TOPIC: UPDATE: JBC STAFF ANALYSIS AND PROPOSALS

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I. SUMMARY

At the January 2014 Commission meeting, Commissioner Garcia requested more information about the FY 2014-15 JBC higher education budget briefing, specifically as it pertained to the discussion regarding the financial health of public higher education institutions. Because the higher education topics of interest, enquiries and recommendations of JBC staff have expanded to include performance funding, institution debt limits, and financial aid we have opted to roll up these various topics into a single discussion item. This will allow the Commission to be better informed about the higher education topics of interest to the JBC staff and their proposed changes to law and policy in these areas.

II. BACKGROUND

It is not unusual for JBC staff to brief the committee on topical areas related to JBC staff assignment through the budget process. Indeed that is the reason for the annual JBC staff briefing which usually takes place in late November or early December. It is, however, somewhat unusual for a JBC staff member to propose the large number of diverse and substantive changes currently being considered for higher education in the FY 2014-15 legislative budget cycle.

The briefing issue that received the most scrutiny and interest during the higher education briefing on December 3rd related to the financial health of public higher education institutions and focused on composite financial index scores for Adams State University and Western State Colorado University. This topic was later addressed by leadership at both institutions during the JBC Hearing on December 12th. The JBC staff briefing also included recommendations around streamlining financial aid statutes. Since the time of the briefing, JBC staff has expanded and further detailed topical enquiries to include recommending changes to the method of determining debt limits at the public institutions and criticism of the performance funding process and plan recently approved by the Commission.

JBC staff has the prerogative to review and analyze programs within the areas they are assigned as part of their legislative oversight function. JBC staff presents findings and conclusions to the committee for potential action through legislation, Long Bill head notes and footnotes and other methods. Ultimately, it is up to the Joint Budget Committee members to determine what if any action will be taken on the recommendations made. Our purpose in presenting this information to the Commission is to provide additional context and detail around these discussions, and proposals in the order of what we perceive to be overall scope and importance.

III. STAFF ANALYSIS

1. ***Performance Funding*** - On January 28th, JBC staff provided a four page memo to the Committee outlining her concerns regarding the implementation of higher education performance funding. The analysis was generally highly critical of the approach taken by the department in collaboration with the institutions in developing our approach to performance funding over the past two years. The focus of the JBC staff concern is (1) there are too many performance metrics in total and that (2) the institutions had too much discretion in selecting the metrics. The analysis concludes that, "Essentially, each institution has been allowed to choose its own test." and that, "Under this system, institutions may be rewarded primarily for their skills at *selecting* metrics."[1]

JBC staff options for action included:

- Modifying Senate Bill 11-052 such that it would narrow the number of performance metrics available to each governing board,
- Sending a letter to CCHE, DHE and Education Committees asking us to work with NCHEMS to narrow the number of metrics, and
- Increasing the amount of funding dedicated to performance from the current level and providing the general assembly with greater discretion in determining performance funding amounts.

Despite criticism of our approach to performance-funding, (described in an article from Chalkbeat Colorado as "unusually harsh"), the JBC members themselves did not seem inclined to want to follow staff recommendations. In response to the criticism, DHE has emphasized (1) the extremely collaborative approach we have intentionally taken with our independent and autonomous institutions, (2) The alignment of the performance funding system and performance contracts with the goals in the master plan, (3) the recognition of the complexities behind implementing performance funding and (4) the ability of the system to make corrections and improvements to performance measurement prior to the allocation of performance funds. The Commission's role and authority with respect to performance funding is clearly significant. DHE will monitor closely to determine if the JBC or General Assembly take any action that might require a Commission response. More information is provided in the JBC memo – "Attachment A."

2. Financial Health of Public Higher Education Institutions – The December JBC briefing included a high level financial analysis of the 10 public governing boards and found that six out of 10 were "relatively weak" with Adams State University and Western State Colorado University perceived to be in particularly vulnerable condition. The JBC analysis followed an

[1] JBC Staff Memorandum, January 28, 2014.

approach outlined in a *Strategic Financial Analysis for Higher Education*, a guideline first created by KPMG the 1980s and last updated in 2005, which relies on a composite financial index based in four key financial condition ratios. The summary of JBC staff findings showed that four of Colorado's public institutions had composite scores below 3.0 (moderate health). The findings also showed that with Adams State University and Western State Colorado University had scores below zero - a point at which the guideline states that institution leadership should "assess institutional viability to survive." The financial analysis methodology applied is nationally recognized and used by accrediting bodies but it does have some shortcomings. The ratios applied were originally utilized by private institutions which have different pricing strategies, revenue models and reserve sources than institutions in the public sector (where a relatively consistent level of state support funding was traditionally assumed). It has also been pointed out that the analysis conducted by the JBC staff represented a "snapshot in time" and can therefore overstate or understate the financial health of an institution when a trend that can account for mid to long-term strategic decisions would provide a more accurate assessment.

The briefing presentation generated a good deal of discussion with the JBC members and other legislators. At the JBC Hearing nine days later, leadership from Adams State and Western State directly spoke to the concerns raised in the analysis and followed up with additional data and information following the hearing. Both institutions described the importance of investment in facilities and maintenance, outlined plans to increase and sustain enrollment and generate revenues from other sources. The JBC and other legislators requested specific plans with benchmarks from institutional leadership to address the concerns. Both institutions indicated that they welcome the additional transparency and accountability. The Commission's authority to become involved directly in operational decisions at an institutional level is obviously limited but the issue warrants close attention given its importance to the system and the high level of interest among state leaders. The JBC staff analysis is provided as "Attachment B."

3. Proposed Changes to Debt Service Limits for Institutions Using Intercept Act – Recall that under the 2008 Intercept Act, certain institutions can save money on capital projects by borrowing at lower interest rates because they are utilizing the state's credit rating. Last year, the State Treasurer's office worked with DHE and the institutions to revise how those limits are established for higher education institutions. In past years the formula for determining how much an institution could borrow using intercept was based on a prior year snapshot of available state funds under fee-for-service contracts. This formula was selected somewhat arbitrarily and it was generally understood that the level of fee-for-service funding had no correlation to an institution's financial health or ability to pay down debt. Last session Senate Bill 13-199, modified that formula by (1) redefining debt capacity as 150% of the institution's annual revenue and (2) requiring that the higher education institution sustain a credit rating of at least "Single-A" by a nationally recognized rating organization. This was considered to be an improvement because it attaches institutions' ability to borrow to an external and independent assessment of financial condition. The State Treasurer's office presented on this topic to the JBC on January 14th. The committee members had no questions regarding the presentation and appeared satisfied that this was a better approach to determining debt limits under the Intercept Act.

Nevertheless, JBC staff is pursuing a statutory change that would link an institution's ability to borrow based upon total state support from the general fund in a given year. In other words, staff is proposing that instead of using just the fee-for-service amount available to the institution, the COF stipend portion of state support would also be available to determine how much the institution can borrow.

The Deputy State Treasurer has expressed concerns about this approach as potentially adding complexity and deemphasizing the external rating test. DHE staff has concerns about the proposed change because of the danger of using the General Fund as the limit giving the historically precarious availability of General Fund for higher education. In short, there is the potential for reductions in state support that could potentially cause institutions to be in violation of the Intercept Act. At the very least, cuts to state funding at an institution could have the effect of crippling the institution's ability to borrow for necessary capital projects or maintenance at the same time that funding for operations are being cut. The proposed legislation to change the limit is expected to be introduced in the next week or two. The Commission's role is largely secondary to the Capital Development Committee, JBC and Treasurer's Office in influencing borrowing limits, but as another proposal that could impact operations at the institutions; we intend to monitor this legislation closely.

4. ***Updating Financial Aid Statutes* –** Prior to the JBC briefing but after the Governor's FY 2014-15 November budget request, JBC staff met with DHE staff to discuss recommending "clean-up" legislation in a number of areas around financial aid. Many of the financial aid statutes were drafted in 1979 and have only been modified since on an ad hoc basis. DHE staff has been generally supportive of the proposal to modernize and clarify statute with the understanding that it would not materially impinge on institutional or Commission authority in this area. The JBC briefing document later went a bit further than recommending only statutory clean up, recommending three options to the JBC:

- Create more financial aid program structure through Long Bill line item, footnote and definitions to give shape to need-based, merit and work study aid,
- Establish "broad parameters" for institutions' use of appropriated financial aid in the statutes that further define the Commission's authority,
- Provide the Commission direct authority to review and approve the financial aid programs, policies and procedures established by the Governing Boards.

To date no action has be taken with these proposals but DHE staff has made clear to JBC staff that option #3 is probably not viable because it would impinge on institutional operational decision making and would likely require additional department staff. Options #1 and #2 could potentially be implemented without interfering with existing Commission policy or institutional autonomy. As you are aware, the Commission's authority with respect to allocating financial aid is very broad. At this point there is little to do but monitor the recommendations until we know if the JBC is inclined to take further action. An excerpt of the JBC Briefing is included as "Attachment C."

III. STAFF RECOMMENDATIONS

No recommendation, discussion only.

STATUTORY AUTHORITY

N/A