F I S C A L   I M P A C T   R E P O R T

ORIGINAL DATE 02/12/14
SPONSOR Hall **LAST UPDATED** 02/18/14 **HB** 327/aHEC

SHORT TITLE Higher Education Finance Act **SB**

ANALYST Hartzler-Toon

APPROPRIATION (dollars in thousands)

Appropriation		Recurring or Nonrecurring	Fund Affected
FY14	FY15		
	NFI	N/A	General Fund

(Parenthesis ( ) Indicate Expenditure Decreases)

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY14	FY15	FY16	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total			Indeterminate	Indeterminate	Recurring	General Fund, Other State Funds

(Parenthesis ( ) Indicate Expenditure Decreases)

Relates to Appropriation in the General Appropriation Act: Section 4J Higher Education, All Colleges and Universities

SOURCES OF INFORMATION
LFC Files

Responses Received From
Higher Education Department (HED)
New Mexico Independent Community Colleges (NMICC)
Central New Mexico Community College (CNM)

SUMMARY

Synopsis of HEC Amendment

The House Education Committee amended House Bill 327 (HB 327), making a technical change to which institutions could receive units for students who complete 30 credits or 60 credits towards their degree.

Synopsis of Bill

House Bill 327 would establish the Higher Education Finance Act. As its primary purpose, the bill would require the Higher Education Department (HED) to establish a funding formula to support instruction and general expenses at colleges and universities. The formula would establish a single unit value, similar to the public school support formula, for institutions, with institutional budgets ranging from 25 to 100 units total. Under Section 4 of the bill, an institution could receive the following units:

Unit Category	Units Possible	Percent of Total Units
Workload Components		
Student Credits	20 to 50 units	20 to 50 percent
Dual Credits	1 to 10 units	Up to 10 percent
Statewide Performance Measures		
STEMH Associate/Bachelors Degrees awarded	1 to 15 units	Up to 15 percent
Financially At-Risk Degrees awarded	1 to 15 units	Up to 15 percent
Mission-Specific Measures		
Academic progress for 30 to 60 course credits towards a degree (comprehensive institutions and community colleges only)	1 to 10 units	Up to 10 percent
Amount of funding received by research institutions (research institutions only)	1 to 10 units	Up to 10 percent
Fixed Costs	1 to 5 units	Up to 5 percent
Total Units	26 to 105 units total	
HB 327 Limits on Units Possible	25 to 100 units	

The bill adds rulemaking and reporting requirements for HED. Under HB 327, HED would promulgate rules regarding the instruction and general operating budget, including the calculations for determining a uniform dollar value per unit, unit allocations, adjustments to unit allocations, and departures from ranges listed in statute. By September 1st, the department would report to the LFC the prior academic year uniform dollar value per unit for all institutions and, on an institutional basis, the unit allocations, adjustments, and departures from statutorily-prescribed requirements. In addition, by January 15th of each year, the department would report to the LFC the subsequent academic year and projected uniform dollar value per unit and individual institutional information.

FISCAL IMPLICATIONS

The department noted the bill provides a basis for requesting general fund appropriations considered by the Department of Finance and Administration (DFA) and LFC. HED did not describe any fiscal impacts of the proposed formula changes on the higher education institutional budget as a whole or for individual institutions. The department noted that the statute does not address or describe how an institution's base instruction and general (I&G) funding should be evaluated and omits any component for reducing prior-year base funding – an important piece of the department's current approach to formula funding.

NMICC and CNM both recognized the similarities in the approach proposed in HB 327 to the public school's state equalization guarantee (SEG) formula. However, both note that the proposed approach represents a significant departure from current budgeting policies and procedures.

SIGNIFICANT ISSUES

Pursuant to Section 21-2-5.1 NMSA 1978, HED is required to "develop a funding formula that will provide funding to each institution of higher education to accomplish its mission as determined by a statewide plan." The department shall consider a list of 13 factors in developing the formula. (See Attachment A.) The department's current statewide plan for higher education (issued late 2010) has not been implemented or updated. The department bases its annual higher education institution general fund appropriation request on the funding formula; DFA and LFC base annual general fund appropriation recommendations on the request, making adjustments that reflect the executive and Legislature's funding priorities.

The Legislature and Executive have worked for years to shift I&G formula funding from solely funding inputs – credit hour enrollment, academic and student support costs, equipment and building replacement and renewal costs, and other faculty and staff costs – to funding outcomes – completed student credit hours; more certificates and degrees; more certificates and degrees in high-demand, high-skill areas (science, technology, engineering, math, and health (STEMH)); and more certificates and degrees earned by financially at-risk students. They worked together and with institutions to try to accomplish this transition by simplifying a complex formula that considered many fixed costs associated with an institution – faculty and staff salaries and benefit costs, costs for the support staff and structures, operations and maintenance costs, and more components – while simplifying the calculations and formula components. A common goal was making a more transparent formula, with clear incentives so as to be effective and have institutions respond. For FY13 and FY14, the state has implemented and developed a funding formula marking this transition, with increased funding dedicated to performance outcomes.

Unlike prior years, the FY15 LFC and executive funding recommendations were based on two different formula methods. (See LFC Volume II: Policy and Performance Analysis (January 2014).) Legislators and others voiced their concerns with using the different approaches during this legislative session. Importantly, both the FY15 LFC and executive recommendations included more performance funding than in prior years and added important mission-specific performance measures to recognize institutions for meeting their research, access, and retention targets. The House Appropriations and Finance Committee substitute for HB 2 built on both recommendations: increasing FY15 funding based on performance, targeting more funding towards certificate and award production generally and awards by at-risk students, and increasing funding for mission-specific performance.

HB 327 proposes to place the formula in statute to clarify the institutional I&G budget calculations, reduce the likelihood that the executive and LFC from using different approaches to build their budget recommendations, and for other purposes. HED states that the proposal will "define a process for capturing the full I&G amount," as compared to the current formula approaches advocated by either the executive or Legislature. Importantly, HB 327 includes performance outcomes that are generally supported by higher education institutions, DFA, LFC, and the Legislature (as evidenced by HB 2/CS HAFC and SB 313).

Both NMICC and CNM observe that the proposed formula provides for a wide range of outcomes, far from being predictable or marginally changing institutional budgets from year to year. Significant changes in an institution's number of units from one year to another could potentially result in shifting funding from one institution to another. NMICC notes that, under the current higher education funding formula, institutional I&G funding generally varies by no more than 5 percent to 10 percent of an institution's prior year funding level. "This bill presumes that the entire budget would be determined solely on the basis of unit value," which can vary dramatically based on the minimum (25) and maximum (100) number of units an institution generates.

Further, a common institutional concern with the current HED or executive's formula proposal is reflected in HB 327: that institutions generally are competing against each other for units because a fixed dollar amount is allocated to institutions based on the number of units generated by each individual institutions. As noted by CNM, "an institution definitely can determine how well it is performing relative to the outcomes proposed [in HB 327]. But an institution does not have access to the data to determine how well it is performing relative to other institutions….As a result, there is no way to know the budgetary impact of an individual institution's performance to plan for subsequent years." In sum, an institution could improve, and expect an increase in units as a logical consequence; however, under the proposed formula, an institution must improve above the average of all institutions' performance (which cannot be known during the data period) to secure additional units – merely improving does not generate additional units or higher values.

PERFORMANCE IMPLICATIONS

The bill would base some level of I&G funding on institutional performance. HED would determine unit values, and units available for funding based on performance. As CNM noted, an institution could improve performance year-over-year, but not generate additional units under the approach in HB 327.

ADMINISTRATIVE IMPLICATIONS

The bill includes specific deadlines for HED to promulgate rules for the formula and providing reports to the Legislature. HB 327 does not appear to be consistent with the department's pending rules, and the department would need to revise its rules should the bill be enacted.

It is unclear from the bill whether or how the formula would impact the appropriations process or affect DFA's or the Legislature's ability to use other methods to build a budget recommendation.

CONFLICT, RELATIONSHIP

As noted above, the bill is not consistent with the department's current direction as evidenced by the department's published rulemaking notice in November 2013.

If enacted, the Higher Education Finance Act must be reconciled with existing Section 21-2-5.1 NMSA 1978. A number of key factors in HB 327 are not included in Section 21-2-5.1.

The bill relates to the appropriations process for institutions, resulting in I&G purpose appropriations in the General Appropriation Act, Section 4.

TECHNICAL MATTERS

Since FY13, the HED's formula and the versions used by the Executive and LFC to base appropriation recommendations recognize the value of certificates, or postsecondary credentials that frequently require less than two years to earn, that have economic value to the student and local workforce. The formulas reward institutions for generally increasing the number of certificates and degrees earned and certificates and degrees earned in STEMH fields. HB 327, Section 4 does not reward institutions for producing certificate holders, as has prior formulas.

Also, HB 327 would reward or determine units based on the production of some degrees – those earned in STEMH fields and by financially at-risk students – but not all degrees and not for certificates in these areas. This is a departure from formulas proposed and used since FY13.

ALTERNATIVES

Both NMICC and CNM noted alternatives to the proposed bill. It was suggested that state institutional officials should meet to review the concepts proposed in HB 327 and develop workable policies and procedures for implementation.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

The HED, DFA, LFC, and institutional leaders will meet after the interim to address concerns with the funding formula. All participants will propose questions, identify possible solutions, and analyze the impacts of proposed options. The executive's and LFC's budget recommendations will be based on this information and related priorities.

POSSIBLE QUESTIONS

Have other states adopted such a formula for higher education institutions?

How does the formula in HB 327 build on the work done by the department in FY12, FY13, and FY14? How does the formula in HB 327 build on work done by institutions and supported by the Legislature in HB 2?

How does the formula in HB 327 achieve specific statewide higher education goals: increasing the state's population with postsecondary credentials, increasing the state's population with STEMH credentials and addressing state workforce needs?

THT/ds