Institute on College Futures

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Goals for Session

- The basic financial/operating model
- Revenues and Expenses
- Projecting growth and "the slope of the line"
- The dynamics of our financial model

What we're NOT going to cover

- Types of budget (operating, capital, restricted)
- Different approaches to budgeting (incremental, zero-based, RCB, formula-based, etc.)
- Fund accounting
- Financial statements (balance sheet, statement of activities, cash flow)
- Ratio analysis (CFI, Primary reserve, viability ratio, etc.)

College Finances 101

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

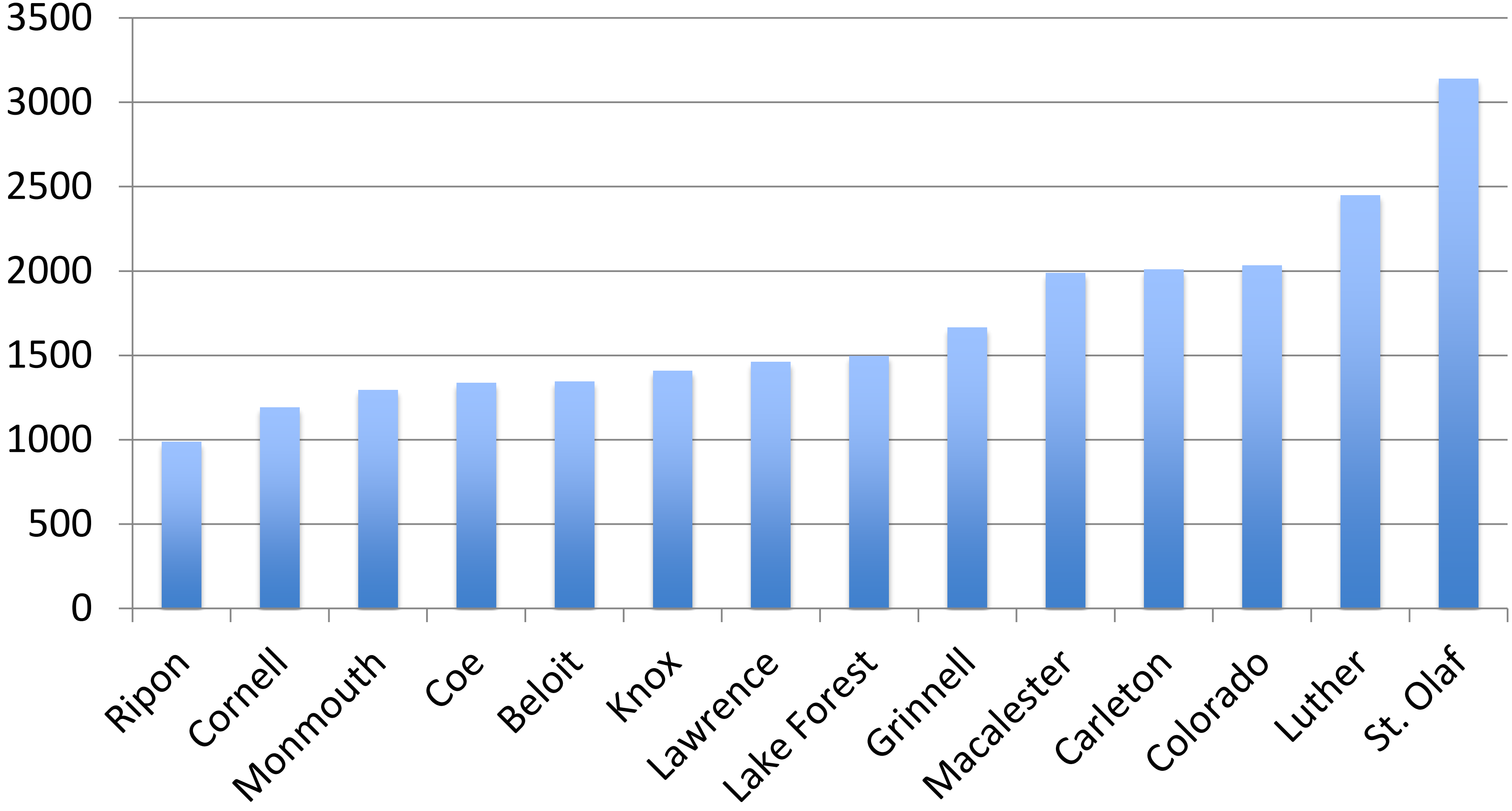
- Size (ACM vs. Penn State)
- Multiple locations
- State appropriations
- Athletics
- Medical school, law school
- Services & auxiliary enterprises

Variations within the ACM

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

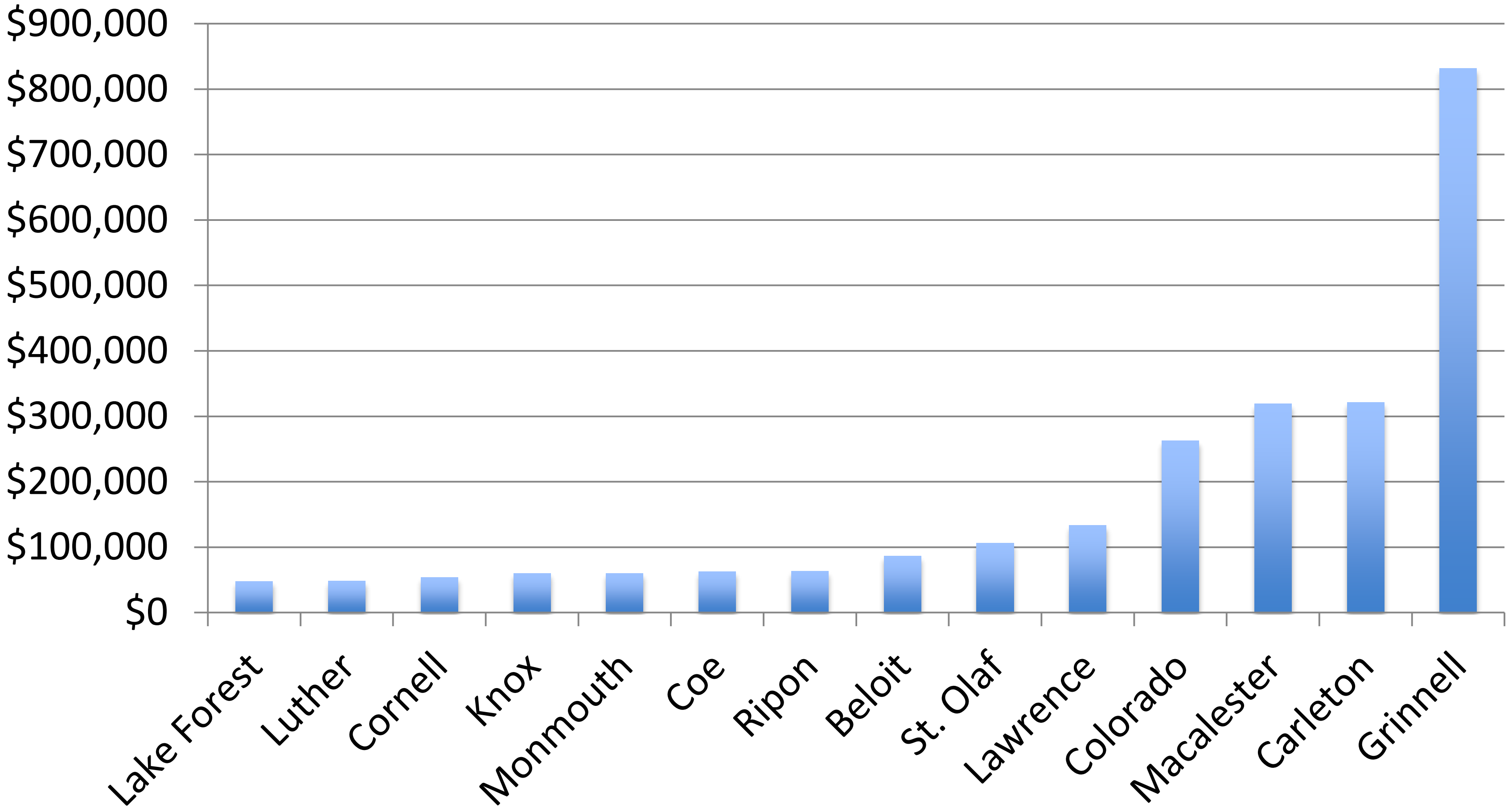
FTE Fall Enrollment, Fall 2011

(Source: IPEDS)

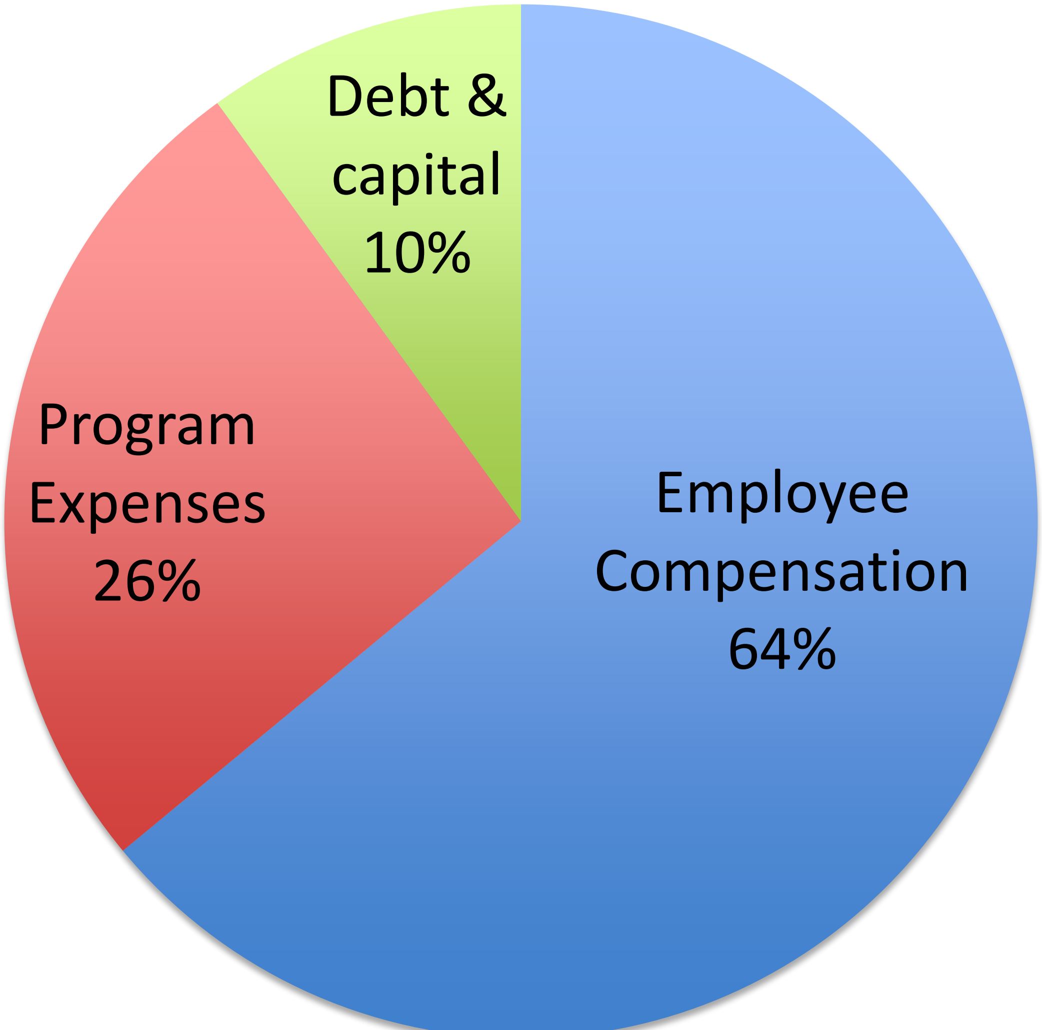


Endowment Market Value per FTE Student

June 30, 2012



Expenses for a typical college



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

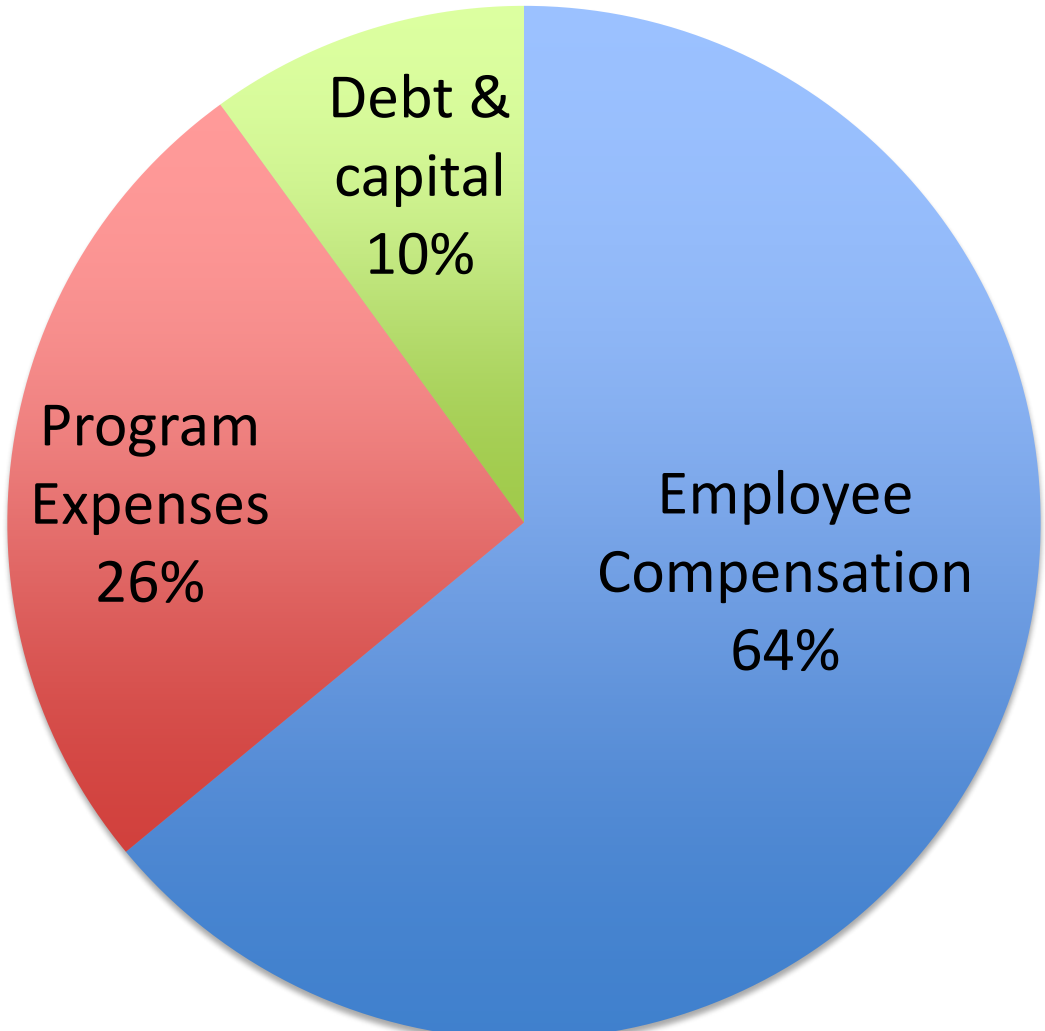
Debt Service

- Long term debt
- Interest

Capital

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

Expenses for a typical college

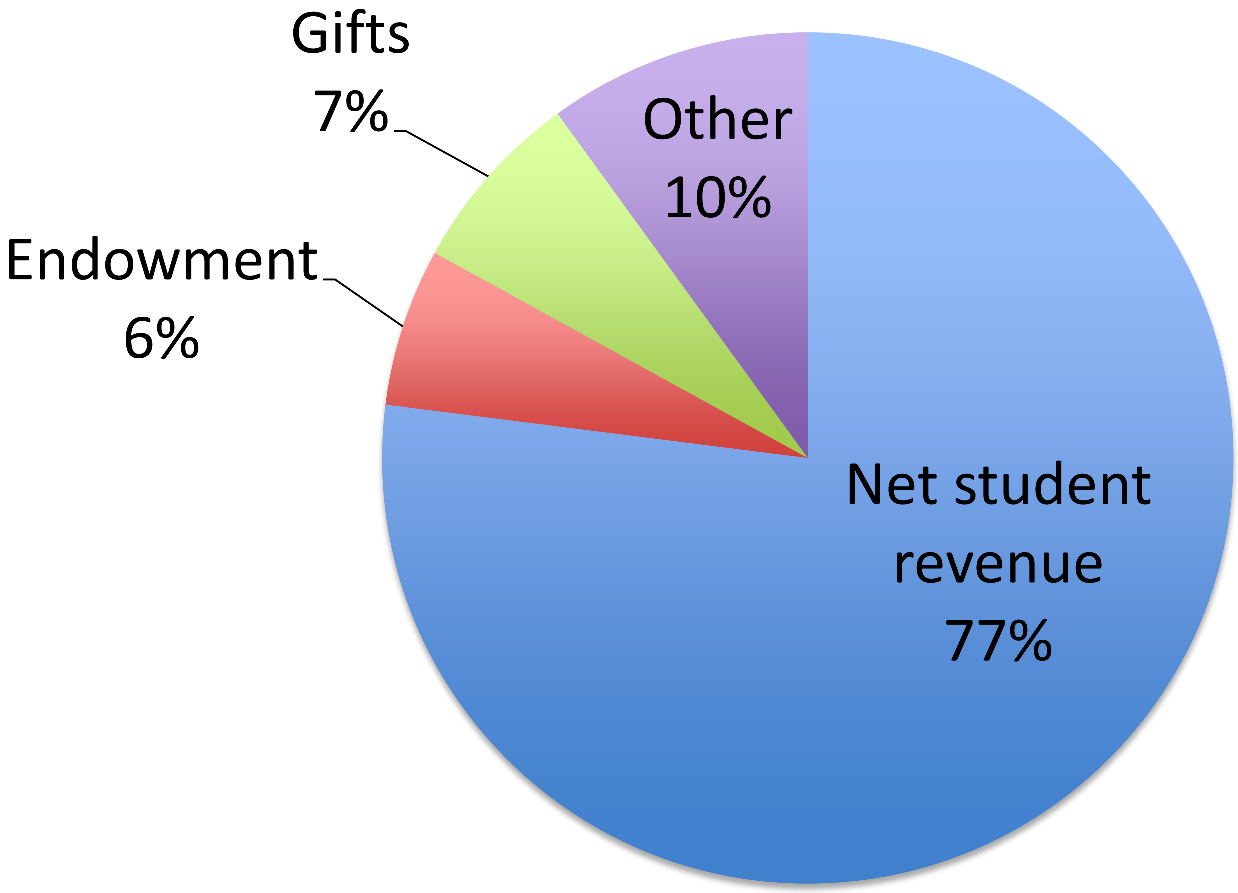


One-Time Expenditures vs. Base Budget

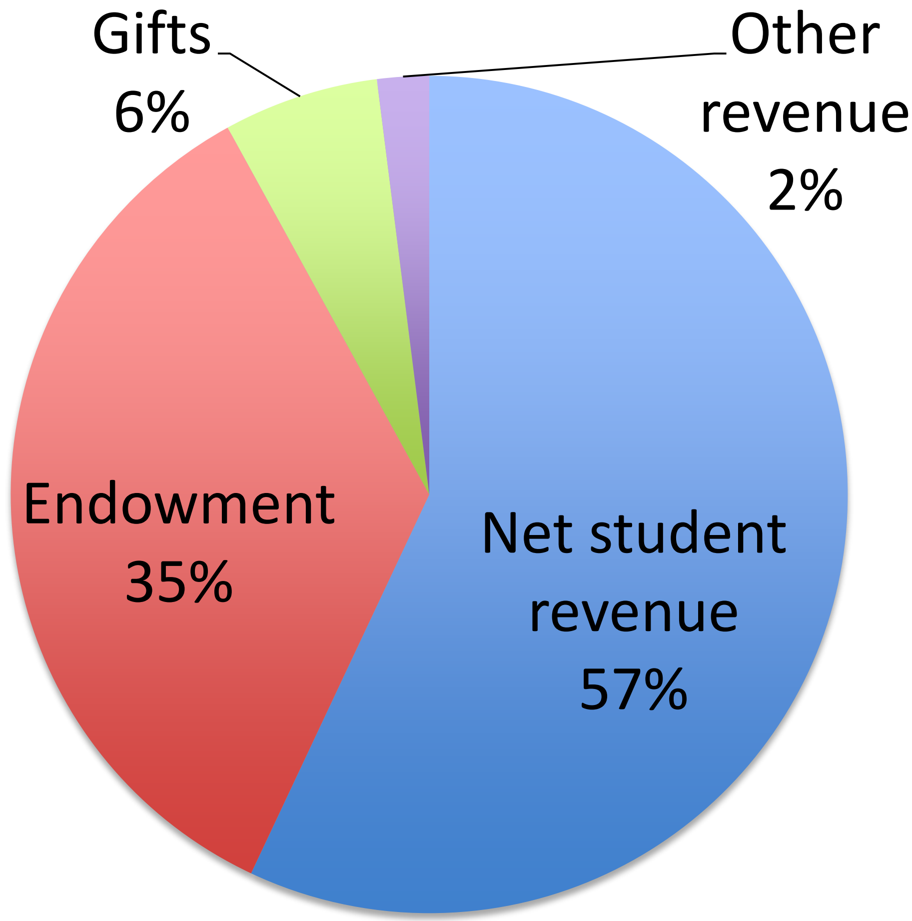
- “Why did ‘they’ spend $__ on campus repairs when it’s more important to increase faculty/staff compensation?”

- 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.

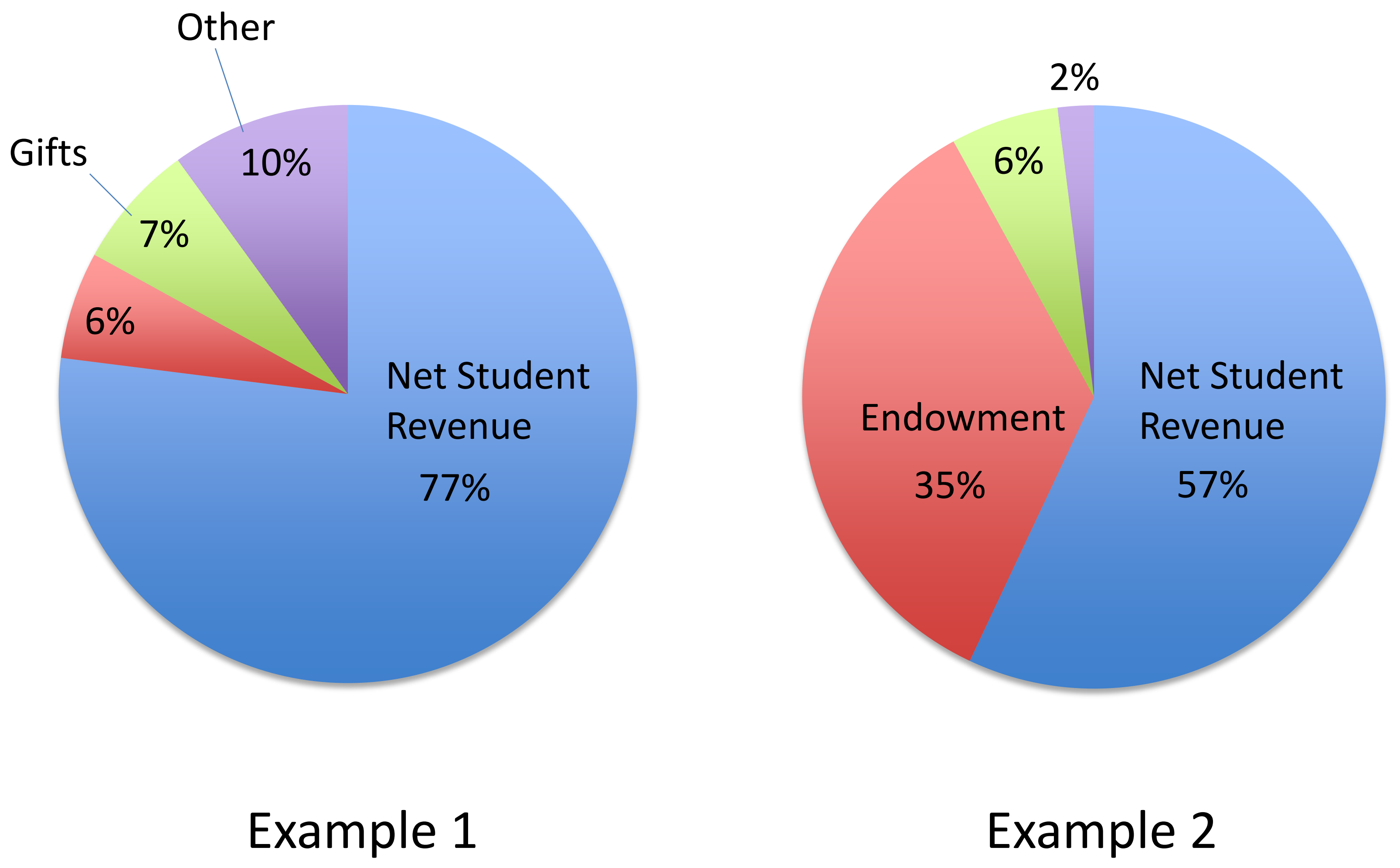
Revenues: Example 1



Revenues: Example 2



Comparison of revenue distribution



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

- Comprehensive Fee
  - Gross tuition
  - Room charge
  - Board plan
  - Student activity fee

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

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)
- Institutions typically fund institutional gift aid from two sources
  - Endowment distribution and gifts (designated student scholarships)
  - Revenue that the institution forgoes as an unfunded discount.

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

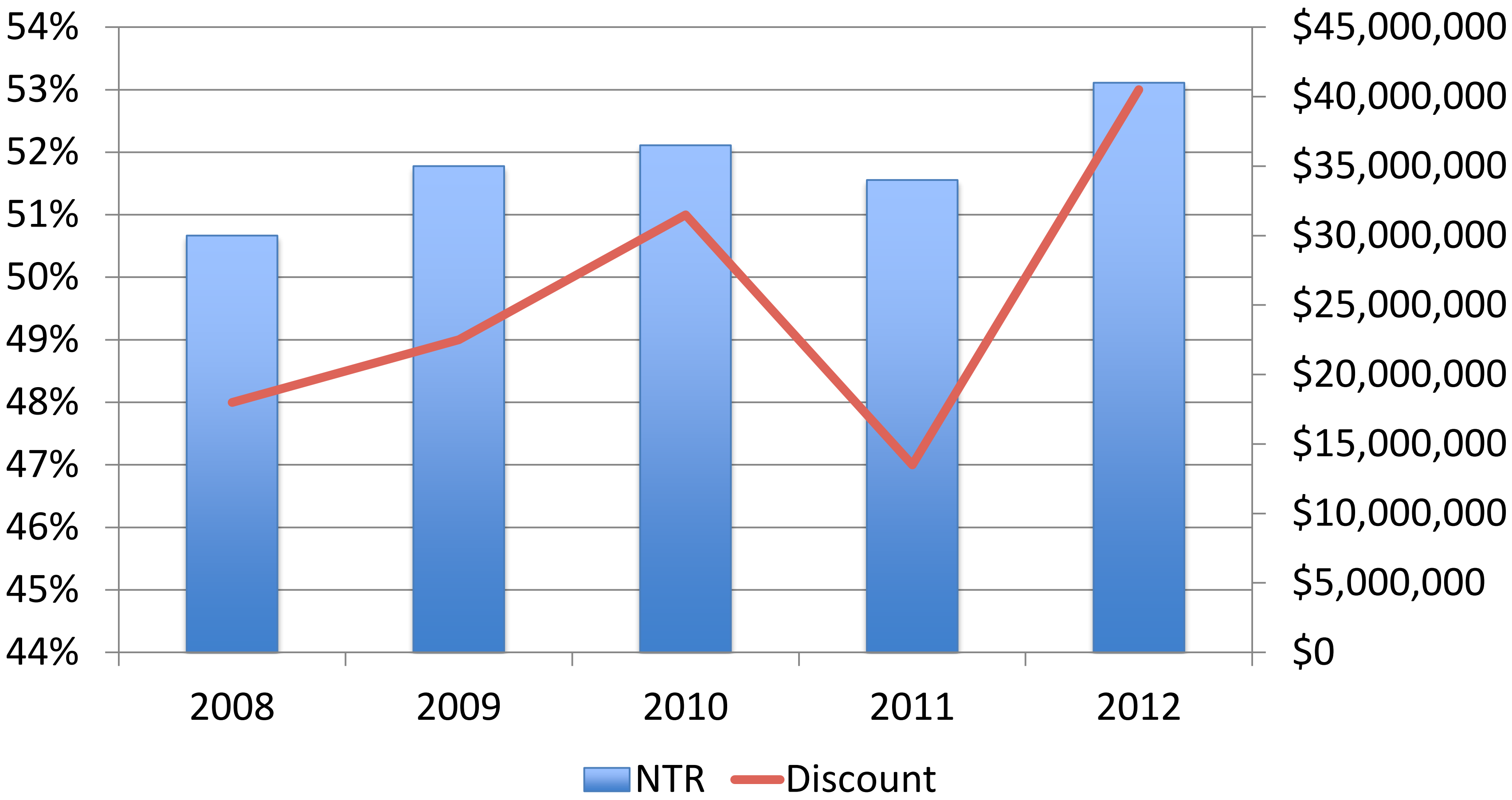
- Federal, State, and Private Grants & Scholarships
- Student Loans (Perkins, Stafford, Parent PLUS, & Private)
- Student Employment

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%

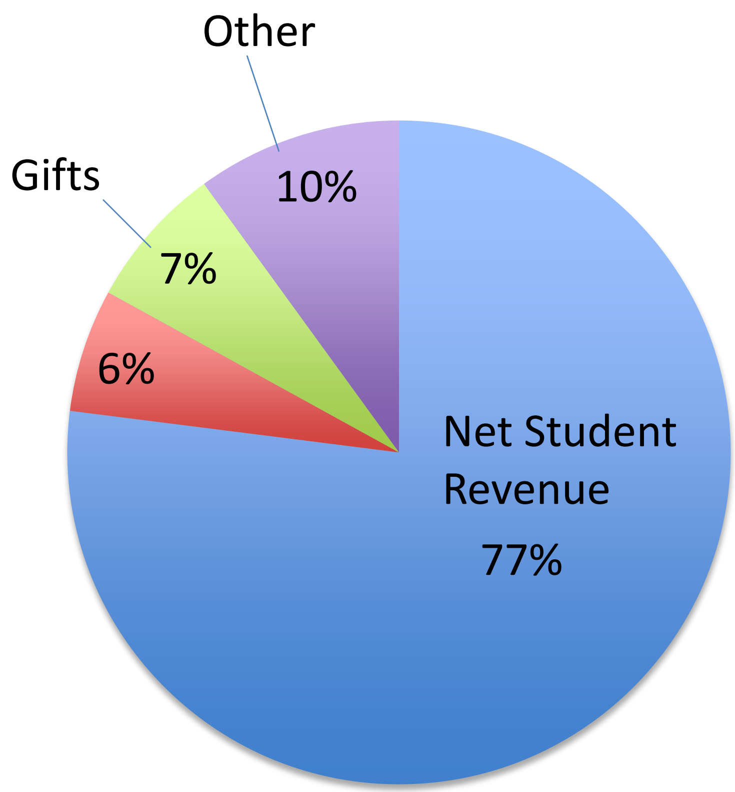
Net Tuition Revenue & Discount Rate



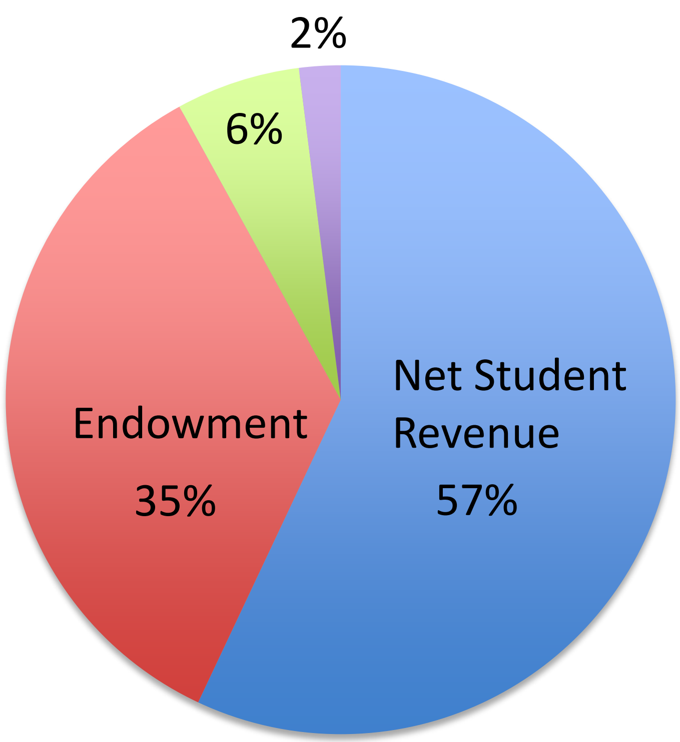
Enrollment Management: A Balancing Act

- Enroll a class of students that meets institutional aspirations
  - Academic profile
  - Diversity
  - Athletics, music programs, academic programs
  - Overall size of student body
- Manage the overall discount rate to generate sufficient net tuition revenue to cover operating expenses
- Enhancing one side of the equation will likely have a negative impact on the other

Comparison of revenue distribution



Example 1



Example 2

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
  - Quasi endowments
- Comply with donors’ wishes
  - Restricted funds vs. unrestricted funds
- Safeguard endowment purchasing power

Intergenerational Equity

"The trustees of endowed institutions are the guardians of the future against the claims of the present. Their task is to preserve equity among generations."

James Tobin, 1974

"What is Permanent Endowment Income," *American Economic Review*, 64 (1974): 427.

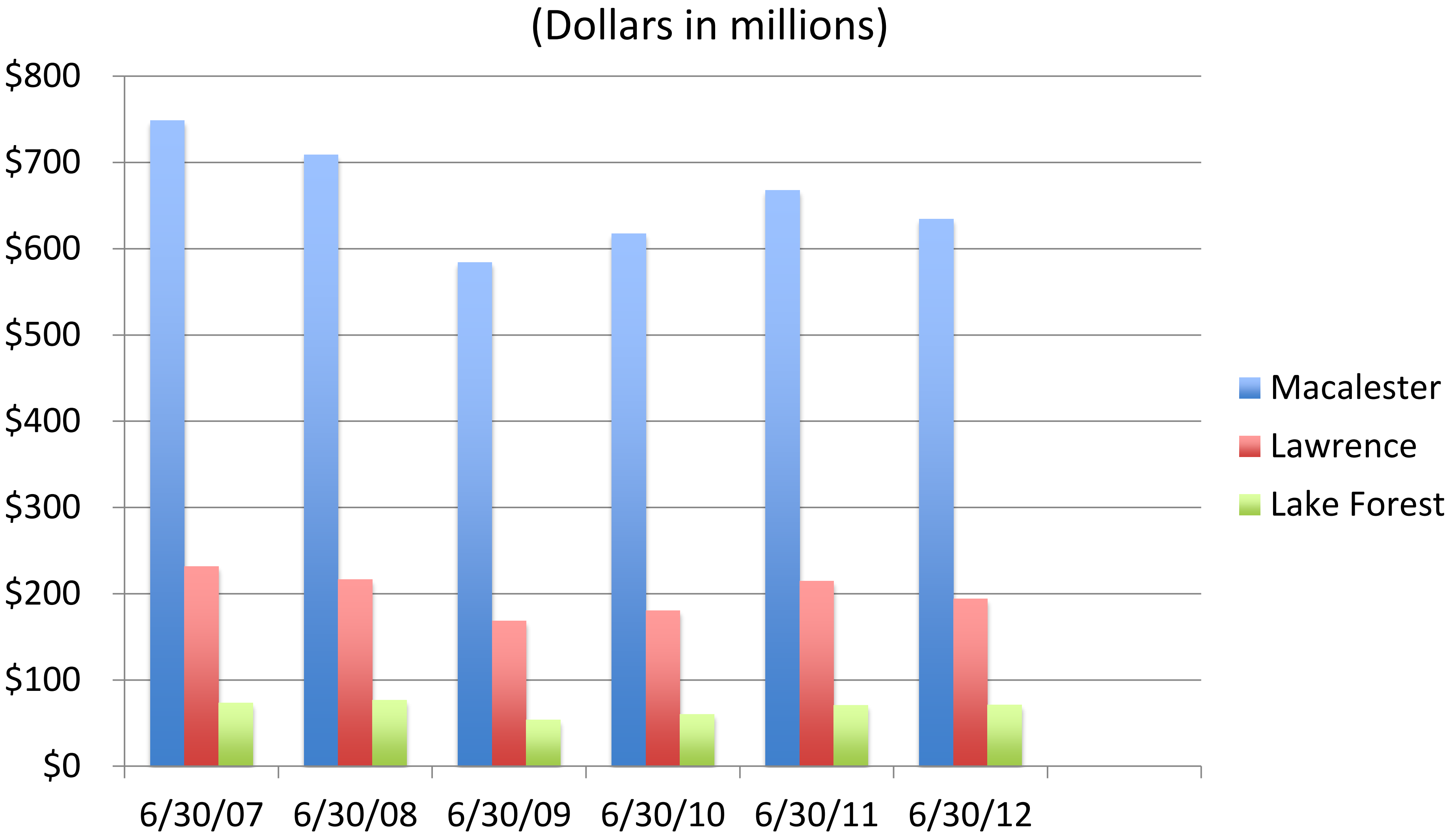
Endowment Revenue

- Ensure distribution respects intergenerational equity and donor restrictions
  - Maintain the purchasing power of the endowment over the long term
  - Provide a stable flow of funds to the operating budget to provide resources to the current generation

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

Market Volatility and Endowment Value



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?

Endowment vs. Tuition Revenue

- A college with 1500 students
- A 5% endowment spending policy
- How much additional endowment is needed to generate revenue equivalent to a $1000 increase in NTR per student?

  - **Total increase in tuition revenue = $1k x 1500 = $1.5M**
  - **Endowment required = $1.5M/0.05 = $30M**

Key Financial Drivers

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

Other Issues

- Rising tuition rates
- Sustainability of high tuition/high aid model
- Is there a price ceiling?
- Economic climate and financial markets
    - Family ability to pay tuition
    - Endowment value and distribution
    - Fundraising & annual fund
- Utilities and healthcare

Financial Equilibrium

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

Discussion Question

What do you think your faculty colleagues would identify as the most significant financial challenges or risks facing your institution?

1) Tuition revenue
   - Making the class
   - Controlling the discount rate
   - Not enough full-pay students
2) Size of the endowment/endowment revenue
3) Meeting financial need of students
4) Deferred maintenance
5) Low compensation
6) Managing rising benefit costs
7) Fundraising
   - Capital funding
   - Annual giving
8) Adding faculty/staff lines
9) Lowering endowment spending
10) Controlling expenses
11) Federal & state financial aid
12) Debt load
13) Something else