The Liberal Arts College Financial Model

Michael T. Orr
Lake Forest College
Topics for Discussion

• Overview of expenses and revenues
• Tuition revenue and the discount rate
• Endowment fundamentals
• Financial equilibrium
ACM Institutions

• Relatively simple operating model
• Three principal expense categories
• Four major sources of revenue
• The biggest expense category is largely fixed
• The most important revenue stream is subject to volatility
• Variations will upset balance between revenues and expenses
Contrast to Other Institutions

- Size of student body
- Multiple locations
- State appropriations
- Athletics
- Medical school, law school
- Services & auxiliary enterprises
Variations within the ACM

• Student FTE
• Endowment
• Auxiliary revenue
• Annual fund gifts
• Capital investment and debt load
FTE Fall Enrollment, Fall 2013
(Source: IPEDS)
Endowment Market Value per FTE Student
June 30, 2014

Source: NACUBO Commonfund/IPEDS
* No data provided by Ripon and Beloit for 2015 NACUBO Commonfund Endowment Study
Expenses: Compensation

• Employee Compensation
  ➢ Faculty and staff salaries
  ➢ Student wages
  ➢ Benefits
  ➢ Taxes

• Number of faculty & staff

• Full-time/part-time
Expenses: Program Expenses

Department budgets
  • Academic
  • Student services
  • Administration

Utilities

Institutional expenses
  • Insurance
  • Food service

Off-campus programs
Expenses: Debt & Capital

Debt Service
- Long term debt
- Interest

Capital
- Maintenance and repairs to physical plant
- Capital improvements
- Equipment and technology
Expenses for a typical college

- Employee Compensation: 64%
- Program Expenses: 26%
- Debt & capital: 10%
One-Time Expenditures vs. Base Budget

• “Why did ‘they’ spend $__ on campus repairs when it’s more important to increase faculty/staff compensation?”

• Compensation is a recurring expense. Unless you are willing to impose pay cuts or eliminate positions, once you allocate funds to compensation, those dollars are “baked” into the budget.

• Repairs and capital investments are one-time expenditures.
Comparison of revenue distribution

Example 1
- Net Student Revenue: 77%
- Gifts: 10%
- Other: 6%
- 7%

Example 2
- Net Student Revenue: 57%
- Endowment: 35%
- Other: 6%
- 2%
Student Revenue

• Tuition, room and board fees

• Impacted by
  ➢ Number of students
  ➢ Type of students
    o Undergraduate degree seeking (F/T & P/T)
    o Non-degree seeking (Special status, P/T, audit)
    o Graduate (F/T & P/T)
  ➢ Price of tuition, room & board ("sticker price")
  ➢ Financial aid (aka “the discount rate”)
Some Key Definitions

• Gross Tuition
  ➢ The tuition “sticker” price charged to attend the institution

• Discount
  ➢ The amount that the “sticker” price is reduced by the institution

• Net Tuition
  ➢ The actual dollars received as revenue and available to pay the bills
Some Key Definitions

- **Financial Aid**
  - Institutional gift aid (“discount”)
  - Federal, state and private grants and scholarships
  - Student & parent loans
  - Work study
Institutional Gift Aid

• Two principal forms:
  - Need-based grants (FAFSA; EFC)
  - Merit scholarships (No athletic scholarships in Div. III)
Financial Aid & the Discount Rate

**Impacts Discount Rate**
- Funded Scholarships (Endowment & Gift income)
- Unfunded Institutional Scholarships & Grants

**Does not Impact Discount Rate**
- Federal, State, and Private Grants & Scholarships
- Student Loans (Perkins, Stafford, Parent PLUS, & Private)
- Student Employment
Calculating Net Tuition & the Discount Rate

- Gross Tuition Revenue – Discount = Net Tuition

<table>
<thead>
<tr>
<th></th>
<th>Example 1</th>
<th>Example 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross Tuition (“Sticker price”)</td>
<td>$40,000</td>
<td>$32,000</td>
</tr>
<tr>
<td>Discount</td>
<td>$22,000</td>
<td>$14,000</td>
</tr>
<tr>
<td>Net Tuition (Amount student pays)</td>
<td>$18,000</td>
<td>$18,000</td>
</tr>
<tr>
<td>Discount Rate (Discount/Sticker price)</td>
<td>55%</td>
<td>44%</td>
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Enrollment Management: A Balancing Act

• Enroll a class of students that meets institutional aspirations
  ➢ Academic quality
  ➢ Diversity
  ➢ Athletics, music programs, academic programs
• Enroll the desired number of students
• Generate sufficient net tuition revenue
Other Revenue & Gifts

Other Revenue

• Summer programs & conferences
• Facility rental
• Bookstore
• External grants

Gifts

• Gifts to the Annual Fund
• Restricted vs. unrestricted
• Alumni participation rate
Endowment Fundamentals

• Preserve the corpus
  ➢ Assets held in perpetuity

• Comply with donors’ wishes
  ➢ Restricted funds vs. unrestricted funds

• Safeguard endowment purchasing power
Endowment Revenue

• Distribution impacted by
  - Rate of return on investments in endowment
  - New gifts to the endowment
  - Distribution formula
    - Moving average (e.g. 5% of the trailing 12 quarter moving average)
    - Alternative approaches: Inflation-based or hybrid
  - Spending policy
Endowment Distribution Growth

• GOAL: Investment return that will fund the endowment draw AND provide sufficient additional earnings to protect the corpus against inflation

• Example:
  - Anticipate >7.5% investment return
  - 5% endowment draw
  - 2.5% growth in endowment spending for operations

• But is this realistic?
  - 6% total return?
Key Financial Drivers

• Net tuition revenue per student
• Rate of increase of compensation
• Endowment market returns
• Annual fund gifts
• Capital investment and debt load
Financial Equilibrium

- Balanced budget
- Ongoing investment in human capital
- Preservation of physical assets
- Maintenance of endowment purchasing power