

## LFC HEARING BRIEF

**AGENCY:** Higher Education

**DATE:** October 22, 2010

**PURPOSE OF HEARING:** To update and inform the committee on the status of the higher education funding formula and its work during the 2010 interim.

**WITNESS:** Mr. Curtis Porter, Chairman, Higher Education Funding Task Force; Dr. Viola Florez, Secretary, Higher Education Department

**PREPARED BY:** Hipolito "Paul" Aguilar, Principal Analyst

**EXPECTED OUTCOME:** Improved understanding of changes to the Higher Education Funding Formula and their impact on the Higher Education appropriations.

### BACKGROUND INFORMATION

The Higher Education Department (HED) is tasked by statute with developing a funding formula that provides funding for each institution of higher education to accomplish its mission as determined by a statewide plan. This formula is not codified in statute and annual changes made by the department with advice from the institutions have a significant effect on the level of general fund support requested. Although LFC staff participates in meetings of the funding task force, no formal approval mechanism of the funding formula and annual changes is in place and should be considered.

The Higher Education Funding Formula, as originally envisioned, calculates the costs associated with providing a system of higher education in New Mexico with differentials for lower division, higher division and graduate classes as well as calculations for a multiplicity of other small factors, including BR&R, ER&R, library acquisition, instructional space, utilities, and institutional support. It appears the formula contains a number of anomalies that are surfacing; first and foremost, the formula assumes a full funding scenario under all circumstances and does not consider economic realities. For example, the formula has calculated a workload adjustment of more than \$60 million for FY12 without considering the capacity of institutions to absorb some of the growth at little or no additional cost.

The formula, originally designed to calculate the cost of providing a system of higher education is now used primarily as the distribution tool to allocate legislative appropriations among institutions. Over time, a number of factors on the expenditure side as well as the revenue side of the formula have been incorporated that are causing inequities in funding to occur. As a result of a number of antiquated funding calculations, many based on data from as far back as 1994, it is doubtful that the current formula accomplishes its original goal to calculate costs for the institutions. Further, the existing funding formula does not address many of the policy goals outlined in statute such as improving the quality of programs central to institution's missions, eliminating unnecessary, unproductive or duplicate programs, and promoting greater accountability by tracking spending (see sidebar, p. 2).

**Funding Formula Task Force.** The Higher Education Funding Task Force met throughout the 2010 interim to address a number of issues and concerns that were identified through the appropriations process during the 2010 session and by other stakeholders related to fairness

**Higher Education  
Funding Formula Goals**

- Improve quality of programs central to institutions' missions.
- Improve programs to meet targeted statewide needs, eliminate unnecessary, unproductive or duplicate programs.
- Consider faculty salary increases supported by analysis based on peer institutions, workload and educational outcomes.
- Recognize costs from enrollment increases.
- Provide equipment, maintenance and library funding.
- Fund off-campus courses.
- Provide incentives for pursuing alternative funding sources.
- Encourage sharing of resources, including joint instructional programs.
- Facilitate student transfers.
- Encourage energy conservation
- Promote greater accountability by tracking spending.
- Make computer-based distance education accessible.

Source: Section 21-2-5.1 (B) NMSA 1978

and equity. Most of the issues considered were the result of changes made to the higher education funding formula that were advantageous to institutions in years when significant revenue increases were available and are not sustainable now.

The task force has focused principally on changes to the tuition revenue credit and implementing a move to a three-year rolling average for enrollment workload. A lesser priority for the task force has been addressing a number of LFC and executive concerns. These include funding inputs primarily based on enrollment while disregarding outcomes based on completion criteria, fully funding enrollment growth at average cost rather than the lower marginal cost of providing services for additional students, and funding excessive credit hours. It is apparent that no recommendations regarding these issues are forthcoming and the Legislature will be faced with competing pressures from the institutions during the 2011 session. The issue has been placed on an agenda to be considered as the funding task force continues its work through the winter.

**Student Credit Hours.** A primary and desirable feature of an effective funding formula is long-term predictability. The current formula provides for workload adjustments only when student credit hours or the Instruction and General (I&G) dollars increase by at least 3 percent or if student credit hours decrease by at least 5 percent. In years when workload remains "in band", workload is "saved" until the institution breaks out of the band. At that time all of the "saved" workload is used to calculate the increase or decrease in workload, resulting in dramatic shifts in funding from year-to-year.

The Government Restructuring Task Force heard testimony that the reason for originally developing the band is that small changes in enrollment could be accommodated without additional funding (marginal cost). However, by "saving" the workload and receiving full funding later, institutions reap a financial windfall, sometimes years after they have absorbed the cost of educating smaller enrollment populations' year-to-year.

The funding task force is recommending doing away with the band and instead using a three-year rolling average to smooth out spikes in funding and to account for enrollment changes annually. Most of the institutions are in agreement that this is an improved methodology; however some resistance is evident as most institutions will see reductions in workload funding in the first year. This is a result of explosive growth in the last couple years after years of relatively flat to declining enrollment. A compromise solution is to use a two-year average for FY12 and then move fully to a three-year rolling average for FY13.

**Funding formula changes should be considered to provide incentives for cost effective services, greater completion rates, and on-time degree production (without dilution of quality); to exclude duplicative or unnecessary degree programs from funding; and to boost funding for identified centers of excellence.**

**The State does not incentivize degree production, nor monitor quality outcomes of existing programming and degrees they produce.**

**Efficiency measures are not considered, including on-time degree completion and reducing excessive student credit hours (SCH)**

Institution	FY11 Formula			FY12 Formula		
	Final Workload	add back soft-landing	Adjusted Workload	Regular Workload	Regular Workload Adj	Share
NMIMT	21,383,231		21,383,231	22,611,828	1,228,597	2.0%
NMSU	136,339,947		136,339,947	147,602,829	11,262,882	18.3%
UNM	205,628,972		205,628,972	216,871,622	11,242,650	18.3%
ENMU	26,931,443		26,931,443	30,048,997	3,117,554	5.1%
NMHU	30,863,136		30,863,136	32,139,705	1,276,569	2.1%
NNMC	8,665,560		8,665,560	9,235,786	570,226	0.9%
WNMU	15,947,109		15,947,109	19,445,358	3,498,249	5.7%
<b>Total 4-Year's</b>	<b>445,759,398</b>		<b>445,759,398</b>	<b>477,956,125</b>	<b>32,196,727</b>	<b>52.4%</b>
ENMU-Roswell	13,549,849	414,745	13,964,594	14,710,850	746,256	1.2%
ENMU-Ruidoso	2,473,606		2,473,606	2,766,144	292,538	0.5%
NMSU-Alamogordo	8,778,582		8,778,582	9,707,412	928,830	1.5%
NMSU-Carlsbad	5,437,237		5,437,237	6,091,699	654,462	1.1%
NMSU-Donna Ana	27,959,494		27,959,494	30,391,931	2,432,437	4.0%
NMSU-Grants	3,361,286		3,361,286	4,231,338	870,052	1.4%
UNM-Gallup	10,155,323		10,155,323	10,860,475	705,152	1.1%
UNM-Los Alamos *)	1,582,459	143,238	1,725,697	1,985,282	(61,198)	-0.1%
UNM-Taos	4,256,915		4,256,915	4,860,399	603,484	1.0%
UNM-Valencia	6,464,897		6,464,897	7,424,744	959,847	1.6%
<b>Subtotal Branches</b>	<b>84,019,648</b>	<b>557,983</b>	<b>84,577,631</b>	<b>93,030,274</b>	<b>8,131,860</b>	<b>13.2%</b>
CNM	85,341,696		85,341,696	98,236,009	12,894,313	21.0%
CCC	9,987,217		9,987,217	11,619,955	1,632,738	2.7%
LCC (FY12 in-band)	6,070,744		6,070,744	6,070,744	0	0.0%
MCC	3,694,404		3,694,404	4,115,761	421,357	0.7%
NMJC	10,209,606		10,209,606	11,093,902	884,296	1.4%
SJC	29,363,759		29,363,759	31,973,133	2,609,374	4.3%
SFCC	14,055,874		14,055,874	16,676,864	2,621,010	4.3%
<b>Subtotal Indep's</b>	<b>158,723,300</b>		<b>158,723,300</b>	<b>179,786,388</b>	<b>21,063,088</b>	<b>34.3%</b>
<b>Total 2-Year's</b>	<b>242,742,948</b>	<b>557,983</b>	<b>243,300,931</b>	<b>272,816,662</b>	<b>29,194,948</b>	<b>47.6%</b>
<b>GRAND TOTAL</b>	<b>688,502,346</b>	<b>557,983</b>	<b>689,060,329</b>	<b>750,772,787</b>	<b>61,391,675</b>	<b>100.0%</b>

While workload calculations include adjustments for instructional support, student services, physical plant, and utilities, it is the number of student credit hours that has the most significant effect on workload growth. For FY11, student credit hours accounted for almost \$27.1 million or 73 percent of the workload adjustment. In FY12, student credit hours are projected to account for \$61.4 million, or 96.3 percent of the total workload adjustment.

**Credit Hour Cost.** In 2004, the funding task force restructured the formula to account for the cost of changing the cost matrix from a 3 x 9 matrix to the current 3 x 3 matrix. The matrix is arranged to account for the cost per credit hour of lower division, higher division and graduate classes as well as by tier to account for the cost factor of various courses.

Tier	Cluster
1	Business
	Education
	Fine Arts
	Foreign Languages
	Law
	Letters
	Mathematics
2	Social Sciences
	Agriculture
	Biology
	Fine Arts
	Health Sciences
	Mathematics
	Physical Sciences
3	Trades and Technical
	Engineering
	Health Sciences
	Physical Sciences

	Lower Freshman Sophomore	Upper Junior Senior	Graduate
Tier 1	\$133.34	\$293.44	\$635.09
Tier 2	\$199.20	\$459.40	\$873.81
Tier 3	\$321.16	\$527.84	\$1,396.77

**One of the biggest impediments to graduation are the excessive volume of courses from which the student withdraws. Institutional policies that allow withdrawals without penalty are not conducive to promoting graduation in a timely fashion and should be reviewed.**

**Out-of-state students have their higher tuition waived, but in-state students performing the same tasks receive no additional subsidy.**

Student credit hours are summarized by tier and by level of instruction then multiplied by the dollar values according to the level of instruction and tier. It appears the matrix should be reevaluated but neither the legislature, the executive nor the institutions have been willing to pay to update the matrix which makes the concept of the formula as a cost calculator impossible to achieve.

The formula in its present structure uses the matrix to fund growth in student credit hours at full value. Clearly each institution has the capacity to absorb a certain number of new students within existing resources, both human and physical. Based on this and testimony noted above, it is clear that some or all of annual enrollment growth should be funded at a reduced level to account for the marginal cost of educating additional students not the average cost. It appears from this that the state has been overfunding growth annually. The task force should address this issue as it continues its work.

**Completion Outcomes.** As noted above, the higher education funding formula is primarily input driven based on the number of student credit hours enrolled. This practice provides incentives to encourage strong recruitment efforts and has led to significant increases in the number of students taking classes, but without a focus on completion, a large number of students are not finishing classes. A recent LFC program evaluation of UNM and NMSU suggests that at these two institutions alone over a three-year period, \$58.4 million in formula funding was generated for student credit hours never completed by students. This difference in formula funding accounted for an estimated \$7.1 million at NMSU in FY09 and almost \$12.4 million at UNM. Assuming similar completion trends statewide, the total instructional workload for courses enrolled but not completed is about \$43.6 million annually, accounting for almost 1 percent of the annual statewide general fund appropriation.

Ultimately, the funding formula should consider all completion factors, (e.g. course completion, certificate completion and graduation), but as a first step, course completion should be a formula factor implemented for FY12. This could be accomplished by weighting student credit hours at 80 percent for enrollment and 20 percent for completion.

**Excess Credit Hours.** The funding formula does not incentivize course completion or degree completion and efficiency measures are not considered, including on-time completion, reducing excessive hours, and unlimited opportunities to re-take classes. As a result, a large number of students statewide graduate with more than 150 credit hours, or 15 percent beyond the number of credit hours required to

<b>Components of Workload Growth</b>
<b>INSTRUCTION</b> Student Credit Hours
<b>INSTRUCTIONAL SUPPORT</b> Academic Support Institutional Support
<b>STUDENT SERVICES</b>
<b>PHYSICAL PLANT</b>
<b>UTILITIES</b>

**Institutions are  
stumbling over each  
other, offering  
competing programs in  
an effort to increase  
enrollment, particularly  
in the Albuquerque  
area.**

graduate. In addition, many students take university courses regularly with no intent on graduating, yet the state continues to subsidize these hours. Both Texas and Arizona have moved to implement incentives for efficient time-to-degree completion rates by restricting state funding for excess student credit hours. The funding task force should consider similar restrictions where students desiring to take additional hours would incur the full cost of classes.

An area of particular concern is the number of student credit hours claimed for distance learning classes, particularly for those students who reside outside of the state and country. Some institutions have indicated that this should not be addressed, but it is questionable whether the state should pay for credit hours that have no practical benefit to New Mexico in terms of a return on its investment. These students should be required to pay the entire cost of these classes and these credit hours removed from the workload calculation.

**Program Duplication.** Workload funding, in addition to enrollment, also includes funding for instructional space. As a result of the economic downturn, more students nationally are enrolling in classes both as first time students and as returning students seeking advanced degrees or job retraining opportunities. This growth, and the associated funding potential, is causing unprecedented competition among the institutions for every available student credit hour. A consequence of this competition is extraordinary growth in the number of programs offered and facility duplication. Institutions have moved to boost student credit hours by expanding the number of programs being offered statewide irrespective of service area or mission focus. For example, similar programs are stumbling over each other in an effort to increase enrollment, particularly in the Albuquerque area with NMSU and Highlands physically located next to each other and offering competing social work programs, NMSU offering public health and education courses that compete with UNM and New Mexico Tech offering engineering courses directly across the street from UNM.

Facility expansion continues among institutions, an example being Dona Ana Community College which recently opened its eighth facility in Dona Ana County. Although the facilities are paid for by local bonds, the operating costs associated with these facilities are borne by the state through the increase in square footage accounted for in the funding formula. In Santa Fe, voters recently approved construction of a new learning center at Santa Fe Community College that will be made available to four-year institutions to offer upper level classes, again with the added square footage being claimed for I&G funding. The boom in facility construction and the increase in leased

Tuition Waivers	
Active Duty Military, National Guard,	\$ 2,789.2
Arizona Receptrocity	\$ 1,101.3
Colorado Receptrocity	\$ 1,715.1
Graduate Assistant	\$14,909.7
International Military, Spouse or Dependent	\$ 134.7
National Guard Members	\$ 173.2
NM Tribal Membership	\$ 620.3
Non-discrimination	\$ 6,293.3
Non-Resident Exchange	\$ 1,497.0
Non-Resident Athletes	\$ 5,297.2
Other Non-Resident	\$ 69.3
Out-of-State Navajo Nation	\$ 1,621.3
Texas 135	\$11,243.8
Undergraduate Competitive Scholarship <sup>(1)</sup>	\$19,515.8
WICHE Student Exchange	\$ 3,334.7
Senior Citizen	\$ 426.7
Non-resident less than 6 hours	\$ 9,073.1
<b>TOTAL</b>	<b>\$ 79,815.7</b>
Source: HED FY11	
(1) Includes estimated impact from 2010 rule change.	

space is a significant contributing factor to the skyrocketing cost of funding workload with more that 428 thousand square feet being added for FY12. Since most program and facility expansion has not been approved by the Legislature, consideration should be given to not funding this growth under the formula workload calculations. Additionally, changes to current statute should be considered to close loopholes that allow institutions to continue to expand construction without legislative approval.

**Tuition Waivers.** Currently, institutions statewide take advantage of about 14 programs that waive out-of-state tuition for students, generally as an incentive to attend the institution. These include waivers for non-resident athletes, Texas residents attending schools within 135 miles of the border, undergraduate competitive scholarships, graduate assistants, active duty military-national guard and dependents, foreign military and a number of tribal waivers among others. The funding formula accounts for the difference between out-of-state tuition and in-state tuition as a credit against the tuition waiver for each institution resulting in a general fund impact. For FY10, these waiver programs had a cost to the general fund of about \$60 million.

Rule changes approved by HED to the Undergraduate Competitive Scholarship waiver expanding the number of scholarships authorized at the large institutions from 2.5 percent of student FTE to 6 percent of student FTE is projected to increase the total waiver amount by more than \$11 million annually. At UNM this rule change increased the authorized slots from about 650 to more than 1,500 and at NMSU from about 400 slots to more than 1,000, all without Legislative approval.

Of concern is that out-of-state students have their higher tuition waived, but in-state students performing the same tasks receive no additional subsidy. The Legislature should consider consolidating some of these programs, deleting others, placing restrictions on the changes that were adopted for FY11 and directing that the cost of the waivers be borne by the institutions. Also, the Legislature should consider only funding tuition waivers established in statute to ensure that proposed changes year-to-year receive legislative scrutiny and approval.

**Tuition Revenue Credit.** Ongoing concerns are raised regarding the tuition revenue credit and the effect it has on the bottom line. The funding formula provides a mechanism to account for increases in the tuition credit assumed in the annual state appropriation and tuition increases implemented by the institutions. At issue is that the tuition credit percentage adopted by the Legislature is applied to institutions that have differing costs per student credit hour. For FY11, as an example, at UNM a 5 percent tuition credit would be \$8.35 while at

CNM it would be \$2.05. When the total number of credit hours at each institution is multiplied against these numbers, the effect is considerable and demonstrates how over time the bulk of tuition increases are borne by students at the four-year institutions. In addition, because such a large share of the tuition revenue credit comes from the four-year sector, the percent adjustment in the base is causing a fairly significant shift in resources to the two-year institutions.

A second concern that arises with the current formula is that credit is taken annually for both the legislatively imposed tuition credit and tuition raised above that amount. The effect of this is that all tuition revenue generated is ultimately rolled into the base and constrains the institutions ability to use that revenue in future years. The funding task force is proposing to eliminate the provision that takes credit for tuition raised above the legislatively imposed amount. The idea is that it would provide flexibility to the institutions rather than being built into base cost. Staff has concerns about this approach but instead would propose that perhaps credit should only be taken against a portion of tuition (30 percent or 40 percent) to give institutions some of the flexibility they desire.

**Mill Levy Credit.** In addition to the tuition credit, the formula takes credit for revenues the four-year institutions receive from the Land and Permanent Fund and the mandatory mill levy the two-year institutions have in place. Independent institutions are required to impose a two mill levy and the branch colleges a one mill levy. In addition to these minimums, the community colleges can, subject to referendum in the taxing district, impose additional millage as they deem appropriate up to a total of five mills for operations and an additional five mills for capital improvements. It is important to note that not all of the community colleges have excess mill levies in place. For those institutions that do, the funding formula does not consider this excess millage in its calculations and institutions can use this funding at their discretion.

Concerns relating to equity among institutions are raised because for a number of institutions these revenues are used to hold down tuition, offset decreases in state funding, or provide instructional or other services while constitutional institutions do not have access to similar revenues. Further, for those institutions that use the excess millage to hold down tuition rates against which legislatively imposed tuition revenue credits are taken, the tuition revenue credit gap noted above is exacerbated. The higher education blue ribbon task force that developed and implemented many of formula changes including the instructional matrix change contemplated that by fully funding BR&R and other "general" components of the I&G these differences would be mitigated by relative expenditure growth. With BR&R and ER&R

EFFECT OF TUITION REVENUE CREDIT - FY11		
Institution	Rate/SCH	5% tuition credit
NMIMT	\$ 165.84	\$ 8.29
NMSU	\$ 155.00	\$ 7.75
UNM	\$ 166.97	\$ 8.35
		\$ -
ENMU	\$ 104.75	\$ 5.24
NMHU	\$ 90.20	\$ 4.51
NNMC	\$ 41.13	\$ 2.06
WNMU	\$ 109.00	\$ 5.45
		\$ -
ENMU Roswell	\$ 46.40	\$ 2.32
ENMU Ruidoso	\$ 28.50	\$ 1.43
NSMU Alamogordo	\$ 61.00	\$ 3.05
NMSU Carlsbad	\$ 33.00	\$ 1.65
NMSU Dona Ana	\$ 46.00	\$ 2.30
NMSU Grants	\$ 56.00	\$ 2.80
UNM Gallup	\$ 53.00	\$ 2.65
UNM Los Alamos	\$ 49.00	\$ 2.45
UNM Taos	\$ 54.00	\$ 2.70
UNM Valencia	\$ 51.25	\$ 2.56
		\$ -
CNM	\$ 41.00	\$ 2.05
CCC	\$ 30.00	\$ 1.50
LCC	\$ 29.00	\$ 1.45
MCC	\$ 40.45	\$ 2.02
NMJC	\$ 29.00	\$ 1.45
SJC	\$ 32.00	\$ 1.60
SFCC	\$ 32.30	\$ 1.62

Source: HED

only partially funded, these differences are magnified and should be addressed by the funding task force.

**Building Renewal and Replacement.** Presently, building renewal and replacement funding is tied closely to the gross square footage of buildings used for instruction. Generally, this funding is intended to be used to maintain facilities and is included as part of the I&G appropriation. However, because it is part of I&G it is available for institutions to use as needed to allocate funds among operational categories as needed to support programs and services. The Higher Education Department (HED) Manual of Financial Reporting provides for the department to require the institutions to budget these funds specifically for BR&R purposes. Institutions have requested flexibility language in GAA to allow them to use some or all of these funds for operational purposes to get around this requirement claiming need based on reduced general fund appropriations. The funding task force recommended that a temporary change be made to the Manual of Financial Reporting to allow up to the entire BR&R amount to be used for other I&G purposes. The task force also recommended that this provision include a sunset date to preclude this practice from continuing once the economic situation improves.

An issue that needs to be dealt with is the increase in allowable square footage year-to-year. Program expansion across the state noted above is causing institutions to take advantage of provisions in the formula to generate additional instructional funding by leasing space. Although these leases need to be approved by the department, it is clear that the practice continues unchallenged if the institutions can prove that classes are being held in this space. The funding task force needs to consider removing these provisions from the formula.

**Equipment Renewal and Replacement.** The formula also provides funding for replacing equipment with a cost greater than \$1,000. The practice of funding equipment separately appears to be unnecessary and should be included as part of the I&G calculation. Changes have been requested by some institutions to allow for less expensive pieces of equipment, in particular desktop and laptop computers, to qualify for this funding. These types of purchases should be planned and executed from existing operational funding and not from a set aside pot of money. This is one of the extensive calculations noted above that take considerable time to distribute a relatively small amount of money.

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