

**BOARD OF TRUSTEES
MINNESOTA STATE COLLEGES AND UNIVERSITIES**

BOARD ACTION

FY2006 Operating Budget and FY2007 Outlook

BACKGROUND

The development of the FY2006 operating budget began a year ago as Minnesota State Colleges and Universities developed and submitted the biennial budget request to the state. The MnSCU budget request was influenced by the projected state budget deficit in the upcoming biennium and the large cuts to MnSCU's appropriation that occurred in the previous legislative session.

After a cut of approximately \$191.5 million in the FY2004-FY2005 biennium, the Governor signed a bill increasing Minnesota State Colleges and Universities' state appropriation by \$107.5 million for FY2006-FY2007.

As the colleges and universities developed their FY2006 budgets, two critical elements were still unresolved -- state appropriation and employee contract settlements. With the information available to them at the time, colleges and universities created various budget scenarios to understand the impact of state appropriation reductions and cost increases on campus finances and student tuition.

Although very late in the budget process, the signing of the higher education bill in late May provided colleges and universities with a level of certainty on a large portion of their revenues. However, even as colleges and universities finalize operating budgets for the new fiscal year beginning July 1, employee compensation, the largest single cost driver, remains unknown.

The purpose of this report is to present the system financial outlook for the FY2006-FY2007 biennium, along with the institutional operating budgets and tuition requests for FY2006. The Board will have an opportunity to review, discuss and take action on FY2007 operating budgets and tuition next winter. The report is organized into the sections outlined below with corresponding attachments.

- I. Overview of FY2006 College and University Operating Budgets and the Outlook for FY2007
- II. Detail for FY2006 College and University Operating Budgets and the Outlook for FY2007
- III. Recommended Committee Action

The information will be presented at the June meeting of the Finance/Facilities committee of the Board of Trustees for initial discussion. The Finance/Facilities committee of the Board of Trustees has scheduled two public hearings for discussion of the information contained in this report. The hearings are:

- June 29, 2005: Minnesota State Community and Technical College - Fergus Falls
Library Building, Room L20
1:00 to 4:00 P.M.
- July 13, 2005: Winona State University
1:00 to 4:00 P.M.

Staff will make any requested additions or modifications to the enclosed information before returning to the July meeting of the Finance/Facilities committee for second reading and adoption of FY2006 operating budget, including tuition and fees.

I. Overview of FY2006 College and University Operating Budgets and the Outlook for FY2007

Minnesota State Colleges and Universities' state appropriation for FY2006-FY2007 is above the prior biennial base level but below the adjusted biennial base. The adjusted biennial base is comprised of the prior biennial base level plus the state enrollment adjustment. The enrollment adjustment is a provision in statute that governs provision of state funds MnSCU enrollment growth. For FY2006-FY2007, the enrollment adjustment was projected to be \$130.8 million. The Governor and the legislature chose not to fund the enrollment adjustment. The final state appropriation was \$107.5 million higher than the prior biennial base or an increase of 9.8%, but a \$23.3 million reduction from the adjusted base. (Table 1) The \$107.5 million is comprised of \$53 million (\$36 million base and \$17 million initiatives) for FY2006 and \$54.5 million (\$36 million base and \$18.5 million initiatives) in FY2007.

Table 1

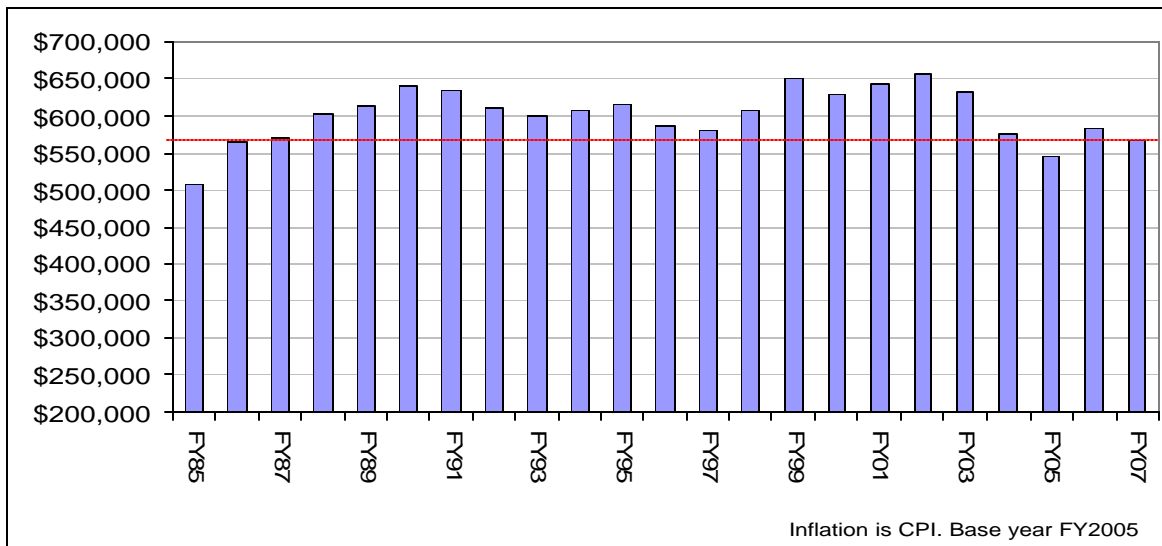
**Minnesota State Colleges and Universities
State Appropriation Funding Levels
FY2006-FY2007**

(\$ in millions)	FY2006	FY2007	Biennium	Change from Adjusted Biennial Base	Percent Change from Adjusted Biennial Base	Change from Prior Biennial Base	Percent Change from Prior Biennial Base
Prior Base	\$547.7	\$547.7	\$1,095.4				
Adjusted Base	\$642.5	\$583.7	\$1,226.2				
Governor's Recommendation	\$603.0	\$599.9	\$1,202.9	-\$23.3	-1.9%	\$107.5	9.8%
Omnibus Higher Education Bill	\$600.7	\$602.2	\$1,202.9	-\$23.3	-1.9%	\$107.5	9.8%

After large cuts to the base in the past three years, the increase for FY2006-FY2007 puts MnSCU back to its FY2002 funding level. Adjusting for inflation, the FY2006 funding level is one of the lowest state funding levels in the past 20 years. (Graph A)

Graph A

**Minnesota State Colleges and Universities
State Appropriation Funding Levels
FY1995-FY2007
Adjusted for Inflation**

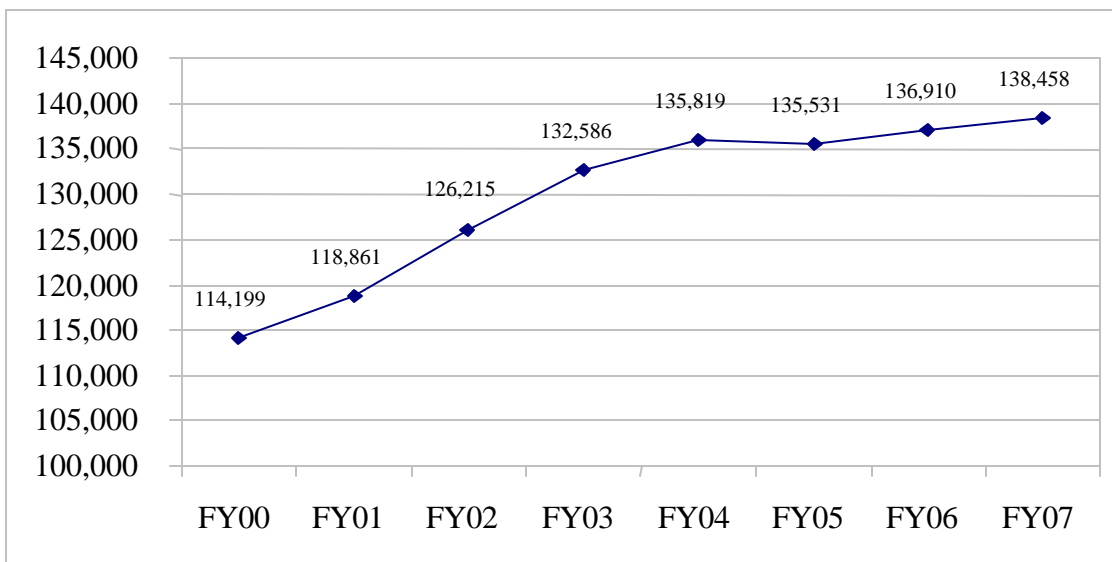


The horizontal dotted line represents the current funding level.

The enrollment at Minnesota’s state colleges and universities has grown from 114,199 full-year equivalent (FYE) students in FY2000 to 135,531 FYE in FY2005 -- an increase of 21,332 or 19%. (Graph B) The enrollment grew significantly between FY2000 and FY2004 (averaging 4.4% per year) and then dipped slightly in FY2005. It is projected to increase at a rate of 1% per year over the next biennium.

Graph B

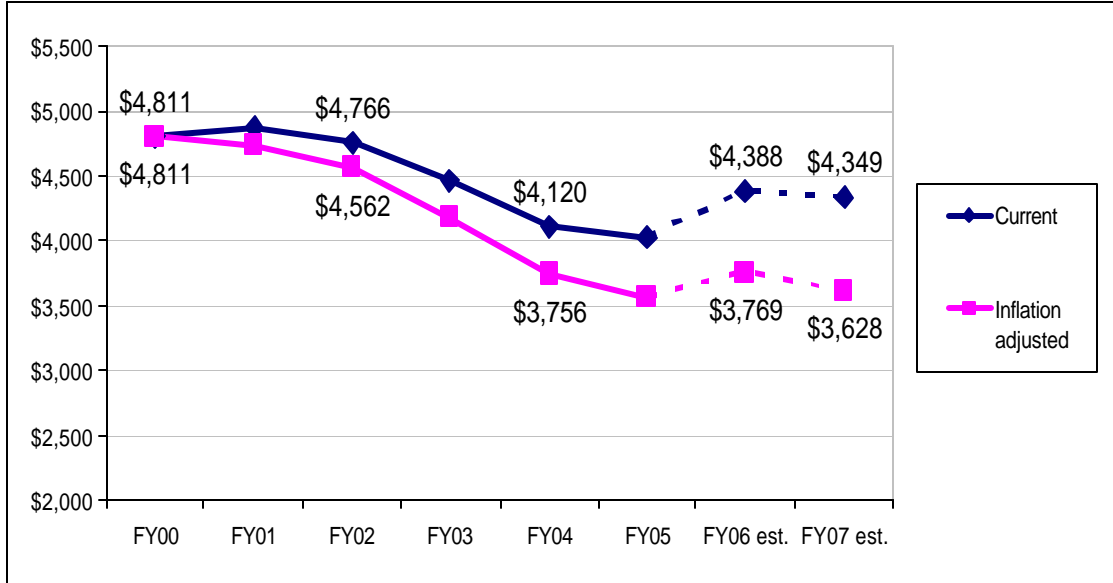
**Minnesota State Colleges and Universities
Change in FYE Enrollment**



The increase in appropriations for FY2006 and FY2007 has reversed a long-term trend of declining state funding per FYE student (Graph C). However, except for the current biennium, the funding per student is lower than any time since FY1997. Adjusting for inflation, the funding level per student is comparable to the funding level of FY1981. The FY2007 appropriation per FYE of \$4,349 will be \$462 lower than the \$4,811 per student in FY2000 – a 9.6% drop. In inflation adjusted dollars, the decrease is \$1,183 or a drop of 24.6%.

Graph C

**Minnesota State Colleges and Universities
State Support per FYE
FY2000-FY2007**



College and University Priorities

Despite flat revenue levels over the past several years, colleges and universities have continued to respond to the changing needs and demands of their local markets, while maintaining their core mission of providing access to the majority of postsecondary students in Minnesota.

Each college and university has a unique way to address their local and regional needs as illustrated by the numerous initiatives explained in the supplemental packet which was provided to Board members in June. Updates will be provided at the July meeting if necessary. Yet, a few common themes have emerged from these initiatives. One of the themes is the development and expansion of programs in high demand fields, often under the rubric of Centers of Excellence. A number of institutions are creating or enhancing programs in allied health, health science and bio-medical science. Other institutions are pursuing opportunities in technical fields, such as network technology and security, manufacturing technology, engineering, and engineering technology. Along with the development in these programs is the expansion and enhancement of math and science programs.

A second common initiative found in the narratives is that of access and affordability, especially for populations historically underserved in higher education. Colleges and universities are looking at ways they can improve the retention and completion of all students, particularly underrepresented groups.

A third common initiative is alternative program delivery, primarily through online learning. Colleges are investing more resources into this medium as a way to increase access and expand enrollments. This approach requires additional investments in faculty and staff development and equipment.

Finally, a theme that is found in all the prior initiatives is that of collaboration. Colleges and universities are creating partnerships with local communities, business and school districts, as well as other MnSCU institutions. The partnerships help MnSCU leverage scarce resources and address critical local, regional and state needs in concert with other interested organizations.

Colleges and universities will continue to pursue these opportunities as they reallocate resources and apply new revenue to core obligations, including faculty and staff salaries, equipment maintenance and replacement, and facility debt service and upkeep. The information in Table 2 suggests that colleges and universities, despite the ongoing challenge of tightening budgets, have continued to invest in core academic functions. The portion of the operating budget directed to instruction and academic support has increased to 64.9% in FY2004.

Table 2

**Minnesota State Colleges and Universities
Portion of Operating Budget Spent on Instruction and Academic Support**

FY2000	63.8%
FY2001	63.3%
FY2002	63.7%
FY2003	63.7%
FY2004	64.9%

Proposed FY2006 All Funds Budget

Colleges and universities have three principal sources of revenue: state appropriation, tuition and auxiliary/enterprise. These revenues support all aspects of the educational enterprise--instruction, student life, administration, physical plant, and the residential life programs.

The System's FY2006 all funds budget is showing a small positive balance after tuition revenue increases, expenditure reductions, and the use of carry forward. The \$1.7 billion budget includes an estimated \$188 million of financial aid revenue and expenditure. Approximately 87% of financial aid revenue (\$164 million) is brought in to pay student obligations (tuition, fees, room and board, and sales and services) with the balance (\$24 million) reflecting the net financial aid expense. The budgeting of financial aid results in all funds revenue and expenditures being overstated by approximately \$164 million. (Table 3)

Table 3

**Minnesota State Colleges and Universities
Summary Outlook
All Operating Funds
FY2005- FY2007**

(\$ in millions)	FY2005 Estimated Budget	FY2006 Projected Budget	Change	FY2007 Outlook
Revenues	\$1,627.3	\$1,719.6	5.7%	\$1,735.5
Expenditures	\$1,659.2	\$1,745.5	5.2%	\$1,798.6
Balance	-\$31.9	-\$25.9		-\$63.1
Carry forward	\$41.5	\$32.9		
Balance	\$9.6	\$7.0		

Proposed FY2006 General Fund Budget and FY2007 Outlook

Table 4 outlines the general fund revenues and expenditures for FY2005-FY2007. In FY2006, colleges and universities used a variety of strategies to balance their budgets that include, but are not limited to, personnel reductions, equipment and supplies reductions, redesigning or eliminating programs, improving administrative efficiencies, tuition rate increases, and the use of carry forward/reserves.

The FY2006 proposal contains a balanced budget with a very modest structural deficit. Colleges and universities submitted plans which include the use of \$31.4 million of fund balances, approximately 2.6% of total FY2006 revenue. Increases in state support and tuition rates provide sufficient revenue to cover the costs of enrollment increases, compensation increases and general operating inflation. Campus administrators also anticipate re-allocations to provide for additional new investment opportunities in support of the goals of the Board of Trustees and the Chancellor.

The FY2007 outlook characterizes the second year impacts of the FY2006 recommendations. The outlook does not include any assumptions concerning a FY2007 tuition increase. It does reflect the second year costs of now pending labor contracts. Colleges and universities were instructed to carry compensation and other operating cost increase assumptions into the FY2007 information. The result is a \$65.9 million gap in the FY2007 outlook, or approximately 5.4% FY2007 budgets, with the gap solution will be presented to the Board in January 2006.

Table 4

**Minnesota State Colleges and Universities
Summary Outlook
General Fund
FY2006 Proposed Budget**

(\$ in millions)	FY2005 Estimated Budget	FY2006 Proposed Budget	Change	FY2007 Outlook
Revenues				
State Support	\$546.4	\$600.7	9.9%	\$602.2
Tuition support	\$518.4	\$550.1	6.1%	\$554.0
Other revenues	\$101.3	\$97.9	-3.4%	\$99.1
Carry forward	\$39.0	\$31.4	-19.5%	
Budgeted Revenues	\$1,205.1	\$1,280.1	6.2%	\$1,255.3
Expenditures				
Compensation	\$864.6	\$908.0	5.0%	\$944.9
Other Operating	\$335.2	\$369.5	10.0%	\$376.4
Budgeted Expenditures	\$1,199.8	\$1,277.5	6.5%	\$1,321.3
Balance	\$5.2	\$2.6		-\$65.9

Budget Planning Process

In January colleges and universities were given direction regarding planning for inflation in the next biennium based on the state Department of Finance (DOF) biennial budget guidelines. DOF suggested planning for a 4% per year increase in employee compensation, both salary and benefits, and a 1.5% increase for other operating costs in FY2006 and 1.6% in FY2007.

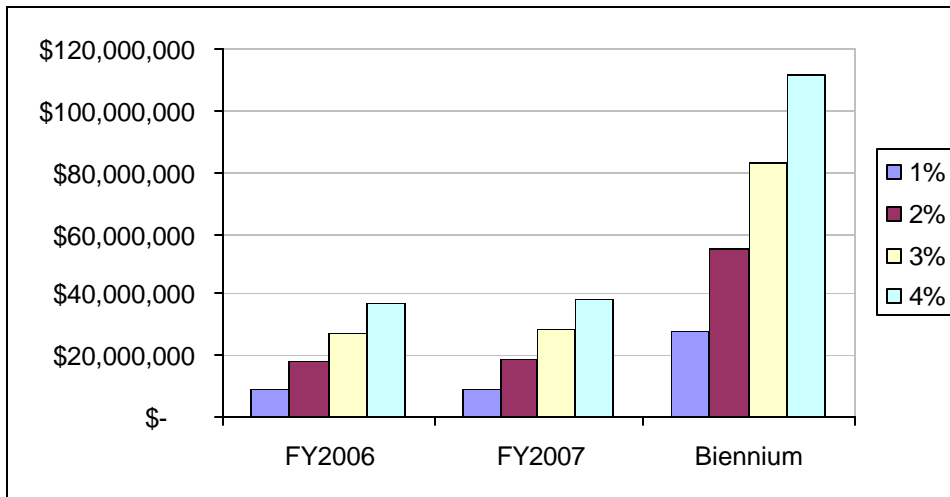
A set of revenue planning guidelines were sent to the colleges and universities based on the Governor's recommended appropriation for MnSCU. As more information was obtained on the state appropriation, additional information was sent to the institutions.

The colleges and universities were encouraged to produce various scenarios around these revenue and expenditure guidelines, tailoring them to the specific make up of their revenue structure and operating cost patterns. In the information submitted for this report, colleges and

universities assumed increases in insurance, progression (lane and step increases), and mandates from the prior FY2004-FY2005 contract settlements (“tails”). Graph D shows that a 1% annual increase in compensation would be approximately \$9.2 million in FY2006 and an additional \$9.3 million in FY2007 for a total biennial increase of \$27.6 million.

Graph D

**Minnesota State Colleges and Universities
Compensation Scenarios
FY2006-FY2007**



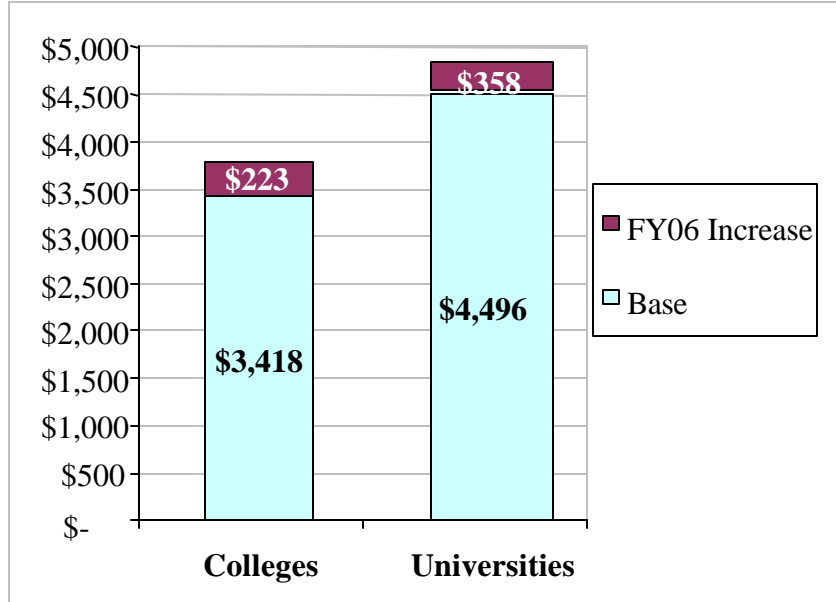
The expenditure projections used by the colleges and universities to develop their FY2006 budgets vary slightly from the guidelines provided. Assumptions regarding compensation increases generally range from 4 percent to 6 percent, while other operating cost increases are estimated to increase between 1 percent and 5 percent.

Tuition

Colleges and universities have been discussing their FY2006 operating budget including tuition and fees with campus constituents for the past several months. The impact for a full year equivalent student is illustrated in Graph E. For colleges, the average tuition for a full year equivalent student in FY2005 was \$3,418. Colleges are proposing an average increase of \$223 for FY2006. For universities, the average tuition for a full year equivalent student in FY2005 was \$4,496. They are proposing an average increase of \$358 for FY2006.

Graph E

**Minnesota State Colleges and Universities
Total Tuition and Tuition Increase per FYE
FY2006**



Attachments 1A through 1D provide the detail to the tuition rate changes proposed in FY2006. State statutes and Board policies do not require a separate tuition rate for out-of-state students, even though it has been the convention of Minnesota State Colleges and Universities since before the merger. Currently, the Board allows colleges and universities to participate in non-resident waiver pilot programs, all of which are set to expire at the end of FY2007. See attachment 2.

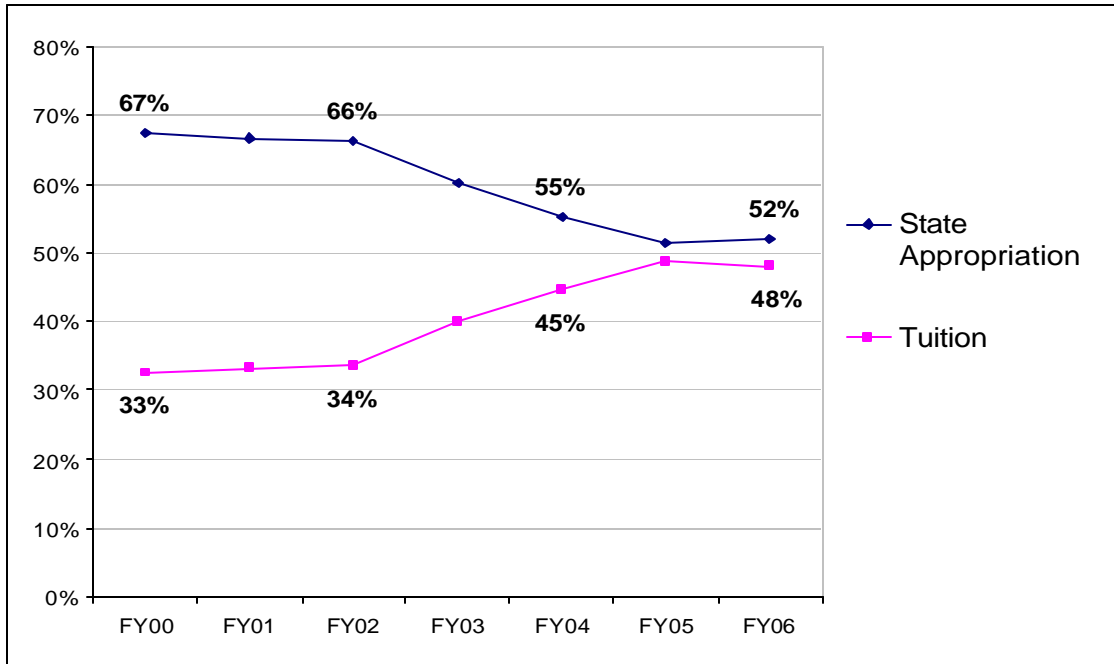
II. Detail for FY2006 College and University Operating Budgets and the Outlook for FY2007

Like most other public higher education systems, state appropriation has historically been the primary revenue source of Minnesota State Colleges and Universities. The relationship between state support and tuition has remained constant over the years, with state appropriation comprising between 65% and 70% of the total of state support and tuition. (Graph F) However, in the last several years, with diminishing support from the state, Minnesota State Colleges and Universities have had to rely more on tuition revenue to support basic educational activities. Although the increase in state appropriations for FY2006 has slowed the recent trends, tuition now comprises practically the same proportion of total MnSCU funding as state appropriation.

For nearly half of the colleges and universities, tuition revenue has become the predominant source of funding.

Graph F

**Minnesota State Colleges and Universities
Major Revenue Sources
Percent of total state appropriation and tuition revenue
FY2000 -FY2006**



Allocations

For FY2006 and FY2007, slightly more than ninety percent of the state funds (including interest earnings) received by Minnesota State Colleges and Universities are allocated to colleges and universities. (Table 5) This is a slight percentage increase over FY2005. Effort is made to direct the maximum possible portion of the state funds to the basic allocation to provide the most flexible support to all colleges and universities. System wide programs, debt service, the Board/Chancellor initiative fund and the budget for the Office of the Chancellor and the Campus Services Division are also supported with state funds. These items comprise the remaining nine percent of the state appropriation in FY2006. The proportions allocated to these latter categories are slightly lower than in the current biennium.

Table 5

**Minnesota State Colleges and Universities
State Funding Allocation Summary**

(All \$ in millions)	FY2005	% of total	FY2006	% of total	FY2007	% of total
Institutional Allocations	\$493.9	90.0%	\$546.6	90.6%	\$548.1	90.6%
System Wide Set Asides	\$17.3	3.1%	\$17.7	2.9%	\$17.7	2.9%
Office of the Chancellor	\$37.8	6.9%	\$39.0	6.5%	\$39.0	6.4%
Total	\$548.9		\$603.2		\$604.7	

In the final higher education bill, MnSCU received a base increase for FY2006 of \$36 million targeted for base budgets and \$17 million for initiatives. Of the \$36 million, \$34.9 million (or 97%) was distributed to the colleges and universities and the remaining \$1.1 million was allocated to the Office of the Chancellor. The \$17 million for initiatives, including funds for competitive salaries and Centers of Excellence, is categorized under institutional allocations. The vast majority of these funds will be distributed to the colleges and universities. Discussions among senior leadership are being held to determine the most appropriate use of these funds in light of the system's initiatives, as outlined in the FY2006-FY2007 biennial budget request. Proposed initiatives will be reviewed by the Leadership Council and presented to the Board of Trustees for approval in July.

Beginning in FY2006, the institutional allocations will be distributed in accordance with the fully implemented allocation framework. This allocation method was first approved by the Board in December 2000, but full implementation was delayed due to a legislative request and state appropriation reductions. In June of 2004, the Board approved implementation of the method for FY2006. In summary, institutions will receive 50% of their allocation based on their prior year base and 50% on the results of the allocation framework with a guarantee that institutions will maintain at least their FY2005 level of funding. The average increase to the base allocations of colleges and universities was 7% for FY2006. The allocation framework formula is based on comparisons of actual college and university costs and external benchmarks.

The Office of the Chancellor and Campus Service Division base budgets are anticipated to increase by 3% in FY2006. (This compares to the 6.5% increase proposed for the colleges and universities – see table 4) The recommendation to increase the base budget was presented to the Finance committee of the Leadership Council. Presidents agreed that the Office of the Chancellor and Service Division base budget should increase in light of previous budget cuts and anticipated inflation in FY2006 and FY2007. Historically, the budget between the Office of the

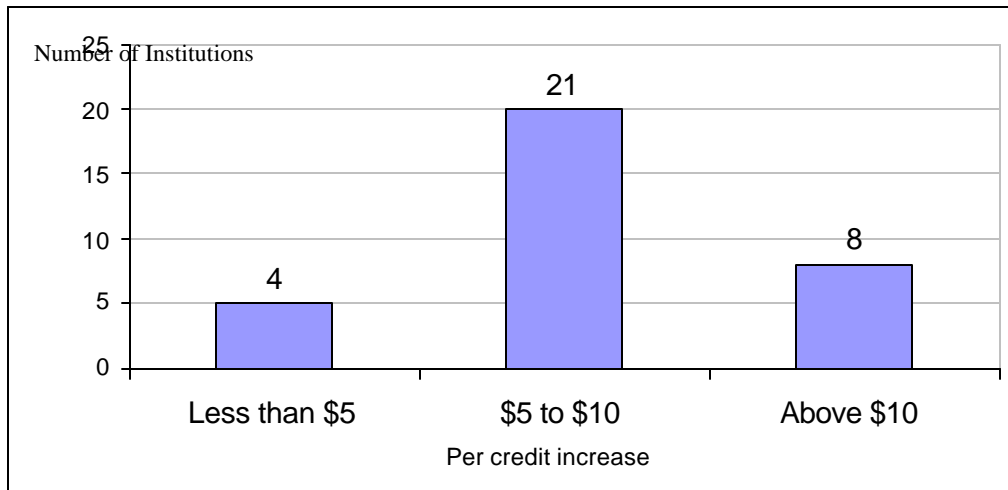
Chancellor and the Service Division represents a one-third to two-thirds relationship with two-thirds of the budget designated for the Service Division.

Tuition Increases

The Board of Trustees is being asked to approve tuition levels for FY2006. Undergraduate tuition increases across the system range from 4% to 10.4% with a system average of 6.9%. The average college tuition increase is 6.5% and the university average tuition increase is 8.0%. Most of the per credit increases for all colleges and universities are between \$5 and \$10. (Graph G) For the majority of colleges, the increases are between \$6 and \$9 per credit and for six of the seven universities, the increases are above \$10 per credit. No institution exceeds \$16 per credit. Included in these changes is the increase for the Winona State University, “Winona Experience” (or ‘New University’) initiative. This initiative will result in a designated tuition increase of \$250 per FYE student at WSU each year from FY2006 through FY2009 in addition to the base proposal.

Graph G

**Minnesota State Colleges and Universities
Undergraduate Per Credit Tuition Increase
FY2006**



After double-digit tuition increases in the current biennium, Minnesota’s neighbors are planning to raise tuition in the 5% to 8% range for FY2006. Minnesota State Colleges and Universities proposed tuition rate increase of 6.9% is in the middle of this range. (Table 6)

Table 6

**Minnesota State Colleges and Universities
Proposed Tuition Increases
Neighboring States FY2006**

Minnesota State Colleges and Universities	Iowa Universities	North Dakota State Colleges and Universities	South Dakota State Colleges and Universities	Wisconsin State Colleges and Universities
6.9%	5.5%	8.5%	5.7%	5% - 7%

Includes only institutions with Carnegie classifications similar to MnSCU institutions. Iowa community college information is unavailable. Iowa includes a proposed 3% mid-year increase. Wisconsin rate reflects the Governor's proposed tuition increases.

Fees

During the May 2006 Board of Trustees meeting, Minnesota State College Student Association's (MSCSA) request to increase the statewide college student association fee from \$0.28 to \$0.30 was approved. No additional requests have been made to increase fee maximums. FY2006 fee changes fall under the current fee structure. The types of fee data reported include technology, athletics, health services, student activity/life, and parking. On average, the total impact of fee increases is 3.9% between FY2005 and FY2006.

Student Consultation Process

Colleges and universities have been discussing the FY2006 budget with campus constituents for several months. The FY2006 Operating Budget supplement packet includes student consultation letters from each institution. Also included in the packet is a document that summarizes the student consultation letters.

In FY2005, representatives from the colleges and universities and the Office of the Chancellor met with both statewide student associations to discuss the student consultation process for FY2006 and FY2007. The purpose of the discussion was to evaluate whether approval of two years of tuition rates would be continued in the upcoming biennium. Both the students and the campus representatives had mixed reviews of the two year approval process. It was concluded that the benefits did not exceed the negative aspects and that the administration would return to tuition consideration one year at a time. Student consultation on the FY2007 operating budget plans including tuition and fee rates will occur during fall semester and be presented to the Board of Trustees at the January 2006 Board of Trustees meeting. This approach should be considered a "pilot" and will be evaluated prior to the next biennium.

Reserves

Board policy calls for college and university reserves of 5% to 7% of revenue. Progress toward this goal during the past several years has enabled several colleges and universities to call on reserves to address unexpected reduction in revenue, such as the Governor’s unallotment of \$25 million in FY2003 and the deep cuts in the FY2004-FY2005 bienium. Due to the challenging fiscal environment, college and universities were allowed to spend down reserves to 1% of revenues in the current biennium if absolutely necessary. They were instructed to start building up reserves in the FY2006-FY2007 biennium. Reserves as a percentage of revenues have remained relatively flat, with a slight dip in FY2003 (Table 7). Reserves are expected to rise slightly in FY2006.

Table 7

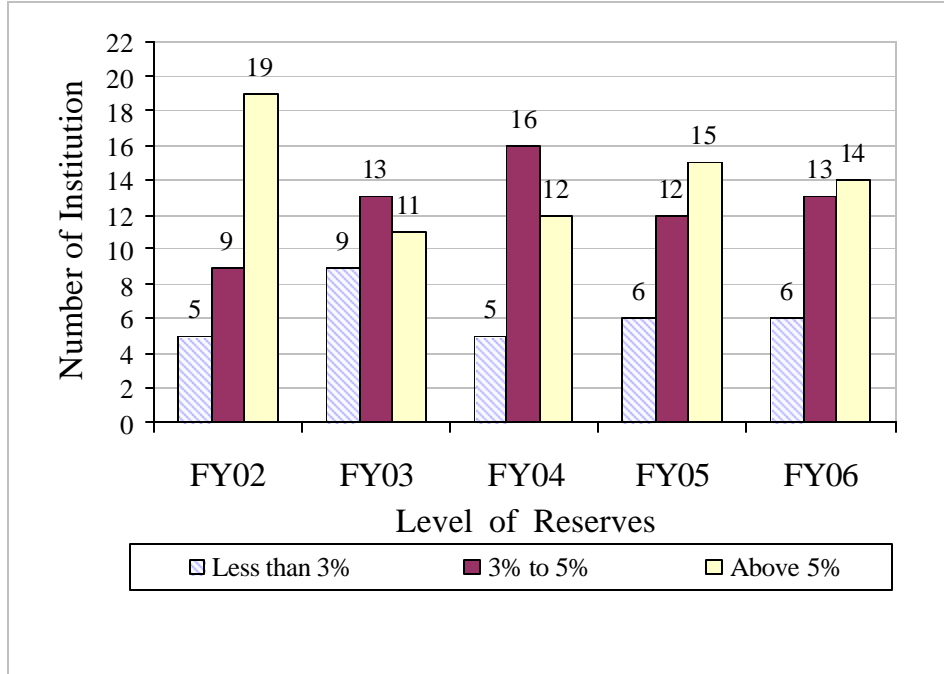
**Minnesota State Colleges and Universities
Reserves Outlook**

	June 2005	% of Revenues
FY2002	\$39.7M	4.3%
FY2003	\$38.1M	3.7%
FY2004	\$45.3M	4.2%
FY2005 est.	\$47.4M	4.3%
FY2006 est.	\$48.6M	4.4%

Reserves are one of the important tools colleges and universities can use to respond to financial difficulties. Each institution must respond to local budgetary demands and use reserves accordingly. The graph below shows the number of institutions that have reserves less than 3%, between 3% and 5% and greater than 5% between FY2002 and projected FY2006. As reserves are used to cover revenue reductions, the number of institutions with reserves greater than 5% declined from 19 in FY2002 to 11 in FY2003 and rose in FY2004, FY2005 and FY2006. The number of institutions with reserves below 3% has remained relative flat, with a slight increase in FY2003. (Graph H)

Graph H

**Minnesota State Colleges and Universities
Estimated Level of Reserves
FY2002 to FY2006**



RECOMMENDED COMMITTEE ACTION:

The Facilities/Finance Policy Committee recommends that the Board of Trustees adopt the following motion:

RECOMMENDED MOTION:

1. Adopt the annual total operating budget and general fund budget for FY2006 in tables 3 and 4.
2. Approve the proposed tuition structure recommendations for FY2006 as detailed on attachment 1A through 1D. The percentage impact of resident tuition rates represents the maximum amount that can be applied to other tuition rates charged by the institution not impacted by reciprocity agreements such as nonresident and off campus rates.

The tuition increase is effective Summer Session or Fall Semester, 2005 at the discretion of the president. The chancellor is authorized to approve tuition structures for new courses or programs proposed after this date and is requested to incorporate any approvals at the time FY2007 tuition recommendations are presented to the Board.

The Board continues the policy of market-driven tuition for closed enrollment courses, customized training, non-credit instruction, continuing education, distance learning and contract postsecondary enrollment option programs.

3. Approve the colleges and universities participation in the non-resident tuition waiver pilot program as outlined in attachment 2.
4. Approve the distribution of the legislative initiative funds as outlined in the recommendation contained in attachment 3 to be presented to the Board of Trustees in July.

Date Presented to the Board: July 20, 2005