

LONG-TERM FINANCE PLAN FOR THE UNIVERSITY OF HAWAI'I



REPORT TO THE 2008 LEGISLATURE

SCR 137 Requesting the University of Hawai'i to design
a long-term comprehensive financial plan
and

SCR 79 Requesting the University of Hawai'i to Report on the
Linking of Funding for Individual Campuses with Performance Goals

February 2008

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CURRENT STATE OF FUNDING FOR THE UNIVERSITY

The University of Hawaii's operational funding is determined for each fiscal biennium based on specific program and personnel requests. In addition, supplemental budget requests are prepared for the second year of each fiscal biennium to address unforeseen issues and funding deficiencies that have arisen after the biennium budget has been approved and implemented. State appropriations for the University fluctuate based on current spending needs and state general revenue levels.

From FY 1991 to FY 2006 total state appropriations for the University of Hawaii has increased 34.1% from \$279 million to \$374 million, but as a percentage of total state general funds it has decreased from 12.7% to 8.5%. Had the University maintained its 12.7% share of state general funds during this period, the cumulative difference in funding would have been an additional \$1.6 billion. When adjusted for inflation using the Higher Education Cost Adjustment (HECA) index, in constant 2006 dollars total state appropriations for the University decreased 16.7% though total state general funds increased 24.7%.

Table 1. State General Fund Appropriations FY 1991 to FY 2006

	State General Fund Appropriations		UH % of Total	UH share at 12.7%	Difference in Funding	Cumulative Difference in Funding
	University of Hawaii	Total				
FY 1990-91	\$279,282,667	\$2,200,326,747	12.7%	\$279,282,667		
FY 1991-92	\$333,946,431	\$2,624,510,366	12.7%	\$333,123,367	-\$823,064	-\$823,064
FY 1992-93	\$343,969,403	\$2,890,451,703	11.9%	\$366,878,720	\$22,909,317	\$22,086,253
FY 1993-94	\$351,711,907	\$3,049,574,839	11.5%	\$387,075,872	\$35,363,965	\$57,450,218
FY 1994-95	\$352,842,693	\$3,076,723,508	11.5%	\$390,521,793	\$37,679,100	\$95,129,318
FY 1995-96	\$283,114,942	\$3,032,203,591	9.3%	\$384,870,977	\$101,756,035	\$196,885,353
FY 1996-97	\$281,727,014	\$3,075,169,162	9.2%	\$390,324,503	\$108,597,489	\$305,482,842
FY 1997-98	\$273,004,765	\$3,100,439,724	8.8%	\$393,532,041	\$120,527,276	\$426,010,118
FY 1998-99	\$260,443,209	\$2,989,716,409	8.7%	\$379,478,172	\$119,034,963	\$545,045,081
FY 1999-00	\$278,280,979	\$3,027,372,255	9.2%	\$384,257,747	\$105,976,768	\$651,021,849
FY 2000-01	\$284,771,780	\$3,104,429,134	9.2%	\$394,038,408	\$109,266,628	\$760,288,477
FY 2001-02	\$293,431,981	\$3,474,013,991	8.4%	\$440,949,006	\$147,517,025	\$907,805,502
FY 2002-03	\$287,192,521	\$3,546,546,859	8.1%	\$450,155,445	\$162,962,924	\$1,070,768,426
FY 2003-04	\$310,563,330	\$3,709,080,352	8.4%	\$470,785,466	\$160,222,136	\$1,230,990,562
FY 2004-05	\$313,001,885	\$3,886,543,379	8.1%	\$493,310,460	\$180,308,575	\$1,411,299,137
FY 2005-06	\$374,484,129	\$4,417,055,390	8.5%	\$560,647,191	\$186,163,062	\$1,597,462,199
% Change FY 1991-2006	34.1%	100.7%				

Table 2. State General Fund Appropriations FY 1991 to FY 2006, in constant 2006 dollars

	HECA*	State General Fund Appropriations		% Change from prior year	
		University of Hawaii	Total	University of Hawaii	Total
FY 1990-91	0.62	\$449,753,478	\$3,543,379,969		
FY 1991-92	0.64	\$519,951,019	\$4,086,334,554	15.6%	15.3%
FY 1992-93	0.66	\$517,262,692	\$4,346,673,906	-0.5%	6.4%
FY 1993-94	0.68	\$513,464,613	\$4,452,077,779	-0.7%	2.4%
FY 1994-95	0.70	\$501,333,870	\$4,371,539,311	-2.4%	-1.8%
FY 1995-96	0.72	\$391,902,749	\$4,197,337,361	-21.8%	-4.0%
FY 1996-97	0.74	\$379,716,265	\$4,144,763,157	-3.1%	-1.3%
FY 1997-98	0.76	\$356,962,605	\$4,053,925,724	-6.0%	-2.2%
FY 1998-99	0.79	\$331,237,277	\$3,802,385,660	-7.2%	-6.2%
FY 1999-00	0.82	\$340,513,945	\$3,704,394,287	2.8%	-2.6%
FY 2000-01	0.85	\$334,493,964	\$3,646,473,706	-1.8%	-1.6%
FY 2001-02	0.88	\$333,719,725	\$3,950,990,577	-0.2%	8.4%
FY 2002-03	0.91	\$316,496,536	\$3,908,422,798	-5.2%	-1.1%
FY 2003-04	0.94	\$330,435,960	\$3,946,420,615	4.4%	1.0%
FY 2004-05	0.97	\$322,435,488	\$4,003,680,402	-2.4%	1.5%
FY 2005-06	1.00	\$374,484,129	\$4,417,055,390	16.1%	10.3%
% Change FY 1991-2006		-16.7%	24.7%		

*Adjusted for inflation using the Higher Education Cost Adjustment (HECA) index

The State Higher Education Executive Officers (SHEEO) conducts an annual State Higher Education Finance (SHEF) report which compares appropriation levels, net tuition levels and enrollment growth by state.¹ The report provides a basis to identify trends in state and student share of higher education costs and funding levels in relation to other states. According to the SHEF FY 2006 report, Hawaii's appropriations per FTE increased 31% from \$8,312 in FY 1991 to \$10,893 in FY 2006. When adjusted for inflation using the HECA index, in constant 2006 dollars appropriations per FTE actually decreased 18.6%. Net tuition per FTE in current dollars and constant 2006 dollars increased dramatically during this period. Overall, total revenue per FTE during this period increased by 50.6% in current dollars, but fell by 6.5% in constant dollars.

Annual changes in Hawaii's appropriations/tuition/total revenue per FTE in constant 2006 dollars fluctuated significantly during this period. Appropriations per FTE saw the biggest drops in FY 1996 and FY 1999 and and largest increases in FY 1997 and FY 2006. The most recent jump in appropriation levels during FY 2006 was primarily due to an overall increase in state general funds and an additional \$30 million in funds to cover costs of the 2005 Manoa flood. The largest increase in tuition per FTE naturally coincided with tuition rate increases in FY 1997.

¹ The SHEEO SHEF report includes only state and local appropriations and tuition and fee revenue since these are the principal revenue sources to support instructional programs. Appropriations exclude support specifically for independent institutions, research, agriculture and medicine. Net tuition and fees excludes state financial aid, institutional discounts and waivers, and medical school tuition.

Table 3. SHEF Hawaii Revenue per FTE FY 1991 to FY 2006

	FTE ¹	Current Dollars			Constant 2006 Dollars			% Change from prior year in constant 2006 Dollars		
		Appropriations per FTE ²	Tuition per FTE ³	Total Revenue per FTE ⁴	Appropriations per FTE ²	Tuition per FTE ³	Total Revenue per FTE ⁴	Appropriations per FTE ²	Tuition per FTE ³	Total Revenue per FTE ⁴
FY 1991	29,970	\$8,312	\$734	\$9,046	\$13,385	\$1,182	\$14,567			
FY 1992	30,796	\$8,167	\$912	\$9,079	\$12,715	\$1,421	\$14,136	-5.0%	20.2%	-3.0%
FY 1993	31,917	\$8,638	\$971	\$9,609	\$12,990	\$1,461	\$14,451	2.2%	2.8%	2.2%
FY 1994	32,969	\$8,284	\$986	\$9,269	\$12,093	\$1,439	\$13,532	-6.9%	-1.5%	-6.4%
FY 1995	33,378	\$8,455	\$944	\$9,398	\$12,013	\$1,341	\$13,354	-0.7%	-6.8%	-1.3%
FY 1996	32,708	\$7,420	\$1,021	\$8,441	\$10,271	\$1,414	\$11,685	-14.5%	5.4%	-12.5%
FY 1997	30,633	\$9,141	\$1,668	\$10,809	\$12,321	\$2,248	\$14,569	20.0%	59.1%	24.7%
FY 1998	29,993	\$9,347	\$1,970	\$11,317	\$12,221	\$2,576	\$14,797	-0.8%	14.6%	1.6%
FY 1999	32,625	\$7,744	\$1,900	\$9,645	\$9,849	\$2,417	\$12,266	-19.4%	-6.2%	-17.1%
FY 2000	32,484	\$8,635	\$2,039	\$10,674	\$10,567	\$2,495	\$13,062	7.3%	3.2%	6.5%
FY 2001	31,810	\$8,419	\$2,066	\$10,485	\$9,889	\$2,427	\$12,316	-6.4%	-2.7%	-5.7%
FY 2002	33,063	\$8,211	\$1,958	\$10,169	\$9,339	\$2,227	\$11,565	-5.6%	-8.2%	-6.1%
FY 2003	34,420	\$8,802	\$2,076	\$10,878	\$9,700	\$2,288	\$11,987	3.9%	2.7%	3.6%
FY 2004	35,441	\$9,293	\$2,355	\$11,649	\$9,888	\$2,506	\$12,394	1.9%	9.5%	3.4%
FY 2005	35,733	\$9,395	\$2,510	\$11,905	\$9,678	\$2,586	\$12,264	-2.1%	3.2%	-1.0%
FY 2006	35,337	\$10,893	\$2,731	\$13,625	\$10,893	\$2,731	\$13,625	12.6%	5.6%	11.1%
%Change FY 1991-2006		31.1%	272.1%	50.6%	-18.6%	131.0%	-6.5%			

1. Annual FTE based on instructional activity, less medical FTE.

2. State government tax and non-tax support less state support to independent institutions.

3. Gross assessments for tuition & mandatory fees less institutional discounts & waivers, state-funded student financial aid, and medical student tuition revenues.

4. Appropriations per FTE plus Tuition per FTE

How did Hawaii compare to other states during this period? After adjusting for differences in enrollment mix, cost of living, and inflation, Hawaii saw a 15.2% decline in appropriations per FTE, a 140.6% increase in net tuition per FTE and overall decrease in total revenue per FTE of 2.6%. The US average of appropriations per FTE decreased by 9.0%, net tuition per FTE increased 44.9% and total revenue per FTE increased 5.1%. However, though Hawaii's appropriations decreased more and tuition increased more than the US average, total revenue per FTE in FY 2006 of \$10,239 was 3.5% higher than the US average of \$9,891. From FY 1991 to FY 2006 Hawaii had higher than average appropriations per FTE and lower tuition per FTE.

Hawaii's total revenue per FTE from year to year fluctuated quite dramatically at times, driven mostly by changes in appropriations rather than tuition, as well as changes in enrollment. For example, in FY 1996 total revenue per FTE decreased by 12.5% from the prior year, but in FY 1997 it increased by 24.7% due to a large decrease in enrollment.

Table 4. SHEF Hawaii vs. US Average Revenue per FTE FY 1991 to FY 2006, in constant 2006 dollars

	Hawaii - Adjusted ¹			US Average			Difference from US Average		
	Appropriations per FTE ²	Tuition per FTE ³	Total Revenue per FTE ⁴	Appropriations per FTE ²	Tuition per FTE ³	Total Revenue per FTE ⁴	Appropriations per FTE ²	Tuition per FTE ³	Total Revenue per FTE ⁴
FY 1991	\$9,657	\$853	\$10,510	\$6,954	\$2,460	\$9,414	38.9%	-65.3%	11.6%
FY 1992	\$9,141	\$1,021	\$10,162	\$6,557	\$2,654	\$9,211	39.4%	-61.5%	10.3%
FY 1993	\$9,551	\$1,074	\$10,625	\$6,317	\$2,818	\$9,135	51.2%	-61.9%	16.3%
FY 1994	\$9,002	\$1,071	\$10,073	\$6,393	\$2,912	\$9,305	40.8%	-63.2%	8.3%
FY 1995	\$9,055	\$1,011	\$10,066	\$6,606	\$2,990	\$9,596	37.1%	-66.2%	4.9%
FY 1996	\$7,770	\$1,070	\$8,840	\$6,682	\$3,095	\$9,777	16.3%	-65.4%	-9.6%
FY 1997	\$9,413	\$1,718	\$11,131	\$6,899	\$3,126	\$10,025	36.4%	-45.0%	11.0%
FY 1998	\$9,501	\$2,003	\$11,504	\$7,103	\$3,137	\$10,240	33.8%	-36.1%	12.4%
FY 1999	\$7,832	\$1,923	\$9,755	\$7,277	\$3,134	\$10,411	7.6%	-38.7%	-6.3%
FY 2000	\$8,473	\$2,001	\$10,474	\$7,343	\$3,049	\$10,392	15.4%	-34.4%	0.8%
FY 2001	\$7,858	\$1,928	\$9,786	\$7,371	\$3,044	\$10,415	6.6%	-36.7%	-6.0%
FY 2002	\$7,298	\$1,740	\$9,038	\$7,100	\$3,050	\$10,150	2.8%	-42.9%	-10.9%
FY 2003	\$7,377	\$1,739	\$9,116	\$6,494	\$3,115	\$9,609	13.6%	-44.2%	-5.1%
FY 2004	\$7,520	\$1,906	\$9,426	\$6,105	\$3,266	\$9,371	23.2%	-41.6%	0.6%
FY 2005	\$7,303	\$1,951	\$9,254	\$6,017	\$3,442	\$9,459	21.4%	-43.3%	-2.2%
FY 2006	\$8,186	\$2,053	\$10,239	\$6,325	\$3,566	\$9,891	29.4%	-42.4%	3.5%
% Change FY 1991-2006	-15.2%	140.6%	-2.6%	-9.0%	44.9%	5.1%			

1. Adjusted for enrollment mix and cost of living

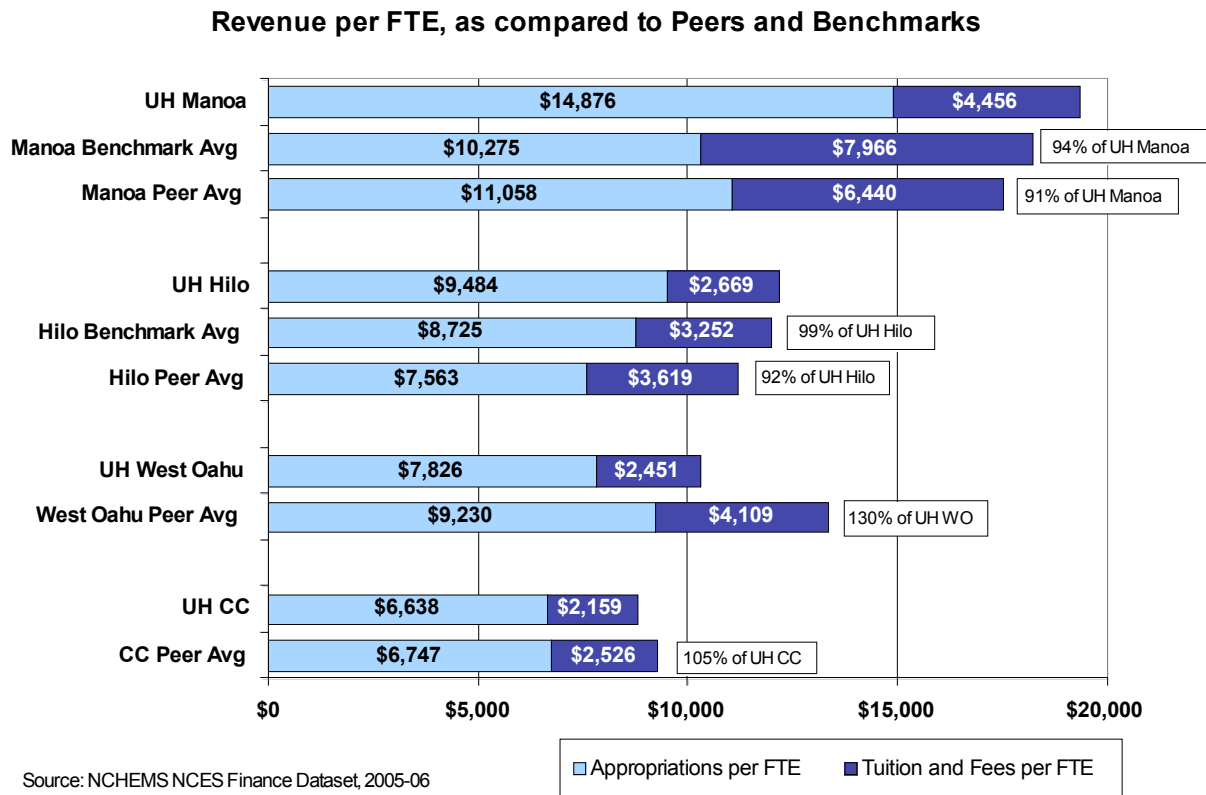
2. State government tax and non-tax support less state support to independent institutions.

3. Gross assessments for tuition & mandatory fees less institutional discounts & waivers, state-funded student financial aid, and medical student tuition revenues.

4. Appropriations per FTE plus Tuition per FTE

The trend over this period in Hawaii was a decrease in state appropriations and increase in net tuition, moving from a 90/10 split in state/student share to 80/20. State share of operational costs in the US in FY 2006 ranged from a high of 85.5% in New Mexico to a low of 21.9% in Vermont, with a US average of 63.9%. At 80%, Hawaii's state share of higher education costs is higher than the average but is not the highest. The large variance in state support levels are indicative of the wide-ranging differences in population, resource bases, institutional and enrollment mix, program emphasis, and tuition policies among states.

Chart 1. University of Hawaii Revenue per FTE, as compared to Peers and Benchmarks



When each University of Hawaii campus is compared to its peer or benchmark institutions, tuition and fees per FTE are lower than the average for peer/benchmark institutions. Appropriations per FTE and total revenue per FTE at the Manoa and Hilo campuses are higher than the average for peer/benchmark institutions, while at West Oahu and the Community Colleges appropriations per FTE and total revenue per FTE were lower than the average of peer institutions. However, without adjusting for differences in cost of living or the size of the higher education systems each institution belongs to (which may benefit from economies of scale that the University of Hawaii does not have), it is possible that even at Manoa and Hilo total revenue per FTE could be at or below peer/benchmark institutions.

While the SHEEO SHEF report and comparison of the University of Hawaii campuses to peer and benchmark institutions are starting points for comparing states and institutions in revenue per student, they should not be used to determine appropriate or sufficient funding. Simply comparing Hawaii to the US average or other states or peer/benchmark institutions wouldn't take into consideration a plethora of external forces not reflected in the interstate financial analysis unique to each state and institution. As outlined by Dennis Jones in his paper *Financing in Sync: Aligning Fiscal Policy with State Objectives*, determining appropriate funding requires educators and policymakers to first define state objectives for higher education, to clarify and set specific goals, and to develop strategies to achieve those goals. The

appropriate level of funding could then be determined by understanding the costs to achieve those goals and objectives.¹

THE UPDATED STRATEGIC PLAN

“Our UH system strategic plan provides a strong vision to which we can aspire, but as we move into our second century, we need to take another look at how best to position the University to meet the needs of the state.” UH President David McClain

The University of Hawaii System Strategic Plan was introduced in 2002 as a means for the University to chart its course through 2010. The Strategic Plan outlined the University’s vision, mission, commitments and core values, and planning imperatives. The plan identified five key strategic goals for the University as a means of advancing its strategic imperatives.

Strategic goals:

1. Educational effectiveness and student success
2. A learning, research, and service network
3. A model local, regional and global University
4. Investment in faculty, staff, students and their environment
5. Resources and stewardship

In fiscal year 2007-2008 the University of Hawaii celebrates its centennial. In addition to recognizing achievements of the past one hundred years, the year also marks an opportunity for the University to reexamine its Strategic Plan and to update it for the next eight years. As the only public higher educational institution in the state, the University of Hawaii is largely responsible for helping the state meet its higher education needs. The higher education needs of the State identified by the Second Decade Project include:

- Increasing the educational capital of the state
- Expanding workforce development initiatives
- Assisting in diversifying the economy
- Address underserved regions and populations of the state, particularly Native Hawaiians

In addition, we need to renew and expand the infrastructure necessary to address these four focus areas.

Central to the discussions on updating the Strategic Plan are the questions of how will the University know when it has met its goals and are there specific targets and timelines for its action strategies? By what measures will the University be evaluated and held accountable?

Through a series of discussions at all ten campuses during the Fall 2007 semester, the System Strategic Plan is being updated as necessary to reflect any new or revised goals, action strategies, and importantly, performance measures that help to address state needs. Varying campus missions will also require each campus to develop its own Strategic Plan in line with the System Strategic Plan.

EDUCATION COMPACT

One alternative to better align higher education with state needs is through the concept of an education compact. A higher education compact is an agreement between state government, the higher education system, the Board of Regents, and the private sector on a public agenda that aligns higher education policies, programs, curricula and resources with current, emerging and future economic needs of the state. A higher education compact should define the long-term goals to address Hawaii's major economic challenges and align the University of Hawaii to the achievement of these goals. The University would be accountable for meeting performance standards in exchange for budget predictability and reduced regulatory and bureaucratic burdens. Through the compact, the Governor and Legislature would provide clear direction on state expectations and priorities for the University. The State would commit to guaranteed funding levels as well as increased flexibility in exchange for the University's commitment to meeting the compact's goals. The higher education compact could be used to clearly link funding for the University with specific goals and performance measures.

ROLE OF A FINANCE PLAN

Long-Term Finance Plan

These days most universities have developed strategic plans, but few institutions also have an accompanying finance plan. So while we know where we want to be and what we want to achieve, how to get there and what it will cost to get there is not so clearly defined. It will be difficult to achieve the Strategic Plan's goals through incremental budgets, short-term plans, or reactions to external forces. A long-term finance plan can help by clearly indicating the long-term costs of achieving the strategic goals, and by providing long-term funding targets for each institution within the University of Hawaii System.

Medium-Term Financial Plan

Concurrent with the development of the Strategic Plan, each campus will also develop a medium-term financial plan. The medium-term financial plan will cover a 3 biennium period, starting with the 2009-11 biennium budget and extended to 2015 to cover the same period as the Strategic Plan. The financial plan will outline the financial costs to achieve the Strategic Plan and will be based on measurable goals.

ALIGNMENT OF POLICIES

Dennis Jones' *Financing in Sync: Aligning Fiscal Policy with State Objectives*, also asserts that the only way for states to fully realize the economic and quality of life benefits of an educated citizenry is to structure higher education financing policies that are "mutually reinforcing around a common objective." States provide funding for higher education for two main reasons: to build core capacity and to utilize capacity to promote state priorities.

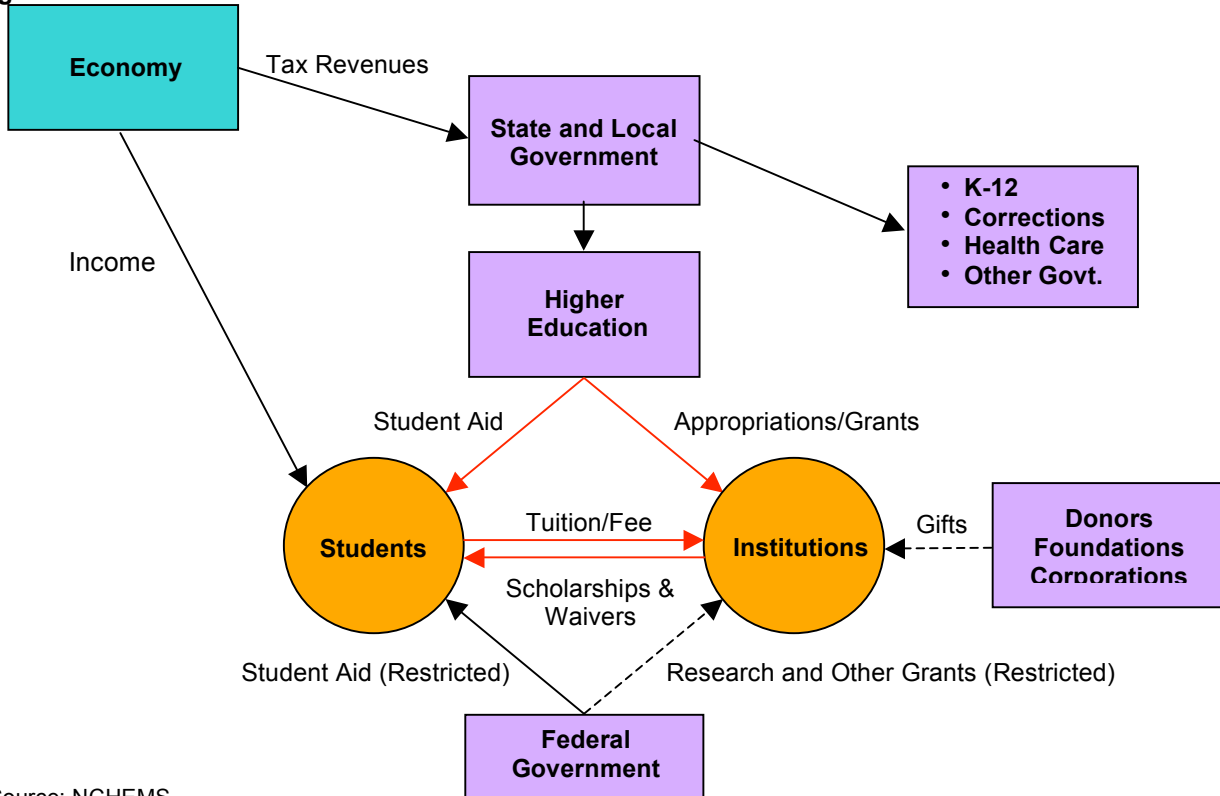
First, states recognize the broad societal benefits of an educated population.

“The most widely recognized gains from postsecondary education are the economic benefits that individual graduates receive in terms of greater lifetime income. But it isn’t just the individuals who have gone to college who benefit: the larger society also gains. Not only do graduates pay more taxes on their typically higher incomes, but they also tend to have better health, rely less on government social programs, are less likely to be incarcerated, and are more likely to engage in civic activities. In fact, each type of benefit leads to others, producing a cascade of benefits from postsecondary education.” Alisa Cunningham²

States want to have a highly educated population and wish to ensure their higher education systems have the capacity to meet the education demands of its citizens. Therefore, the major focus of state funding is general purpose funding to build core capacity. Since appropriations and tuition are the two main sources of funding for capacity building, normally the higher the level of state funding, the lower the level of tuition and vice versa.

The second purpose is funding to promote state priorities. Most funding has so far been student-focused, primarily in the form of need-based or merit-based student financial aid. Gaining in popularity is institution-focused performance funding. Performance funding provides additional resources to institutions and is conditioned on the achievement of identified state priorities.

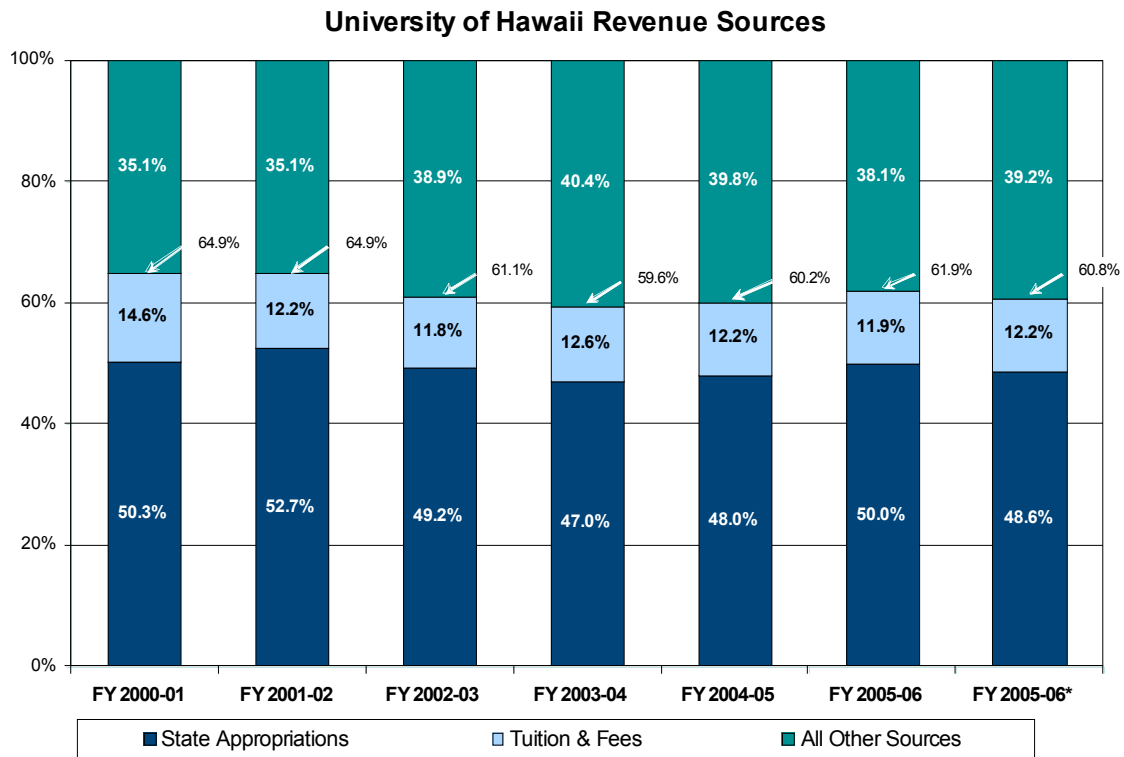
Figure 1. Flow of Funds



Source: NCHEMS

The Flow of Funds figure illustrates the relationship between the entities that have a role in financing higher education. The primary sources of unrestricted operating revenues come from the state via appropriations and from students via tuition and fees. State appropriations and tuition and fees comprise about 60% of the total revenue for the University of Hawaii. This core funding is more or less used to provide formal degree-level courses. The remaining 40% of university revenue is generated from other important sources of revenue. Funds from the federal government and from private sources represent about 30% of revenue, but these funds typically do not support general operating expenses. Most funds from the federal government are specifically earmarked for research or other restricted activities, and gifts from donors, foundations and corporations are usually provided with stipulations to be used only in ways specified by the donor. Auxiliary revenue generated by such functions as bookstores, food services, and athletics, is essentially self-supporting and these functions do not use state funding.

Chart 2. University of Hawaii Revenue Sources FY 2001 to FY 2006



*Excluding \$31 million in state appropriations for the October 2005 Manoa flood

Thus, in formulating the University's long-term finance plan, the primary focus will be on the following four components:

1. State appropriations
2. Tuition and fees
3. State student financial aid
4. Institutional student financial aid

The three major players in public higher education (state government, students, and institutions) have different core objectives. State governments want to control costs but also provide broad access to education for its citizens and have the necessary educational capital to meet the economic needs of the state. Students seek affordable access to quality higher education. Institutions desire adequate and stable levels of funding to fulfill their educational missions at high levels of excellence. If a funding policy is not appropriately aligned, one or more participant will suffer: taxpayers pay more than their fair share, students cannot afford to pay for their education, or institutions do not have the necessary resources to carry out their missions. What do the major players expect from higher education financing policy?

State expectations

States expect financing policies to be affordable, given actual tax revenues and the priority of higher education in the state. Financing policies should also allow institutions to have the capacity to meet student demand and produce the outcomes to meet state needs. States have at their disposal control over direct appropriations to the institutions and direct student financial aid. They may also have control or influence over tuition levels and institutional student financial aid.

Student expectations

Affordability and value are the primary student expectations of financing policy. Students want the net price of higher education to be affordable, and the quality of education to be high enough to be of value. To a certain extent students have at their disposal a competitive marketplace of higher education providers from which to select. In Hawaii, students' options may be limited due to the distance from other universities and the high tuitions of mainland institutions as compared to the University of Hawaii.

Institution expectations

Institutions expect financing policies to provide adequate funding to allow the institution to fulfill their educational missions at high levels of quality. Additionally, institutions seek to have equitable funding for different institutions given varying missions (e.g. research university vs. community college) and funding that is fairly stable.

Keeping in mind these state, student and institution expectations, effective finance policy criteria should:

- Meet state priorities
- Create and maintain institutional capacity necessary to meet those priorities
- Ensure affordability for the state and students
- Be fair for both sides
- Be transparent

FUNDING POSSIBILITIES

There are many different methods used by states and institutions to determine funding levels. Some examples include:

Peer-Driven Funding

A peer-driven funding method looks at an institution's appropriation levels relative to a group of self-selected peer institutions. Funding goals aim to achieve comparable levels of funding over a given period. Example: North Dakota University System's 2001 goal to be at 85% of peers within six years and 95% of peers within 12 years.

Enrollment-Driven Funding

Enrollment-driven funding has a fixed and variable portion. Institutions are provided a base budget, and additional funds are provided based on enrollment growth. Example: California 2006-07 Budget Act provided enrollment growth funding of \$9,901 per student for University of California institutions and \$7,225 per student for California State University institutions.

Base-plus

Base-plus funding assumes prior year budgets will be available for next year's budget plus any adjustments (i.e. salary increases, inflation adjustments).

Cost-share Policy

An agreement is established between the state and institution that sets the appropriate state and student share of the cost of instruction.

Example: The Connecticut Board of Governors for Higher Education tuition policy targets the student share of the Education and General budget to be within the following percentage range:

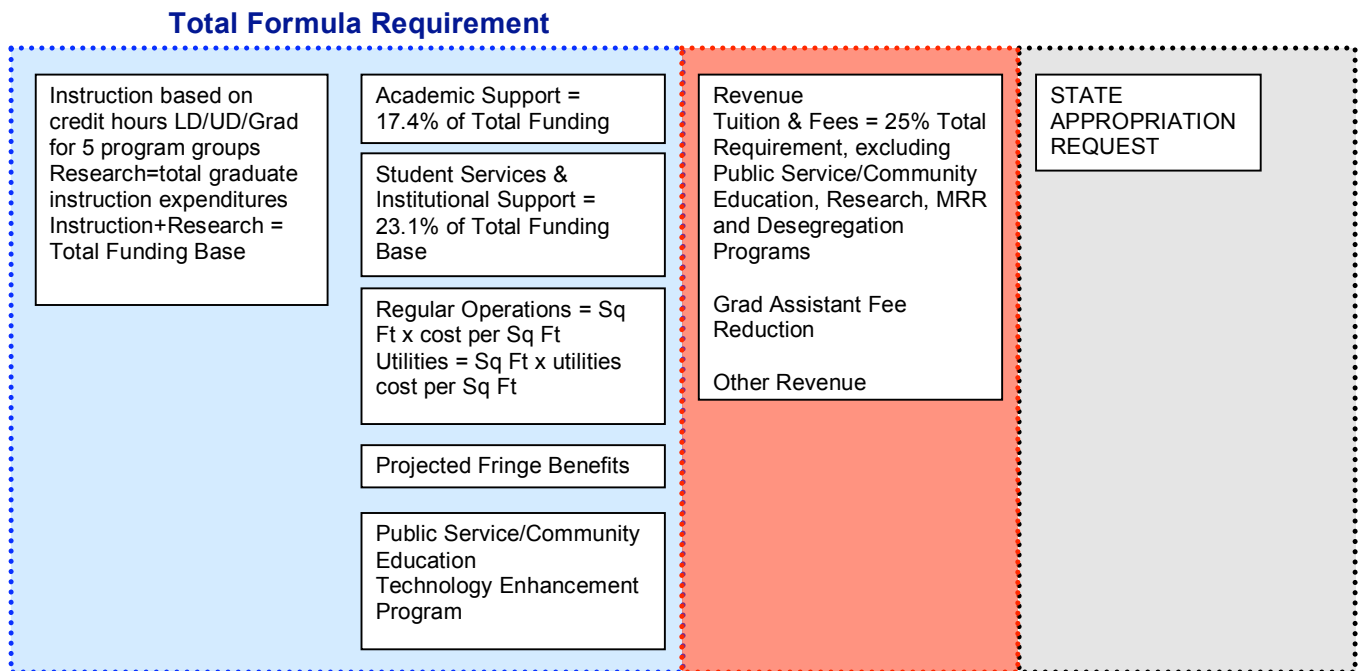
	<u>Minimum</u>	<u>Policy Goal</u>
University of Connecticut	30%	35%
Connecticut State University	30%	35%
Community Colleges	25%	30%

Formula Funding

Formula funding uses a mathematical relationship between levels of activity (i.e. student credit hours) and cost to arrive at an estimation of future budget requirements. There is no single "correct" formula, but rather depends on the best judgment of what works best for each state/institution.

Figure 2. Formula Funding Example: University of Georgia

$$\text{Total Funding Base} + \text{Other Expenditures} - \text{Revenue} = \text{Funding Request}$$



ADVANTAGES

- Objective cost-productivity measure
- Provides equitable distribution of funds among institutions
- Results in more adequate levels of support
- Easy to understand
- Based on quantifiable data
- Minimizes political involvement/influence

DISADVANTAGES

- Focuses on current needs and not long-range planning
- Not able to react quickly to changes in market or demand
- May have no incentive for innovation
- No quality measurements
- Formulas may not be linked to public policy
- May perpetuate past inequities
- May disadvantage nontraditional education delivery models (continuing education, distance learning, etc.)
- May become very complicated

Performance Funding

Performance funding provides rewards to institutions for meeting agreed upon goals. Example: In 2007 Texas Governor Rick Perry proposed a bill to allow for \$350.2 million in performance funding, which was later approved by the Texas Legislature for \$100 million. Under this performance funding plan, Texas universities and community colleges would receive financial rewards for meeting state goals, based primarily on the number of degrees awarded.

Texas Performance Funding Proposal

INSTITUTION	MEASURE	ESTIMATED AVERAGE REWARD
Universities	<ul style="list-style-type: none"> Degrees awarded with additional weight for students considered at-risk, majors in engineering, math, physical science, nursing, computer science, allied health, math/science teacher education Master's, doctoral and professional degrees awarded 	\$2,229 per graduate
Community/ Technical Colleges	<ul style="list-style-type: none"> Certificates earned in approved programs and associate degrees completed Students completing at least 30 hours with a GPA of 2.5 or higher who transfer to a 4-year state college High scores on a general education or licensure exam Additional weight for majors in engineering technology, computer science, math, physical science, allied health and nursing 	\$1,216 per certificate/ degree/ transfer student
Health-related Institutions	<ul style="list-style-type: none"> Degrees, residencies completed, and licensure exams with additional weight for at-risk students and primary care residencies 	\$8,200 per degree or residency completed
Exit Exams	<ul style="list-style-type: none"> Baccalaureate graduates will be given an exit exam, and additional weight and money will be awarded for students with high scores on the exam Licensure exams or major field tests provided by the Educational Testing Service (GRE, PRAXIS, etc.) will be used for various degrees to which these exams apply 	

WHAT OTHER INSTITUTIONS ARE DOING

The following survey was conducted by State Higher Education Executive Officers (SHEEO) on our behalf in September 2007:

The 2007 Hawaii State Legislature has adopted a resolution requiring the University of Hawaii to submit a report on its findings and recommendations for a long-term comprehensive financial plan, particularly with respect to the appropriate balance between state appropriations, tuition and external funds. Part of the requirement for the report to the Legislature includes a survey of other states. We would appreciate your assistance in responding to the following questions:

- Does your State/System have a long-term (beyond the current or next year) financial plan? (Yes/No)
- If yes, what was the mechanism for establishing a financial plan? (e.g. board policy, legislation, practice)
- If yes, does it specify the share of higher education funding to be supported by:

	Yes/No	How is the share determined? (e.g. funding formula, minimum appropriation levels, compacts with state legislature, internal estimates)
State Appropriations		
Tuition and Mandatory Fees		
Other Funding Sources		

4. Does your financial plan include performance related goals and incentives? (Yes/No)
 If yes, what are your performance measures and/or incentives?

Twenty states responded to the SHEEO survey with the following results:

Response	Yes - 1	Developing - 3	No - 16
States	North Dakota	Arizona, Washington, West Virginia	Arkansas, California, Connecticut, Delaware, Georgia, Illinois, Louisiana, Maine, Minnesota, Nebraska, Nevada, Ohio, Pennsylvania, Tennessee, Utah, Wyoming

North Dakota was the only state that responded that has a long-term financial plan. Three other states, Arizona, Washington, and West Virginia, are currently working on developing strategic plans with a long-term financial/funding component, while the 16 remaining respondents do not have a long-term financial plan.

NORTH DAKOTA EXAMPLE

In 1999 the North Dakota Legislative Assembly passed a resolution requesting a study to “...*address the expectations of the North Dakota University System in meeting the state’s needs in the 21st century, the funding methodology needed to meet these expectations and needs, and an accountability system and reporting methodology for the University System.*”³ By 2002 and every six years thereafter, the State Board of Higher Education (SBHE) would have to report to the Governor and Legislative Council on the status of the university system and the long-term goals and objectives that would best serve the state. A Roundtable on Higher Education comprised of 61 representatives from the North Dakota University System (NDUS), the private sector, the executive and legislative branches, K-12 education and other state agencies was formed.

The Roundtable outlined the expectations for all the key stakeholders of higher education and identified agreed upon accountability measures. These Roundtable goals and recommendations were adopted by the SBHE in 2000 and laid the foundation for the NDUS strategic plan. In addition to the mission, vision, beliefs and core values of the NDUS, long-range goals of the SBHE, and accountability measures, the strategic plan also included a corresponding long-term finance plan. The long-term finance plan addressed the funding methodology for the strategic plan and was approved by the State Board of Higher Education in 2001.

Important companion documents to the NDUS strategic plan are the annual operating plan, action plans, and accountability measures. The operating plan includes annual objectives that help achieve the long-term strategic goals and the action plans describe the tasks/steps for accomplishing each objective. The accountability measures published each year are linked to the strategic plan and over time will allow stakeholders to determine if progress is being made toward the long-term goals.

North Dakota's strategic plan has six cornerstones and each cornerstone has a set of accountability measures. The North Dakota Legislative Assembly in 2001 enacted 25 accountability measures, and the SBHE adopted 12 additional measures it considered important to the board and useful to the NDUS campuses. In 2005 the Legislative Assembly approved a proposal to reduce the number of measures from 25 to 22, and the SBHE reduced its measures from 12 to 9.

North Dakota University System Long-Term Finance Plan

North Dakota's long-term finance plan has 3 key components: base operating funds, capital asset funds and incentive funds. These three funding components address operations, infrastructure and performance, but not major capital projects. The long-term finance plan provides guidance for the allocation of *additional* state general fund appropriations, but not for reallocation of existing state general funds.

Base Operating Funds

Base operating funds are used to support core campus functions: instruction, research and public service.

- Parity: These funds are necessary for the university to remain at status quo, continuing to offer current programs and services and adjusted only for inflation and salary/benefit increases.
- Equity: Additional operating funds are needed to move campuses closer to the goal of attaining funding level equity with peer institutions.

Capital Asset Funds

Capital asset funds are used for repair and replacement of facilities and deferred maintenance.

- Current repair and replacement: These funds are needed to cover the cost of repair and replacement of facilities and infrastructure.
- Deferred maintenance: Funds are also needed to address the deferred maintenance backlog at each campus, including health and safety concerns, ADA compliance, computer networking, and other major repairs.

Incentive Funds

Incentive funds provide funding to finance special SBHE initiatives that support state and system priorities. These funds would be used to reward collaboration, increasing access to education, incorporating entrepreneurial behavior, demonstrating accountability, and/or exemplifying other actions envisioned by the Roundtable on Higher Education.

North Dakota University System Long-Term Finance Plan: Three Key Components

COMPONENT	APPLICATION	GOAL
<p>1. Base Operating Funds</p> <p>Support core campus functions: instruction, research and public service. Forms the foundation upon which campuses leverage other resources</p>	<p>Parity</p> <p>Funds needed to continue current programs and services</p> <p>Includes: salaries, benefits, inflationary cost increases</p> <p>Equity</p> <p>Funds needed to move each campus closer to “benchmark” or average funding level of peer institutions</p>	<p>Allocate no more than 20% of new funding to parity and no less than 80% to equity</p> <p>Move campuses to 85% of peer institution funding within six years (by 2007-2009) and to 95% of peer institution funding within 12 years (by 2013-15)</p>
<p>2. Capital Asset Funds</p> <p>System-wide funding model for repair and replacement of facilities based on age, replacement value and the deferred maintenance backlog at each campus</p>	<p>Current Repair and Replacement</p> <p>Funds needed to cover current repair and replacement of facilities and infrastructure (not including major capital projects)</p> <p>Deferred Maintenance</p> <p>Funds needed to address deferred maintenance of facility and infrastructure</p> <p>Includes: health and safety, ADA compliance, computer networking, other major repairs</p>	<p>Move campuses to 100% of the building and infrastructure formula over a 10-year period (by 2011-13) and addresses deferred maintenance over a 14-year period (by 2015-17)</p>
<p>3. Incentive Funds</p> <p>Provide the State Board of Higher Education flexibility to finance special initiatives that support state and system priorities consistent with the goals of the Roundtable on Higher Education</p>	<p>Funds used to provide incentives for collaboration, increasing access to education, incorporating entrepreneurial behavior, demonstrating accountability and/or exemplifying other actions envisioned by the Roundtable on Higher Education</p>	<p>Dedicate 2% of North Dakota University System state appropriations to special initiatives by 2007-09</p>

The NDUS has the following targets for state and student share of the cost of education:

Institution Type	State Share	Student Share
Research	60%	40%
Master's	65%	35%
4-year	70%	30%
2-year	75%	25%

RECOMMENDED FUNDING PLAN FOR THE UNIVERSITY OF HAWAII

In FY 1989-90, the Hawaii Legislature provided the University \$150,000 to develop a higher education master plan “in order to determine proper funding appropriations in the future, for general fund appropriation for institutional support.”⁴ The master plan for the University of Hawaii System developed by the Board of Regents and published in January 1991 had two major goals: to design a higher education system to meet the future needs and demands of the State, and to become an international educational, research and service center known for excellence in the US and throughout the Pacific/Asia. In addition, the Legislature also provided \$25,870,034 for nonrecurring repair and maintenance and \$17,037,666 for nonrecurring equipment expenditures for the 1989-1991 biennium. Just as important as funding for improving education, gaining prominence in research, providing service to the State, expanding access to education, or maintaining diverse campus missions, is funding for maintaining and improving the University’s infrastructure.

The long-term finance plan for the University of Hawaii should align state, student and institution policies, and include agreed-upon goals and measures. Ultimately, the purpose for developing a long-term finance plan is to provide a level of stability and predictability in funding for the University. The funding plan should be simple enough to prevent being bogged down by details, but broad enough to allow for flexibility in addressing market or priority changes. The recommended funding plan for the University will aim to align state appropriations, tuition and fees, state student financial aid and institutional student financial aid policies. The intended result of the finance policy is to find a balance that allows the University to meet state priorities while ensuring affordability and fairness for both the State and students.

1. State Appropriations

Using North Dakota University System’s long-term finance plan as a starting point, the recommended funding plan for the University of Hawaii System will also be comprised of the same basic key components: operations, capital infrastructure, and incentives.

1. Operations	Base-plus approach: determine the amount of funding needed to maintain current programs and services, including adjustments for inflation and pay increases, use peer funding per FTE as an indicator of adequacy of funding
2. Capital Infrastructure	Funding to address Repair and Maintenance as well as the Deferred Maintenance backlog
3. Incentives	Funding to achieve specific goals to meet state needs

Currently, the University’s budget is built each biennium through a series of individual funding requests. Any time the University would like to add, expand or change an existing program it must submit a Program Change Request for funding. When additional resources are needed, new positions must be approved. Additionally, budgeting is done by object symbol, or specific expenditure categories. The recommended

funding plan would eliminate line-item budgeting, and instead allow campuses, colleges, and departments to prioritize their allocations.

The expectation is that given the added flexibility of this approach, campuses will be more efficient and discerning in their expenditures, and will have the means to reallocate funds as needed to meet changing demands. Incentive funding is a concept that in recent years has been gaining traction. The premise is that providing monetary rewards will encourage faculty and administrators to maximize funding by pursuing activities that result in achieving specific goals designed to meet state needs. This approach would also ensure that infrastructure needs are not overshadowed by a focus on educational output. The result would be a win-win situation for all parties: state needs and priorities are met, campuses are provided a predictable level of funding with additional spending flexibility, and students are provided with an education that meets their needs.

2. Tuition and Fees

In May 2005 the Board of Regents approved a tuition and fee schedule for all campuses for the 2006-2007 through 2011-2012 academic years. The tuition increase amounts aim to bring the UH tuition up to either the projected national average or Western Interstate Commission for Higher Education (WICHE) average in 2011-2012. The tuition increases are necessary to reduce the projected funding gap between expected revenue and campus needs. A proposed mid-schedule review during Spring 2009 will be used to assess the impact of the tuition increases and the future funding needs of the University.

3. State Student Financial Aid

The State of Hawaii provides the B Plus Scholarship program. This program grants scholarships for Hawaii residents that enroll in any campus within the University of Hawaii system, provided they graduated from a Hawaii public high school after 2005, completed a rigorous high school curriculum, had a cumulative grade point average of 3.0 or higher, are considered low-income according to the State of Hawaii Department of Education's guidelines for students qualifying for the free and reduced price lunch program, and completed the Free Application Federal Student Aid (FAFSA) form. Awards may be renewed for up to four years with the possibility of renewal for a fifth year in exceptional circumstances.

4. Institutional Student Financial Aid

The University of Hawaii Board of Regents provides student financial assistance in the form of grants and scholarships funded by tuition revenues. They include need-based Opportunity Grants and non-need based Achievement Grants which include merit scholarships such as the Regents and Presidential Scholars for Hawaii residents, International Student Scholarships, and Pacific Islander Scholarships. The University also participates in the WICHE Graduate Student Exchange Program and provides tuition exemptions for senior citizens, faculty, staff, spouses or domestic partners of faculty/staff, graduate assistants, and Native Hawaiian students. Waivers of non-resident tuition differentials are also provided for East-West Center

student grantees, military personnel and dependents, members of the Hawaii National Guard and the Hawaii Reserves, non-resident Native Hawaiians, and non-resident employees of the University and their spouses and dependents. Additionally, citizens from eligible Pacific Island jurisdictions qualify for tuition rates at 150% of the resident tuition rate.

The current policies regarding tuition and fees, state student financial aid and institutional student financial aid were all developed at different times and likely with varying objectives. The long-term finance plan for the University should reexamine these policies as well as the recommended state appropriations funding policy in context with each other. Appropriate alignment of policies will ensure an equitable split between state and student share of higher education costs, maximize affordable access for low-income students, and provide the University with a level of funding necessary to meet the State's higher education needs.

Figure 3. Linking Goals, Funding and Performance Measures

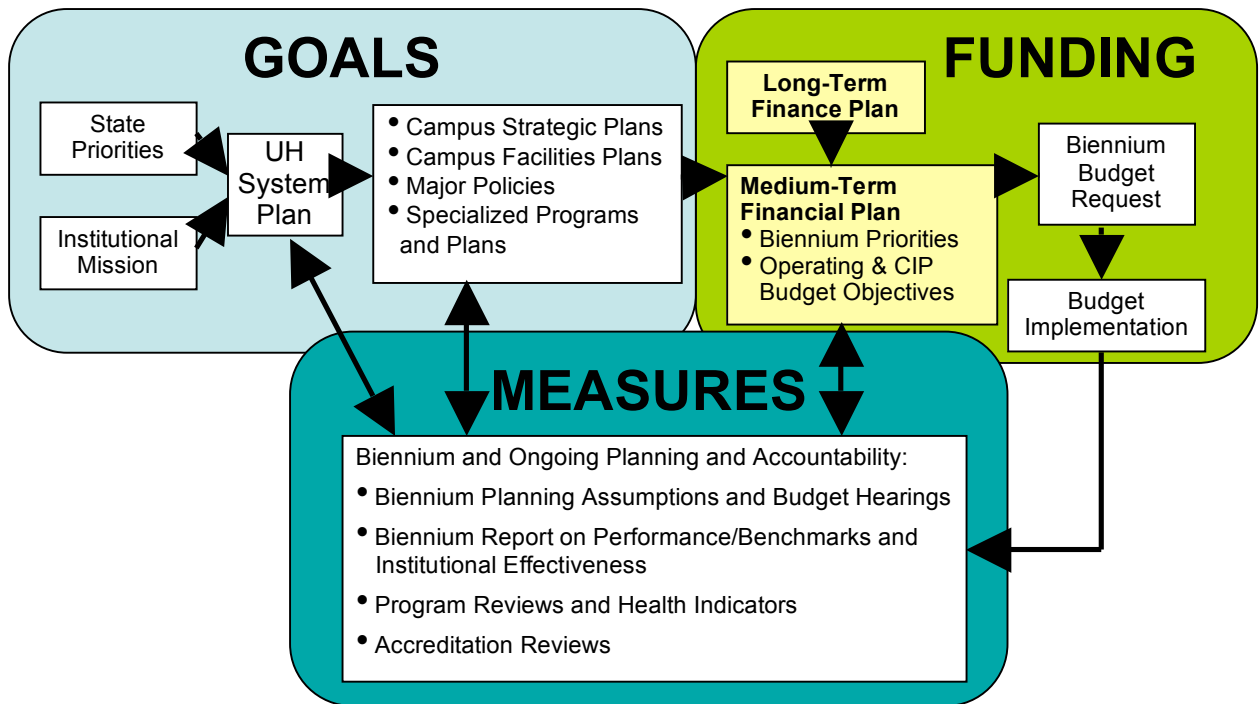


Figure 3 outlines the way in which the University's goals, funding and performance measures will be linked. State priorities and institutional mission will determine the Strategic Plan goals. The Strategic Plan goals as well as the Long-Term Finance Plan will drive funding needs for the Medium-Term Financial Plan and biennium budget requests. Performance measures for which the University will be held accountable will be used to measure progress against the Strategic Plan as well as to determine future funding.

SYSTEM STRATEGIC OUTCOMES AND PERFORMANCE MEASURES

As mentioned earlier, we are in the process of updating the University of Hawaii System Strategic Plan. The initial round of strategic plan discussions conducted by the Vice President for Academic Planning and Policy across the ten campuses has validated the importance of the existing system strategic goals. More importantly, however, the discussions have resulted in the following strategic outcomes and performance measures (all are subject to further modification).

STRATEGIC OUTCOMES	PERFORMANCE MEASURES
1. To position the University of Hawaii as one of the world's foremost indigenous-serving universities by supporting the access and success of Native Hawaiians	❖ Degree attainment of Native Hawaiians
2. To increase the educational capital of the state by increasing the participation and completion of students, particularly Native Hawaiians, low income students, and those from underserved regions	<ul style="list-style-type: none"> ❖ Number of PELL grants awarded ❖ Going rates of public and private high school graduates ❖ Degrees and certificates of achievement earned
3. To contribute to the state's economy and provide a solid return on its investment in higher education through research and training	<ul style="list-style-type: none"> ❖ Extramural fund support ❖ Patents, invention disclosures, and licenses
4. Address critical workforce shortages and prepare students (undergraduate, graduate and professional) to be leaders in a globally competitive economy	<ul style="list-style-type: none"> ❖ Degrees in STEM fields ❖ UH output relative to projected annual vacancies in shortage areas statewide
5. To acquire, allocate, and manage public and private revenue streams and exercise exemplary stewardship over all of the University's resources, including physical and human resources	<ul style="list-style-type: none"> ❖ Annual investment needed for physical plant ❖ Increase in non-state revenue streams

The report, "Serving the State of Hawaii: UH System Strategic Outcomes and Performance Measures, 2008-2015" is appended to this report as Attachment 1. This report will continue to be updated and modified as discussions continue and more input is gathered.

CONCLUSION

There is no single right answer for determining appropriate funding levels. If we compare the University of Hawaii's revenue per FTE to peer and benchmark institutions, some campuses are higher than average and some are lower than average. The SHEEO SHEF report also shows that Hawaii has higher than average revenue per FTE as compared to other states; however, when we make these comparisons, it is difficult to also appropriately account for such things as Hawaii's unique geographic isolation, small population and size, high cost of living, and smaller economies of scale for program missions that span a system from a comprehensive research university to rural community colleges. The general trend over the last decade and a half has been a decrease in the University of Hawaii's share of state general fund appropriations. When adjusted for inflation, UH state appropriations decreased 16.7% from FY 1991 to FY 2006 while total state general fund appropriations increased 24.7%. The decrease in appropriations over this period has been increasingly offset by tuition and fees, moving from a 90/10 to 80/20 split in state/student share. The same trend was also reflected in the US average, which moved from a 74/26 to 64/36 split. However, bringing Hawaii to the national average will double the student share of overall higher education costs. Hawaii's Measuring Up 2006 affordability grade at a 20% student share was a D, down from a C- in 2000.⁵ Moving Hawaii closer to the national average would decrease the burden on taxpayers, but could students absorb a greater share of the costs given existing affordability issues? Even if students and families could absorb a greater share, it is possible they would be less willing to attend the University of Hawaii and instead opt to attend a mainland school if the in-state tuition cost savings isn't attractive enough. How would the University of Hawaii operate if revenue from both state appropriations and tuition decreased? Even if taxpayer burden was eased or tax dollars could be reallocated for other state services, how well would the State fare if more and more of its young people chose not to pursue higher education or moved to the mainland? What is the appropriate balance and how do we ensure it is fair for all parties? Clearly, higher education is vital to the future success of the State of Hawaii. As the only public higher education institution in the state, the University of Hawaii must be able to provide the education and training the state and students demand. An education compact should be established between the University and the Governor and Legislature to clearly link funding for the University with specific goals and performance measures and providing the University with assured funding levels and required flexibility. The University of Hawaii Strategic Plan is being updated to address how the University plans to meet state needs, while the Long-Term Finance Plan provides the financial framework for carrying out the Strategic Plan.

The Long-Term Finance Plan framework recommended for Hawai'i has three key components:

- Base Operating Funds – these are funds to support core campus functions and would require additional funding only for inflation and collective bargaining increases. Additionally, adjustments to move campuses closer to funding level equity with peer institutions may be proposed through a combination of internal reallocations and additional funding. Factors such as funding per FTE enrollment, enrollment mix and credit hours may be used in measuring adequacy of funding in relation to peer institutions.

- Capital Infrastructure Funds – these are funds for repair and replacement of facilities and for deferred maintenance. This will include a current repair and replacement level of funding in order to maintain the status of existing facilities and infrastructure as well as a funding component to reduce the University’s deferred maintenance to \$125 million at the end of fiscal year 2015. The annual funding requirement for this is indicated in strategic outcome #5 at Attachment 1.
- Performance Incentive Funds – these funds would provide incentive for meeting performance measures for initiatives proposed by the Legislature, the Governor, or the University. The level and specific amounts of these incentives should be agreed to between the parties, preferably through the proposed education compact. While these incentives will continue to evolve as circumstances and needs change, we propose several for consideration, based on the strategic outcomes and performance measures developed in our current strategic planning update. These are reflected in Attachment 2 which provides an example of how the long-term finance plan might operate.

After the Strategic Plan goals are set, the appropriate level of funding can then be determined by identifying the costs to achieve those goals and objectives. The Long-Term Finance Plan aligns state appropriation, tuition and fee, state student financial aid, and institutional student financial aid policies. Performance measures will be used to measure progress against goals and also determine proposed incentive funding amounts. Though excluded from the discussion on core funding in this paper, other sources of revenue from research, private scholarships, and gifts are still important and significant to the University of Hawaii, and our efforts to maximize these revenues will continue as we balance all sources of revenue in service to the state of Hawaii.

¹ Dennis Jones, “Financing in Sync: Aligning Fiscal Policy with State Objectives,” *Policies in Sync: Appropriations, Tuition, and Financial Aid for Higher Education* (Boulder, CO: Western Interstate Commission for Higher Education, 2003).

² Alisa Cunningham, “The Broader Societal Benefits of Higher Education,” *Solutions for Our Future* (Washington D.C.: American Council on Education, 2006).

³ Creating a University System for the 21st Century. North Dakota University System State Board of Higher Education, November 2005.

⁴ Act 316, SLH 1989, Section 163.

⁵ Measuring Up 2006: The State Report Card on Higher Education. The National Center for Public Policy and Higher Education, 2007.