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

- Lake Forest
- Luther
- Cornell
- Knox
- Monmouth
- Coe
- Ripon
- Beloit
- St. Olaf
- Lawrence
- Colorado
- Macalester
- Carleton
- Grinnell
Expenses for a typical college

- Employee Compensation: 64%
- Program Expenses: 26%
- Debt & capital: 10%
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.
Revenues: Example 1

- Net student revenue: 77%
- Endowment: 6%
- Gifts: 7%
- Other: 10%
Revenues: Example 2

- Net student revenue: 57%
- Endowment: 35%
- Gifts: 6%
- Other revenue: 2%
Comparison of revenue distribution

Example 1

- Gifts: 6%
- Other: 7%
- Net Student Revenue: 77%

Example 2

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

Net Student Revenue
Gifts
Other

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

• 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**
- 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>
</tr>
</tbody>
</table>
Net Tuition Revenue & Discount Rate

- 2008: $5,000,000, Discount: 44%
- 2009: $10,000,000, Discount: 45%
- 2010: $15,000,000, Discount: 46%
- 2011: $20,000,000, Discount: 47%
- 2012: $25,000,000, Discount: 48%
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
- Gifts: 7%
- Other: 6%
- Net Student Revenue: 77%

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

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

(Dollars in millions)

Macalester
Lawrence
Lake Forest
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