COMMISSION FOR HIGHER EDUCATION
Friday, September 12, 1997

DECISION ITEM D: **Incentive and Performance Funding Initiatives**

Staff Recommendation

That the Commission adopt the incentive and performance funding initiatives proposed in the September 4, 1997 document entitled *1999-01 Incentive and Performance Funding Initiatives.*

Background

As the Commission developed its 1997-99 budget recommendations, the Commission signaled its interest in exploring several incentive and performance funding initiatives to be addressed in future budgets.

Commission staff, institutional representatives, legislative staff, and State Budget Agency staff have met on multiple occasions to develop a collection of initiatives which will benefit the State and the institutions. The result was reviewed with the Commission at its August, 1997 meeting. At the time, several changes were suggested, and the attached document reflects that discussion.

The initiatives propose changes in the way the State funds enrollment change, new facility operating expenses, debt service, degree completion, and new degree programs.

Supporting Document

1999-01 Incentive and Performance Funding Initiatives, September 4, 1997.

1999-01 Incentive and Performance Funding Initiatives

September 4, 1997

1. <u>Enrollment Funding for Changing Campuses</u>

   Rapidly-growing campuses, under existing enrollment change funding procedures, suffer at least two problems. The first concerns timing, and the fact that the funds don't arrive at the campus until long after the additional instructional expenses have been incurred. (For example, 1996-97 enrollment growth won't be funded until 1999-00). The second concerns the per-student adjustment amount, and the fact that the marginal costs approach may be inadequate when growth is very rapid.

   Campuses with declining enrollment have a "timing" problem, too. Current procedures call for negative adjustments to be spread over three years, and by the time the third year comes around, the campus may be growing again. This puts the campus in the difficult position of facing rising costs with declining appropriations. An adjustment to the current methodology will address these concerns.

   - *A 4-year average enrollment (Hoosier FTE) will be calculated, using the most-recent 2 years of actual enrollment data, and 2 years of campus-projected enrollment data. Of the two campus-projected years, the first year estimate will be very accurate because the year will be partially completed when the projection is made. The second year estimate will be more subject to error.*
   - *This 4-year average will be compared with the 4-year average from the previous biennium to calculate increases and decreases.*
   - *By comparing rolling 4-year averages, change will be less volatile and there is less need to phase-in negative adjustments over an extended period of time. Accordingly, all adjustments (positive and negative) will be made in the first year of the biennial budget.*
   - *The enrollment change adjustment amount will be calculated as one-half of the average university operating appropriation per Hoosier FTE. (Under this calculation, the $2,450 adjustment amount used in the 1997-99 budget would have increased to $3,000.)*
   - *When the campus-projected two years of estimated data can be replaced with actual data, 4-year averages will be recalculated so that institutions may reimburse the State for campus-projected students who never materialized and the State may reimburse campuses for added students beyond the campus projections.*
   - *This procedure begins with the 1999-01 budget cycle, but in this first cycle, a special calculation is needed to reflect the transition from the existing formula. Rather than comparing two rolling averages, the first cycle will compare FY96 with the average of (FY97,FY98,FY99,FY00).*

     A biennium later, the phase-in will be complete as AVG(FY97,FY98,FY99,FY00) is compared with AVG(FY99,FY00,FY01,FY02).

Enrollment Change Funding Proposal

Enrollment Change From	Enrollment Change To	Addressed by this General Assembly	Yielding $ in this Biennium
FY94 *actual*	FY96 *actual*	1997	1997-99 *(with 3rd installment on negative adjustments due in FY00)*
FY96 *actual*	Average of (FY97 *actual*, FY98 *actual*, FY99 *base year*, FY00 *estimate)*	1999	1999-01
Average of (FY97 *actual*, FY98 *actual*, FY99 *actual*, FY00 *actual)*	Average of (FY99 *actual*, FY00 *actual*, FY01 *base year*, FY02 *estimate)*	2001	2001-03

Note: Not shown on this page are the one-time payments necessary to correct forecast errors. For example, the 2001 General Assembly's budget for 2001-03 would include a one-time payment (+ or -) to reflect the fact that FY99 and FY00 enrollment data had been estimated two years previously, but would in 2001 be known certain.

2. Enrollment Funding for Stable Campuses

As campuses enroll greater or fewer numbers of Hoosier students, the State responds by adding or subtracting funds to reflect the changing enrollment.

For "stable" campuses, which tend to serve about the same number of students every year, this procedure may be more complicated than necessary. The State makes only modest adjustments to reflect modest changes in enrollment, and over several years the positive and negative adjustments tend to offset each other.

To address these problems for stable campuses, the State and the campuses will agree on expected levels of enrollment, and as long as the enrollments remain within a predefined tolerance level for the last year of actual data, there will be no funding adjustment either up or down.

If growth occurs above the upper end of the bracket, or if losses occur below the lower end of the bracket, a one-time adjustment will reflect the aberration. The adjustment is one-time, not permanent, because there is an expectation that enrollments will quickly return to the bracketed range. If that does not happen, the Commission and the institution will revisit the issue of the appropriate enrollment level for the affected stable campus.

- *"Stable" campuses include IU Bloomington, PU West Lafayette, Indiana State University, and (eventually) Ball State University.*

- *In the 1991-94 period, Ball State University's enrollment was level, and the institution fit the "stable campus" model. Since then, however, enrollment has dropped, and the university anticipates a 4-8 year process of restoring the previous enrollment level. Ball State will be funded as if it were a "Changing Campus" until in-state enrollment reaches 17,500 annual FTE students or eight years, whichever first occurs. This enrollment would be approximately equal to BSU's FY94 level, and slightly below its peak (FY92) level of 17,800 FTE. (The reference to eight years means the 1997-99, 1999-2001, 2001-03, and 2003-05 biennial budgets. BSU will in any case be treated as a stable campus in the 2005-07 biennial budget.)*

- *This policy applies to traditional on-campus enrollment only. It does not apply to extension, off-site, and distance education enrollment. Such enrollment will be considered separately, perhaps under the* Enrollment Funding for Changing Campuses *policy. Examples include ISU's Pepp initiative and BSU's distance education MBA.*

- *In the 1999-01 budget cycle, enrollment growth between FY96 actual and FY98 actual will be funded using the existing procedure, except that any reductions will be phased over two rather than three years.*

- *Beginning with the 2001-03 budget cycle, stable campuses with Hoosier FTE levels within an agreed-upon bracketed range will not receive an enrollment adjustment. The bracketed range will be round numbers, proposed by the stable campuses and agreed upon by the Commission, approximately equal to the 1997-98 Hoosier FTE on-campus enrollment, plus/minus 5%. While 1997-98 Hoosier FTE levels are not known at this writing, representative data follow:*

	1997-98 On-Campus In-State FTE	Bracket = Plus/Minus 5%
IUB	21,500	20,500-22,500
PUWL	22,000	21,000-23,000
ISU	8,500	8,000- 9,000

3. Plant Expansion Funding for New Facilities

As campuses construct new facilities approved by the General Assembly, there is an expectation that when the new facilities are opened, the State will automatically provide "plant expansion" funds to pay for the facility operating expenses.

In its 1997-99 budget recommendation, the Commission signaled its intention to review this policy, and cautioned campuses not to assume the automatic provision of plant expansion funding in the future.

- *Beginning in 1999, when the Commission develops its biennial capital recommendation, it will also indicate for each individual capital project the amount (if any) of recommended future plant expansion funding.*

- *If the General Assembly authorizes a capital project for which the Commission has not made a plant expansion recommendation, the Commission will make its plant expansion recommendation when the plant expansion funds are later requested by the institution.*

- *Requests for 1999-2001 plant expansion funds for capital projects authorized prior to 1999 will be considered in the Commission's 1999-2001 operating budget recommendation.*

4. Debt Service Funding for New Facilities

Historically, Indiana has provided an opportunity for institutions to use *variable rate financing* and *short-term borrowing* as an alternative to traditional long-term fixed-rate financing. When they do so, borrowing at rates below the rates associated with a traditional issue, annual debt service requirements are lower.

In these circumstances, the State Budget Agency has often given institutions approval to receive their full debt service appropriation (as if there were a traditional issue), provided that they use the "excess appropriation" to buy-down principal. This procedure comes at some risk to the institution, because if variable rates later increase above the original traditional rate assumption, the State does not come to the rescue with additional appropriations.

Occasionally, when the State has had special fiscal needs, institutions have been asked to share a portion of the savings with the State, using part of the savings to pay down principal, and returning part of the savings to the State.

The Commission and the institutions will formalize the following policy for the budgetary treatment of debt service appropriations.

- *Debt service appropriations in excess of actual debt service requirements are available to the institutions to be used for (1) paying-down additional principal on state-funded projects and (2) repair and rehabilitation of academic/administrative space, according to the same State review requirements as the General R&R formula appropriation.*

- *At least one-half of an institution's excess debt service appropriation must be used for paying down principal, with the balance available for R&R purposes.*

- *This policy begins with 1997-99 debt service appropriations.*

5. <u>Degree Completion</u>

The current enrollment change formula provides additional state-funding for each additional credit hour of instruction delivered. While this may serve as an incentive to generate credit hours, it does not serve as an incentive toward timely degree completion.

The Commission recommends a financial incentive to increase the number of Hoosier undergraduates earning degrees and to reduce the average amount of time required to do so. The additional funding provided through this incentive will support campus programs intended to make further progress.

- ♦ *For each additional associate or baccalaureate degree recipient, beyond the number of recipients two years earlier, a campus will receive a base adjustment approximately equal to its average expenditure (i.e. appropriation plus tuition-fees) per Hoosier undergraduate.*

- ♦ *The per-degree adjustment amounts will be:*
  $12,000 IU Bloomington, PU West Lafayette, Indiana State, Ball State
  7,500 Other 4-year campuses
  6,000 Two-year campuses

- ♦ *If the number of degrees declines over a 2-year period, funding will be reduced only to the extent that it offsets previous increases attributed to this initiative.*

Degree Completion Performance Funding Example

	1995-96 Hoosier Graduates			*Hypothetical Data* 1997-98 Hoosier Graduates					
	Assoc. Degrees	Bacc. Degrees	Total Degrees	Assoc. Degrees	Bacc. Degrees	Total Degrees	2-Year Change	Adjust Factor	Adjust Total
IU Bloomington	55	3,440	3,495	60	3,500	3,560	65	$12,000	$780,000
IUPU Ft. Wayne	472	742	1,214	500	750	1,250	36	$7,500	$270,000
Ivy Tech State College	2,120	0	2,120	2,200	0	2,200	80	$6,000	$480,000

Note: If funded by the 1999 General Assembly, the then-most-current data will address 1997-98 graduates and the 1995-96 graduates of two-years prior.

6. <u>Enrollment in new Degree Programs</u>

When the State funds a new degree program, students eventually enrolling in that degree program do not generate enrollment change funding until the number of students exceeds the anticipated and previously-funded level. In this way, the State avoids "paying twice" for the same students. But there are two disadvantages: First, a complicated long-term monitoring process is necessary. And second, there is little financial incentive to the institutions to reach the enrollment levels they had anticipated.

Both problems could be eliminated if new programs were funded under the assumption that enrollment change funding would provide some of the necessary revenue. This shifts the burden to the institution, to generate the enrollment to yield enrollment change funding to provide a portion of the necessary revenue for the program.

- *When new academic programs are funded, the amount of funding will be net of the expected contribution from the enrollment change adjustment.*

- *The "watch-list" will be phased-out of the enrollment change funding calculus.*

- *Since stable campuses do not receive enrollment change adjustments, that funding source cannot be assumed to be available for their new academic degree programs. Instead, stable campuses are normally expected to reallocate to their new academic degree programs, the revenue which becomes available from scaling back other degree programs.*

  This expectation is reasonable because stable campuses are not expected to add overall enrollment through new degree programs. Rather, students on stable campuses are expected to migrate from existing degree programs to new programs.

- *There may be occasions when reallocated funds are insufficient to fund a new program. In such cases, the Commission will review the circumstances and may recommend additional funding.*