Memorandum

February 24, 2012

To: President Wiewel and Vice Presidents

From The University Budget Team—
Roy Koch, Monica Rimai, Kevin Reynolds and Deborah Janikowski

Re: Budget Planning - Education and General Funds

Now that we have successfully concluded salary negotiations, we can begin developing our budget for the 2012-13 academic year and beyond. In pages 1-4 of this document, we will review both the **external and internal context** as it relates to our budget and present a **financial trajectory and challenge** as a basis for our planning. This document also provides our **observations** on revenue and expenditures, the **components of a balanced budget strategy** for addressing the budget challenge, **principles** that we need to be mindful of, **assumptions and approach** proposed and a **timeline** to guide us. Beginning on page 5 is an Overview of the approach we will take to the 2012-13 budget.

EXTERNAL AND INTERNAL CONTEXT: Our largest external source of revenue is the allocation provided by the legislature through the Oregon University System. As the economy remains sluggish and tax revenues remain depressed, Portland State will receive substantially less in state allocation during this biennium than we did in the previous biennium. This is a result of both a reduction in the allocation to OUS and the loss of stimulus funding that helped mitigate reductions in state allocations during the last biennium. In addition to the reduction of public funding, the University is also subject to substantially increased costs to support the Public Employees Retirement System (PERS).

Anticipating this substantial reduction in state funding and an increase in costs, we took a balanced approach to increasing revenue and decreasing costs as we planned for our budget this year. To address the reduction in funding, we significantly increased tuition for 2011-12, reduced unit allocations by about 3% and are planning to use a combination of unit and central fund balances, as required, to meet our expenses for this year.

As has been the case when we have implemented substantial tuition increases in the past, both headcount enrollment and SCH have been essentially flat so far this year despite our expectation for small enrollment increases.

Finally, we all agreed that it was in our collective best interest to increase the salary of all of the employees who make it possible for us to carry out our mission of the University. The cost of salary increases phase in over the 2011-13 biennium and fully roll up as ongoing costs in the 2013-15 biennium representing another increase in obligations that need to be addressed going forward.

FINANCIAL TRAJECTORY and CHALLENGE: The combination of external and internal factors has created a budget environment where we are now operating at a permanent deficit into the foreseeable future. It is imperative that we address this situation by bringing our revenue and expenses into balance. We can demonstrate our ongoing shortfall through a base projection of revenue and expenses (attached), along with the use of fund balance for this biennium and the next based on a set of conservative assumptions. In developing this base projection, we only included increases in revenue and expenditures that are known or can reasonably be anticipated. The base projection includes the revenue that the tuition increase for 2011-12 is projected to generate and the proposed increases in tuition remissions to support both our student success and enrollment management initiatives. It does not assume any tuition increases beyond 2011-12 since tuition is set through a campus-wide process of consultation and must be approved by the State Board of Higher Education. Based on our experiences this year, the base projection also assumes no enrollment growth over the next three years. The other major source of revenue, funding from the state, is assumed to remain unchanged for the rest of this biennium with a slight decrease into the next biennium. With regard to expenses, we have included the additional salary and benefit costs which phase in over the 2011-13 biennium and fully roll up into the 2013-15 biennium. In addition, we have included a few additional capital projects (the Collaborative Life Science Building and the Oregon Sustainability Center) that are either underway or may proceed. These assumptions can be easily adjusted based on the outcome of the current legislative session. We did not include additional costs for salary increases beyond this biennium since this is largely determined through collective bargaining.

Based on these assumptions, expenditures exceed revenue starting this year and that trend continues with the shortfall increasing through this biennium and beyond. In this base projection, the annual budget is balanced each year using our reserves (the fund balance). Without specific action to increase revenue, reduce costs or both, the shortfall will continue to increase and the reserves will be completely exhausted by the end of the 2013-15 biennium.

The base projection is the starting point for this year's budget planning process and will be used to inform decisions on tuition increases and expenditure reductions. However, given the magnitude of shortfall, we propose that the decisions made for the coming year be in the context of a multi-year process for achieving fiscal stability.

OBSERVATIONS: An inspection of the revenue and expenditure projection results in several important observations.

- Tuition produces by far the largest component of our revenue. This has been a trend over the past two decades and is likely to continue. Increased tuition revenue can result from increases in the tuition rate, enrollment growth, changes in student mix or some combination of each. Therefore, any significant increases in revenue will come from tuition. However, for the second time in ten years, a significant tuition increase this year resulted in no student credit hour growth.
- In contrast to tuition, state funding is a small fraction of our overall revenue so that even a reasonably significant increase in state allocation will provide only a marginal increase in our overall revenue.
- Salaries and benefits represent by far the largest component of our annual expenditures so a reduction of expenses will require a reduction in personnel.
- Our reserves mitigate the budget shortfall temporarily but without either additional revenue or expenditure reduction, will be exhausted in the 2013-15 biennium. However, it does provide us with the ability to address the structural budget shortfall over several years.

COMPONENTS OF A BALANCED BUDGET STRATEGY: Given this multi-year budget projection, it is clear that there are three components that, taken either separately or together, will move us toward a sustainable fiscal condition.

- *Reducing expenditures*. Permanent expenditure reduction is a clear path toward a more sustainable budget. A 1% annual expenditure reduction reduces the shortfall by about $2.6M, noting that there are some items that cannot be reduced such as debt service. Unfortunately, since the vast majority of our expenses are for personnel, any significant reduction in expenditures will require us to carry out our work with fewer people who either generate the revenue or provide important support services to students.
- *Increasing tuition*. Since tuition is the major component of revenue, increasing in-load tuition revenue can have a positive impact on our fiscal condition. A 1% increase in undergraduate resident tuition results in an increase of

approximately $0.7M in revenue. Because we seek to support our access mission and because tuition rates may be related to enrollment, the impact of increases in tuition must be carefully considered.

- *Growing enrollment (SCH).* Over the past 15 years, our enrollment has grown substantially and, together with tuition increases, has partially mitigated the impact of reduced state funding. A 1% enrollment growth for all students (undergraduate and graduate) currently results in additional revenue of approximately $1.6M. However, this depends on the student mix. If we were to grow the enrollment (more specifically the student credit hour production) of nonresident students faster than resident students, the revenue would increase.

As we proceed to develop our budget for 2012-13, we must consider each of these components. There are many ways to approach each of these and we will use the budget process to sort out the impacts of specific actions in an effort to continue the progress we have made toward our institutional goals.

PRINCIPLES: We are challenged by our ongoing budget shortfall and must create a pathway to fiscal stability. At the same time, we cannot lose sight of our institutional priorities and the reason we do our work. As we develop a budget plan for the coming year, in the context of a multi-year plan, we must continue the progress we have made on our institutional initiatives. In particular, we will use the following principles to guide the development of our budget plan:

- *Improving student success by continuing to increase retention and completion rates.* This is a central component of our mission, represents a significant institutional effort and an area of some success over the past few years and is critical to the students we serve and to our success as an institution.
- *Expanding our research productivity with a focus on external funding.* We have made considerable progress in expanding our scholarly output over the past several years. In that effort, we have significantly increased the amount of external funding available to support selected of those activities. Since research is a key component of our mission we must continue our efforts to support and grow our research activities, with a focus on work that is of particular importance to the metropolitan region.
- *Providing educational opportunity by maintaining the capacity to serve students.* As the only comprehensive public institution of higher education in the metropolitan region, we have the responsibility to provide opportunity to everyone in the region. As such, we need to both maintain our capacity to serve the region's diverse population and continue our efforts to work with our partners in K-12 and at the Community Colleges to assure that all of these students are college ready.
- *Using our resources in the most effective manner possible to maintain our educational capacity and quality.* As we create strategies to address our budget shortfall, we must do so in ways that do not reduce our ability to generate revenue or to serve our students. As such we will have to critically evaluate practices across the institution as we adjust to this new budget reality.
- *Continuing efforts to expand our resource base through strategic enrollment management, philanthropy and external research funding.* While we work in the short term to preserve our capacity and quality, we cannot lose sight of activities that will impact our future in the longer term, in particular those activities that will result in a diversification of our resource base and increased funding for mission-critical activities.

ASSUMPTIONS and APPROACH: For budget planning and using the attached base projection as a starting point, we used a conservative estimate for revenue generation achieved through a combination of tuition increases and enrollment growth. Applying these assumptions suggests that Portland State could be required to decrease its expenditures by about 4% per year ***in each of the next three years*** to eliminate the shortfall, achieve a balanced budget by the end of the 2013-15 biennium and retain an adequate fund balance based on the State Board's expectations. This approach will put us on a solid financial footing for the future. We recognize that there are several outcomes that can improve our situation including tuition increases above the low level we have assumed, increased numbers of non-resident students, increased enrollment and even the possibility of increased state funding in the 2013-15 biennium. We will be working on a number of initiatives that move us toward these outcomes even as we plan for this scenario.

We have prepared for this fiscal situation by building significant reserves. These funds are available for use only once but will permit us to start a multi-year planning process so that by Fiscal Year 2014-15, we will balance the University's operating budget through a combination of reducing expenditures, increasing tuition, and growing enrollment with a focus on changing the mix of students.

What follows in the Overview is a description of the approach we will take this year in connection with achieving a balanced budget by Fiscal Year 2014-15. We look forward to working with all of you in a collaborative and inclusive manner as we work our way through these challenging times and explore opportunities to advance the mission of PSU.

OVERVIEW

Our budget planning will have a two-tiered approach.

Tier One: Systemic All University Actions

As noted, because we have identified a three year time frame in which to balance our operating budget, we can, and must, undertake the development of systemic all university polices that address our fundamental organization and operations. Thus, overlying the budget planning in individual units, the following initiatives can bring to PSU operational efficiencies, improved revenue production, and data-driven decision making, all of which can help us achieve a balanced budget, and improved mission delivery:

Performance Based Budgeting (PBB)

Strategic Enrollment Management (SEM)

Administrative and academic organization

Curricular efficiency and effectiveness

Retirement incentive programs

Our efforts around Performance Based Budgeting and Strategic Enrollment Management are well underway. In addition, a team of individuals from the General Counsel's Office, OAA and FADM are developing recommendations for the implementation of retirement incentive programs that will generate real salary savings. Efforts related to administrative/academic organization and curricular efficiency and effectiveness need to begin sooner rather than later and conclude with specific action steps. Accordingly, the Vice Presidents for Academic Affairs and Finance and Administration will partner to initiate this planning process as early as this coming spring.

Tier Two: Budget Planning Parameters For Fiscal Year 2012-13

A) Use of one time funds

As a fiscally prudent step, reserves required for balancing the budget over the next 3 years will be encumbered in restricted central reserve (RCR) and restricted unit reserve (RUR) funds. Reserve funds that are not encumbered in the RUR will remain with the respective units for strategic investments. For each unit the RCR and available RUR funds will be drawn upon to cover increased payroll costs through the next 3 years. RUR funds will remain with the unit that generated those funds, and be restricted exclusively to balance that unit's payroll costs. The extent to which RUR funds will be used will be determined by the speed at which we are able to balance our budget through expenditure reductions and revenue increases.

B) Identification of permanent reductions in expenditures

Each unit will be asked to identify a prioritized list of a 4% reduction in all Education & General expenditures for 2012-2013. Units will need to examine their operations to ensure that there is not an accompanying loss in revenue or services. Additional 4% reductions may also be necessary for each of the subsequent two years in order to reach a balanced budget by 2014-15. Our anticipation is that we may not be required to take all of these reductions in any year, but this approach will allow us to evaluate tradeoffs and provide an opportunity to make strategic reductions and to align our expenditures with the emerging PBB model. The base for the 4% reduction will be projected actual E&G expenditures for 2011-2012 plus approved strategic investments. These increases will include outstanding strategic investments, the increased benefit costs for 2011-12 and contractually obligated mid-year salary increases for 2011-12.

This endeavor will require an alignment of current budget allocations with actual expenditures. This change will ensure that real reductions in expenditures are accomplished, provide much needed institutional position control with more accurate and simplified forecasting, a transparent view of the origin of unit reserves, and an opportunity to realign allocations with the emerging PBB model.

C) Revenue enhancement

For units that generate revenue, a plan for net increases to revenue should be submitted. For academic units this plan can help for the basis for our emerging SEM and should include opportunities to increase student credit hour (SCH) generation. This SCH generation can come from either addressing a known demand or increased improvements in student success and retention. Academic units may also propose a differential tuition increase with justifications and the basis for believing there will not be a concomitant reduction in SCH generation. These revenue enhancements must be achieved within the context of expenditure reductions, but will allow an opportunity to ameliorate these to some extent and is consistent with the move towards PBB.

The following attachments will provide additional context with which these budget instructions were developed and describe in detail action required and important timelines.

Attachments (5 total)
Base Case Scenario - E&G Revenue & Expenditure Projection
Context and Details for Submission of Budget Templates
4% Budget Reduction Template
FY11-12 E&G 4% Cut Base
Increased SCH Generation Template (academic units only)

If you need any assistance or clarification to complete these templates, please contact your Budget Office liaison.

By March 9, you will receive the following additional information:
FY 12-13 Staffing Plan instructions and template for your unit
Restricted Unit Reserve (RUR) Use of Fund Balance template
Estimate of School/College 2011-12 SCH

Timeline:

- February 24 — Distribute budget instructions, 4% budget reduction template, and FY12 E&G 4% cut base to units
  Distribute Increased SCH Generation template (with instructions) to units
- March 9 — Distribute dollar amount of RUR fund balances to units and FY 12-13 Staffing Plan instructions and templates to units
- March 23 — Budget proposals, reduction templates, RUR Use of Fund Balance template, and Increased SCH Generation template (if applicable) due from units to the Vice President
- April 9 — Budget proposals submitted by Vice Presidents to UBT
- April 16 — Budget recommendations to President
- May 1 — Post budget decisions and hold public hearings/forums
- May 15 — Final budget decisions