Item #X-12
September 27, 2016

# SETTING A CONTEXT FOR FISCAL YEAR 2018 BUDGET DEVELOPMENT

**Submitted for:** Informational

**Summary:** *Setting a Context for Fiscal Year 2018 Budget Development* is intended to traditionally provide an overview to the Board as it develops its fiscal year 2018 budget recommendations. While it is intended to stimulate thought and discussion with Board members and staff at institutional levels, developing the Fiscal Year 2018 budget recommendation is an extraordinary task given the current budget situation without having a full budget since Fiscal Year 2015.

This informational item provides an overview of the IBHE's statutory requirement, the budget development schedule and process, highlights of the State's fiscal condition, and a look back at higher education and pension funding in light of the state's goal of 60 X 2025. The summary ends with an overview of efficiency and effectiveness of the higher education system and a review of capital and deferred maintenance concerns.

**Action Requested:** None.

# SETTING A CONTEXT FOR FISCAL YEAR 2018 BUDGET DEVELOPMENT

## IBHE Statutory Requirements

Pursuant to the Board of Higher Education Act (110 ILCS 205), the Illinois Board of Higher Education (IBHE) is required to annually submit to the Governor and the General Assembly budget recommendations for the ensuing fiscal year budget for higher education programs. The Board receives budget submissions from each public university, the Illinois Community College Board, Illinois Student Assistance Commission, the Illinois Mathematics and Science Academy, and the State University Civil Service Commission for operation, capital and grant program needs.

## IBHE Budget Development Schedule and Process

The tentative timeline and processes for the development of the Board's fiscal year 2018 operating and capital budget recommendations are listed as follows:

| 2016 | Action/ Process |
|---|---|
| July | Distribute budget development schedules and accompanying memos |
| August 1 | Distribute historical RAMP materials<br>Distribute operating and capital budget request materials<br>Distribute technical questions |
| September 28 | Historical RAMP submissions due back to IBHE |
| October | Budget overview meetings with public universities, ICCB, and higher education agencies |
| October 1 | IMSA operating and capital requests due back to IBHE |
| October 15 | All other operating and capital requests due back to IBHE<br>Technical question responses due back to IBHE |
| December | IBHE to consider staff budget recommendations<br>Presentation to GOMB and distribution to the General Assembly |

## State's Fiscal Condition

The Comptroller issued a statement shortly after passage of the Stop-Gap II bill on July 14, 2016, that the growing backlog of unpaid bills is estimated to be $10 billion by end of 2016 resulting in payment delays of at least six months. The Comptroller said the state is on pace to spend $2.5 billion more than it takes in the next six months which creates severe cash shortages that will force her office to perform triage to help those most in need and protect our most critical

services. She did indicate that some payment priority will be given to colleges, universities, and MAP Grant students who faced significant cuts and delays this past year.

On June 27, 2016, Moody's downgraded seven Illinois public universities due to their reliance on state appropriations. Fifteen community colleges have also been downgraded due to their reliance on state funding, totaling 23 colleges that now have "negative" outlooks and could possibly see further downgrades.

- University of Illinois was downgraded (Aa3 for the Auxiliary Facilities System Revenue Bonds and Certificates of Participation, A1 for the South Campus Development Project Bonds and A2 for the Health Services Facilities System Revenue Bonds).
- Illinois State University was downgraded to A3.
- Southern Illinois University was downgraded to Baa1.
- Northern Illinois University was downgraded to Baa2.
- Governors State University was downgraded to Baa3.
- Northeastern Illinois University was downgraded to Baa3.
- Eastern Illinois University was downgraded to Ba1 for the Auxiliary Facilities System Revenue Bonds and Ba3 for the Certificates of Participation.

The Commission on Government Forecasting and Accountability's (COGFA) *Monthly Briefing* (July, 2016) "the Commission's FY 2017 [revenue] estimates presented in early March, 2016 was $31.912 billion. A review of that estimate (based on current law), including actual performance over the final third of the fiscal year, FY 2016 actuals, updated economic measures, and certified refund percentages, results in an updated forecast of $30.883 billion. The net estimate of the large economic related sources has been reduced by $338 million since the March 2016 estimate. The majority of the change stems from the increased percentage of income taxes being set aside for refunds per the Dept. of Revenue. The net impact of the increased refund percentages makes up approximately $218 million of the change, with the remainder attributed to lower estimated corporate income taxes based on last year's actuals. Growth assumptions are very similar to those used in the spring."

On August 31, 2016 the Moody's Investor Services, Inc. reported Illinois' stopgap budget is insufficient to stem widening deficit and liquidity pressures. Specifically, they cite that the state's (Baa2 negative) operating fund deficit will widen further and liquidity pressures will grow in Fiscal Year 2017 after the state failed to enact a full budget for a second consecutive year. "Illinois' spending is rising, even without a full package of budgetary spending authorizations, and the state projects its revenues will remain flat without any mid-year actions to raise revenues," Ted Hampton, a Moody's Vice President – Senior Credit Officer is reported to say to Global Credit Research, "As liquidity pressure increases on the state's operating funds, the backlog of unpaid bills will almost certainly rise."

The report identifies analysis done by COGFA projecting "the general fund deficits will more than double to $7.8 billion in Fiscal Year 2017 from last year's $3.8 billion. The executive branch is still assessing the likely deficit, but believes that it will be lower than the commission's estimate. The stopgap budget has expenses rising by 12 percent while revenues are projected to remain flat. Illinois' tax revenues have fallen substantially in the last two fiscal years because of legislative provisions that largely reversed income tax hikes imposed in 2011 without finding offsetting revenue sources or expense cuts.

**Higher Education Funding History, State Pensions**

The State of Illinois invests billions of dollars in the educational and social development of its citizens each year. At the primary and secondary education levels, the state's investment is directed toward helping local school districts provide a high-quality education at no cost to students. At the postsecondary level, the State's investment is directed toward providing a high-quality education to students at subsidized prices, both through direct subsidies to colleges and universities and through grants to students with significant financial need. The State also invests in educational, research, and public service outcomes at the postsecondary level through grants and specific program support that improve the state's economy and quality of life.

The state's fiscal condition has deeply impacted higher education in Illinois over the past decade. State appropriations for higher education operations and grants (excluding retirement) have decreased from the all-time high water mark of $2.4 billion (excluding the pension appropriation) in Fiscal Year 2002 in general funds to less than $1.9 billion in Fiscal Year 2015.

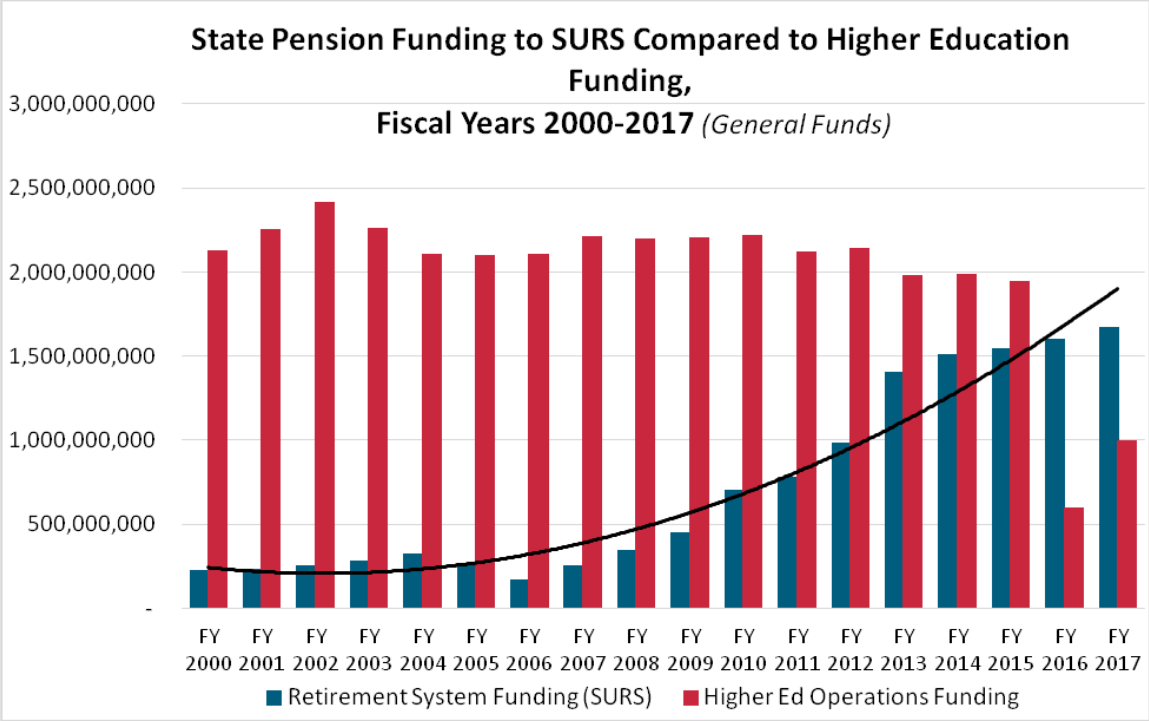
IBHE's budget recommendations for both Fiscal Year 2016 and Fiscal Year 2017 provided a full-year budget for higher education operations and grants. Over the past two budget cycles, the Board has essentially recommended a maintenance level budget from original appropriations made in fiscal year 2015. This included a total of $3.5 billion in general funds for approximately $1.5 billion in state payments to SURS, $1.2 billion for public universities, $346 million for community colleges and adult education, and $444 million for ISAC that included an additional $50 million for MAP awards.

On April 22, 2016, the Illinois General Assembly passed SB 2059, representing a partial Stop-Gap I budget for higher education in fiscal year 2016. Overall, the fiscal year 2016 state budget totals $600 million in EAF, including $350 million for public universities, $74 million for community colleges, $6 million for IMSA, and $170 million for MAP. This represented approximately one-third of the funding for public universities and community colleges, and funding for only the fall 2015 semester MAP award claims.

On June 30, 2016, on the very last day of the fiscal year, the legislature passed SB 2047, representing a Fiscal Year 2016 and 2017 Stop-Gap II budget, consisting of nearly $1 billion in general funds (including funding from the Personal Property Tax Replacement Fund and the Fund for the Advancement of Education) for higher education operations and grant programs. Combining both Stop-Gap totals into one budget year, it represents $1.6 billion, or approximately 82 percent of the Fiscal Year 2015 budget for higher education. However, if no additional funding is provided for Fiscal Year 2016 and the first half of Fiscal Year 2017, the Stop-Gap funding over an 18-month period reflects only 55 percent of the fiscal year total appropriation for all programs of higher education.

Figure 1 reflects the latest appropriations for higher education in Fiscal Year 2016 and 2017 with the total state pension contributions that are made under the continuing appropriation clause for each of the last two years. The ramp up of pension contributions from the state has increased dramatically since Fiscal Year 2007. In fact, current retirement contributions make up 44.3 percent of the total funding for higher education, while in 2007 they comprised of just 10.3 percent. It seems apparent that until pension reforms are made, required state contributions driven by $22.4 billion in unfunded liabilities will continue to compete for available state resources that could otherwise go for higher education programs.

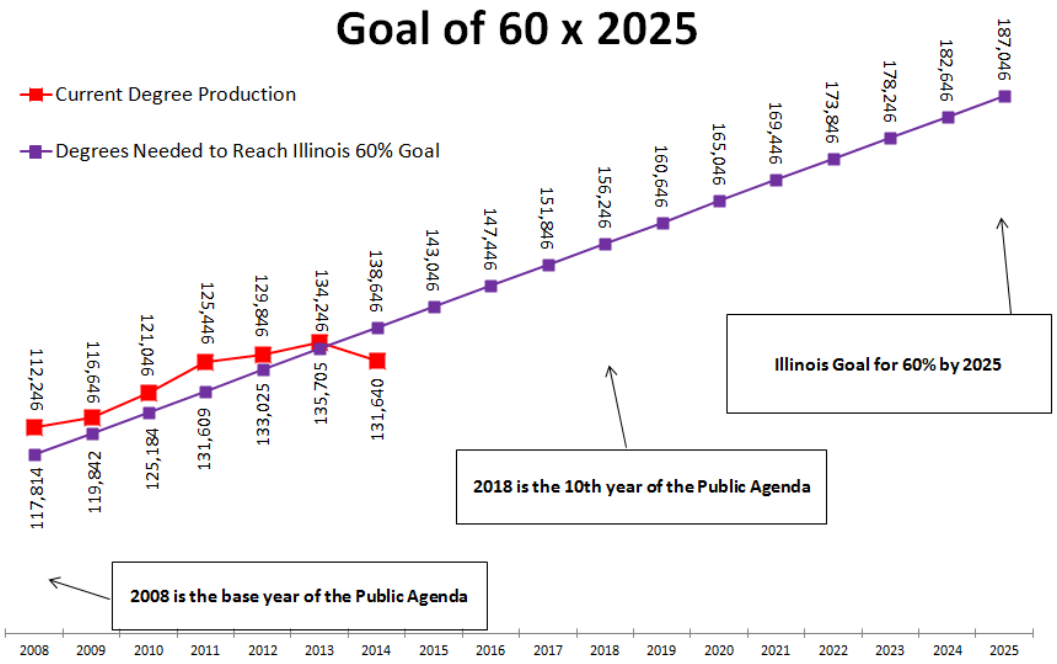
*Figure 1*




**State's 60 X 2025 Goal**

It is particularly worrisome that the path of the 60 X 2025 has taken a sharp decline since 2014. In fact, during IBHE's fall budget meetings last year, each university administrator was presented with their own institution's current standing relative to the trend line for reaching the 60 x 2025 goal in which most public institutions have sharply dipped below the trend line. Many higher education administrators view the 60 x 2025 goal as unattainable unless additional state investment is provided. They made clear how the uncertainty of the budget situation hampers effective budget modeling limiting their efficiency and effectiveness which in turn limits their ability to contain costs for students. They argued that without a sound budget model tied to predictable revenue projections, it is extremely difficult for any college to get back on track to strive toward the degree production necessary to reach Illinois' 60 x 2025 goal. The IBHE staff will update the 60 X 2025 trend line chart later this fall and will once again include it in their budget development discussion with university and college administrators.

*Figure 2*




Source: IBHE and Complete College America, 2015 .

## Efficiency & Effectiveness of Higher Education Systems

State support for our higher education systems has declined significantly over the past decade as institutions try to maintain a high level of excellence for their current and future students. However, IBHE has made it clear that improved state investment in Illinois higher education systems must be accompanied by system commitments to improved performance: containing costs for students and improving student success outcomes. At a minimum, improvement strategies should include: 1) remodeling business practices; 2) remodeling academic delivery models to contain costs and improve student success; 3) aligning credentials with workforce needs; and 4) targeting investment in collaborative programs improving fairness and student success.

IBHE continues to work with university administrators in reviewing academic programs at each campus to assess low producing academic programs that could be consolidated, closed, or redesigned to increase degree production and better serve student needs. In 2015, IBHE issued its inaugural report, *Annual Report on New, Consolidated, Closed, and Low Producing Programs at Illinois Public Universities*, which marks the starting point for future collaboration with university leaders to increase the efficiency and effectiveness of academic programs. This review and assessment will be performed annually.[1]

[1] Illinois Board of Higher Education, Annual Report of New, Consolidated, Closed, and Low Producing Programs at Illinois Public Universities, Academic Year 2014-2015, Oct. 20, 2015

Furthermore, under direction from the Affordability Action Team, IBHE staff continues to analyze cost comparisons between Illinois universities and their peer institutions, the relationship of state investment to degree production, and identifying what has been driving system costs. These are essential issues that will be discussed during the budget development meetings with IBHE staff and administrators in mutual efforts of striving for a higher education system that optimizes effectiveness and efficiency in operations while providing an affordable quality postsecondary education to Illinois citizens.

**Capital Construction Concerns/ Deferred Maintenance**

Each year, IBHE collects and analyzes detailed information regarding the capital needs of public colleges and universities and makes annual budget recommendations to the Governor and General Assembly. Overall, the Board uses a set of established priority-setting criteria to make its recommendations which place priority on: (1) protecting the state's capital investments; (2) completing projects for which planning or partial funding has been provided; (3) addressing life, health and safety issues; (4) supporting Board of Trustee top priorities; (5) supporting priority needs for the state; and (6) meeting academic program requirements.

Lack of capital appropriations prevent colleges and universities from constructing new facilities to meet enrollment and programmatic needs, forcing institutions to crowd classrooms and laboratories and inhibiting them from meeting student demand for courses and services; but it also affects existing facilities. While the state made significant investment over time in higher education facilities, and the Board's Committee on Statewide Capital Policies and Priorities reaffirmed in April 2004 that IBHE would give high priority to protecting that investment, the state's continued fiscal uncertainty has diminished that likelihood.

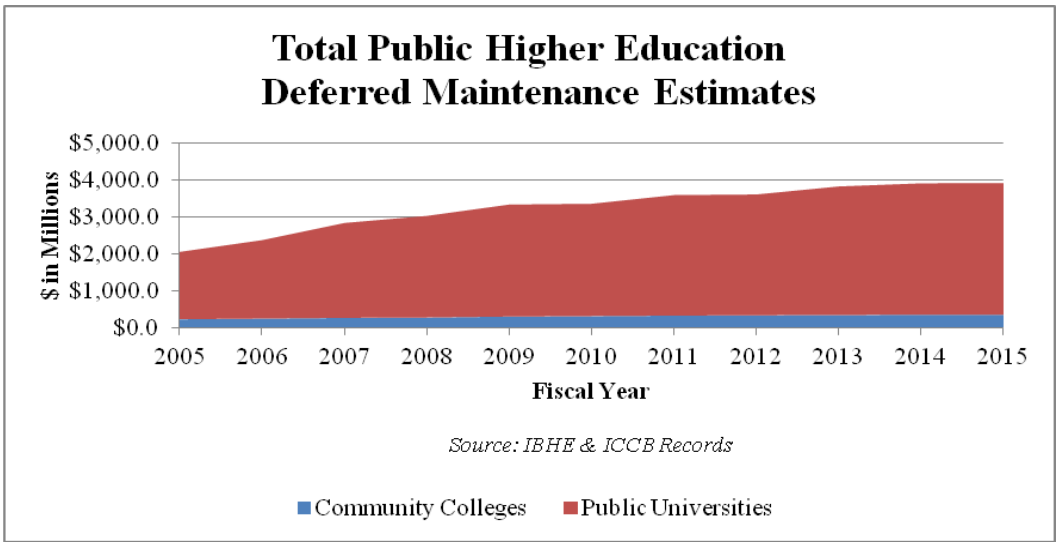
In Fiscal Year 2010, the Governor and the General Assembly approved the $3.1 billion *Illinois Jobs Now!* capital program that included more than $1.6 billion in new appropriations for nearly 120 higher education capital construction and renovation projects. While appropriations were approved for these projects, the actual release of funding was not immediately forthcoming due to the lack of available bond proceeds and the limited amount bonding authority authorized for Fiscal Year 2010. The General Assembly has not approved of any new capital appropriations since then except with limited grant funding for select capital projects was approved in Fiscal Year 2014. Until a new capital bill is approved, the General Assembly must also annually approve of the reappropriations for capital projects approved in prior capital bills.

In June, before the final Stop-Gap bill was finalized, GOMB's proposed capital plan fully reappropriated approximately $926 million for universities, community colleges, and IMSA providing an estimated $118 million in capital project funding to be available that has been delayed since July 2015 due to the lack approved reappropriations. However, the final Stop-Gap II appropriation only provided $183.8 million in reappropriations for select projects.

The Board's Fiscal Year 2018 Capital Budget Recommendation will most likely once again mirror prior year proposals since no new capital funding has been approved. For Fiscal Year 2017, the Illinois Board of Higher Education's Capital Budget Recommendations totaled $1.3 billion for regular capital projects, capital renewal projects, and higher education escalation and emergencies at IMSA and the public universities. Also included in this total is ICCB's request of $120 million to fund capital renewal projects. Approximately $1.2 billion is reported to address deferred maintenance needs at community colleges. The recommendations also note continued support for the release of funding for projects in the *Illinois Jobs Now!* plan. This includes $350 million in capital renewal allocations that protect and enhance the state's current investment in higher education facilities at 12 public universities and IMSA.

Figure 3 reflects the backlog in deferred facilities maintenance at public universities and community colleges, which was estimated to be over $3.9 billion in Fiscal Year 2016. Lack of capital appropriations and the growing deferred maintenance problem has led nearly all universities to assess a student campus improvement or facilities maintenance fee, which has a direct effect on affordability. The *Illinois Jobs Now!* program has reduced the deferred maintenance backlog to some degree, but the colleges and universities will require years of sustained funding to reduce the backlog to a manageable level in the short-term and long-term.

***Figure 3***




*Source: University responses to IBHE technical questions; ICCB*