



Board of Governors

Monday, October 29, 2018

4:00 p.m.

Via conference call

Conference Room A
Administration Building
2986 North Second Street
Harrisburg, PA 17110-1201

Agenda

- Call to order
- Roll Call
- Public Comment
- ACTION: Fiscal Year 2019/20 Appropriation Request
- New business
- Adjourn

NOTE: An executive session may be called as needed.

Board of Governors Meeting
October 29, 2018

SUBJECT: Fiscal Year 2019/20 Appropriation Request (ACTION)

UNIVERSITIES AFFECTED: All

BACKGROUND: Educational and General (E&G) financial projections for fiscal year 2019/20 have been developed to support the ongoing operations of State System universities based upon the most accurate information available. Limited Commonwealth resources, continued increases in System compensation obligations, upcoming collective bargaining negotiations, and constraints on enrollment and price all indicate that the System will continue to face financial challenges for fiscal year 2019/20. The System's financial requirements are provided in the attached *Fiscal Year 2019/20 Educational and General Appropriation Request Overview*.

At its meeting on October 11, 2018, the Board of Governors reviewed the System's expenditure requirements, which were built on university budgets and driven primarily by known and anticipated mandatory cost increases. In addition, the following adjustments have been incorporated in the System's 2019/20 requirements.

- An estimated 2 percent reduction in undergraduate enrollment; net of a 0.2 percent increase in retention.
- An estimated 3 percent tuition rate increase, with a commitment to utilize 75 percent of the increase for need-based financial aid for low- and middle-income students.

The 2019/20 budget projections exclude unknown changes in pay for System employees that may result from future collective bargaining negotiations. (This is not a bargaining position.)

The combined net change in revenue and anticipated mandatory expenditures totals \$37.7 million. It is proposed, as reflected in Table 1 of the attached document, that the State System seek full funding of the remaining budget gap, with an E&G appropriation request of \$505.8 million, an increase of \$37.7 million, or 8 percent. Notwithstanding the aggregate effect of creating a balanced budget, several universities will continue to face significant financial challenges.

MOTION: That the Board of Governors approve a fiscal year 2019/20 E&G appropriation request of \$505.8 million.

Supporting Documents Included: *Draft Fiscal Year 2019/20 Educational and General Appropriation Request Overview*

Other Supporting Documents Available: Materials from October 11, 2018, Board of Governors meeting

Reviewed by: N/A

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**Pennsylvania's State System of Higher Education
Fiscal Year 2019/20 Educational and General Appropriation Request Overview
DRAFT as of October 26, 2018**

Appropriation Request Highlights

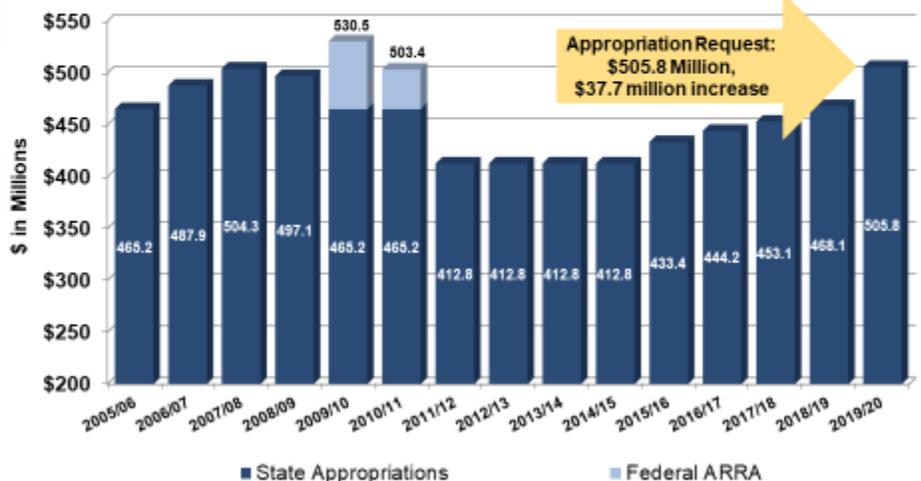
Pennsylvania's State System of Higher Education currently receives \$468.1 million in state appropriations. Over the past four years, the Commonwealth's budget has provided the System with a combined increase in appropriations of \$55.4 million (13 percent in nominal dollars), following six years of reduced or stagnant appropriations. The State System is appreciative of the increased support provided by the General Assembly and Governor Wolf, and acknowledges the continued fiscal challenges facing the Commonwealth.

The System's 2019/20 Educational and General (E&G) appropriation request builds upon the Commonwealth's commitment to increase funding for its state-owned universities, while addressing real affordability constraints experienced by Pennsylvania's low- and middle-income students. As such, this request is built upon a budget that incorporates:

- An estimated 2 percent reduction in undergraduate enrollment, net of a 0.2 percent increase in retention, and the corresponding impact on revenue.
- Anticipated mandatory cost increases, especially in employee pay, healthcare, and pension obligations. (Note: pay components of all collective bargaining agreements end summer 2019; estimates exclude unknown changes in pay for System employees that may result from future collective bargaining negotiations.)
- Understanding the Commonwealth continues to face fiscal challenges and cannot fully fund the System's requirements, a 3 percent tuition rate increase is anticipated. However, to address the affordability issues as evidenced by declining enrollment of low- and middle-income students (with annual family income levels of less than \$110,000), the System will earmark 75 percent of the revenue generated by the tuition rate increase for need-based financial aid.
- An appropriation request of \$505.8 million, an increase of \$37.7 million, or 8 percent. If fully funded, this increase will continue the combined efforts of the Governor and the Legislature to replace lost state funding to the State System, returning to the 2010/11 funding level.

State Appropriations
Historical Trends in Nominal Dollars

If the System's appropriation request of \$505.8 million is fully funded, state support will be fully restored in nominal dollars to the 2010/11 level.



Fiscal Year 2019/20 Educational and General Budget Requirements

In accordance with Act 188 of 1982, the System's appropriation request is based upon university financial requirements as submitted in adherence to specific guidelines. The 2019/20 university budget projections continue to build upon the System's long-standing prudent and strategic use of available resources and provide for limited increases in basic operating costs.

The System's 2019/20 E&G budget reflects the following adjustments, as presented in Table 1, found on page 6.

Enrollment

Preliminary fall 2018 enrollment reflects a decline at all but three System universities due to the compounding impact of reductions in the number of high school graduates and the proportion of those who pursue a higher education, increased admissions standards at several universities designed to improve long-range retention, and the impacts of an unfortunate and damaging narrative about the System's viability. This resulted in an overall reduction of approximately 3,800 full-time equivalent (FTE) students, or 4 percent. Estimates for 2019/20 reflect a further decline of approximately 1,400 FTE students, or 2 percent, net of a 0.2 percent increase in retention. Enrollment stability will be reached in the future as the effects of modern enrollment management strategies, student retention efforts, and improved admissions standards begin to take hold.

Employee Complement

The System has worked diligently in recent years to manage its human resources, filling only essential positions as they become vacant. Continuing to align human and fiscal resources remains a priority. The System is also working closely with its unions to address issues of faculty and staff cost and allocation, initially by engaging at the leadership level for both management and labor in very deliberate and purposeful efforts to address issues of trust, information sharing, and collaboration. An example is evident in this appropriations request—a request on which the leadership of three collective bargaining groups have had an opportunity for review and comment.

Additionally, several universities are in the midst of program realignment and workforce planning, including cross-campus academic programming efforts that promise to address workload and cost issues, while improving utilization of the enormous faculty talent in the System.

2019/20 Anticipated Revenue

Tuition and Fees—The System's 2019/20 estimated tuition and fee revenues include a tuition rate increase of 3 percent, with a commitment to use 75 percent of the new revenue to fund financial aid for low- and middle-income students. Tuition revenue estimates also include an estimated 2 percent projected reduction in undergraduate enrollment throughout the System, changes in the mix of students (e.g., full-time versus part-time, residency, and student level), and continued implementation of pricing pilots and alternative pricing strategies. The result is an increase of \$18.6 million in gross tuition and fee revenue, which will be partially offset by a \$14.3 million increase in student financial aid expenditures, for a net impact of \$4.3 million in added revenue.

State Appropriation—The state appropriation in Table 1 reflects requested funding of the E&G appropriation at \$505.8 million, an increase of \$37.7 million, or 8.1 percent.

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All Other Revenue—Most universities do not anticipate increases and/or continuation of certain miscellaneous revenue sources until these revenues are received. In addition, they limit expenditures supported by these specific revenue streams in their budget estimates.

Planned Use of Carryforward—Typical initiatives funded with Carryforward include implementation of new academic programs, major equipment purchases and upgrades, necessary facilities maintenance and improvements, and transitions through demographic changes. Universities also reflect a Planned Use of Carryforward in 2018/19 as a transitional tool to partially fund ongoing expenses, while implementing multiyear realignments of programs to workforce needs; where this occurs, a similar amount is also reflected in 2019/20. The overall reduced reliance on Carryforward in 2019/20 supports a corresponding anticipated reduction in expenditures through sustainable restructuring and completion of one-time capital projects and academic initiatives.

Anticipated Expenditures

Salaries and Wages—State System universities operate in a competitive environment for faculty and staff. In order to continue to recruit and retain a talented work force, pay increases for all employee groups, consistent with existing collective bargaining agreements, have been addressed in the 2018/19 and 2019/20 estimates. Compensation requirements for 87 percent of System employees are established in eight collective bargaining agreements, all of which are either currently under negotiation, or will be by the end of this fiscal year. At this time, future compensation requirements are unknown for these employees; therefore, as has been the case with respect to prior appropriation requests, 2019/20 budget projections incorporate the residual impact of cost increases that will occur January 2019 for all bargaining units, but exclude unknown future changes in pay for employees. (This is not to be viewed as a bargaining position.)

Compensation for 2019/20 also incorporates an increase of 73 FTE positions; even so, total budgeted complement is projected to be less than last year's (2017/18) total authorized positions. The increase in budgeted positions is mostly associated with the annualization of filling vacancies midyear, as well as limited new faculty and staff positions to support projected enrollment growth, the implementation of 40 new academic majors and 31 certificate programs, student success and retention, and university compliance. Most of these positions have been repurposed based on critical needs analyses that universities conduct when positions are vacated. Increases in employee complement typically are funded by the universities either through enrollment growth or other university revenue sources and do not contribute to the System's overall funding request. These combined changes in compensation requirements and complement generate an estimated increase in employee salaries and wages of \$14.7 million, or 1.7 percent, in 2019/20. These pay adjustments also generate a corresponding fiscal impact on social security and retirement benefit costs.

Employee Benefits—Employee healthcare rates are anticipated to increase similar to national trends and pension rate increases are de minimis. Overall, 2019/20 employee benefits expenditures are expected to increase \$15.4 million, or 3.8 percent.

Approximately half of the System's employees have chosen one of the two primary Commonwealth pension programs—State Employees' Retirement System (SERS) and Public School Employees' Retirement System (PSERS)—as their retirement vehicle. In accordance with Commonwealth budget guidelines, the most common SERS employer

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contribution rate is projected to increase 0.1 percent to 34.68 percent of salaries; PSERS rates are expected to increase 4.1 percent. Retirement rates associated with the alternative retirement programs remain the same, although retirement and social security costs increase as salaries and wages increase. The combined fiscal impact of pension rate changes alone will cost the System an additional \$0.6 million in 2019/20; total retirement costs are expected to increase \$2.9 million, or 2.0 percent.

Of those employees who receive health benefits, approximately 65 percent are enrolled in the System's healthcare program. The employer share of healthcare rates for active and annuitant employees within the System-managed programs is projected to increase an average of 5.5 percent next year for employees and retirees, based upon a combination of national trends, the System's healthcare experience, participation in the wellness program, and the anticipated change in complement. The remaining 35 percent of System employees receive healthcare through the Pennsylvania Employees Benefit Trust Fund (PEBTF). The Commonwealth budget guidelines include a 6.0 percent increase in the 2019/20 employer contribution rates for employees, and contribution rates for the Commonwealth's retiree healthcare program are projected to remain at the same level as 2018/19. Combined healthcare costs are anticipated to increase \$11.1 million, or 6.3 percent.

Student Financial Aid—In April 2014, the Board of Governors amended Policy 1996-01-A: *Sources of Funding for University Scholarships*, to allow councils of trustees to establish institutional scholarship programs with limited E&G revenue. Given the growing emphasis on affordability, retention, enrollment management, and the net price to the student, E&G expenditures for student financial aid are reflected as a separate category in the budget summary. Significant growth in the use of institutional unrestricted resources for student aid has occurred each year since, corresponding with the flexibility provided by Board policy and efforts to ensure affordability. E&G student aid expenditures in 2019/20 are expected to grow an additional \$14.3 million, or 24.0 percent, to \$73.9 million, as the State System is committed to improving affordability for low- and middle-income students.

All Other Basic Operating Expenditures—Given the current fiscal environment, universities continue to limit nonmandatory spending and seek further efficiencies through strategic sourcing. Therefore, anticipated expenditures for all other services, supplies, and materials are projected to decrease \$5.0 million, or 1.8 percent.

The System's 2019/20 utilities costs are projected to increase \$0.9 million, or 2.9 percent, to address anticipated rate adjustments. Rate increases are partially offset by energy conservation efforts derived, in part, through the use of energy savings contracts and some universities converting to more efficient energy sources. In total, expenditures on services, supplies, institutional aid for students, and utilities are estimated to increase \$10.2 million, or 2.8 percent.

Capital Expenditures and Transfers—Capital expenditures and transfers, which primarily represent each university's investment in its physical resources from the E&G budget, are projected to remain relatively stable from a System-wide perspective, although activity varies significantly by university. In total, capital expenditures and transfers reflect a decrease of \$1.7 million, or 2.6 percent.

As described above, the System's anticipated 2019/20 expenditure requirements are driven primarily by known and anticipated mandatory cost increases in salaries and employee benefits costs. Assuming no change in the System's E&G appropriation and excluding any impact of

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future collective bargaining agreements, the System's budget estimates result in a 2019/20 requirement of an additional \$37.7 million.

E&G Appropriation Recommendation

Additional support from the Commonwealth is critical to the continued success of Pennsylvania's public universities and the students they serve. A \$37.7 million increase in the State System's E&G appropriation would ensure continued access to and affordability of a high quality education for the citizens of this Commonwealth. As indicated above, full funding at this level, combined with an anticipated nominal tuition rate increase, allows the Board of Governors to:

- Increase funding for need-based financial aid by more than \$14 million, a 24 percent increase, for students from Pennsylvania's low- and middle-income families, to mitigate the impact of tuition increases and improve affordability.
- Enable investment in innovative academic programs and student retention that are vital to the System's long-term success.
- Continue to align the System's capacity with its enrollment levels.
- Provide the breathing space the System needs to redesign itself—driving quality, accelerating the pace of the universities' programmatic differentiation, and fundamentally changing cost structures.

The requested appropriation of \$505.8 million, combined with other projected changes in the System's revenue and anticipated mandatory expenditures, results in a balanced E&G budget of \$1.73 billion. Notwithstanding the aggregate effect of creating a balanced budget, several universities will continue to face significant financial challenges. Although a tuition rate increase has been incorporated into these projections, along with 75 percent of the revenue generated by that increase being used for need-based student financial aid, tuition rates for 2019/20 will not be addressed by the Board of Governors until spring 2019.

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Table 1
Pennsylvania's State System of Higher Education
Fiscal Year 2019/20 Educational and General Budget Requirements
As of October 26, 2018

(\$ in Millions)						
Revenue/Sources	Actual FY 2017/18	Projected FY 2018/19	Percent Change	Projected FY 2019/20	Dollar Change	Percent Change
Tuition	\$878.1	\$878.7	0.1%	\$895.7	\$17.0	1.9%
Fees	209.0	211.9	1.4%	213.5	\$1.6	0.8%
State Appropriation	453.1	468.1	3.3%	505.8	\$37.7	8.1%
All Other Revenue	99.8	96.1	-3.7%	91.3	(\$4.9)	-5.1%
Planned Use of Carryforward	12.4	33.7	171.8%	20.9	(\$12.8)	-38.1%
Total Revenue/Sources	\$1,652.4	\$1,688.5	2.2%	\$1,727.2	\$38.7	2.3%
Expenditures and Transfers						
Compensation Summary:						
Salaries and Wages	\$818.1	\$847.3	3.6%	\$862.0	\$14.7	1.7%
Benefits	393.8	411.2	4.4%	426.6	15.4	3.8%
Subtotal, Compensation	\$1,211.9	\$1,258.5	3.8%	\$1,288.6	\$30.2	2.4%
Student Financial Aid	56.7	59.5	5.0%	73.9	14.3	24.0%
Utilities	29.4	30.3	3.0%	31.1	0.9	2.9%
Other Services and Supplies	260.2	275.5	5.9%	270.5	(5.0)	-1.8%
Subtotal, All Services and Supplies	\$346.3	\$365.3		\$375.5	\$10.2	
Capital Expenditures and Transfers	89.2	64.8	-27.4%	63.0	(1.7)	-2.6%
Total Expenditures and Transfers	\$1,647.4	\$1,688.5	2.5%	\$1,727.2	\$38.7	2.3%
Revenue/Sources Less Expenditures/Transfers	\$5.0	\$0.0		\$0.0		
Annualized FTE Enrollment						
Annualized FTE Enrollment	Actual FY 2017/18	Projected FY 2018/19	Percent Change	Projected FY 2019/20	Change	Percent Change
In-State Undergraduate	73,426.11	70,296.11	-4.3%	68,769.01	(1,527.11)	-2.2%
Out-of-State Undergraduate	9,253.37	8,672.04	-6.3%	8,627.53	(44.51)	-0.5%
In-State Graduate	9,120.81	9,002.88	-1.3%	9,167.81	164.93	1.8%
Out-of-State Graduate	2,440.65	2,451.67	0.5%	2,451.88	0.21	0.0%
Total FTE Enrollment	94,240.94	90,422.71	-4.1%	89,016.23	(1,406.48)	-1.6%
E&G FTE of Budgeted Positions						
E&G FTE of Budgeted Positions	Approved FY 2017/18	Projected FY 2018/19	Change	Projected FY 2019/20	Change	Percent Change
Faculty	5,267.28	5,190.53	(76.75)	5,225.20	34.67	0.7%
AFSCME	3,008.57	2,984.46	(24.12)	2,993.77	9.32	0.3%
Nonrepresented	1,463.90	1,480.52	16.61	1,503.44	22.93	1.5%
SCUPA	540.53	566.06	25.53	571.34	5.28	0.9%
All Other	633.39	632.33	(1.06)	632.17	(0.16)	0.0%
Total FTE of Budgeted Positions	10,913.68	10,853.89	(59.79)	10,925.92	72.03	0.7%

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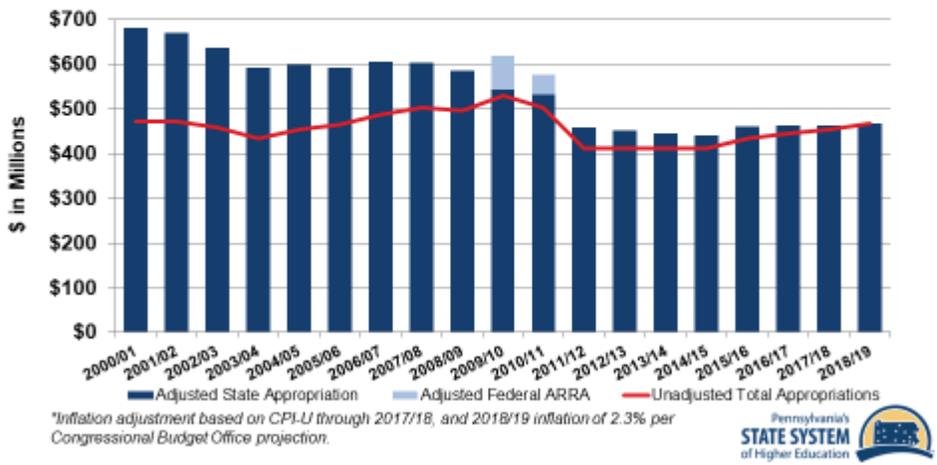
**Appendix:
Historical Context**

Today's appropriations for the State System are similar to the nominal funding level the System received in 2000/01—while serving a similar number of students. This represents a reduction in inflation-adjusted dollars of more than \$200 million, or 31 percent. Taking into account cost increases (e.g., in salaries and benefits, and utilities), the total funding gap the System has been required to fill in this period is estimated at over \$900 million, of which almost 55 percent (approximately \$500 million) has been made up through tuition and fee increases.

The continued employment of cost savings strategies by the System universities has been essential, as mandatory expenditure requirements eclipse available revenue each year. The chart below reflects the annual reality of combined funding from the Commonwealth (blue), funding from students through tuition and fee rate increases (gold), and university cuts (red). Universities have eliminated more than \$400 million in base budget costs since 2000, through aggressive management of their physical, financial, and human resources.

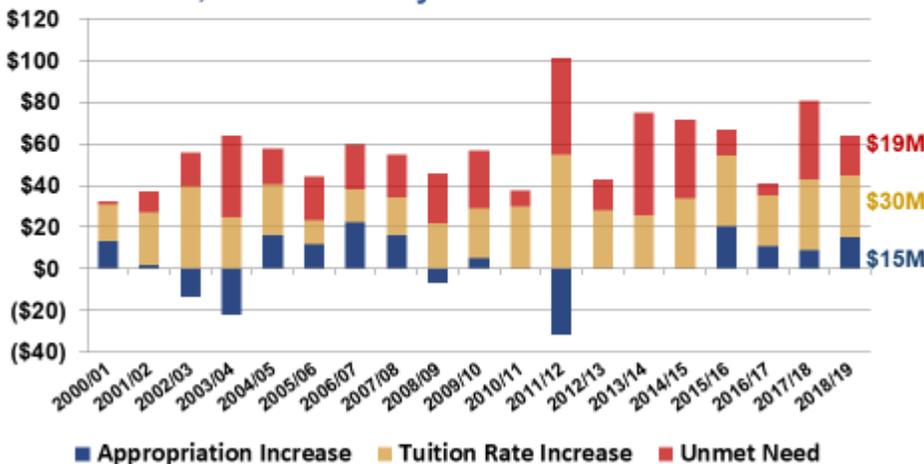
Constraints: State Appropriations

- Nominal dollars—Current state funding is at 2000/01 levels
- Inflation-adjusted—Current state funding down \$200 million (31%)



E&G Budget Request vs. Funding
Nominal Dollars in Millions

Every year, the System's financial requirements are met by a combination of change in state funding, change in price to students, and university cuts.



The gap has been filled through workforce reductions (the System has approximately 1,100 fewer permanent employees today than in fall 2009, resulting from a combination of retirements, voluntary separations, and furloughs), suspension or elimination of academic programs (over 400 academic programs have been discontinued or eliminated since 2009), streamlining of basic operations, and efficiency

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gains including those achieved through shared services both at the System level and between individual universities.

The universities have also leaned heavily on innovation, in particular through the use of technology (including online learning), and the introduction of new programs that align directly with regional workforce demands, the majority of which are proving to be as attractive to students as they are important to regional employers.

In addition to new academic offerings, universities also continually reinvest existing resources into strategic enrollment management, student success and affordability, campus-wide technology upgrades, and academic facilities renovation. These efforts are essential to ensure the continued alignment of academic programs with workforce needs while attracting, retaining, and graduating students of diverse backgrounds, serving them through various delivery modalities and student-focused learning.

The net result is a System that is achieving a size and shape more accurately reflecting student and employer demands and whose universities are becoming ever more differentiated in ways that reflect the distinctive needs of the communities and students they serve. More importantly, it continues to deliver enormous value to its students and to the Commonwealth.

- In 2017/18, the System graduated almost 25,000 students, continuing to be the largest degree producer in the state; these degrees were among the most affordable from anywhere in the Commonwealth.
- The majority of university graduates go on to fill jobs in the state's highest demand areas for skilled workers—business, healthcare, education, and STEM—and the cost of their education is returned in the form of salaries that are significantly higher on average than those available to people with a high school degree or some college but no college degree.
- Faculty at System universities routinely integrate “high-impact” instructional practices that have proven efficacy in developing the soft 21st century skills—critical thinking, communication, team work—that employers need and expect.
- Satisfaction with the overall quality of education provided remains above 80 percent, based on the System's survey of recent graduates. Employers surveyed identified critical thinking and problem-solving skills as the most highly sought after skills of graduates. Over 87 percent of the System graduates surveyed indicated they are confident in their critical thinking and problem-solving abilities.

These successes in the midst of financial challenges have not come without significant cost to the System and its students, and ultimately to the Commonwealth. Recent data on enrollments suggest that the System is at or near the limit on tuition increases for the low- and middle-income Pennsylvania students whom the System has historically served—students with annual family incomes of less than \$110,000. Pennsylvania must educate these students to the postsecondary level if it is to meet its projected workforce needs. Efforts to retain students (an important means of growing enrollments and producing graduates) are hampered by the cutbacks that universities have had to make, including in student support services.

At the same time, enrollments continue to decline at most System universities, further threatening quality outcomes, financial health, and service to the Commonwealth and its families. Some of this decline is natural, as it reflects the continued downward trend of the size of Pennsylvania's high school graduate population and efforts made at several System

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universities to raise admissions standards as a means of improving student retention and success. However, a good portion of that decline may have been avoidable. Some may have resulted from negative reports to the public about the System's fragility, including the use of casual, even insensitive, terms regarding closure and consolidation at a time when students and their families were deciding between university admissions offers.

The net result of these trends chips away at the System's ability to serve the state by offering all students a high quality affordable postsecondary education that is aligned with middle- and high-skilled jobs, which are projected to grow from 3.2 million in 2016 to 3.4 million in 2026. Realizing that the System was at a watershed moment, officials embarked on an aggressive redesign plan by improving its capability for strategic planning and implementation, strategic finance, transparency and accountability; re-engineering processes and policies that stand in the way of being nimble; and extending shared services to further enable universities to collaborate with one another—not just in the delivery of back-office functions such as procurement, but in core areas of academic programming and student support services. Pushing in all of these directions, hard, at once, deliberately, the System is not only being redesigned, but it is reimagining 21st century public higher education; positioning Pennsylvania's State System of Higher Education to accelerate the pace of its universities' programmatic differentiation while fundamentally changing their cost structures, yet maintaining high quality programs and experiences.

This appropriations request of \$505.8 million seeks a level of support that will enable the System to:

- Increase funding for need-based financial aid by more than \$14 million, a 24 percent increase, for Pennsylvania's students from low- and middle-income families, to mitigate the impact of tuition increases and improve affordability.
- Reduce the need to make further cuts, allowing for more investment in innovative academic programs and student retention—investments that are vital to long-range success.
- Continue to align human resources with enrollment levels.
- Focus more energies on and deliver a fundamental System redesign.