

Contact: Patrice Sayre

REPORT OF PERFORMANCE-BASED REVENUE MODEL TASK FORCE

Action Requested:

- ▶ Receive the report of the Performance-based Revenue Model Task Force.
- ▶ Consider approving the recommendations of the Task Force.

Executive Summary: While a growing concern exists nationwide regarding the affordability of a college education, the most significant impact has been a shift in costs from the state to the student. The Regents have resolved to serve the state better with a two-prong approach:

- Engaging an outside consultant to find efficiencies and transform the delivery of higher education; and
- Appointing a Task Force to examine state general education funding models that use performance metrics and make recommendations for Iowa's public universities.

At its April 13, 2013 meeting, the Board appointed former Regent President David Miles to head a Task Force to recast the state's funding formula for higher education. The Task Force was to gather information and research how to most effectively allocate the state's funds while ensuring that the needs of the universities are met. The Task Force was asked to complete its work by the June 2014 Board meeting.

The Task Force, chaired by David Miles, consists of the following members:

- Katie Mulholland, Board of Regents President Pro Tem;
- Len Hadley, retired CEO of the Maytag Corporation;
- Cara Heiden, retired co-president of Wells Fargo Home Mortgage; and
- Mark Oman, retired Senior Executive Vice President of Wells Fargo and Company and Vice Chair of the Board of Trustees of the UNI Foundation

The Task Force Report is attached. The recommendations of the Task Force begin on Page 12. Members of the Task Force believe these recommendations set a new standard for state funding of higher education and incentivize the universities to align with state and Regent higher education priorities.

Mr. Hadley voted "no" with respect to Recommendation Four and will submit a minority report.

Report of the Performance-based Revenue Model Task Force

To: The Board of Regents, State of Iowa
From: The Performance-based Revenue Model Task Force

The Task Force sincerely thanks the Board of Regents for the opportunity to study the funding of Iowa's Public Universities and to recommend a framework for future funding that will further the ongoing policy discussion on higher education with all stakeholders.

Summary:

To meet the demands of the 21st economy, Americans have to have a 21st century education. It is projected that 65% of U.S. jobs – almost two-thirds – will require some form of postsecondary education by 2020.¹ The U.S. college attainment rate is just 42% - ranking us 13th among developed nations - not an enviable position in today's increasingly competitive global economy.² Increasing the number of college graduates in Iowa is a priority for Iowa's Public Universities. One approach is incentivizing these institutions through Performance-based Funding.

Over the last nine months, the Regents Performance-based Revenue Model Task Force has conducted an in-depth evaluation of the Board's process for determining its annual request from the State of Iowa for General Education Funding (GEF) for Iowa's Public Universities.

Our Task Force recommends that the Iowa Board of Regents move over time from its traditional "base-plus" budgeting methodology to a Performance-based Model weighted *initially* 60% to resident enrollment and 40% to outcome metrics explained in further detail in this report.

Based upon our survey of best practices across the nation and our review of the unique characteristics of Iowa's Public Universities, we believe the proposed Performance-based Model offers significant advantages over the existing approach in terms of:

- Equity across the universities
- Incenting the institutions to achieve the objectives of the State and the Board
- Appropriate governance of our outstanding institutions, and
- Effectively advocating to our elected State officials for appropriate funding

State Funding of Public Universities: A National Look:

The primary source of direct taxpayer funding of higher education at public universities across the country is the states, which provide support for academic activities and operations primarily to defray a portion of the costs so that resident students have affordable access to a quality higher education.

Through the end of the Second World War, most states provided this funding largely through a political process without using any funding formula. Beginning in the 1950s, however, states began to depoliticize their funding by shifting toward formulas based on the number of students enrolled at each institution. In the 1960s and 1970s, many states began to add some measure of cost per student to the calculation. In the 1990s, in response to continuing calls for greater

¹ *A Decade Behind*. Georgetown University Center on Education and the Workforce, 2012

² Organization for Economic Co-operation and Development

accountability, at least a dozen states began to fund their public institutions partially on the basis of performance measures, although this performance-based funding typically applied to a very small proportion of total funding.³

The History of General Education Funding in Iowa:

The Task Force reviewed the Iowa Board of Regents historic practice for determining its annual General Education funding (GEF) request to the Governor and the legislature. Tracking funding records back to 1946, the University of Iowa (SUI) and Iowa State University (ISU) received virtually the same amount of funding for their operations, with ISU receiving \$23,000 more. To our knowledge the allocation was not based on any formula, but on the needs of each university as approved by the Board of Regents and funded by the State. In 1950, ISU requested that its appropriation be separately allocated to its three missions of General Education, Agricultural Research and Extension Services, and the State complied. At that time, GEF appropriations were allocated 47% to SUI, 30% to ISU, and 23% to UNI. Again, this was not a formula, simply how the total added up.

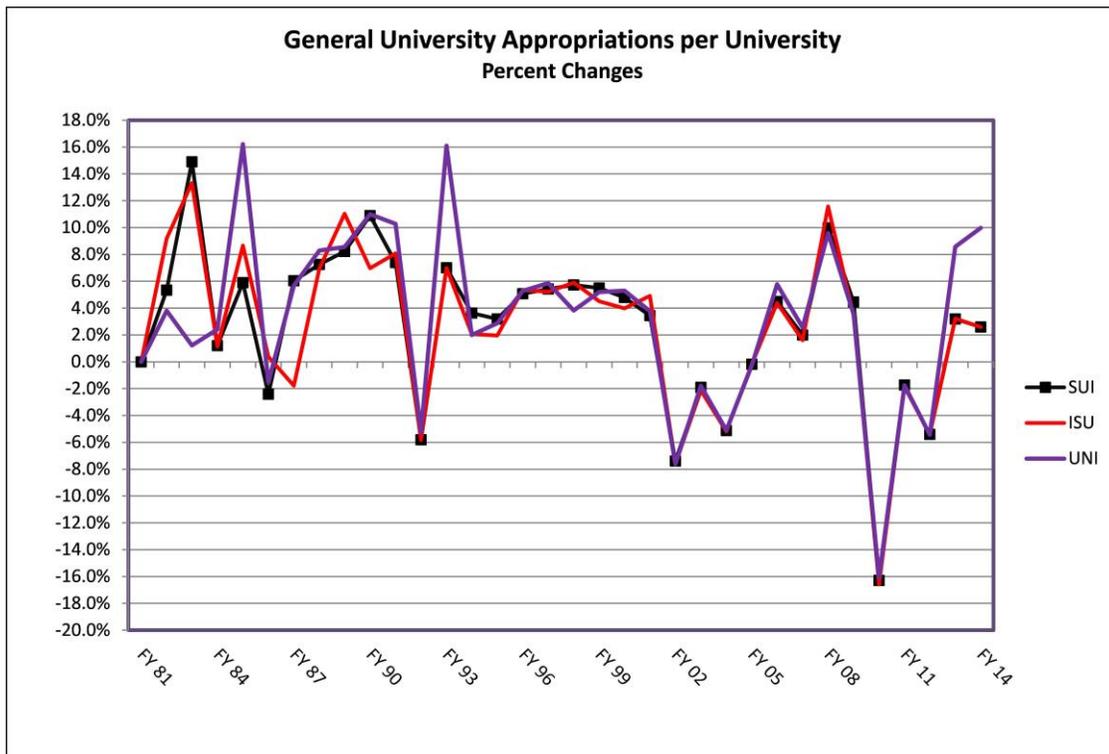
While budgets have been presented in many different forms, the Regents funding requests to the Governor and the legislature over the years have - with few exceptions - relied upon a "base-plus" in methodology. From all evidence, that base has not been comprehensively revisited in decades.

In general, the legislature has not distinguished between the universities when considering levels of incremental funding and has continued to allocate funds to the universities on the same percentage basis; that is, if incremental funds were available, each university received the same percentage increase. Chart One on the next page shows that only in a few cases were different percentage increases in GEF appropriations granted.⁴ For instance, in 1993, UNI received a 16.1% increase, partly due to enrollment increases after all universities were cut the previous year; and recent increases have been received to address UNI's unique financial dependence on state funds.

³ *Using Institutional Incentives to Improve Student Performance* by Arthur M. Hauptman

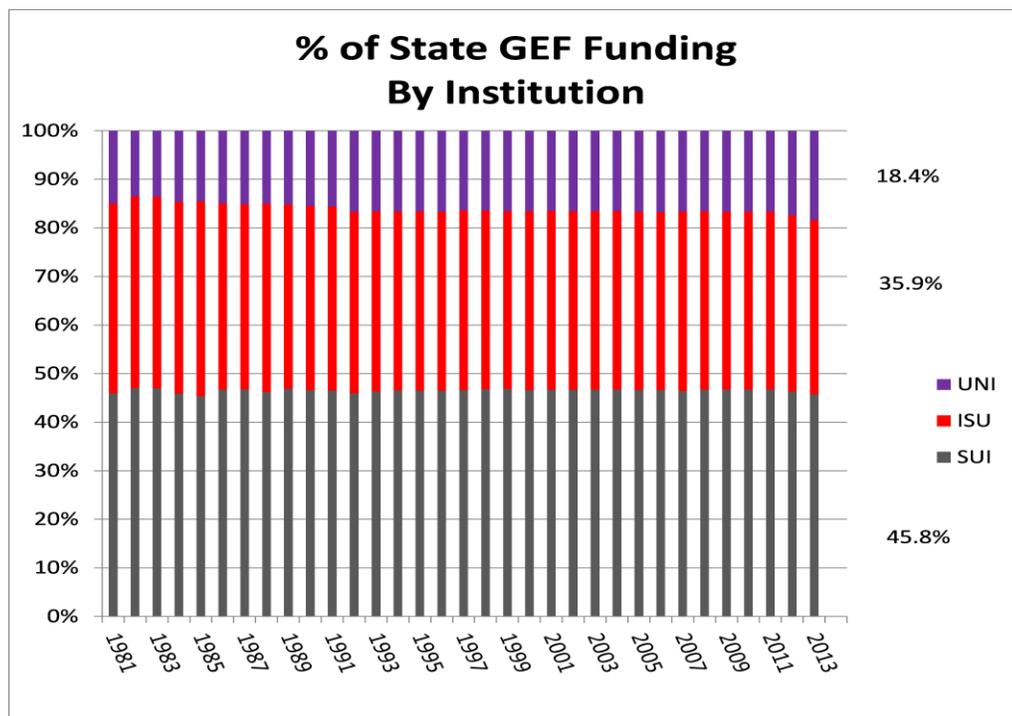
⁴ While the actual GEF appropriation frequently falls below, occasionally dramatically below, the Regents' requested amount, we believe it is a sign of the strength of the system for funding public higher education in Iowa that the legislature entrusts the allocation of their GEF appropriation to the Board of Regents.

Chart One



By 1981, the GEF share to the institutions had settled at about 47%/37%/16%. These allocations have remained essentially static since that time. See Chart Two.

Chart Two



The universities, however, have changed a great deal – particularly as to their enrollments. The numbers are summarized in Table One below.

Table One

SUI Headcount Enrollment

	Undergraduate		Graduate-Masters		Doctoral/Professional		Total	
	Resident	Non-Res	Resident	Non-Res	Resident	Non-Res	Resident	Non-Res
Fall 1981	14,258	4,398	2,171	1,188	2,813	1,637	19,242	7,223
Fall 2013	12,012	9,962	1,238	1,146	2,789	2,930	16,039	14,038
Change	-2,246	5,564	-933	-42	-24	1,293	-3,203	6,815

ISU Headcount Enrollment

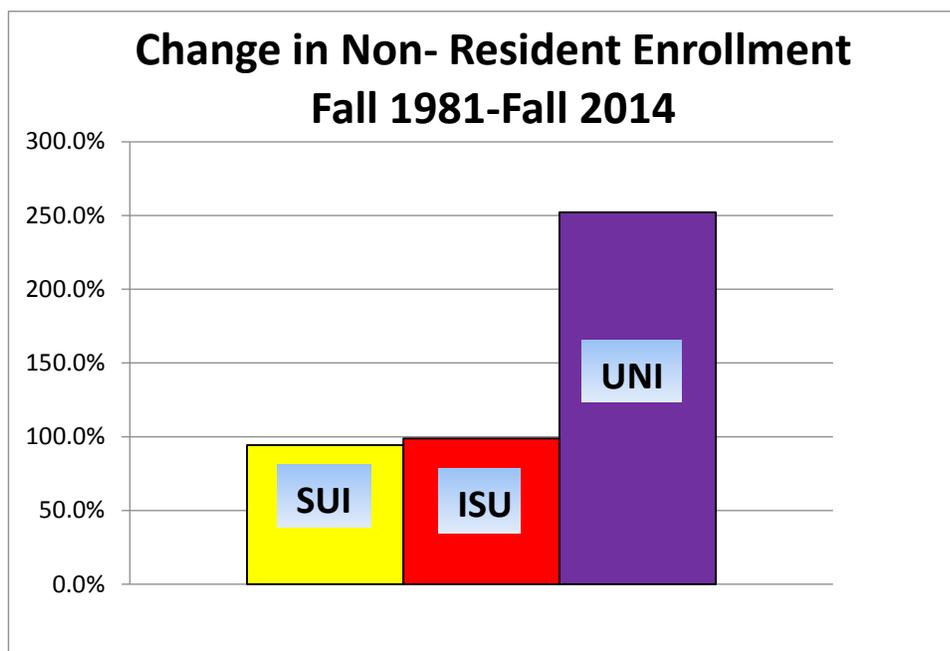
	Undergraduate		Graduate-Masters		Doctoral/Professional		Total	
	Resident	Non-Res	Resident	Non-Res	Resident	Non-Res	Resident	Non-Res
Fall 1981	15,622	4,697	984	719	1,003	1,177	17,609	6,593
Fall 2013	18,009	9,650	1,178	1,444	663	2,011	19,850	13,105
Change	2,387	4,953	194	725	-340	834	2,241	6,512

UNI Headcount Enrollment

	Undergraduate		Graduate-Masters		Doctoral/Professional		Total	
	Resident	Non-Res	Resident	Non-Res	Resident	Non-Res	Resident	Non-Res
Fall 1981	9,429	308	821	51	330	15	10,580	374
Fall 2013	9,411	969	1,015	268	416	80	10,842	1,317
Change	-18	661	194	217	86	65	262	943

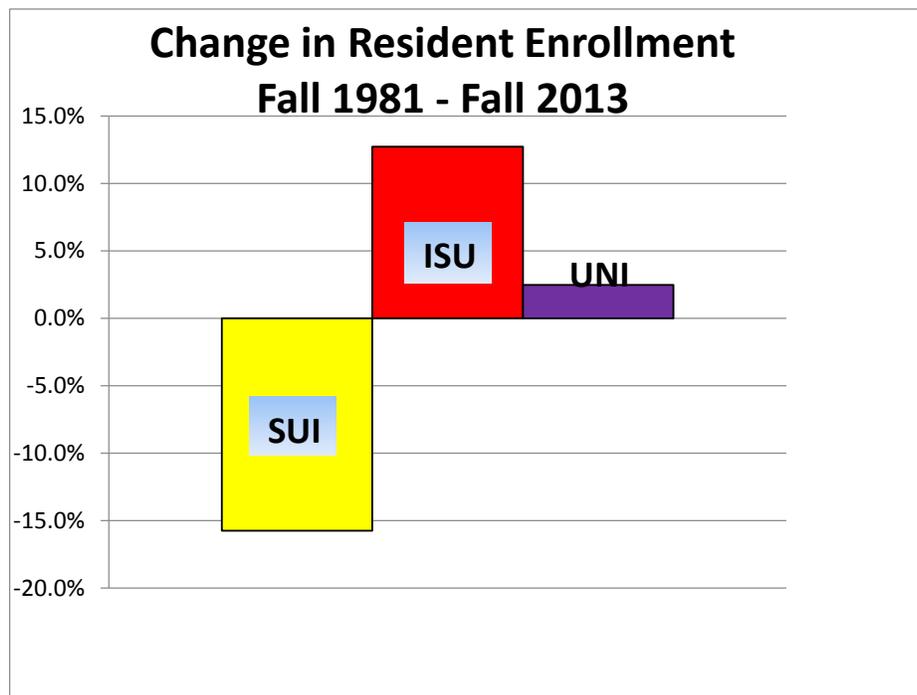
The most dramatic changes came in the growth of non-resident enrollment, with UNI generating a more than three and one-half fold increase in non-resident enrollment. See Chart Three.

Chart Three



But the data show divergent paths with respect to resident enrollment. See Chart Four.

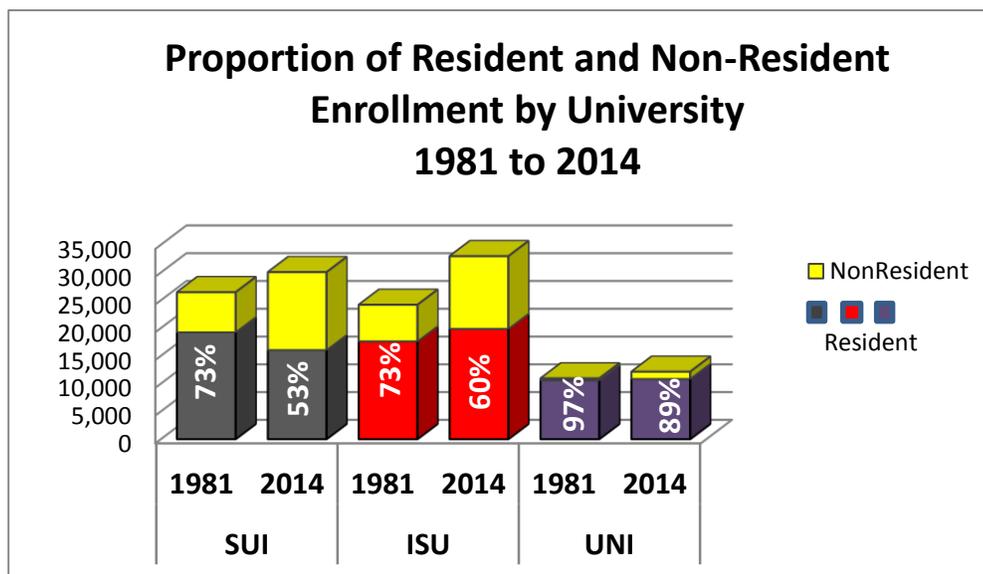
Chart Four



While UNI's resident enrollment was largely unchanged over the period, ISU's resident enrollment grew nearly 13%, and SUI's declined almost 16%. As Table One indicates, SUI actually enrolled 3,203 fewer Iowa residents in FY 2014 than they had 32 years earlier.

As a result, the mix of resident/non-resident students on our campuses had changed dramatically by 2014. There has been a net increase of 14,270 non-resident students and a decrease of 700 resident students over this time period. See Chart Five.

Chart Five



As noted above, the allocation of GEF appropriations has changed little for decades. With funding allocations remaining static, and resident enrollment numbers shifting, state

appropriations per Iowa resident student *by university* have changed considerably. See Chart Six.

Chart Six

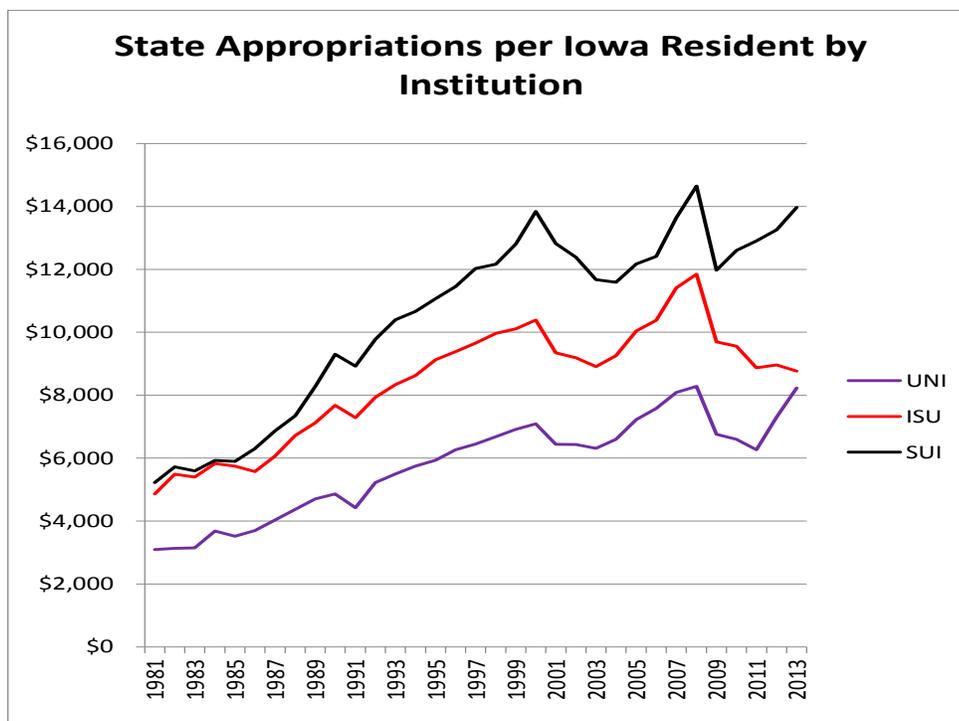


Table Two summarizes the dramatic shift in GEF appropriations per resident student by institution.

Table Two

State GEF per Resident Student

	UNI		ISU		SUI	
	\$	% of SUI	\$	% of SUI	\$	N.A.
Fall 1981	3,093	59%	4,863	93%	5,224	
Fall 2013	8,229	59%	8,765	63%	13,966	

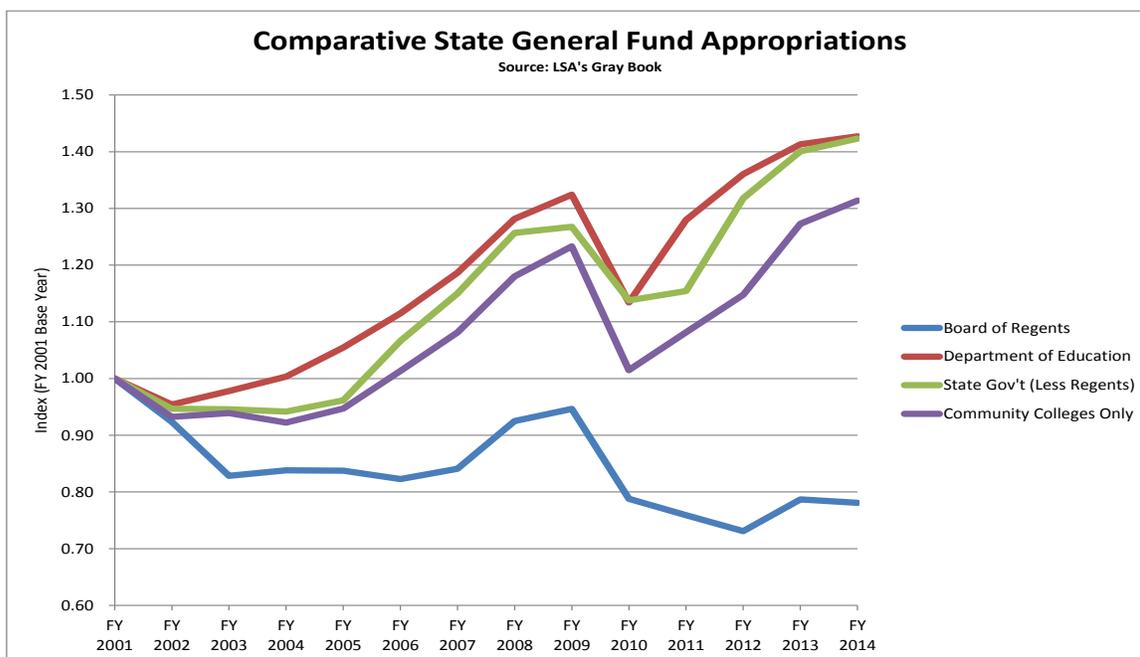
In light of the Iowa data presented and the review of budgeting practices across the country, the Task Force concludes that the Board's long-time practice for determining its annual budget request is out of date. For too many years, the Board's budget request has been developed using a "base-plus" methodology that uses the prior year's allocation to each university's general education budget as the starting point and seeks additional funding to address increased costs related to salary and other inflationary increases. Presently, the Board is perpetuating the priorities of yesterday rather than funding the priorities of today and tomorrow.

By relying for so long on a base-plus budgeting approach, the Board has failed to adequately leverage the most powerful tool of any governing body for influencing the behaviors of its executives and institutions – the institution's budget – to achieve its priorities. No tool is more powerful than a clear statement of goals and priorities which is then translated into a budget that allocates resources on the basis of an organization's abilities to achieve those priorities.

Further, experience causes the Task Force to wonder whether the Board’s long tradition of “base-plus” budgeting has caused the Regents’ case for higher education funding to successive Iowa governors and legislatures to be less and less compelling in recent years.

Since at least the early 1980’s, Iowa, like so many other states facing growing financial challenges, has used higher education funding as the balance wheel for its state budget. When times are bad, higher education – and in Iowa, particularly the Regent institutions – repeatedly suffer budget cuts that come earlier and are greater in percentage terms than other areas of the state’s budget. And when economic conditions improve they are rarely fully restored to prior levels. This funding cycle of lower highs (during the good times) and lower lows (during the bad times) has resulted in a dramatic net reduction in funding to Iowa’s public universities over the last thirty years. Again, Iowa is not alone in this, but Iowa’s Public Universities were hit particularly hard during the recent financial crisis, and despite the recovery, funding to Iowa’s public universities has not been restored to pre-crisis levels. See Chart Seven.

Chart Seven



Review of Performance-based Funding

As noted earlier, beginning in the 1950s, the majority of states began moving toward an enrollment-based funding model for GEF appropriations. Recently, many states have reconsidered those enrollment-based models (at least in part) and are instead aligning their funding models more closely with clearly articulated state goals and priorities. Today, twenty-five states—Arizona, Arkansas, Florida, Illinois, Indiana, Kansas, Louisiana, Maine, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, New Mexico, Nevada, North Carolina, North Dakota, Ohio, Oklahoma, Pennsylvania, South Dakota, Tennessee, Texas, Utah and Washington—have a funding formula in place that allocates some amount of funding based on performance indicators such as course completion, time to degree, transfer rates, the number of degrees awarded, or the number of low-income and minority graduates. Five states—Colorado, Georgia, Montana, South Dakota and Virginia—are currently transitioning to some type of performance funding, meaning the Legislature or governing board has approved a performance funding program and the details are currently being worked out. Another ten states are in formal discussions (including Iowa), and only ten have no formal activity underway. See Chart Eight.

It is important to note that PBF is not the answer to the larger issue of declining support and funding for higher education, and thus should not be used to meet the greater funding issues of higher education.

The Task Force invited a number of experts to speak on state funding:

- Art Hauptman, Public Policy Consultant – National Trends and Issues in Funding Public Higher Education
- Matt Pellish, Director of Member Education, Education Advisory Board – Preparing for Performance-based Funding
- Martha Snyder, Sr. Associate, HCM Strategist, Lumina Foundation Strategy Labs Network Policy Lead – Performance Funding
- Jan Friedel, ISU Assoc. Professor, Education and Zoe Thornton, Registrar, Marshalltown Community College and ISU PhD Candidate – National Landscape for Performance-based Funding
- Russ Deaton, Assoc. Executive Director Fiscal Policy & Administration, Tennessee Higher Education Commission – Tennessee Metrics
- David J. Peters, ISU Asst. Professor, Sociology – Demographics of the College Student Population in Iowa
- Tahira Hira, Sr. Policy Advisor to President Leath and ISU Professor, Human Development and Family Services and Roberta Johnson, ISU Director of Financial Aid – Student Debt

The Task Force also reached out to the university presidents and asked them to present their thoughts and models for performance-based funding at a public meeting.

Premises

After extensive fact-gathering and discussion, the Task Force adopted the following guidelines to be used in determining its recommendations to the Board:

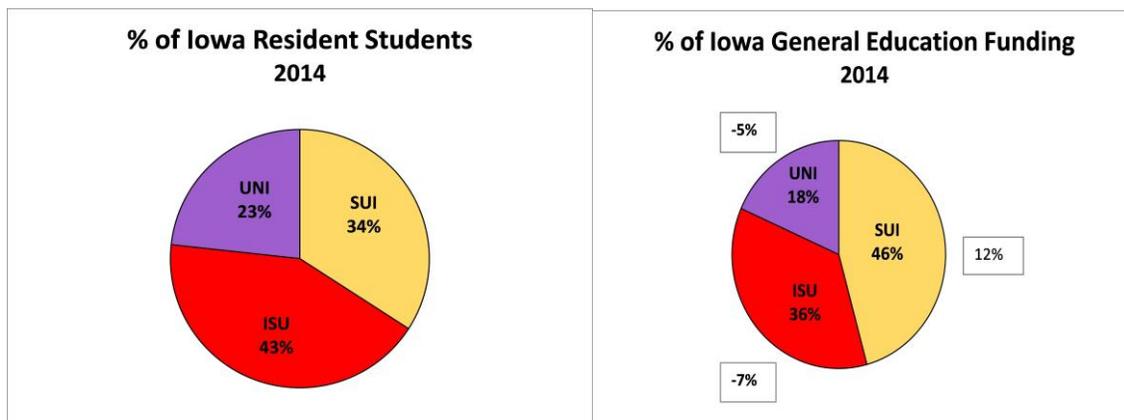
1. States provide funding for higher education because they recognize the public benefit of higher education for their citizens and their state.
 - a. Through time, the first and enduring principle for public funding of higher education has been to defray a portion of the costs so that resident students have affordable access to a quality higher education.
 - b. Therefore, the highest (though not necessarily the sole) priority for state appropriations is to fund the education of resident students.
2. A fundamental role for any governing board is the careful evaluation and approval of an annual budget and plan. For the Iowa Board of Regents, a critical element of this task is the submission of its annual request for appropriations to the State of Iowa.
3. The methodology for seeking state appropriation requests should:
 - a. Be equitable; it should not favor one institution over another, but it should also recognize the unique missions and contributions of each institution
 - b. Be fact-based
 - c. Link directly to the Board's priorities as articulated in the strategic plan and elsewhere
 - d. Be straight-forward, clear and readily understandable
 - e. Be consistent, reliable and predictable
 - f. Focus on a combination of outcomes and inputs
 - g. Provide a clear line of sight into how state appropriations are being utilized by Iowa's Public Universities to benefit Iowans
 - h. Demonstrate accountability to the legislature, governor, and the citizens of Iowa for the funds entrusted to the Board and its institutions
 - i. Reward each institution for achieving the objectives of the Board of Regents rather than emphasizing competition between them

The Need to Align with Resident Enrollment

The Task Force finds that the funding model for Iowa’s Public Universities needs to more closely link GEF appropriations to resident enrollment at the three universities. This is not simply a matter of equity, but a practical matter of providing adequate funding. Let us not forget that resident tuition does not cover the full cost of an Iowa student’s education at any of our universities. A university that admits 1,000 new residents but sees no increase in its GEF appropriation creates a funding deficit for each of those students that puts pressure on the entire institution. Conversely, a university that decreases its enrollment of resident students by 1,000 but sees no decrease in its state GEF funding frees up additional net resources to support its overall operations. And – at least under our historic funding model – an institution that adds 1,000 non-resident students in place of 1,000 resident students benefits doubly through retention of its prior year’s GEF funding and through much higher non-resident tuition revenues.

What is needed is a new financing arrangement that produces better results and is more equitable. See Chart Nine.

Chart Nine



The Task Force believes state appropriations per resident Full-time Equivalent (FTE) student should have more parity among the universities. In fact, the lack of such a direct link in our traditional funding approach creates an incentive to overlook Iowa resident students in favor of out-of-state students that pay higher tuition.

Recommendations:

The Regents’ Performance-Based Funding Task Force hereby recommends the following actions to the Iowa Board of Regents:

Recommendation One: The Board should formally acknowledge that the “base-plus” methodology for determining annual state appropriations requests – which uses the prior year’s allocation to each university’s general education budget as the starting point and seeks additional funding to address rising operating costs indicated by the Higher Education Price Index (“HEPI”) – has failed to keep pace with changing higher education realities and priorities at our outstanding institutions, and needs to be replaced with a more flexible system that links appropriation requests to the priorities of today and tomorrow.

Recommendation Two: As the starting point for its evaluation of general education funding (“GEF”), the Board should adopt as its first principle that the highest (though not sole) priority for state appropriations is to defray a portion of the costs of higher education so that Iowa students have affordable access to a quality higher education.

Recommendation Three: The Board should adopt a performance-based funding (“PBF”) methodology that:

- Provides essential funding to educate Iowa students;
- Supports the unique missions of each institution; and
- Incentivizes the institutions to align their activities with the priorities of the State and the Board, and rewards them for accomplishing those objectives.

Recommendation Four: The Performance-Based Task Force recommends the following metrics be adopted to determine the annual GEF appropriations request to the Governor and the Legislature (phased in over time per Recommendation 5 below):⁵ All metrics will be calculated on Iowa residents, except for Job Placement or Continuation of Higher Education in Iowa – that will include all students.

60% of state funding based on Resident FTE enrollment	This would tie funds directly to supporting Iowa students using a 3-year rolling average.
15% for Progress and Attainment	<ul style="list-style-type: none"> • 5% to be awarded based on achieving Student Credit Hour thresholds of 24-48-72. • 10% based on Degree Production. Measurement would be most recent year completed.
10% for Access	Regent universities should have a diverse student body as measured by low-income students, minorities, Iowa community college transfers, and veterans. Measurement would be over a 3-year rolling average.
5% for Job Placement or Continuation of Higher Education in Iowa	Iowa’s public universities have a role to play in the economic development of the state. Measurement of this metric to be determined; until then, dollars weighted to mirror overall allocation. Suggested timeframe: 1-5 years.
10% based on Regent Selected Metrics	<ul style="list-style-type: none"> • 5% to be awarded based on sponsored research for the most current year recognizing the boon to economic development that the public universities provide. • 5% to be customized metrics selected by the Board of Regents in conjunction with the universities. A suggested methodology for awarding dollars on these metrics which does not place the universities in direct competition is attached in Exhibit B.

Rationale

Metric One: 60% Based Upon Resident FTE Enrollment

The most common method of allocating state general education funding is a direct link to enrollment. Indeed, this is the way that most states allocate the overwhelming majority of their GEF dollars. They do so because the primary reason for a state to fund public

⁵ This recommendation was approved by the Task Force on a vote of 4-1, with Mr. Hadley voting “no”. Mr. Hadley’s dissent will be distributed to the Board under separate cover.

higher education is that there is a public benefit to the entire state of having better educated residents, and by investing state dollars they can reduce tuition costs for their residents.

We find this reasoning to be compelling for the State of Iowa. Whether viewed as economic development or through the broader lens of having an informed and engaged citizenry, Iowa benefits by allowing its residents to pay a discounted tuition rate. The flip side of that coin, however, is that for students to pay a discounted level of tuition, the gap must be closed with state funding.

The Task Force considered a number of alternative methods of measurement. The primary options – based on a review of other states – were:

- Resident Undergraduate Enrollment
- Total Resident Enrollment
- Total Enrollment (including both resident and non-resident students)
- Resident Enrollment with a Higher Weight for Masters, Doctoral & Professional Programs

Though each Task Force member had their own views on this critical question, we ultimately settled upon Total Resident Enrollment as best representing the State's interest in funding public higher education. We chose resident enrollment because it is resident tuition that is being subsidized. By state law, non-resident tuition must cover no less than 100% of the cost of instruction; in practice, non-resident tuition typically pays for well more than the direct cost of instruction.

Counting only resident undergraduates was considered, particularly given that resident undergraduate tuition has been the primary focus of the Board's efforts to ensure affordability and access. Ultimately, we were persuaded by the state's need to produce more graduates with advanced degrees that we thought it important that GEF dollars link to total enrollment.

This latter concern – the need for more advanced degrees – caused us to consider giving a higher weighting to enrollment in advanced degrees. While the Task Force saw some merit in this, we noted that an Iowa resident who pursued their undergraduate and graduate education at any of Iowa's Public Universities receives a consistent tuition subsidy each year over what may be an extended period of years. We also noted that the additional potential earning power from an advanced degree allows our institutions to charge a higher, market-level of tuition for graduate programs. We thus did not place an additional weight on graduate enrollment.

The 60% / 40% weighting to resident enrollment / outcome metrics is meant to reflect a balance between providing necessary funding to pay the costs of educating our students and allocating sufficient weight to achievement of desired outcomes to incent the universities to achieve the strategic priorities of the Board and the State of Iowa. We view this weighting as a reasonable starting point. National experts recommend that no less than 15% of total general education revenues (not just state appropriations) be weighted to outcomes to create sufficient incentive to influence institutional behavior. Weighting 40% of GEF to outcomes equals about 14.5% of total general education revenue at our institutions.

As the Board gets more comfortable with this new funding model over time, we strongly recommend that consideration be given to re-balancing the metrics further toward desired outcomes.

Performance-based Funding

As noted earlier, dissatisfaction with the base-plus method of budgeting led the majority of states many years ago to move at least a portion of their funding to an enrollment-based model. The primary benefits of this approach are (1) it incents universities to increase enrollments, and (2) it should – at least in theory – provide funding to pay for newly enrolled students. [Too often in practice state legislatures do not fully fund the model, resulting in funding shortfalls].

Recently a flood of states have adopted – in whole or in part – what has come to be termed “performance-based funding” or “PBF”. Broadly, PBF describes a funding methodology which seeks to use the appropriation process to incent the institutions to achieve the outcomes desired by the State.

Though bringing the existing appropriations up to current enrollment realities on our campuses would be a big step forward, we believe that the Board should use this opportunity to move beyond measuring inputs to measuring and rewarding outcomes.

While enrollment is easy to measure, our analysis of the Board’s Strategic Plan tells us that raising enrollment in and of itself is not the Board’s priority. Enrollment is largely an input measure of how many students we have on campus. Enrolled students who are making slow progress toward their degrees, who are generating ever greater student debt, who may or may not graduate, are all counted as enrolled. Moreover, shifting to enrollment could spur an arms race among the public universities, and between the public universities and other higher education alternatives in Iowa, that wouldn’t be healthy for the Iowa higher education system overall, and again, may not produce any greater number of degreed Iowans.

Nor do we want to turn the focus of our universities overly inward, for three reasons. First, Iowa resident students benefit from the energy and diversity of students from other parts of the country and the world who choose to attend our institutions. Second, for many years Iowa has been distinguished as one of the top destination states for students entering college. We presently rank 7th among all 50 states for the “net importation” of college students. That students travel to Iowa to get a higher education is a testament to the quality of what we have to offer, is a great boost to our economy in the near term, and – since a number of them stay here – can help to grow our population of college-educated residents. Finally, and this unpleasant fact must not be ignored, the number of college-aged Iowa residents is projected to fall by 17% by 2030. Too narrow a focus on enrolling resident Iowans then would not be a positive step for our State.

By contrast, the budget model we recommend incents the universities to achieve the outcomes – starting with increasing credit hours and degrees awarded – that we need from Iowa’s Public Universities. While it is true that one way to achieve the identified outcomes may be to increase enrollments, it will not do so if the universities do not move a growing proportion of those enrollees quickly and cost-effectively to graduation.

The outcome measures we recommend are intended to reward alignment with the State’s priorities as articulated in the Board of Regents Strategic Plan and elsewhere.

Metric Two: 15% Progress and Attainment

The Task Force is pleased to suggest a weighting of 15% to two progress and attainment metrics – 5% awarded on student credit hour thresholds and 10% on degrees completed. The combination of these two measures is intended to accurately capture and reward the universities’ efforts to help students progress as rapidly as possible in their educational efforts, with the ultimate objective of achieving their degrees. Our

progress measures are focused on undergraduates, but we award degree attainment at all levels.

Metric Two aligns with the Regents' strategic goals to improve 4-year graduation rates, as well as the strategic plan priority of "Access, Affordability, and Student Success". By encouraging the universities to help students move more rapidly through their studies, and to generate more bachelors and advanced degrees, we should see improvement in the cost-per-degree, benefitting students and all Iowans through a more cost-effective educational delivery system.

Metric Three: 10% Access

The Iowa Board of Regents has long been committed to providing affordable access to quality higher education for Iowa residents. The Task Force recommended allocating 10% to this metric for two reasons. First, we believe it a transformative step to directly tie funding to ensuring access for targeted student groups. This shines a bright spotlight on ensuring access in a way that has not happened before. Second, as we bring focus to progress and attainment, we want to be clear that Iowa's Public Universities need to continue to work for all Iowans, not just a select few.

Metric Four: 5% for Job Placement or Continuation of Higher Education in Iowa

Iowa's Public Universities play a major role in the economic development of the State. We believe that they can contribute even more to growing our state's population of educated and engaged citizens by actively partnering with businesses and communities across the state to retain our graduates in Iowa upon graduation. Importantly, this metric will measure graduate retention of both residents and non-residents.

Accurate data on graduate retention is not available at this time. The Board office will work with the universities to identify a methodology. Until that is done we suggest that these dollars be allocated to mirror the sum of the remaining metrics.

Metric Five: 10% for Regent Selected Metrics (with 5% Directed Toward Research)

This metric breaks down into two measures:

- 5% related to university research. This measure is intended to reflect the unique research missions of SUI and ISU – both outstanding AAU universities – as well as UNI's more focused research efforts. It is simply the case that while research is often funded by outside parties, it does create additional infrastructure costs for the institution. The initial allocation recommended mirrors the total of the other metrics.
- 5% related to customized metrics selected by the Board of Regents in conjunction with the universities.

A growing practice nationally is for the governing board to identify specific goals that they particularly want each university to focus upon. Often those goals are unique to a certain institution, and ideas for those customized metrics frequently come from the institutions. A suggested methodology for awarding dollars on these metrics which does not place the universities in direct competition is attached in Exhibit C.

Outcomes

The benefits of the PBF model recommended include greater alignment between the Board's strategic plan and the actions of each university, greater transparency, a clearer line of sight into how state appropriations are being utilized by Iowa's Public Universities to benefit Iowans, improved understanding of the impact of state funding on the ability of the universities to accomplish their missions, and greater accountability to the legislature and the Governor.

A high level model of the potential financial implications of budgeting using these suggested metrics is attached as Exhibit A. We want to stress that while we have not been blind to the potential financial impacts of our work, we took seriously the charge to the Task Force to research and recommend changes to the funding model based on the merits. We have not engineered our recommendations to a particular financial result, and indeed proceeded with no preference for any particular outcome. That dollars may be allocated differently as a result of this approach is not surprising, but that outcome played no role in our deliberations.

Recommendation Five: Implementation of the new model should move forward in a careful manner that continues to provide essential support to all three universities. We recommend the following transition measures:

1. The recommendations of the Performance-Based Funding Task Force should be implemented beginning in Fiscal Year 2016.
 - a. Between now and October, the Board should work with Board office staff and the institutions to work through the implementation details of this model to ensure that the metrics are correct and will lead to the intended outcomes.
 - b. Beginning now allows the institutions a full-year to prepare for any changes in funding brought about by the Board's new funding methodology.
 - c. Each institution should be given the opportunity to present to the Board a plan for responding to the revised funding model.
2. Implementation of these recommendations should be paid for through restoration of State funding to Iowa's public universities.
 - a. The proposed PBF model creates a direct and transparent link between dollars invested by the State and achievement of the State's priorities. The improved educational outcomes generated by this new funding model merit additional State investment.
 - b. Despite considerable progress, State GEF funding in Fiscal Year 2013 remained \$98 million below Fiscal Year 2008 levels, meaning that all three institutions are already managing through significant funding reductions. A better funding model should benefit all of our universities; the State can play a critical transition role.
 - c. The abiding contribution of this new approach is to reward each institution for achieving the objectives of the State and the Board of Regents, not in creating competition between them. By funding the transition to PBF, the State can minimize any short-term disruptions caused by reallocations among the institutions, while sending a strong message of support to the Board of Regents for taking this much needed step.

3. The Board should transition to the new funding model over time – the Task Force suggests 2-4 years – keeping in mind the following:
 - a. The Task Force wants to be clear to this Board that while we believe strongly in the new funding model and its long-term benefits to the universities and the State of Iowa, nothing in this report should be taken as a criticism of any of our outstanding universities, each of which is investing the State's resources to provide a superior-quality education to their students, generate world-class research, and to serve the citizens of Iowa.
 - b. The model we recommend here is intended to enhance the institutions over the wide arc of time, not to address near-term funding issues.
 - c. A move to a new funding model – particularly when the former base-plus methodology has gone unchanged for so very long – requires the Board to balance competing factors. To the extent that the State provides less than full funding to implement PBF, we recommend that any reallocations of funding from any university be capped at 1%-2% of the institution's 2013 general education revenues per year.
 - d. Incremental funds will not accrue to a university whose funds are negatively reallocated until the percentages per university in the model are reached.
 - e. Concurrent with the implementation of PBF, we recommend that the Board actively explore the potential for differential resident-tuition among the institutions.

Recommendation Six: This move to PBF should be considered a first step. The Board should remain actively engaged to:

1. Revise the model based on experience;
2. Respond to any unintended consequences; and
3. Move a growing proportion of funding toward the achievement of desired outcomes.

Thank you for the opportunity to serve. We believe that recommendations advanced here will provide a clear line of sight into how state appropriations are being utilized by Iowa's Public Universities to benefit Iowans, and demonstrate accountability to the legislature, governor, and the citizens of Iowa for the funds entrusted to the Board and its institutions.

Exhibit A

Table A-1, on page 19, shows how the proposed metrics would redistribute funds if applied *in their entirety in a single year*, using FY 2014 appropriations. While the model is believed to be accurate based on FY 2014 data, a number of cautions are in order in reading this table:

1. This table is included to provide an understanding of the potential magnitude of the changes proposed, but it does not accurately portray our recommendations in two respects.
 - a. First, as we state clearly in Recommendation Five, we believe that the value to the State of Iowa of this new funding approach warrants additional state funding to pay for the transition to the new funding model. We do not believe – and this table should not be read to suggest – that current State GEF appropriations are adequate to meet the needs of any of our universities, including SUI. We do not endorse a wholesale transfer of State GEF appropriations from SUI.
 - b. Second, as we note in Recommendation Five, even if the State does not wholly address the funding needs of the universities, any necessary reallocations should be scaled in over time, with no more than 1-2% of SUI's 2013 total general education revenues (\$6.5 -- \$13 million) available for reallocation in any one year.
2. Table A-1 makes no allowance for changes that our universities may implement to respond to the new funding model. Given that the purpose of the model is to financially reward the universities for pursuing the Board's strategic priorities, we would expect the institutions to respond.
3. A reminder that *no* changes will go into effect for more than 12 months from the date of this report.
4. Finally, to provide a bit more context, Table A-2 illustrates the dollars that would be relocated if the existing base-plus model were replaced by a model that allocated 100% of state appropriations on *total enrollment* (including both resident & non-resident FTE students). Though we do not recommend this model due to our focus on providing State funding to reduce the cost of higher education to resident students, even this approach would reallocate \$30 million from SUI and \$7 million from UNI.

Table A-1

OUTCOMES	SUI	ISU	UNI	TOTAL
Current Distribution of General University Appropriations	\$ 222,041,351	\$ 173,986,353	\$ 83,222,819	\$ 479,250,523
Redistribution of Funds based on Task Force Metrics				
Enrollment	\$ 97,561,633	\$ 123,140,103	\$ 66,848,577	\$ 287,550,314
Student Progress	\$ 7,556,328	\$ 10,403,050	\$ 6,003,148	\$ 23,962,526
Degree Production	\$ 17,843,292	\$ 18,380,067	\$ 11,701,693	\$ 47,925,052
Access	\$ 15,720,353	\$ 19,843,756	\$ 12,360,944	\$ 47,925,052
Job Placement/Continued HE	\$ 8,147,259	\$ 10,064,261	\$ 5,751,006	\$ 23,962,526
Customized Metrics				
Sponsored Research	\$ 8,147,259	\$ 10,064,261	\$ 5,751,006	\$ 23,962,526
Regent/University Selected	\$ 8,147,259	\$ 10,064,261	\$ 5,751,006	\$ 23,962,526
Redistributed Appropriations	\$ 163,123,384	\$ 201,959,759	\$ 114,167,380	\$ 479,250,523
Variance	\$ (58,917,967)	\$ 27,973,406	\$ 30,944,561	\$0
		47%	53%	\$0

Percentage of Appropriations				
Current	46%	36%	17%	100%
Redistribution	<u>34%</u>	<u>42%</u>	<u>24%</u>	<u>100%</u>
	-12%	6%	6%	0%

Note: Metrics for Job Placement/Continued Higher Education and Customized Metrics have not been determined. The numbers in those fields on this model are based on the appropriations distributed from finalized metrics.

Table A-2

OUTCOMES	SUI	ISU	UNI	TOTAL
Current Distribution of General University Appropriations	\$ 222,041,351	\$ 173,986,353	\$ 83,222,819	\$ 479,250,523
Dollars per Resident FTE	\$ 15,356	\$ 9,533	\$ 8,400	\$ 11,245
Redistribution of Funds based on Task Force Metrics				
Redistributed Appropriations	\$ 192,027,565	\$ 210,881,838	\$ 76,341,120	\$ 479,250,523
Variance	\$ (30,013,786)	\$ 36,895,485	\$ (6,881,699)	\$0
Percentage of Appropriations				
Current	46%	36%	17%	100%
Redistribution	<u>40%</u>	<u>44%</u>	<u>16%</u>	<u>100%</u>
	-6%	8%	-1%	0%
Dollars per Resident FTE	\$ 13,280	\$ 11,555	\$ 7,705	\$ 11,245

Exhibit B

Suggested Point System for customized metrics selected by the Board of Regents in conjunction with the universities is outlined below.

1. Assign the same number of points to each university.
 - a. Points assigned only for goal achievement
 - b. No bonus points awarded for exceeding goal
 - c. Partial points for progress towards goal could be awarded at the Board of Regents' discretion
2. Multiply total points awarded for performance by a base weighting. An initial weighting which mirrors the sum of all prior factors is suggested as a starting point.
3. Add up all weighted points and divide each university's points by the total number of awarded weighted points to arrive at a percentage per university.
4. Multiply the percentage by the total appropriation pool (5%) to arrive at dollars awarded to each university.

Note: If the universities do not reach their full potential in points, the Board could determine how to reallocate unclaimed dollars.

Minority Report

MEMORANDUM

To: Iowa Board of Regents

From: Leonard Hadley

May 20, 2014

I would like to thank the Board of Regents for appointing me to serve on the Performance-Based Funding Task Force, and I would like to thank David Miles for his service as chair of our group.

As a retired business leader, I understand and appreciate the value of examining the funding model for Iowa's public universities. This is an important topic. The amounts we are talking about add up to nearly half a billion dollars of taxpayer funding, and the incentives built into the funding model will influence higher education in our state for years to come.

I am writing to ask the board to consider three modifications to the proposal submitted by the Task Force. I believe these modifications will help the funding model to better serve the needs of Iowans. Although I served as the University of Iowa representative to the Task Force, I am making these recommendations with the long-term success of all three Regents universities in mind.

Recommendation #1: assure appropriate funding for post-baccalaureate programs

There are significantly higher costs associated with graduate and professional degree programs. These programs provide the state with the professionals that it needs: physicians, dentists, veterinarians, pharmacists, nurses, attorneys, teachers, business leaders and other highly skilled people who contribute to the economic vitality of our state and the well-being of our people.

The current "base-plus" model of funding has for many years provided our universities with the resources that make it possible for Iowa students to obtain high-quality graduate and professional education at a relatively affordable cost. The model proposed by the committee does not provide adequate funding to support these needed programs.

The argument has been made that professionals earn higher salaries and therefore should be expected to pay higher tuition. This is true; our Iowa students who are working to become doctors, dentists, pharmacists, veterinarians, and so on do pay a higher tuition than students working to earn bachelor's degrees. We know that currently many of our young Iowans in these programs are graduating with large amounts of debt. We must be careful that the new funding model does not cause tuition to grow so high that our young professionals need to leave Iowa and move to large cities where they can earn salaries that will allow them to pay off larger loans.

If the model is implemented as proposed- with no additional funding to support graduate and professional programs - it will force the universities to make up the shortfall by doing some or all of the following:

- Reducing enrollment in graduate and professional programs
- Raising tuition and fees for Iowa students
- Reducing the number of seats reserved for Iowa residents in these programs, in order to attract more out of state students who pay higher tuition.

These are undesirable actions, but they would be rational responses that any business leader would take when faced with the same situation. I think we would all agree that it would not be good for our state and for our students if these occurred.

Fortunately, there is a relatively simple solution the board can adopt. It is to weight the allocation to account for the differences in costs associated with various types of programs as follows:

- Bachelor's degree students: 1.0
- Master's degree and JD students: 2.0
- Doctoral degree students: 3.0
- Health sciences professional students 5.0
(for example, students in medical, dental,
veterinary, nursing, pharmacy, etc.)

These weightings are based on the differential costs of providing each of these kinds of degree programs in Iowa. They are also consistent with the weightings used by other states.

Recommendation #2: include a fixed base component to the funding model

The cost structure of any higher education institution includes a large proportion of fixed costs (expenses that don't change much when inputs, like enrollment, change). Fixed costs include infrastructure support like IT, libraries and building maintenance. Every university needs to provide these kinds of services, and no university can quickly reduce these kinds of costs when enrollment fluctuates.

The proposed funding model does not take this economic reality into account. It places the entire state allocation "at risk." Only three of the other states that have adopted performance-based funding have chosen to make the entire state allocation variable. The majority have included a fixed amount of funding in their formulas.

To reduce the risk for our universities, I recommend that the board change the model so that each institution receives a guaranteed base amount of 20 percent of its current general education appropriation. This amount should be inflation-indexed so that it doesn't disappear over time. The remaining 80 percent of the appropriation could be split between enrollment and outcome measures in any way the board chooses (the table below shows my thinking).

	Task Force model	My recommendation
Enrollment-based	60%	40%
Outcomes-based	40%	40%
Fixed	0%	20%

A fixed component will provide a more stable and predictable funding stream for the universities, better allowing them to weather the cyclical variations in the marketplace. And a more stable revenue picture will also help assure that the universities can obtain more favorable interest rates when they need to issue bonds in the future. These benefits are good for taxpayers and good for students.

Recommendation #3: phasing in the changes

The Task Force has recommended that the model be phased-in over 2 to 4 years, and that an amount equal to 1 to 2 percent of general educational revenues will be moved in any one year. I support the idea of a gradual approach. It will give each institution time to identify and adopt new strategies, and it will also give students sufficient time to plan ahead for any changes that may affect them.

I ask the board to consider implementing the model in Fiscal Year 2017 (July 1, 2016) so that our universities have sufficient time to prepare. In addition, I recommend that the board phase in the changes in over 4 to 6 years, and limit the amount to be moved in a single year to no more than 2 percent of each campus's general education fund appropriation.

The new model will incentivize the campuses to do things that require time to achieve results such as improving graduation rates. And with the majority of the funding allocated on a three-year rolling average of enrollment, it is appropriate to give the campuses time to increase their enrollment.

Our three public universities are very good - but they can't turn on a dime, nor do we want them to. It is good public policy for the board to grant them the time to develop and implement sound, thoughtful strategies for responding to the policy directions that the board will establish.

Conclusion

In conclusion, although I have other concerns about the Task Force's proposal, I feel that the three recommendations above will address the most significant aspects of the model without affecting the board's purpose in adopting a new approach to funding our public universities. I thank the board for considering these modifications.