**LEGISLATIVE EDUCATION STUDY COMMITTEE**
**BILL ANALYSIS**

**Bill Number: HB 327** **51st Legislature, 2nd Session, 2014**

**Tracking Number: .195656.3**

**Short Title: Higher Education Finance Act**

**Sponsor(s): Representative Jimmie C. Hall**

**Analyst: Ian Kleats and Frances Ramirez-Maestas** **Date: February 13, 2014**

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**Bill Summary:**

HB 327 creates the *Higher Education Finance Act* for the purpose of outlining a funding formula methodology that will use a unit value concept to allocate for instruction and general (I&G) funding to public postsecondary education institutions.

Among its provisions, HB 327 defines:

- "degrees" to mean degrees or certificates;
- "state educational institution" as an institution of higher education enumerated in Article 12, Section 11 of the Constitution of New Mexico (see "Technical Issues," below);[1]
- the terms "branch community college," "comprehensive institution," "independent community college," and "research institution," and
- includes these entities in the definition of "public post-secondary educational institution."

Other provisions of the bill:

- require each public postsecondary educational institution to provide data pursuant to an institutional finance schedule issued by the Higher Education Department (HED), which includes:
    - financial data;
    - enrollment data;
    - performance data; and
    - any other data required by HED; and

- establish a funding formula for I & G budgets of public postsecondary educational institutions based on units and a uniform dollar value per unit determined by HED taking into account the availability of legislative appropriations;

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[1] Includes the University of New Mexico, New Mexico State University, New Mexico Highlands University, Western New Mexico University, Eastern New Mexico University, New Mexico Institute of Mining and Technology, New Mexico Military Institute, New Mexico School for the Blind and Visually Impaired, New Mexico School for the Visually Handicapped, New Mexico School for the Deaf, and Northern New Mexico State School.

- allocate a minimum of 25 units and a maximum of 100 units (see “Technical Issues,” below) to public postsecondary educational institutions as outlined in the following table and summarized below:

| | Unit Category | Units | Percent of Total Units |
|---|---|---|---|
| | **Workload Components** | | |
| (1) | Student Credits | 20 to 50 units | 20 to 50 percent |
| (2) | Dual Credits | 1 to 10 units | Up to 10 percent |
| | **Statewide Performance Measures** | | |
| (3) | Degrees awarded | 1 to 15 units | Up to 15 percent |
| | **Mission-Specific Measures** | | |
| (4) | Academic progress for 30 to 60 course credits towards a degree | 1 to 10 units | |
| (5) | Amount of funding received by research Institutions | 1 to 10 units | Up to 10 percent |
| (6) | **Fixed Costs** | 1 to 5 units | Up to 5 percent |
| | **Total Units** | 25 to 100 | 100 percent |

(1) 20 to 50 units based on credits from courses in which students received a grade with adjustments for the type and level of courses;
(2) 1 to 10 units based on the number of dual credits awarded to a student who completed the course and received a grade;
(3) 1 to 15 units based on the number and types of degrees and certificates awarded with adjustments for:

  - associate or bachelor’s degrees awarded in science, technology, engineering, mathematics, or health science (STEM); and
  - degrees awarded to students from financially at-risk populations;

(4) 1 to 10 units for a branch community college, independent community college, comprehensive institution, or state educational institution based on the number of students who completed 30 or 60 course credits applicable toward a degree or certificate (see “Technical Issues,” below);
(5) 1 to 10 units for a research institution based on the amount of research funding attained from sources other than legislative appropriations; and
(6) 1 to 5 units as the base amount to contribute toward the fixed costs of public postsecondary educational institutions; and

- require HED:

  - by November 1, 2014 to promulgate rules detailing the bases for calculating the annual I&G budget, including the rationales, policies, and considerations for determining:

    - the uniform dollar value per unit;
    - the unit allocations to public postsecondary educational institutions;
    - adjustments to unit allocations within prescribed ranges; and
    - departures, if any, from adherence to the unit ranges prescribed in the *Higher Education Finance Act* or HED rules;

- by September 1, 2015 and September 1 of each subsequent year, to provide a report to the Legislative Finance Committee (LFC) outlining:

  - the prior academic year uniform dollar value per unit for all institutions;
  - unit allocations;
  - adjustments to the unit allocations for each institution; and
  - departures, if any, from the prescribed ranges or HED rules; and

- by January 15, 2016 and January 15 of each subsequent year, provide a report to the LFC outlining:

  - the subsequent academic year uniform dollar value for all institutions;
  - unit allocations;
  - adjustments to the unit allocations; and
  - departures, if any, from the prescribed ranges or HED rules.

Finally, HB 327 is the subject of House Executive Message #110.

**Fiscal Impact:**

HB 327 does not contain an appropriation.

**Fiscal Issues:**

The Central New Mexico Community College (CNM) bill analysis suggests that further study may be warranted because the outcome-based units determined by HED could result in redistribution of funds from some higher education institutions to others.

The New Mexico Independent Community Colleges (NMICC) bill analysis notes that because each institution would receive a minimum of 25 units and a maximum of 100 units, it appears that the largest I&G budget could be at most four times the smallest.

Currently, HED develops its budget recommendation for higher education institutions based on a prior-year base and performance measures. According to Volume II of the LFC's FY 2015 Budget Recommendations, the FY 15 HED budget recommendation for I&G budgets included 11 percent that was tied to performance-based outcomes. These and other recommendations are considered by the Legislature, which appropriates funds to each individual higher education institution.

**Technical Issues:**

The definition of "state educational institution" references certain institutions from Article 12, Section 11 of the Constitution of New Mexico, which includes the New Mexico Military Institute. It is unclear whether the New Mexico Military Institute's postsecondary functions would qualify it for funding through the proposed funding formula.

Page 4, lines 15 through 19, allocate a range of 1 to 10 units for a branch community college, independent community college, comprehensive institution, or state educational institution based on the number of students completing 30 or 60 credit hours applicable toward a degree. Because of the definition of "state educational institution," it appears that research institutions would be entitled to those units as well.

As a result, HB 327 requires HED to allocate a maximum of 110 units to research institutions and a minimum of 26 units. However, this appears to be in conflict with the 100-unit maximum and 25-unit minimum prescribed on Page 3, lines 20 through 23.

If it is the sponsor's intent that research institutions ought not to qualify for those units on Page 4, lines 15 through 19, the sponsor may wish to amend language in that section or within the definitions to exclude them. However, if the sponsor intends research institutions to qualify for those units, the sponsor may wish to amend the unit maximums and minimums to reflect those units.

**<u>Substantive Issues</u>:**

There may also be a point of concern regarding the relationship between the act created in HB 327 and existing provisions regarding the higher education funding formula. Section 21-2-5.1 of the *Post-Secondary Educational Planning Act* requires HED to develop a funding formula "that will provide funding for each institution of higher education to accomplish its mission as determined by a statewide plan." Statute further identifies a number of factors that this formula "may" include, among them:

- consideration of competitive faculty salaries and benefits;
- recognition of additional costs as a result of increases in enrollment; and
- funding of off-campus courses and other nontraditional delivery systems "at a level sufficient to allow their development."

Because the language in existing law is permissive and the language in HB 327 is prescriptive, the two sections may not actually conflict; however, how the two sets of provisions might interact seems unclear.

Also unclear is how the provision in HB 327 allocating a range of 1 to 10 units based on the number of dual credits awarded to a student who completed the course and received a grade would interact with existing law (Section 21-1-1.2 NMSA 1978), which requires HED to revise procedures in the funding formula to address enrollments in dual credit courses and to encourage institutions of higher education to waive tuition for those courses. As this statutory provision is currently applied, HED does not take credit for waived tuition for dual credit courses when allocating funds to a postsecondary institution. If both this provision and the one in HB 327 were in effect, postsecondary institutions may receive double funding based on the dual credits awarded.

HB 327 requires adjustments to the units allocated based on the number and types of degrees awarded for:

- associate or bachelor's degrees awarded in a STEM field; and
- degrees awarded to students from financially at-risk populations.

It is unclear why graduate degrees from STEM fields are not included for the purposes of this adjustment. Graduate degrees in STEM provide an alternative avenue to teaching licensure for those subjects, and the Legislature has supported the notion that teachers in those fields are in high need through appropriations in recent years.

On the point of teacher training, the proposed funding formula does not explicitly provide for adjustments on the basis of metrics associated with teacher education and licensure. As a result, it is unclear how the proposed formula would affect the Colleges of Education in the state.

HED's bill analysis asserts that a formula that calculates most of an institution's I&G budget based on performance measures would likely lead to higher overall performance on those measures.

**Background:**

Narrative in Volume II of the LFC's FY 2015 Budget Recommendations provides a brief history of higher education budgets, including a discussion of recent changes to the I&G formula employed by HED. Relevant sections of that narrative have been attached for reference.

**Committee Referrals:**

HEC/HAFC

**Related Bills:**

None as of February 13, 2014.

**STATUTORY AUTHORITY:**

Article XII, Section 11, of the New Mexico Constitution established the state educational institutions and the control and management of each institution by a board of regents. Other institutions are established by statute, pursuant to Articles 13, 14, and 16A NMSA 1978. Most statutory provisions pertaining to postsecondary education can be found in Sections 21-1-1 through 21-29-6 NMSA 1978.

**BUDGET ISSUES:**

The appropriations for higher education institutions and special schools are based on state general fund appropriations, other state funds, and federal funds. The general fund appropriation supports instruction and general (I&G) and other expenditure categories, including athletics and research and public service projects. The Higher Education Department (HED) submitted a FY15 budget request for all institutions and special schools totaling $3.2 billion, of which $780 million, or 26 percent, was from the general fund. The department's request included $652.2 million for I&G purposes, $114.1 million for research and public service projects and other activities, and $7.8 million for the special schools. The department requested $5.9 million in general fund appropriations for the scheduled 0.75 percent increase in employer retirement contributions pursuant to Section 21-11-21 NMSA 1978. The department's general fund request was $18.5 million, or 2.4 percent, higher than the FY14 general fund appropriation.

The LFC's FY15 general fund recommendation for institutions and special schools totals $801.5 million, nearly $20 million more than the request and $40 million more than FY14 operating levels. The increase provides $18.6 million in I&G funding, $8.1 million in funding for research and public service projects, $3.8 million to fund the scheduled 0.75 percent increased retirement contribution, and $9.7 million for a 1.5 percent cost-of-living-adjustment (COLA) for faculty and staff. The increase in I&G appropriations includes sufficient funding for institutions to provide compensation increases, in addition to the recommended COLA, to reward performance and recruit and retain faculty and staff. The recommendation provides a third year of increasing general fund support for institutions, though the total appropriation level remains below the highest level funded in FY09.

Instruction and General Funding.

Since the late 1980s, the state has used a formula to calculate the approximate cost to provide postsecondary training and education to New Mexicans and to determine annual state general fund appropriation support. The formula is based on a cost matrix reflecting an institution's prior-fiscal-year costs of instruction and general services faculty and staffing, plant and facilities operation and maintenance, equipment and building replacement and renewal, state-required scholarship transfers, and other expenditures. During the solvency era, and specifically after FY13, the formula and resulting general fund appropriations evolved from reimbursing an institution's actual instructional costs to allocating state revenues for in support of instructional costs. The department's request and LFC's recommendation for FY15 continue this trend.

Whether funding institutional costs or simply allocating state funds, HED is charged with developing a funding formula that supports institutions sufficiently to accomplish their missions as articulated in a statewide plan. Historically, the formula supported statewide education goals, like increasing student access to postsecondary education and providing instructional facilities in locations that allow more students to participate in college and training. And, formula changes, like changing statewide goals and objectives, would be reviewed and revised annually based on the recommendations and efforts of the long-standing Higher Education Funding Formula Task Force, which included institutional leaders, Department of Finance and Administration (DFA) and LFC staff at a policy-making level. More recently, the department has maintained close control over formula discussions, with limited input by steering and technical committee members, to produce the final formula used as the basis for the appropriation request. For example, the department did not provide the proposed formula mechanism to DFA, LFC, or institutions prior to the November 1 budget submission deadline for FY14 and FY15.

During the 2013 interim, LFC held two hearings to learn about institutional efforts to improve student performance since the formula provisions have been enacted. Presidents and provosts from research, comprehensive, and two-year institutions highlighted intense academic activities and student services for incoming first-year students, including summer academic boot camps and concentrated remedial courses. Institutions began streamlining academic programs within an institution and between two-year and four-year institutions to improve transfer rates and timely program completion. More intrusive academic counseling and student services have proven successful in increasing student retention rates at other institutions, and New Mexico's colleges anticipate similar results. LFC and others will continue to follow these efforts to determine whether state institutions experience similar performance results and are able to capitalize on gains with increased performance funding.

Also during the interim, LFC requested HED and institutions to review the revised formula for any unintended impacts, review formula credit and awards matrices, and develop mission-specific performance measures. The HED's technical committee reviewed the awards matrix and performed limited data analysis but did not work on mission-specific measures. However, institutions took the initiative and proposed mission-specific measures and more for FY15.

Late November 2013, the department provided LFC with the I&G formula that served as the basis for the department's FY15 request. The department changed the formula from prior years by (1) altering the definition of performance outcomes; (2) creating a point system to index the value assigned to measure performance in generating certificates and degrees (collectively, "awards") to the value of a bachelor's degree; (3) changing the method for counting awards earned from rewarding all eligible certificates and degrees earned to a "one student, one award" approach; and (4) basing change in institutional performance over three-year rolling averages instead of on an annual basis. The department verified the approach of assigning greater value to institutions that generate more awards in total, more awards to financially at-risk students, and more awards in workforce concentrations (science, technology, engineering, math, and health (STEMH) fields). In response to the Legislature's request for appropriations based on the most recent academic data available, the department incorporated the 2012-13 academic year data in the formula for the FY15 request. Lastly, the department did not alter values in the underlying cost matrices used to calculate appropriation levels for completed student credit hours and for statewide outcome measures based on awards.

For FY15, the department redefined outcome measures to exclude completed student credit hours and requested funding the credit hour component at 5 percent of the approximate cost to produce some credits. This approach resulted in a request of $404.2 thousand in workload funding for FY15. Funding a small fraction of the cost to provide courses fails to provide consistent funding to institutions, particularly the state's open-access colleges, because institutional leaders work with students for two, four, or more years to earn the funding available when certificates and degrees are awarded.

Using the revised formula, the department developed a point system to reallocate prior base-year funding and any new general fund revenues. To calculate an institution's point totals, the department totaled the number of eligible certificates and degrees an institution awarded in each of the past six academic years, multiplied these numbers by the appropriate values in the formula's awards matrix, and indexed each year's total values by the value of a bachelor's degree ($33 thousand) in the awards matrix. From this data, the department then established two three-year sets of academic years to determine historic and the most recent average performance levels.

The department used these three-year performance averages to reallocate 10 percent, or $58.3 million, of the FY14 I&G formula funding appropriation and generate $7.9 million in new general fund support for FY15. The department also requested $404.2 thousand in general fund appropriations for completed student credit hours, or 5 percent of the total $8.1 million possible under the formula. In total, the department allocated $66.6 million of the $591.3 million in I&G funding, or 11 percent, based on performance, particularly awards-driven outcomes. This is a significant percentage increase over FY13 and FY14 levels, 5 percent and 3.6 percent of total I&G formula funding, respectively.

Unclear with the department's direction on formula revisions and limited technical committee input, institutional leaders took initiative to refine mission-specific performance measures from the 2012 interim and went further by developing an alternative funding formula. In late October 2013, institutions shared this proposal with DFA, LFC, HED, and others.

Supporting performance funding goals, institutions sought to develop a clearer and more transparent formula, one with greater mission-differentiation. (See Volume III: Higher Education I&G Funding Formula: Current and Proposed.) They also wanted a formula that could be run by institutions, DFA, LFC, HED, and others without relying on the department's limited staff. Echoing the department's original proposal for the revised formula in FY13, institutions proposed a straightforward method for rewarding institutions for awards produced, limiting those certificates and degrees for which an institution will receive formula funding. Like HED's formula, institutions assigned higher rates for producing awards depending on program length and rates for awards earned in STEMH disciplines and by financially at-risk students. Research demonstrated that completed student credit hours could be funded at a single, flat rate that was consistent with funding levels of the last 20 years. The institutional proposal included mission-specific measures, rewarding research universities for securing federal grants and contracts and comprehensive universities and community colleges for their success with students reaching certain academic milestones and providing dual credit opportunities for high school students. The proposal recognized other institutional revenues that support I&G expenditures, allowing a credit to be taken. Lastly, institutions offered options to reduce both the prior-year appropriations base and all performance funding to achieve performance funding goals and appropriation funding levels.

The proposal, overwhelmingly supported by presidents at all research and comprehensive universities and community colleges, offers much to consider. LFC acknowledges the institutions' leadership in presenting a set of generally accepted measures that reward institutional success at meeting their missions. Like the HED's formula proposal, the institutional proposal incorporated many objectives suggested by LFC when the formula revision was initially proposed: (1) maintains the direction of outcomes funding, (2) recognizes student success, (3) provides stability and equity in funding institutions, and (4) rewards institutional success. However, it has not been sufficiently vetted by LFC and others due to its late delivery during the FY15 budget process and near the end of the department's formula review process. Similar to the department's proposal, relying fully on the institutional proposal is difficult without the opportunity to fully discuss and document the policy goals, rationale for supporting values, and targets.

Because HED's request was revised four times and the full formula was delivered to DFA and LFC in late November, the LFC recommendation is based on the institutional proposal, with some modifications. The recommendation provides for $601.1 million in I&G formula funding. Like the HED's request, the LFC's recommendation sands the FY14 base-year appropriation, reducing the base $14.6 million, or 2.5 percent. Adding $18.1 million in new general fund support and $14.6 million of prior-year funding, the recommendation allocates $12.2 million for completed student credit hours, $17.2 million for awards-based performance, and $3.7 million for mission-specific performance. These totals fund institutional performance at 90 percent, or $33.1 million, compared with the institutional proposal's 100 percent funding at $38.9 million. In addition, LFC amended the values of the mission-specific measures. The recommendation also applies the institutional share credit, for a total reduction of $380.7 thousand. Under the recommendation, all but two institutions receive an increase in I&G funding for FY15; two institutions received significant mill levy revenues that offset what would have otherwise been a general fund appropriation increase. With 5.5 percent of I&G formula funding based on performance, the LFC recommendation exceeds the HED's 5 percent target for FY15.

Both the HED request and LFC recommendation support increased state funding based on student performance, including performance in specific academic concentrations and by a diverse student population. While there are differences in approaches and mechanics, DFA, HED, and LFC generally agree that a formula should reward program completion, focus on measures that reward institutions for excelling at their public mission, and can reallocate a portion of base-year funding without destabilizing institutions. For these agreements to lead to better outcomes, LFC recommends the executive branch, institutions, the Legislature, and local communities focus on linking performance funding with well-defined statewide goals and action steps for higher education in New Mexico. The I&G funding formula, with funded performance measures, and other tools, like improved Accountability in Government Act measures, represent opportunities to discuss larger policy issues, like improving and measuring academic quality and aligning goals with performance targets.

While not formula-based, the University of New Mexico's Health Sciences Center (UNM HSC) receives a direct general appropriation for I&G funding for the school of medicine and receives some funding from UNM main campus for providing formula-based I&G services (example, completed student credit hours for colleges of pharmacy and nursing). For FY15, HED requested flat funding for UNM HSC at $60.9 million and an additional $500 thousand for the increased retirement contribution pursuant to Section 22-11-21 NMSA 1978. LFC's recommendation increased funding by $500 thousand, for a total of $61.4 million, in addition to funding the employer's retirement contribution of nearly $300 thousand. This additional base funding supports the continued strong student performance on required licensure exams and the increased costs associated with medical and health professional education.

Research and Public Service Projects.

State general fund appropriations also support other categories of funding besides instruction and general expenditures, particularly research and public service projects. During the 2013 interim, the department significantly revised the administrative process regarding reporting and budget requests for research and public service projects. Each project currently funded was required to submit a year-end fiscal and program report, and, for programs seeking funding for FY15, an opening fiscal projection and program report. After this extensive process, implemented late in the budget cycle, HED requested $4.5 million for five new projects and a significant expansion of an existing university center. Most of the department's new projects, totaling $2.4 million, were not vetted through the revised project review process.

LFC recommends a total of nearly $120 million in general fund support for research and public service projects. This is an increase of $8.1 million, excluding the statutorily required 0.75 percent increase retirement contribution, or $613 thousand, for such projects. Of the new funding, $2 million would support research and public service projects that support economic development and workforce training programs, student success programs, and safety programs.

Importantly, the LFC recommendation provides more than $11.7 million total in healthcare workforce funding to colleges and universities. In addition to $3.1 million of FY14 base funding, the recommendation for higher education institutions includes $4.4 million in new general fund appropriations for undergraduate ($1.9 million) and graduate ($1.6 million) nursing education and nine medical residency positions ($905 thousand) and allocates $1.2 million directly to maintain undergraduate nursing programs. This recommendation builds on the LFC's recommendation of $2.9 million to HED to expand financial aid loan repayment programs and dental school student slots.

Special Schools.

HED requested and LFC recommends a total of $7.9 million in general fund support for the New Mexico School for the Blind and Visually Impaired, the New Mexico School for the Deaf, and the New Mexico Military Institute. Both the request and recommendation include an increase over FY14 general fund levels for the 0.75 percent retirement fund contribution required under Section 22-11-21 NMSA 1978. The LFC recommendation recognizes that these schools will likely realize substantial increases in land grant permanent fund payments in FY15.