Fiscal year 2013	$24.4	$41.5	$87.0
Biennial total	**$71.8**	**$120.5**	**$245.0**

*Biennial total calculation: fiscal year 2012 (x2) + fiscal year 2013.

Colleges and universities have incorporated into their budget planning process varying tuition rate increase scenarios, keeping in the forefront the expectation of reasonableness. If the Board approved on average a five percent tuition rate increase, the rate charged to the student would be the five percent plus the two percent mitigated tuition from fiscal year 2010. On average, the rate charged to a student would be seven percent above the fiscal year 2011 level. The tuition mitigation was supported by the Legislature, Board and the student associations. The Board and Chancellor have been very transparent about the impact of the fiscal year 2010 tuition mitigation and that it will be the responsibility of the student to pay the mitigated amount in fiscal year 2012.

For illustrative purposes only, the results of a five percent tuition rate increase along with the impact of the tuition mitigation are shown in Table 6. A five percent rate increase at colleges would result in a $224 annual increase. However, the impact to the student would be $307 ($224 new increase plus the $83 mitigated amount). At the universities, a five percent increase would be $420 ($310 new increase plus the $110 mitigated amount).

Table 6

Minnesota State Colleges and Universities
Illustration of Tuition Rate Increase and Mitigation Impact

	Colleges				Universities			
	Fiscal Year 2011	**Fiscal Year 2012**	**%**	**$**	**Fiscal Year 2011**	**Fiscal Year 2012**	**%**	**$**
Average Annual Tuition (Board-Approved)	$4,480	$4,704	5%	$224	$6,196	$6,506	5%	$310
Average Annual Tuition (Charged to Students)	$4,397	$4,704	7%	$307	$6,086	$6,506	7%	$420
Difference	($83)	$0		$83	($110)			$110

Inflationary costs. Inflationary cost increases will put pressure on the expense budgets of the colleges and universities and the Office of the Chancellor. The inflationary guidelines provided to the colleges and universities have been to recognize inflationary cost increases at the CPI referenced in the state’s February 2010 economic outlook (2.1 percent for fiscal year 2012 and 1.9 percent for fiscal year 2013), modified for local conditions. The state’s July 2010 economic outlook has revised the CPI downward to 1.5 percent for fiscal year 2012 and 1.4 percent for fiscal year 2013. Colleges and universities and the Office of the Chancellor are modeling various scenarios to determine impact on budgets.

As shown previously in table 1, the overall system’s fiscal year 2011 general operating fund budget of $1.5 billion is comprised of 73 percent compensation expenses and 27 percent other operating expenses. The compensation reliance at colleges and universities ranges from the high 60 percents to the low 80 percents. The system is a service organization and heavily reliant on individuals to fulfill its mission. Under the current labor contracts, the system will experience compensation cost increases estimated at $55 million (assuming current roster), if **nothing** is done in the next round of labor negotiations. The “fixed” compensation cost increases include the following:

- “Tails” from the fiscal year 2011 step increases for classified employees and mid-year health insurance rate increase of 6.7 percent that will occur January 2011.
- Under the current structure of the state health insurance program, the projected health insurance rate increases are 16.5 percent in January 2012 and 8 percent in January 2013. During the next round of collective bargaining, any shifts or changes made to the state health insurance program could raise or lower the costs to the employer and/or the employee.

Compensation costs will increase above the “fixed” amount if new employee salary increases (i.e., steps and/or across-the-board increases) are negotiated through the collective bargaining process.

Budget gap. The purpose of this report is to provide the Committee the 2012-2013 budget outlook when combining a set of “what if” revenue and expense assumptions. The following set of revenue assumptions were applied to the current fiscal year 2011 budget:

- Appropriation: $559.4 million in fiscal year 2012; $524.4 million in fiscal year 2013
- Tuition: 5 percent rate increase each year
- Enrollment: no volume change
- Other general fund revenue: no increase
- Compensation: 1.5 percent total each year (CPI estimate from state economic outlook)
- Other operating costs: 1.5 percent total each year (CPI estimate from state economic outlook)

As shown below in Table 7, applying the set of revenue assumptions noted above results in negative $6.7 million revenue over the 2012-2013 biennium. With negative new revenue, the system would need to cover any increased expenses through reductions.

Table 7

Minnesota State Colleges and Universities
2012-2013 General Operating Fund “New” Revenue Simulation
(Based on a set of assumptions)

($ in millions)	**Fiscal Year 2011 (base)**	**Fiscal Year 2012 Revenue Change**	**Fiscal Year 2013 Revenue Change**	**Biennium Total**
State appropriation	$605.5	($46.1)	($35.0)	($127.2)
Tuition (5 percent rate increase)	$790.3	$39.5	$41.5	$120.5
Other	$128.0	$0.0	$0.0	$0.0
Simulated New Revenue	**$1,523.8**	**($6.6)**	**$6.5**	**($6.7)**

The revenue outlook is based on a set of “what if” assumptions and does not represent the actual revenue change for 2012-2013.

As noted above, the system is projecting “fixed” compensation cost increases of $55 million (assuming current roster). Negative revenue of $6.7 million and “fixed” compensation cost increases of $55 million produces a $61.7 million budget gap before applying any new inflationary costs. Table 8 shows the budget impact when combining the revenue assumptions with the fixed compensation costs and inflationary cost assumptions that total $123.5 million. The information below is provided to assist in framing for the Committee the severity of the 2012-2013 budget outlook.

Table 8 **Minnesota State Colleges and Universities 2012-2013 Inflationary Cost Assumptions**

($ in millions)	Biennial Total
Estimated New General Fund Revenue	**($6.7)**
Plus "fixed" compensation costs	$55.0
Budget gap	**($61.7)**
Plus compensation increases at 1.5% each year	$49.9
Budget gap	**($111.6)**
Plus other operating inflation at 1.5% each year	$18.6
Budget gap	**($130.2)**

The budget gap would widen significantly if the system were to experience an appropriation reduction at the level of $210 million. The budget gap would narrow if tuition rate increases were above 5 percent and/or enrollment growth was greater than one percent. To the extent compensation cost increases were limited, the budget gap would also narrow.

Biennial operating budget development 2012-2013

Every other year, as part of the state's operating budget process, the system develops a biennial operating budget request. The operating budget request for the 2012-2013 biennium is due to the governor and legislature in late fall of this year. The Chancellor sought advice and input from the system's constituent groups and the Leadership Council during the past few months regarding development of the biennial budget. There has been varying input from asking for no new resources (protecting current level of funding) to asking for funds for inflationary cost increases.

During the 2010-2011 biennium, the state was projecting a budget deficit of $940 million. After consideration of the state's economic outlook, the Board approved a 2010-2011 biennial operating budget request of $71.7 million (a 5.3 percent increase). The system did not receive its request, but rather an appropriation reduction of $92.7 million (a 6.8 percent decrease). Factoring in the governor's unallotment and supplemental budget reductions of $60.5 million for fiscal year 2011, the total appropriation reduction to the system in the current biennium will be $153.2 million (11 percent below forecast base).

As mentioned earlier in this report, the system's forecast base provided for under current law is $1,260.7 million which is $49.7 million above the current fiscal year 2011 base funding doubled of $1,211.0 million. As shown in Table 9, the base appropriation increase coupled with tuition revenue at a five percent rate increase would provide the financial resources to cover the inflationary cost increases and to continue moving forward the Board's strategic and action plans.

Table 9 **Minnesota State Colleges and Universities**
2012-2013 Biennial Budget Outlook

($ in millions)	**2012-2013 biennium**
2012-2013 forecast base under current law	$1,260.7
Fiscal year 2011 base funding doubled	$1,211.0
Increased appropriation under current law	**$49.7**
Tuition revenue (5 percent rate increase each year)	$120.5
New revenue	**$170.2**
Inflationary cost assumptions	$123.5
Balance of new revenue	**$46.7**

The Chancellor feels strongly that it is his responsibility to ensure that the system has adequate financial resources to cover inflationary cost increases. With the forecast base an additional $49.7 million above current level funding, it would be the Chancellor's intent to bring forward a 2012-2013 biennial operating budget request totaling the forecast base of $1,260.7 million. There would be no further request for additional resources above the forecast base. Staff will work tirelessly to promote the budget request and gain legislative support of the forecast base.

Next steps

The Office of the Chancellor and the colleges and universities are continuing with their multi-year budget planning and with consultation with their campus communities. Decisions will be made that ensure the colleges and universities and the Office of the Chancellor reach structural balance by the end of fiscal year 2011 and that will create long-term sustainability and viability for the system. The planning assumptions for appropriation, tuition and inflationary cost increases will be modified as more information becomes available.

The state's economic outlook is grim and it causes the system's outlook to also be grim. Multi-year budget planning and identification of a set of budget assumptions better position colleges and universities and the Office of the Chancellor to handle the uncertainty of the 2012-2013 biennium. The assumptions are fluid and will be adjusted when more information becomes available. However, preliminary budget decisions are being made based upon the best set of assumptions to meet the faculty and staff notification period.

The Chancellor has directed staff to develop the 2012-2013 biennial operating budget request at the forecast base of $1,260.7 million. The Chancellor's recommendation will be presented to the Board in November for action.

Date Presented to the Board: September 15, 2010