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

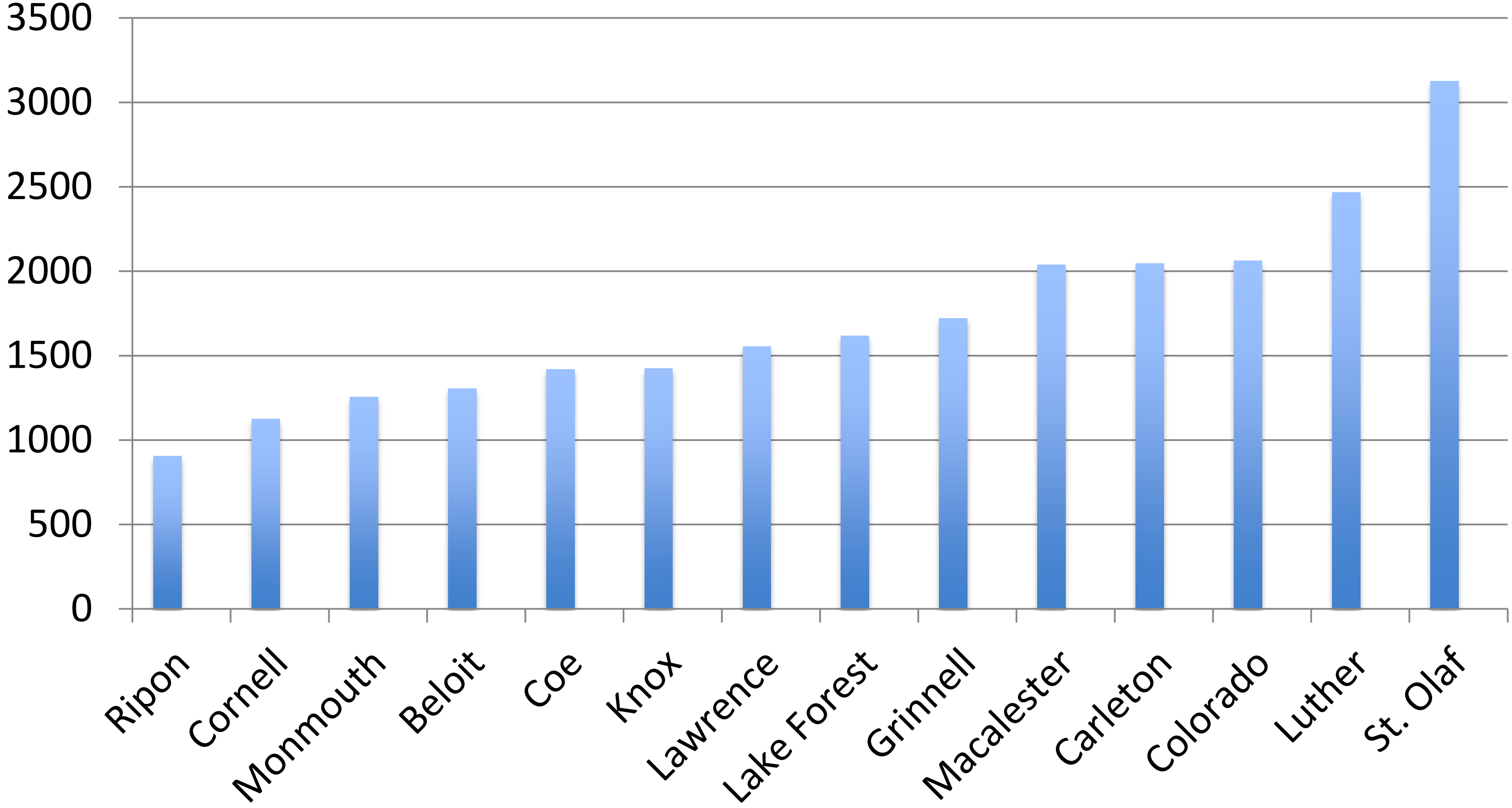
- Size of student body
- Multiple locations
- State appropriations
- Athletics
- Medical school, law school
- Services & auxiliary enterprises

Variations within the ACM

- Student FTE
- Endowment
- Auxiliary revenue
- Annual fund gifts
- Capital investment and debt load

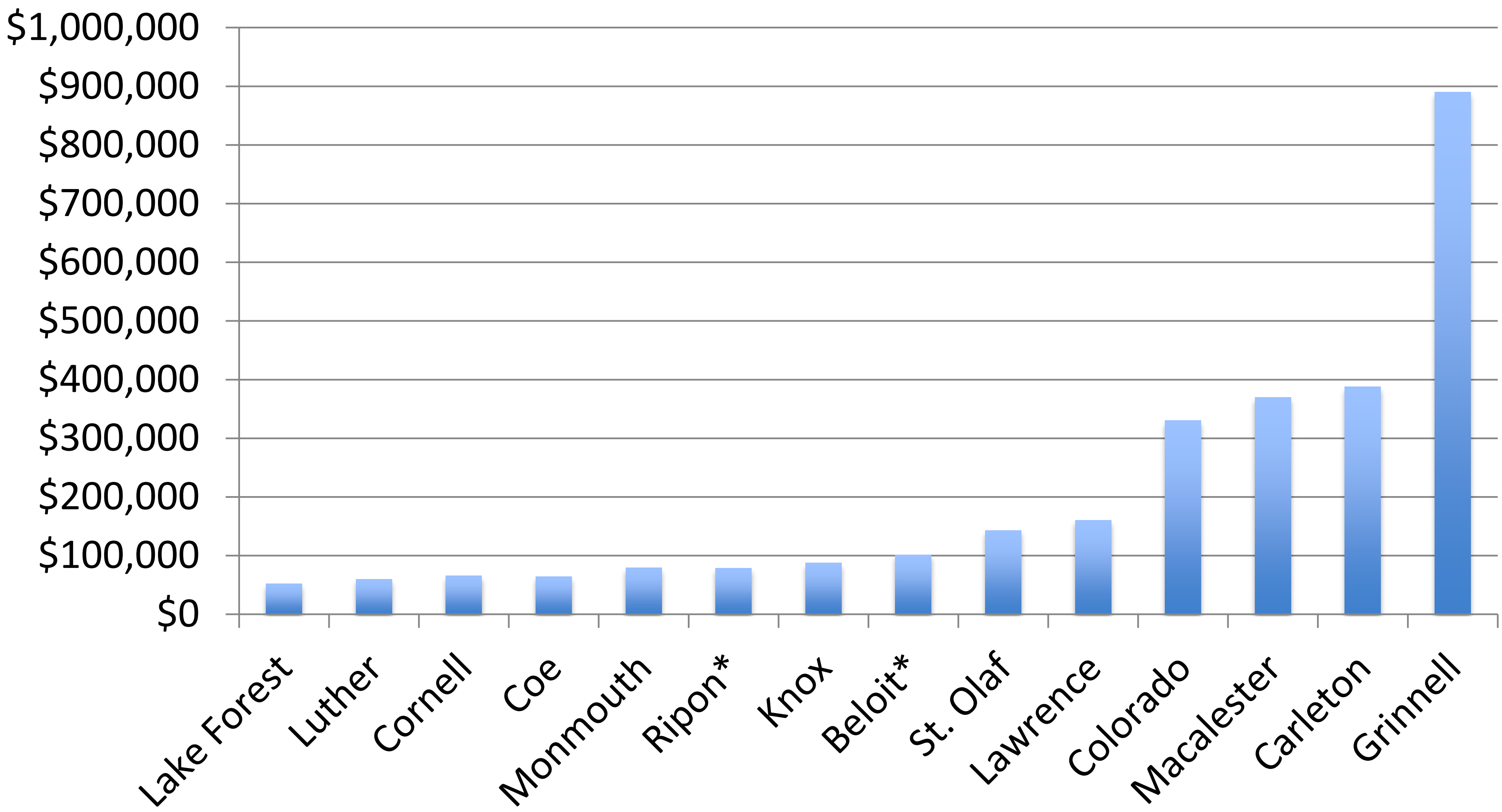
FTE Fall Enrollment, Fall 2013

(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

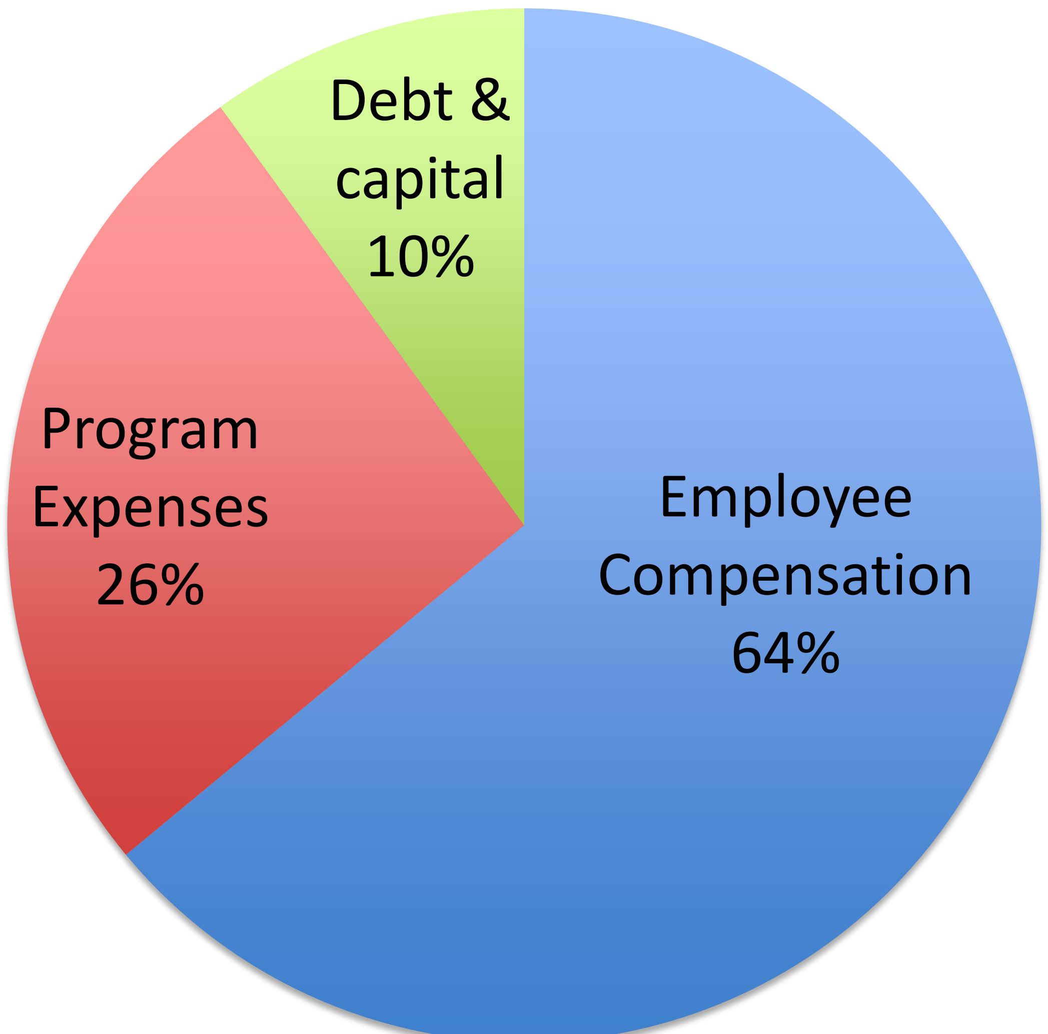
Debt Service

- Long term debt
- Interest

Capital

- Maintenance and repairs to physical plant
- Capital improvements
- Equipment and technology

Expenses for a typical college

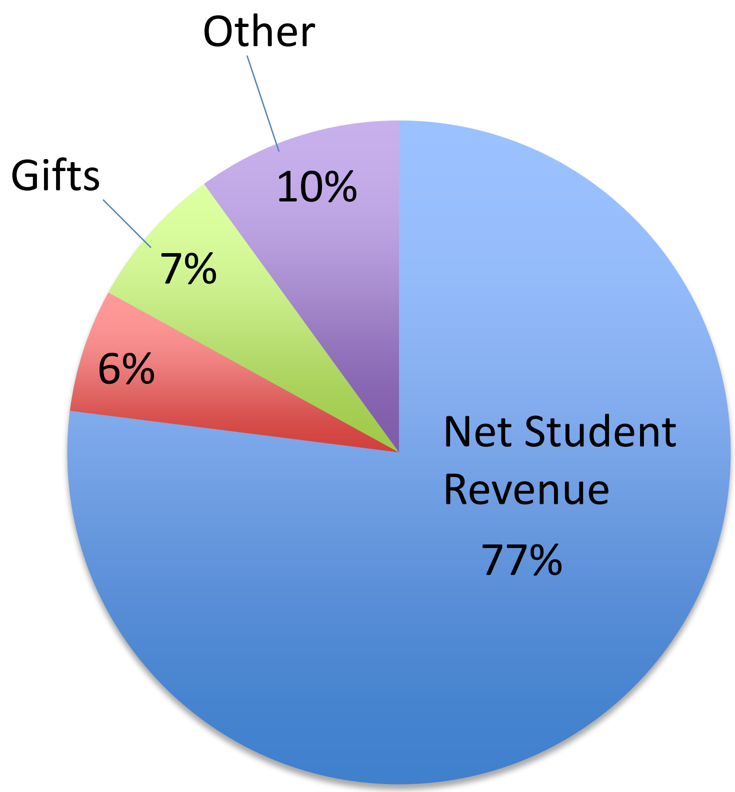


One-Time Expenditures vs. Base Budget

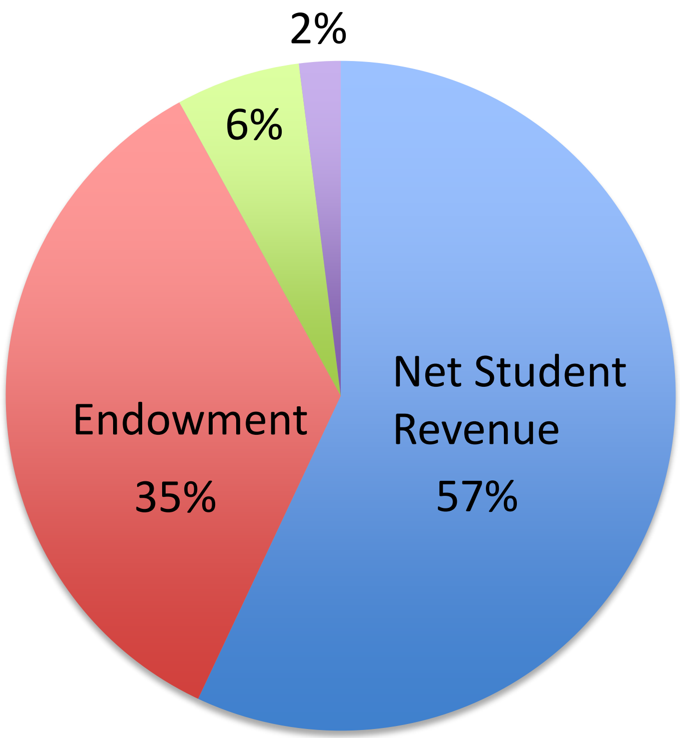
- "Why did 'they' spend $__ on campus repairs when it's more important to increase faculty/staff compensation?"

- 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



Example 2

Student Revenue

- Tuition, room and board fees
- Impacted by
  - Number of students
  - Type of students
    - Undergraduate degree seeking (F/T & P/T)
    - Non-degree seeking (Special status, P/T, audit)
    - 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

Institutional Gift Aid

- Funded Scholarships (Endowment & Gift income)
- Unfunded Institutional Scholarships & Grants

Does not Impact Discount Rate

Other Aid

- 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

	Example 1	Example 2
Gross Tuition (“Sticker price”)	$40,000	$32,000
Discount	$22,000	$14,000
Net Tuition (Amount student pays)	**$18,000**	**$18,000**
Discount Rate (Discount/Sticker price)	55%	44%

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