Fiscal/Economic/Political Environment Workgroup February 22 Minutes

Meeting started in SU 105 at 2:00 p.m.

Members Present: Ken Kline (Facilitator), Charles Brown (Strategic Planning Committee Liaison), Natasha Dempsey, Karen Zerhusen Kruer, Russ Kerdolff, Rick Kolbe, Gary Clayton, Joe Wind (Writer), Kristi Haik, Steve Nienaber, Erik Pederson, Ryan Salzman, Leah Stewart, Mary Paula Schuh (Strategic Planning Committee Liaison), Sue Hodges Moore, Eric Brose (Recorder)

State/Fiscal Economic Issues

Write up report follows.

State Fiscal/ Economic Issues

- **State Budget Outlook**
  - State tax collections are at 1970 levels - 7% of income. At current spending levels, "Kentucky will have a structural deficit that could reach $1 billion by 2020." Please see Graphs 1 & 2.
  - Kentucky's recurring budgetary problems are due in part to the long-term decline in revenue as a result of our current tax code. Contributing factors include:
    - the gradual shift in personal income away from taxable sources;
    - transition from a <u>taxed</u> goods-producing economy to a largely <u>untaxed</u> service-providing economy;
    - the rise in "mail order" sales; and an aging population (Blue Ribbon Tax Commission on Tax Reform).
  - The Kentucky Retirement System (KRS)[1] has a $30 billion unfunded pension obligation (Report by the Blue Ribbon Tax Commission on Tax Reform and <u>Lane Report)</u>.
    - Problem Magnitude:
      - Nationally, Kentucky is second-worst state behind Illinois
      - A state employee's pension is a "defined-benefits" plan and hence a legal contract with the state;
        - Legislative changes to the pension payout system are <u>not</u> retroactive, but are effective from the day of legislation *going forward* (<u>Lane Report)</u>

[1] The Kentucky Retirement System (KRS) has six components: the Kentucky Employees Retirement System (KERS); Kentucky Teachers (KTRS); County Employees (CERS); State Police (SPRS); Kentucky Judicial (KJRS); and Kentucky Legislators (KLRS). Contributions, payouts, and other features differ from one system to another. <u>Lane Report</u>, pp. 24-27.

            - By law, pension obligations have a *higher priority* in state budgets than municipal bonds (Lane Report)
        - NKU Impact:
            - A potential *increase* in NKU's contribution by $5 million in FY2015 (NKU Accounting Department).
            - This could potentially *decrease* other state funds available to higher education
        - Possible Solutions:
            - Bankruptcy of state pension systems not allowed by the courts under chapter 11
            - Double the sales tax (Lane Report)
            - Double the state income tax (Lane Report)
    - Kentucky needs a broader tax base so that revenues can keep up with future economic growth.
            - Gambling at the state's seven horse tracks may provide a short term economic growth by providing an initial $1.7 billion. (Kentucky.com).
            - Other sources of revenues from tax reform and legalization of industrial hemp
    - However, highly likely opposition to new revenue measures by members of the Tea Party and others

- **Peer funding comparisons**
    - NKU operates with fewer state dollars /student than other Kentucky comprehensive universities.
        - If NKU were funded at the average of the other comps, NKU would receive an additional $18.4M in state appropriations. Please see Graph 3.
        - Without a change in the state funding formula, it is estimated that this trend will continue over the planning horizon. Please see Graph 4.
    - When looking at total revenue collected per student, NKU ranks #18 out of 27 national peer institutions (#1 receiving the highest revenue per student). Please see Graph 5.
        - NKU falls slightly below both the mean and median revenue per student.

- **Increased State Funding for Post-secondary Education?**
    - Even though post-secondary education is still seen as a high priority in the state of Kentucky, it receives a smaller percentage of the pie (General Fund) than it did in 1998, despite the higher education reform of 1997.
        - Monies have been redistributed based on required expenditures, e.g. Medicaid, Corrections, and Debt Service. Please see Graph 6 & 7.
        - Additionally, the majority of monies given to postsecondary education have been to fund student financial aid. Please see Graph 8.
        - Since FY2008, Net General Fund Appropriations per FTE student for comprehensive universities have fallen by $1,726 per student, or 26%; however, Total Public Funds have increased $357 per student. Therefore, we have seen

an increase in tuition paid by the student- roughly $1,400. Please see Graphs 9-11.

    - It is predicted that the student share of total public funds will continue to decline from FY2013 to FY2020. (Total Public funds = tuition + state appropriation). Please see Graph 12.
    - Unfunded KRS pension liability is expected to compete with, if not overtake, higher education/NKU funding needs.

- **Sources**
  - Lane Report citations are from the February 2013 edition, pages 24 - 27.
  - Graphs 1, 2, 6, &12 came from Governor Beshear's Blue Ribbon Tax Commission on Tax Reform power point presented by Jerry Abramson (Lt. Governor, Chairman) and Mary Lassiter (Secretary, Governor's Executive Cabinet).
  - Graphs 3 & 4 were prepared by the NKU Budget Office.
  - Graph 5 was extracted from the Delta Cost project. (www.deltacostproject.org)
  - Report by the Blue Ribbon Commission on Tax Reform to Governor Steve Beshear, December 17, 2012. (http://ltgovernor.ky.gov/taxreform/Documents/Report/TaxReformCommissionReportFinal.pdf)
  - "KY study puts first-year value on casinos at $1.7B" by Karla Ward. (www.kentucky.com/2012/01/17/2031120/chamber-of-commerce-study-casinos.html)
  - Graphs 7-11 came from Robert Kings' (CPE President) power point presentation, "Making Kentucky Stronger by Degrees," to members of the Council on Post-secondary Education on February 7, 2013.

Discussion:

The team reviewed the bullets. If we took those that don't want to participate out of the system, would the unfunded liability decrease? It's predicated that all of us in it stay for 27 years. If only 5/1050 staff decided to retire from the state, would that change the actuarial? There isn't an answer for formulae beyond Lane Report. Various groups are part of the state retirement. We probably wouldn't be able to leave as an institutional group. We're a defined contribution program, but for others the interest rate discount has been in inverse proportion. Future liabilities could come down. 2 ways to deal with it: either fund unfunded now or over a period of time to see the change in movement of investments/liabilities. It's bleak, NKU will have to deal with it, and state will take more from NKU to address the broader underfunding.

Over 16 years, the rest of government was cut from 11% to 6% of the state budget. Those offices are coming after resources, funds, etc. Students have borne the state's cuts to PSE, specifically to NKU. Publicly, state says to cap tuition, but quality goes down if funds aren't stable. Politically, legislators won't say it's the citizens (students) who pay. Some legislators don't understand PSE fixed costs and factors that drive education expenses. State took away, and we increased tuition and now we cannot keep this balanced any longer. 3 levels: UK/U of L, Regionals, KCTCS.

Two other issues not bulleted: public policy changes and the influence of the Tea Party. Increased taxes would be considered unacceptable.

Gross tuition does get discounted with scholarships and other aid. It would lower state net tuition. There is the burden on students, but more profoundly, and long-lastingly, on the concept of borrowing. Large loans and no jobs = growing default rates. Institutions can't wait 3 years to issue a bond.

Anything else? Chunks = leaky bucket that cost the state a lot of money (Medicaid, Corrections, etc.) There needs to be a big push to address public policy in relation to state funding. As Kentuckians, we need to tell legislators to fix the bucket. We have to work together. (30% of our students and a significant number of our employees are OH residents). Take pride in education and engage in a higher level. Otherwise, it won't change. Would political process be part of the Strategic Plan? NKU is "state-supported" not "state funded" anymore. Financial support will come from students first. State support is 23% ('12); we were over 30% before the recession. There is a public and internal (mis)perception. For a Research University – 10% from state, but significant funding comes from outside research and grant funds. Our major buckets are tuition and state funds. Students fund us. "State-located" "state assisted" etc.

CPE Rules and Regulations – some of the statistics in the CPE paper are from 2011. Please be aware of this. Numbers will be updated where possible.

Fiscal/Economic/Political Work Group

CPE Subgroup Draft – 2/22/13

Productivity, Efficiencies and Cost Containment

- As state support for colleges and universities has declined over the last several years, institutions across the country have raised tuition rates in order to sustain operations, maintain quality, and improve student success. College affordability continues to be a major concern at the national, state and local levels.

- Like in many other states, Kentucky's institutions face increasing scrutiny by policy leaders, the public, and the media on the effective and efficient use of resources in order to keep college affordable for students. In both its accountability and advocacy role, the Council on Postsecondary Education is calling on each institution to explain and defend its use of public resources as well as explore central consolidation of administrative activities (such as back office operations) and system-wide contracts , such as health insurance and energy.

- Under the current proposal, CPE would require institutions to report detailed documentation and evidence of efficiencies, cost reductions, cost containment and productivity efforts on an annual basis. Examples include: business process reengineering, financial and budgetary initiatives, academic/student initiatives, partnerships with external entities, restructured employee benefits, streamlining information technology, and sustainability initiatives.

- In addition, the CPE has begun tracking and reporting statewide and institutional productivity metrics, including degrees per FTE, degrees per $100,000 in state appropriations, total public funds per degree, and education and related costs per degree.

- It is unknown whether these efforts to increase transparency and accountability around efficiencies will influence legislators to increase the state's investment in postsecondary education, which would help maintain access and keep college affordable in the future.

Performance and Outcomes-based Funding

- Kentucky enacted a formula funding model based on enrollment in 1982 but later moved to an incremental model for most years to preserve funding bases. The most recent four biennia have resulted in reductions in state appropriations, and all institutions have been cut by the same percentage, regardless of enrollment trends.

- Institutions with greater-than-average enrollment growth and high degree productivity, including Northern Kentucky University, have suffered the most when state funding policies have reverted to incremental funding models and across-the-board funding cuts.

- For instance, disparities in state appropriations per FTE student among the regional comprehensive universities have grown, even as the appropriations per FTE students have declined. Declines among the regional universities range from 10.7% to 17.8% in state appropriations per FTE student (checking on which institutions are highest and lowest).

- In 20011-12, the average stare funding per FTE ranged from $5,674 at for Murray State University (MuSU) to $3,806 at Northern Kentucky University, a difference of $1,880 per full-time equivalent student.

- The most recent data available also illustrates that the amount of state appropriations per baccalaureate degree awarded varies significantly among the Kentucky regional universities from a high of $41,023 for Morehead State University to a low of $25,604 for Northern Kentucky University.

- From the perspective of state funds as a proportion of total public revenues, Kentucky regional universities do not receive an equitable level of support from the state. Data from fiscal year

2010-11 indicates the state share of total public funds varies significantly among Kentucky universities with a high of 42% at Morehead State to a low of 20% at Northern Kentucky University.

- According to a recent report by the Southern Regional Education Board, it is estimated that over half the states nationally have some form of performance-based funding. Many state legislatures have passed legislation or considered legislation to adopt a performance funding approach.

- Some states are moving toward outcomes-based funding, which is a specific type of performance-based funding model. This model is designed to not only further state goals for its postsecondary system but also strengthen the reliability, sustainability, and adequacy of funding for each of state's public colleges and universities.

- There is interest among some Kentucky legislators in looking at these new postsecondary education funding models emerging in other states. In December 2012, representative Carl Rollins introduced a pre-filed bill calling for a review of tuition and financial aid policies, as well as the manner in which state appropriations are distributed.

- The Council on Postsecondary Education is supportive of a long-term funding strategy but prefers to wait until the 2016-18 biennium. The institutional presidents are considering the engagement of an external consultant to provide assistance to the institutions in developing an outcomes-based funding model that has the support of all of the presidents, as well as the Governor, General Assembly, and CPE.

- Having an outcomes based funding policy in place as soon as possible could help address the disparities noted above. It also would greatly inform NKU's strategic planning deliberations, particularly financial planning, enrollment strategies, and the academic master plan.

Discussion:

Sue outlined the plan. Kristi and Russ added. Adult Learners population is one thread that CPE metrics and funding aren't historically focused on, but we have discussed this population in open sessions. State Performance funding metrics for each institution need to be explicated or specific kickers for each institution. There is no 'formula', but rather an accumulated history of various plans gerrymandered together. No interest in a zero based approach by state. We'll need to compel with enormous logic to convince the state. Politicians focus on citizens and value to them. What do we do for our students and what will the degree provide? KY leaders are focused on PSE investments as an avenue for jobs and a growing economy. Legislators think of it as a lump sum to be divided, rather than going further to see how it needed to be split realistically. Carl Rollins put in HCR Res 13 for a task force to identify financial aid and how universities are being (under)funded and how that relates to loans. We are inclined to support his initiative to shed light on our historical underfunding. "What do we (citizens) get for the lump sum?" The 9 state institutions have to agree – NKU has 15 of 138 legislators to motivate for this,

but it's an uphill battle because the majority represents other universities' constituents. We hope for rational arguments. We have to focus on our destiny. We have to focus our efforts on student recruitment partnerships and private investments. There's money that others wish to invest. We have to give deliverables and be transparent. Track front door and back door.
Performance based funding is at varying levels of support from other Regionals. Other comprehensive universities have a common objective to maintain their current base funding and will use their considerable delegations to secure it. We are a rural state and there is animosity between rural and urban. Rural culture doesn't always see the value in an additional investment in PSE.

Other thoughts to crystallize report: what is the time frame for the funding model? Don't know, but we're pushing for 14-16 Biennial. We can build that into planning efforts. There may be no ore increase in funds at that time.

Recap: no new state funding over next 3 years; money from other institutions and national trends favor that if we follow CPE outcomes; cost containment through collaboration; affordability for tuition.

Meeting adjourned at 2:55 p.m.

Please email write-up reports to Ken (klinek1@nku.edu).

Write-up reports due February 27:

Public Policy Issues

Federal issues, laws, regulations, and mandates/trends

Next Meeting is Friday, March 1, 2:30 – 3:30 p.m. in SU 109.