

MINNESOTA STATE COLLEGES AND UNIVERSITIES
BOARD OF TRUSTEES STUDY SESSION
ALLOCATION FRAMEWORK REDESIGN PRINCIPLES
NOVEMBER 18, 2015

Present: Chair Michael Vekich, and Trustees Margaret Anderson Kelliher, Duane Benson, Alexander Cirillo, Jay Cowles, Dawn Erlandson, Robert Hoffman, Maleah Otterson, Thomas Renier, Elise Ristau, Louise Sundin, and Chancellor Steven Rosenstone

Absent: Trustees Ann Anaya and Phil Krinkie

Convene and Introduction

Chair Vekich convened the study session on the allocation framework redesign principles at 8:05 am. He welcomed Laura King, vice chancellor – chief financial officer, and Deb Bednarz, system director, financial planning and analysis.

Chair Vekich remarked that he consulted with Trustee Cowles and Chancellor Rosenstone on the format of the study session so that the board could have an in depth discussion on the redesign of the allocation framework principles prior to the Finance and Facilities Committee meeting. The recommendation to redesign the system's allocation framework is a recommendation from the Charting the Future System Incentives and Rewards Committee and it is also included in the 2016 system workplan. The first step in that effort is a board level discussion of the redesign principles or objectives which brings us to today's discussion. It is important to emphasize that no design decisions have been made. The board is committed to full consultation in this effort as are the vice chancellor and the chancellor. The Leadership Council, bargaining units, student associations, and campus leaders have all been a part of the review to date and will be involved over the next few months. Chair Vekich thanked the Inter Faculty Organization and the Winona State University Student Senate for taking the time to offer thoughtful feedback and comments. Today's study session is the first of several on this topic. As the work proceeds over the coming year, the board and the Finance and Facilities Committee will be engaged and a part of the effort.

Chair Vekich explained that the discussion during the study session will provide insight and advice to the Finance and Facilities Committee, which also has this item on its agenda. He added that the discussion should focus on the proposed principles rather than the mechanics of the current model. Chair Vekich encouraged individual trustees to meet with staff if they are interested in delving more deeply into the current method. Chair Vekich asked trustees to keep three strategic questions in mind during the presentation:

- Do the principles appropriately balance the competing interests on behalf of colleges and universities and the system?
- Is the board comfortable with the direction of the work?
- Are there other principles that the board would like staff to consider?

History and Development of the Allocation Framework

Vice Chancellor King commented that the allocation framework is the method used just to distribute the state appropriation. All tuition and other campus generated revenue stays on the campuses. Vice Chancellor King explained that the current formula and method was designed by system managers and administrators 15 years ago. It was approved by the board and it is overseen by the Leadership Council. The Board of Trustees adopted guiding principles for a single model in August of 1999 to frame the development work. The principles were:

- Academic goals should drive financial planning.
- Delegation of authority to the institution and the resulting program diversification are necessary to create a responsive system.
- Decentralized management systems require incentive and accountability mechanisms.
- An equitable distribution of funds is needed which recognizes the diversity of institutions, programs, and students.
- Adequate funding is essential to fulfill missions and respond to compelling state needs.
- Access is a core element of the system's mission.

Management workgroups were established in the late 1990s, and the model was implemented in 2002. The model was fully implemented in 2006. The Allocation Framework is the methodology by which all state appropriation is allocated. In general, state funds are divided into four categories.

Institutional Base Allocations (83%): state appropriated dollars allocated to colleges and universities for general operations.

Priority Allocations (4%): special allocations for board and legislative priorities; examples include access and opportunity and leveraged equipment funding.

System Set Asides (8%): enterprise technology, debt service (system share), attorney general, etc.

System office support (5%): state funds to support system office operations.

A set of algorithms is used to calculate the institutional base allocation for a college or university. Presidents have broad authority to spend resources within the constraints of statute and board policy to best meet the needs of their colleges and universities. It was a strong principle of the board in the 1990s that presidents have the greatest flexibility to manage their budgets.

The current mechanics are built on algorithms perfected through the work of the Technical Advisory Committee. It runs on data that has been quality assured. Each component has rules, data sets, and time series. At the time of its implementation, the board spent a lot of time finding the balance between responsiveness and stability in the results. Over the years, there has been very little redistribution between the college sector and the university sector. There are devices in the current framework that tips toward stability over volatility and that is a design decision that we will be faced with in this current redesign effort. We worked really hard to recognize the cost differences between different kinds of programs. The allocation framework takes into account the

different costs of programs. It is based on an extensive cost study that lines up every program and every institution, strikes averages, and plus or minuses around the bands. For years we have been paying more in the framework for high cost programs and less for low-cost programs.

In general as we think about the current framework versus the work ahead of us, some observations and comments came out of work that Chancellor Rosenstone launched after his arrival. The chancellor wrote a white paper on the facts of the current allocation framework that was reviewed by the Board of Trustees and the Leadership Council. The current framework is viewed as positive in that it provides that all revenue earned locally stays local. We are not redistributing or cross subsidizing tuition revenues or parking revenues, etc. It is very responsive to enrollment changes, program mix, and course cost efficiency. It rewards enrollment, recognizing while this is a zero sum exercise, those that grow faster than others see a benefit. It provides stability, predictability, and modest redistribution of resources from year to year. Our CFOs know today within one to two percent what their state appropriation allocation will be for next year.

Questions and Discussion

Trustee Renier inquired if there is a difference in the allocation framework's responses to changes in enrollment. Vice Chancellor King replied that enrollment at the course level matters. That is part of the calculation for cost efficiency. If enrollment drops suddenly, then FYE costs go up and that could hurt you in the instructional component. We have enrollment embedded but it is an overall value in the formula. The current principles are viewed as positive because all local revenue stays local. How responsive should the redesign be to changes in enrollment, program mix, and course cost efficiency is a pending question. The current framework rewards enrollment which some see as a criticism because it is too tied to enrollment. The current framework provides stability, predictability, and modest redistribution. It does not recognize or support student success outcomes, access or diversity, and a collective success of the system to serve the state and its regions through collaboration. A redesign decision to make is how much to reward enrollment. The draft redesign principles do not take a position on the stability question. What do we do about outcome based funding, enrollment dimension, stability, and predictability. We will come back to the board about where to strike that balance. We do not anticipate any revenue redistribution going forward.

Trustee Hoffman commented that the current framework does not work in theory the way it is supposed to work. It is too predictable. There is an urgency and we need to be more responsive to changing conditions. With the band situation, it is a three-year phase. We are not rewarding the successful leadership; we are protecting the less successful leadership. The impact of enrollment is not recognized until 4-5 years. Vice Chancellor King agreed with Trustee Hoffman about the need to be more responsive. She added that we also would like to address how to treat PSEO and concurrent enrollment in the redesigned framework.

Chancellor Rosenstone noted that an important point is how to get the balance between immediate responsiveness and supporting the immediate adverse impact of campus enrollment declines, etc. Maybe the three-year phase in is too slow for the responsiveness that the board wants out of the allocation framework. Another fundamental question is the extent to which we built support into the framework; some base protection for campuses that are impacted by demographic changes that

are occurring in the state. These are some of the fundamental questions that the board will need to debate in redesigning the principles.

Responding to a question from Trustee Benson, Vice Chancellor King explained that there is no incentive in the current framework for a campus to refer a student, or to share a student, or help a student dual enroll. The current frameworks sets up a competitive institutional posture to the disadvantage to the students.

Trustee Cirillo inquired if there is any way of collaborating in terms of programs? Vice Chancellor King said that work is happening today, both in the design and delivery of programs.

Chancellor Rosenstone added that there may be a way to incent all programs. On the student success side, we may be able to do more with collective outcomes than on the individual level.

Vice Chancellor King explained that the System Incentive and Rewards Implementation Team recommended a redesign of the current financial model to incent and reward current collaboration, strategic framework commitments, and the Charting the Future recommendations.

Chancellor Rosenstone commented that this conversation creates uncertainty and it is a difficult conversation. There are some hard conversations ahead of us. One of the draft principles is that we have a transition that will create a minimal amount of disruption.

Trustee Cirillo inquired if there is a sense from the sitting presidents of how important the attenuation of change, such as a 3-5 year filter is for them? Vice Chancellor King replied that 15-years ago, the relationship between state appropriation and tuition was very different. Now we have to think about the response runway that presidents have as their revenue and expense outlook changes and being sensitive to lining up the implementation path. The three-year rolling average was the device implemented 15 years ago to accommodate changes in labor contracts, program review and approval, closure timetables, enrollment strategies, etc.

Trustee Renier asked how we should factor in changes in the external environment that are not due to lack of leadership, but are out of our control. He also expressed that he is worried about the vast difference in the sizes and complexities of our colleges and universities. The larger institution has more flexibility to deploy resources for change than a small one. Vice Chancellor King commented that scale matters and she recalled that the board endorsed a 5-year hold harmless provision for the Northeast Higher Education District for that very reason. The results of the current framework were so disruptive that the board endorsed a step down just for NHED because there was so much dislocation.

Trustee Erlandson stated that she is interested in fixed versus variable costs and how the formula addresses them. In terms of Charting the Future, in terms of collaboration, not just in marketing, but in online classes, if enrollment in a particular course is too low it is closed because costs get too high. How is revenue allocated based on these scenarios? Vice Chancellor King observed that this is a terrific example of how we are doing it half right today. In the current framework, we do not distinguish between online credit sold and an on ground credit sold. We have not solved the shared student between separate institutions whether they are on ground or online. This is a collaboration opportunity for us going forward. The instructional cost model is 100 percent

variable cost. It holds Pine Technical and Community College to the same cost efficiency standards as St. Cloud State University if they are offering the same course and that is a challenge for the smaller schools.

Proposed Allocation Framework Redesign Principles

Vice Chancellor King referred to the proposed Allocation Framework Redesign Principles, on pages 17 and 18, as follows:

The Allocation Framework should support the following:

- Academic and student success goals
- The educational and workforce needs of the state
- Financial and functional sustainability of diverse institutions, programs, and students
- Delegation of authority to colleges and universities
- Collaboration and systemic change by leveraging the power of the system

The design of the allocation framework should:

- Be flexible, simple, and transparent
- Incorporate measurable outcomes that recognize the diversity of institutions and their missions
- Incent and/or reward
 - Student success, e.g. retention, graduation, transfer, employability, elimination of the opportunity gap
 - Collaboration around academic planning, student success efforts, administration, resource development, and achievement of collective goals
 - Administrative best practices and efficiencies
- Reach an appropriate balance between stability and responsiveness to changing conditions
- Recognize that costs of serving students varies by academic program and student requirements
- Implementation of the new design should provide for a smooth transitions

Questions and Discussion Continued

Trustee Benson noted that the third bullet in the proposed redesign principles on incent and /or reward student success, e.g. retention, graduation, transfer, employability, elimination of the opportunity gap are best for students and why we are here.

Trustee Otterson inquired how the formula incentivizes student success. She asked how student success is measured compared to students' individual goals, which may be taking only one course, for example? Vice Chancellor King explained that the design principle around student success is the beginning of a conversation on which measures we want to use and recognizing that this is an annual allocation process. Student success is measured over much more than twelve months, or even 2-4-6 years in some cases and we are trying to find a way to do it year to year. We are very aware that there are diverse views of what student success looks like for individual students.

Vice Chancellor King explained that the principle for the allocation framework to be flexible, simple, and transparent was developed by the Technical Advisory Committee which is a group of

Chief Academic Officers and Chief Financial Officers, and reviewed by Leadership Council, sent back to the Technical Advisory Committee, and then sent out for broad consultation before being presented here today in draft form. If the Finance and Facilities Committee approves the draft principles, they will be back to the board for approval next spring along with the framework changes developed this winter. The principles will be sent out for consultation and review to the whole community in the spring and summer with a goal of having a recommendation back to the committee and board next fall. Vice Chancellor King noted that the best case is to finish the work and have it before the board again before year-end which will give campuses time to model and predict what the FY2018 allocation will look like. This timeline will give campuses six months preparation, and the community six months of consultation time.

Trustee Cowles asked about the process for engagement with the campuses and various stakeholders in this discussion going forward. Vice Chancellor King explained that as the work continues and design decisions are near, the recommendations would be moved out to the campus community and the local community for feedback. An update would be back to the Finance and Facilities Committee in the spring followed by an update to the committee and the full board in the fall. The goal is to balance giving the community an opportunity to engage but not in such a way that the work gets out of sync. There will be time for regular review for comment and circulation of work over the next nine months, discussion in the Finance and Facilities Committee in the spring before more review and comment over the summer and back in the fall.

Chair Vekich suggested holding a public hearing in the fall of 2016 regarding the redesign recommendations after the work is done to hear from all voices.

Trustee Sundin inquired if there have been discussions on additional income strategies? For example, the statewide levy referenda that other states use, and if it is a part of the discussion? She also inquired if there is a way to fund wrap around services, mental health, dental, and food shelf, through collaboration? Trustee Sundin suggested a joint tour of North Hennepin Community College and Brooklyn Center High School where they are the statewide model for wrap around services. There needs to be an acknowledgement that there are costs that go with collaboration. Trustee Sundin added that the system requested \$89M for student and staff internships/externships, residencies, and other opportunities for students to get real work. If funds for these opportunities are not included in our allocation from the state, is there a way to internally allocate for them? Can the definition of collaboration include external groups such as community advisories, etc.? Trustee Sundin also asked if the board can discuss the metrics that are used to make program decisions. Chair Vekich asked Trustee Cirillo to add a discussion of the metrics to the agenda for the Academic and Student Affairs Committee.

Vice Chancellor King replied that the observation around wrap around services is at the heart of student success and what it takes for this process to make it work. There is also a charge from the Technical Advisory Group to look at system wide services, and Human Resources transformational services. There are many creative and new things happening around student success and the non-classroom student support work. Funds for student internships are 100 percent board discretion as a system priority, or whatever the board deems to be a priority. On the revenue

side, there have been discussions about customized training, but the allocation framework is focused on distributing the state's allocation.

Trustee Erlandson inquired about incentives in Charting the Future to make sure each institution is doing its very best in securing outside grants, corporate or high donor individuals, federal government, alumni giving, etc. Does Charting the Future have any incentives to make sure we are collaborating together to get the Gates, Lumina, and other grants.

Chancellor Rosenstone replied that the Charting the Future recommendations are somewhat silent as there are a lot of incentives in each of our colleges and universities to be very aggressive on this front. As the allocation framework comes forward, he added that it is important to not inadvertently do anything in the framework to interfere with these incentives and rewards. Increasing giving is a goal for each president.

Trustee Hoffman commented that it is very important to have transparency in the entire process for the allocation framework redesign principles.

Trustee Cirillo inquired if we have the ability to do modeling as we go through for making this change? Do we have a robust algorithm that we can change? Vice Chancellor King replied that we have a significant capacity to model instructional costs, enrollments with modeling, etc.

Chair Vekich invited presidents to comment on the proposed principles.

President Potter, St. Cloud State University, stated that the chancellor's acknowledgement of uncertainty is on all of our minds. There is no new money. President Potter added that he has had to make cuts to adjust to increased costs and enrollment declines. He noted that the presidents recognize that they are partners in this work and are sensitive to the need for urgency.

President Olson, Winona State University, commented that the reason stability is built into the model is because the bargaining units have well deserved and well-earned rights that have to do with when and how you separate as an employee. Depending on the bargaining unit, it may be a nine month to 18-month process. He also encouraged the work to include looking at both how a college or university is improving but also at sustained excellence. For example, retention and graduation rates are really important, but the closer you get to one-hundred percent each incremental percent gets harder and harder. We want to incent the change and growth, but he encouraged the board to not lose sight of the institutions that are already performing at a high level. President Olson added that he hopes that the model will preserve the diversity of institutional types which is the beauty and great strength of the system.

President Johns, Lake Superior College, commented that many of the issues raised during the discussion are right on target. The principles are idealistic, and the decisions will be tough.

President Ester, Normandale Community College, commented that her college has pursued external monies by looking at grants. Normandale has been successful over the past 2-3 months in securing grants but they are one-time money and helpful but then you have to find the money to

sustain those programs. Normandale is increasing its grant writing staff and research staff. As the board looks at ways for us to go after monies, it comes at a cost to other items. The foundation board has been successful raising money for scholarships but now will have to raise funds for capital projects.

Chair Vekich thanked the presidents for their comments.

Trustee Sundin commented on the announcement of more layoffs of steelworkers in the Iron Range. She added that she hoped we are willing to work directly with the union to help the laid-off workers. Chancellor Rosenstone remarked that we are very much engaged and will be part of the solution for the next step for these workers. He added that he spoke by phone with the governor's chief of staff and expressed our concerns for the displaced workers. He also spoke with President Maki, Northeast Higher Education District, regarding customized training programs to help train for additional careers. Organized labor will be a part of the solution for the next step for these workers. The Advance Minnesota customized training program can turn on a dime and is prepared to move at lightning speed.

Adjournment

Chair Vekich thanked everyone for a good discussion and adjourned the study session at 9:16 am.