Higher Education Finance

An offering of Higher Ed 101

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February 10, 11, 14, 2020

Presentation

I. Premises

II. Anatomy of Higher Ed Finance

III. Financial Health Metrics

IV. Beyond Tuition and State Funding

V. TCNJ's Financial Status

Session 2: Academic and Enrollment Finance, *covering tuition and fees, financial aid, class composition and budgeting, class sizes, cross-subsidies in higher education….. and more* (Feb 17, 18, 20)

Premise

For financial health, revenues should exceed expenditures.

Revenues

Students & Families:
tuition & fees, room & board

NJ taxpayers,
via the Legislature:
state appropriation

Grantors, Donors, Friends:
gifts, grants

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Expenditures

On people:
compensation and benefits for faculty & staff; wages and aid for students

On things:
services, supplies, utilities, buildings & grounds

On programs:
travel, memberships, community efforts

On obligations:
debt service

Premise

Colleges have four financial options to achieve financial health. Most colleges use them all.

1. Raise Revenues	2. Decrease Expenditures
3. Find Efficiencies	4. Borrow

Premise

The key strategic question is, “are we positioned for sustainability?”

Financial

- Does the institution have sufficient liquidity and a substantive financial forecasting capability?
- Does the institution have a substantive budgeting approach and are all reporting entities taking responsibility for their budgets?
- Have all asset monetization opportunities been analyzed?
- Is the institution using its real estate in the most optimal, efficient and cost-effective manner?
- Is the endowment at an appropriate level?
- Is the school’s support community providing necessary and appropriate elements of support?
- Is the institution focused on long-term strategic planning, analyzing potential risks and opportunities, in concert with sustainability?

The “Change Readiness” Test

- Are the institution and its leadership teams realistically positioned to make difficult decisions to create change and embrace economic models that are financially sustainable?
- Does the institution and its board have a clear vision for the future, and is it equipped to effectively communicate its vision with all constituents, both within the institution and throughout its support community?

Source: Alvarez & Marsal, Higher Education: A Restructuring Perspective, 2019

Anatomy of Higher Ed Finance

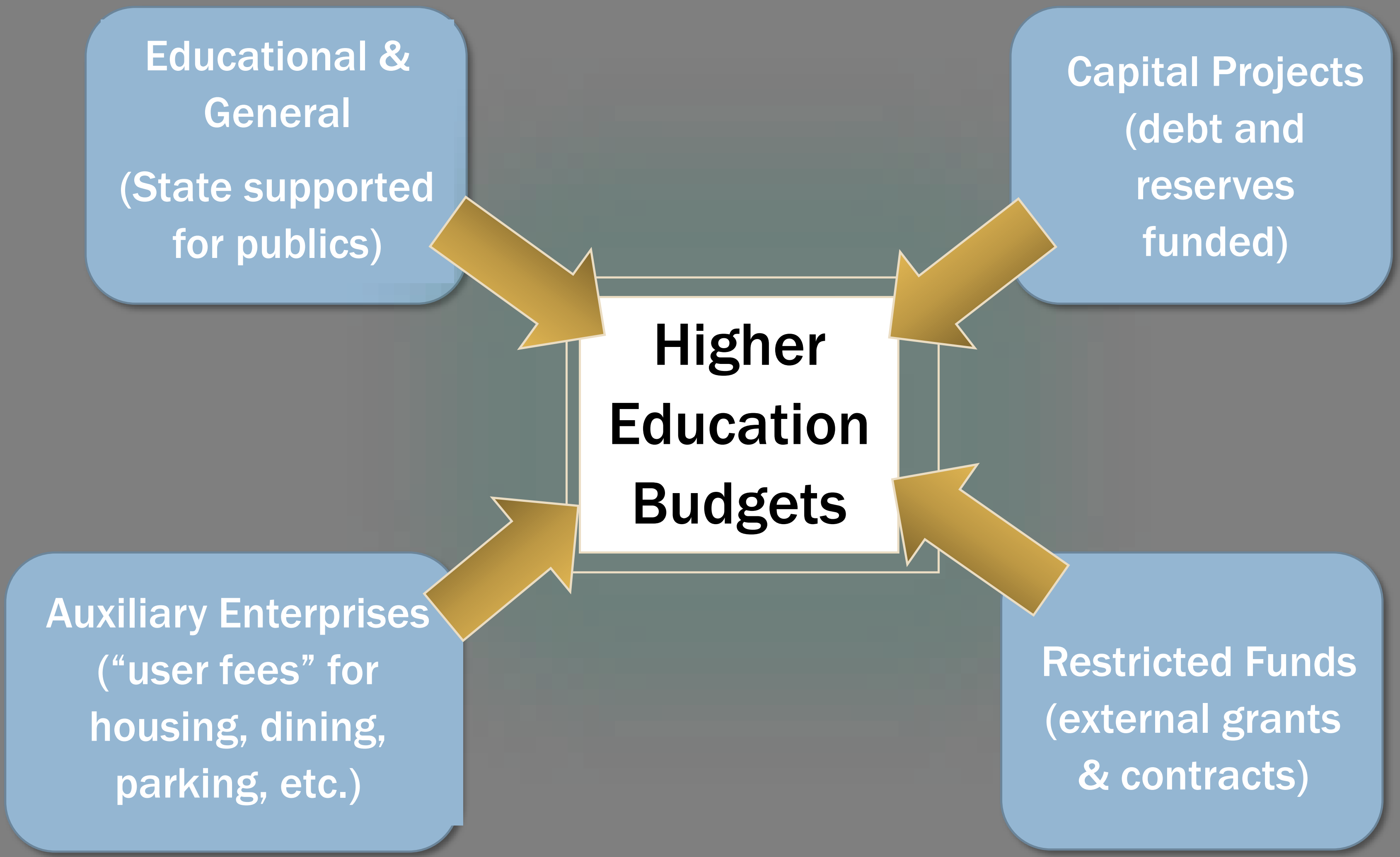
Since 2015, Moody's has lost confidence in the US higher education sector.

	2015	2017	2019
RATINGS	**Stable**	**Negative**	**Negative**
FACTOR	Expected increase in state funding and improved revenue growth at 4-year public and private institutions	In 2018, operating expenses are expected to exceed revenue due to decline in state funding and slowdown in tuition growth	Weak net tuition revenue growth outpaced by increasing expenses, 65%-75% of which are labor costs

Source: Institute of International Education - 2018 OpenDoors Survey

Anatomy of Higher Ed Finance

There are four distinct higher education budgets. They vary by source and use.



Anatomy of Higher Ed Finance

Higher Education Institutions also put aside reserves – six months' worth — to:

- Maintain financial strength
- Provide funds for renovations, repairs, and replacements
- Insulate an institution from potential major financial risk
- Cover unanticipated and uninsured events
- Address temporary revenue shortfalls
- Cover unanticipated expenditure requirements
- Cover unforeseen legal obligations
- Mitigate failures in central infrastructure or major business systems
- Protect against external volatility
- Provide a foundation for debt management and issuance
- Allow flexibility in strategic planning

Anatomy of Higher Ed Finance

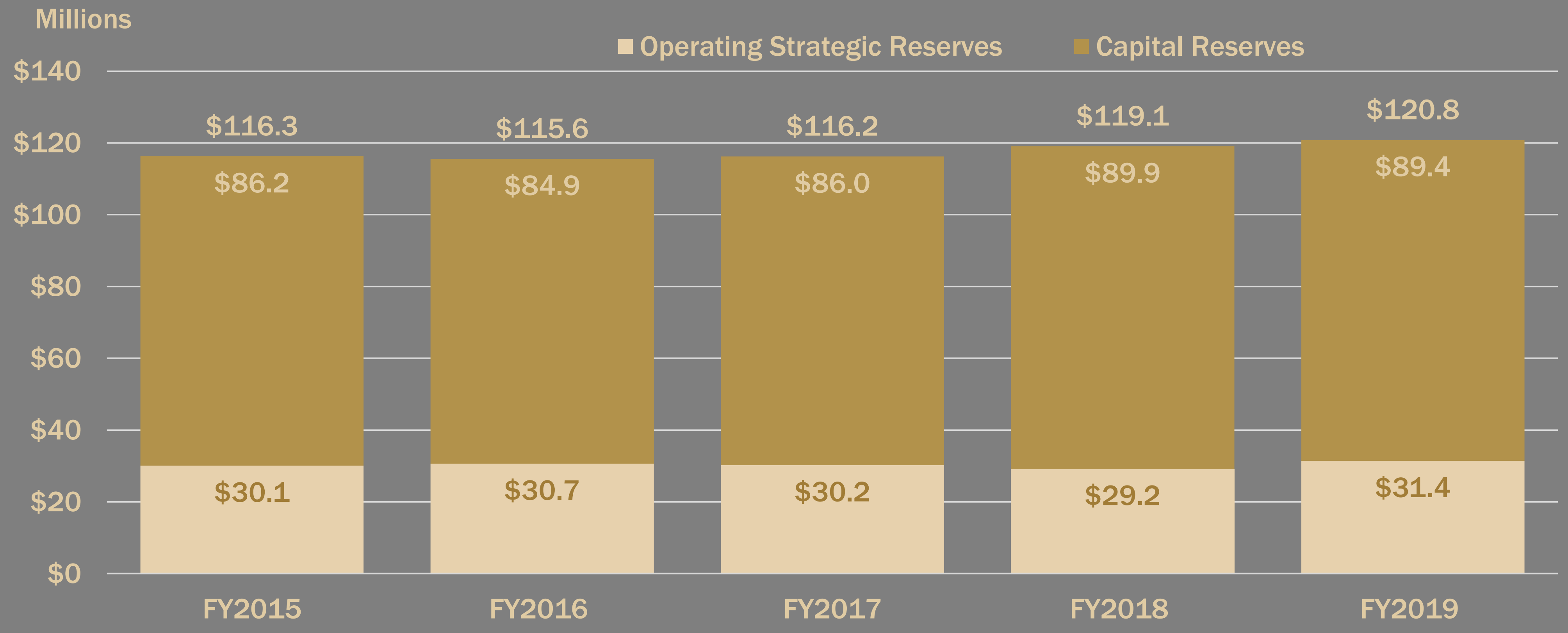
Reserves also vary by size and use.

- Unrestricted funds
- Designated funds
- Quasi-endowments
- Investment earnings
- Unrealized investment gains
- Other miscellaneous revenues

Anatomy of Higher Ed Finance

TCNJ reserves are sufficient but recent growth has been modest.

At the end of **FY2019**, the total reserves were **$120.8 million**, representing 62% or **7.2 months** of the operating budget, exceeding the 50% minimum benchmark established by the Board of Trustees.



Why slow growth? *TCNJ reserves have been used to supplement funding for capital projects (STEM , Brower Student Center , other renewal projects, matching funds for grants)*

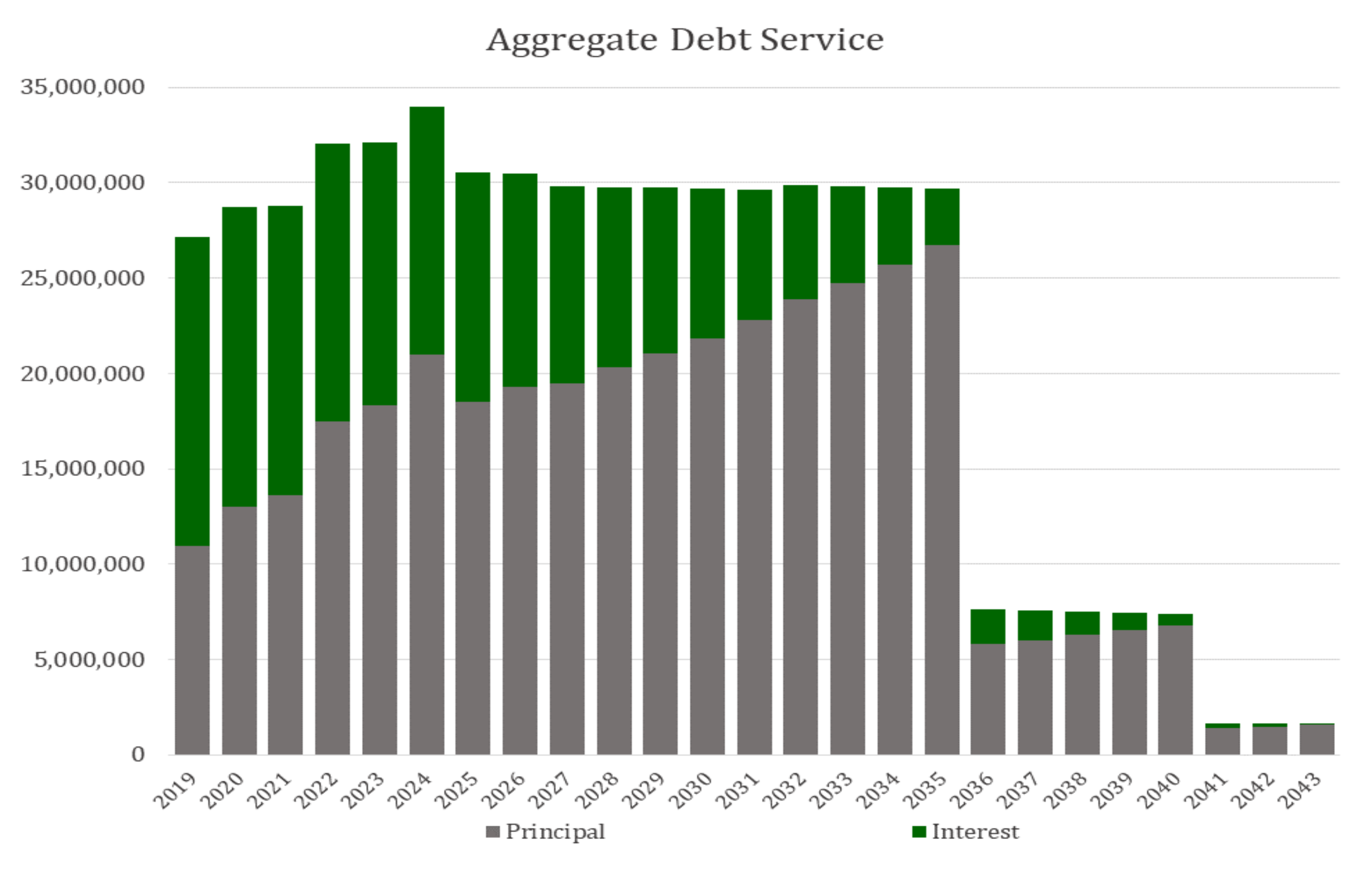
Financial Health Metrics

TCNJ monitors eight key financial performance metrics; most are on track.

Indicator	Why it Matters	How It's Measured	Time-Specific Performance Goal	Current Level – FY2019 Budget	Status
Year-End Operating Margins	The annual surplus or deficit indicates whether the college is living within its means	Year-end budget surplus (deficit)/total operating budget	Net operating margins between 2 and 4% annually	6.5%	Exceeds Goal
Student Revenue Dependence	In competitive markets, reliance on enrollment adds risk to financial health	Share of total budget reliant on tuition, fees, room and board	No greater than 66% of operating budget	66.2%	In the Vicinity
Endowment Power	Endowments provide a steady steam of revenue and are considered by external sources when considering the financial health of a college/university.	Year over Year Endowment Growth	Increase the endowment 5-7% annually for the next five years en route to an endowment size of .5 of operating budget	5.5%	On Track
Revenue Diversification	Diverse portfolio of revenue sources provides financial flexibility and security	Share of operating revenues from non-state and non-enrollment sources	Goal of 15% by 2022	9.6%	In Progress
Graduate Revenue Streams	Graduate enrollment carries higher profit margins than does undergraduate. Boosting the share of graduate tuition dependence diversifies revenues	Grad tuition and fees as share of total net tuition and fees	Goal of 15% by 2023	9.2%	In Progress
Donor Growth and Retention Rates	Donor growth diversifies revenues and signals sustained interest and linkage in the college; retention rates signal a healthy organization and consistent fah in the cause	Annual increase in number of donors; Number of returning donors/number from previous year	Increase number of donors by 5% annually for the next five years; retention rates of .90 by 2023		
Reserves Ratio	Healthy reserves provide financial flexibility and security and enable the college to weather market or operational downturns	Level of reserves/total operating budget	Reserve ratio consistently above .60 and no lower than .50	60.2%	Exceeds Goal
Debt Ratio	A high debt ratio limits financial flexibility and jeopardizes the ability to pursue new opportunities	Annual payment on debt/total operating budget	No more than 10% with a goal of 8% by 2025	11.5%	Goal not achieved

Financial Health Metrics

Debt, though, is a chronic concern. Level is high and repayment burdensome.



Rating Commentary

Moody's *(01/21/2020 Report):* A2 (Stable)

- Very high debt burden
- Constrained funding from the State of New Jersey
- Ongoing identified capital needs, with modest additional debt capacity given high leverage

Fitch *(11/22/2019 Report):* A+ (Stable)

- Enrollment incrementally increased despite tuition increases.
- Flat to weakening support from the State of New Jersey
- Debt burden is high, limiting operating flexibility and ability to fund future strategic and capital needs
- Available fund level against debt is very weak

S&P *(02/08/2019 Report):* A (Stable)

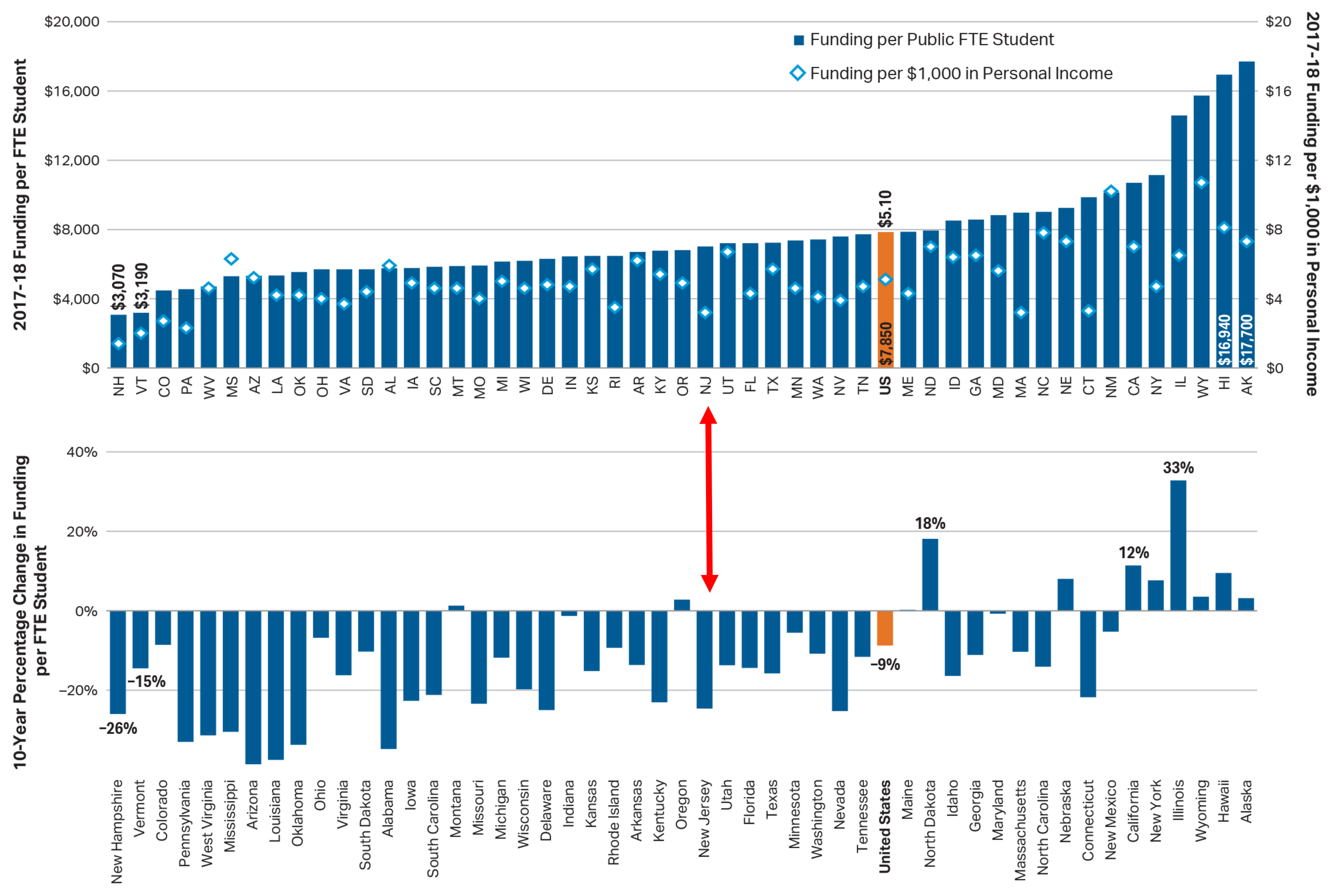
- Excellent adjusted UNA as a pct. of adj. operating expenses
- Low adjusted UNA relative to debt compared with the rating category median due to high debt load
- High maximum annual debt service burden

Financial Health Metrics

NJ funding per student and 10-yr change in funding are below U.S. averages.

2017-18 State and Local Funding for Higher Education per Student, by State

10-Year Percentage Change in Inflation-Adjusted Funding per Student, by State



Source: The College Board, Trends in College Pricing 2019

Beyond Tuition and State Funding

TCNJ and other colleges support foundations.

THE COLLEGE OF NEW JERSEY FOUNDATION

Why Public Colleges and Universities have them:

- Separately incorporated 501c 3
- Receiver and repository of philanthropic gifts
- Receive philanthropic gifts for tax deductibility purposes
- Protect funds from becoming public property
- Safeguard gifts and provide vehicle to comply with donor intentions
- Invest the assets in accordance with the Investment Policy Statement
- Provide private support for programmatic and strategic priorities of the college

Beyond Tuition and State Funding

THE COLLEGE OF NEW JERSEY FOUNDATION

Campaigns and gifts come in all shapes and sizes.

Campaign Types

- Annual
- Capital
- Comprehensive

Gift Types

- Cash
- Securities
- Gift in Kind
- Real Estate
- Pledges

Gift Purpose

- Current use
  - Unrestricted
  - Restricted
- Endowed
  - Restricted
  - Unrestricted
- Deferred
  - Bequests
  - Charitable Gift Annuities

Beyond Tuition and State Funding

Endowment gifts also vary by donor intentions.

THE COLLEGE OF NEW JERSEY FOUNDATION

- True or Permanent
  - funds received from a donor with a restriction that they create a permanent source of support for the organization..
- Restricted
  - the principal is held in perpetuity, while the earnings from the invested assets are expended per the donor's specification.
- Unrestricted
  - assets that can be spent, saved, invested and distributed at the discretion of the institution receiving the gift.
- Quasi (board designated endowments)
  - funds functioning as endowments at the direction of Foundation itself, not by specific donor intent. The principal and income may be utilized at the discretion of the organization.

Beyond Tuition and State Funding

Colleges are limited by how they may spend endowment.

THE COLLEGE OF NEW JERSEY FOUNDATION

Spending Policy: 4.5 percent of a 12-quarter average for all endowments, exclusive of expenses

	2019	2018	2017	2016
All Public Colleges & Universities	4.6%	4.6%	4.5%	4.4%
Institutionally-Related Foundations	4.2%	3.8%	4.1%	3.9%
TCNJ	4.5%	4.5%	4.5%	4.5%

Endowment Illustration

Year	Balance	3-year Total	3-year Average	Payout
-2		$0		
-1		$0		
Gift year	$100,000	$100,000	$33,333	$1,500
+2	$105,000	$205,000	$68,333	$3,075
+ 3	$110,000	$315,000	$105,000	$4,725
+4	$115,000	$330,000	$110,000	$4,950
+5	$120,000	$345,000	$115,000	$5,175

Example: A $1 million endowment will generate $45K annually and grow over time

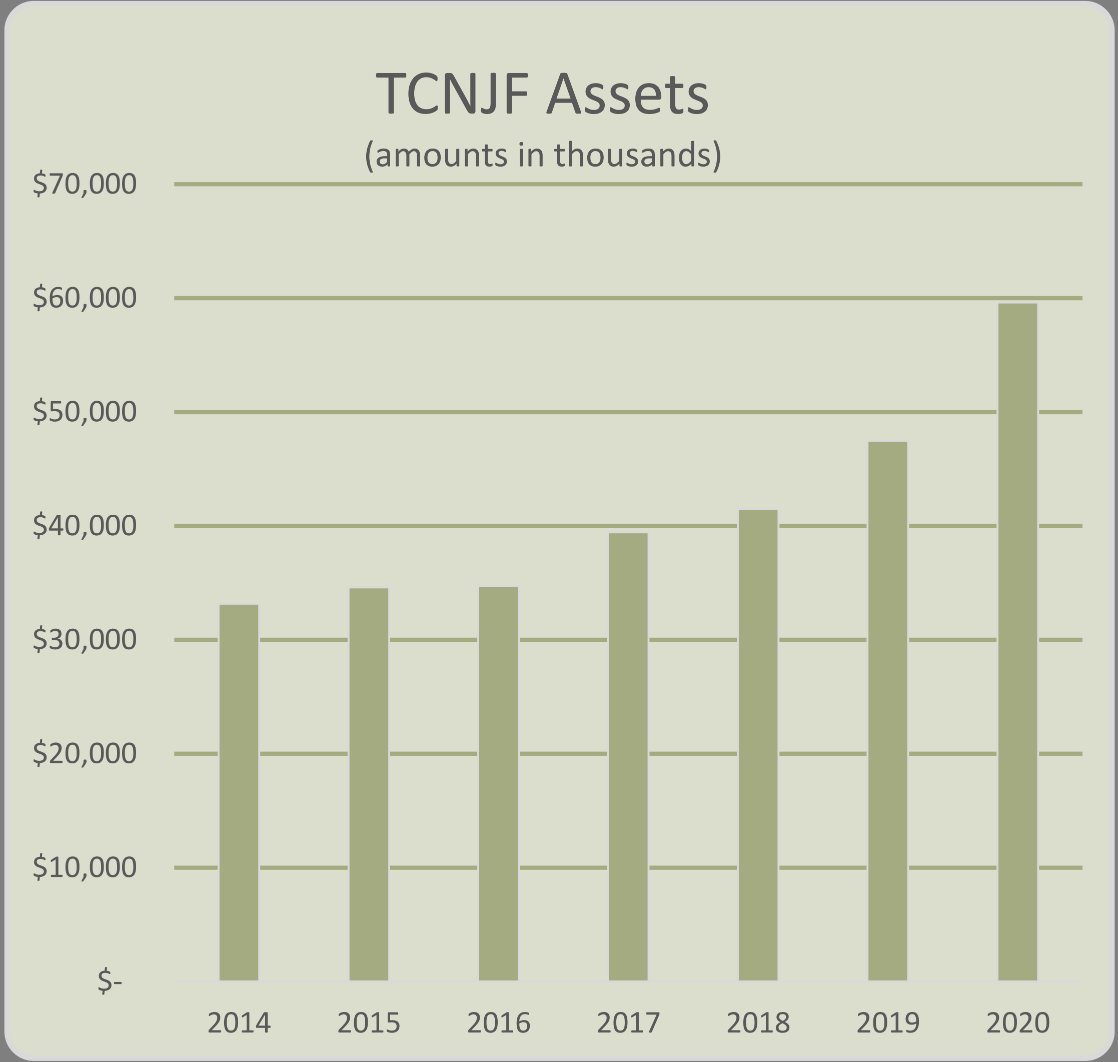
Beyond Tuition and State Funding

TCNJ Foundation follows an investment policy.

Purposes:

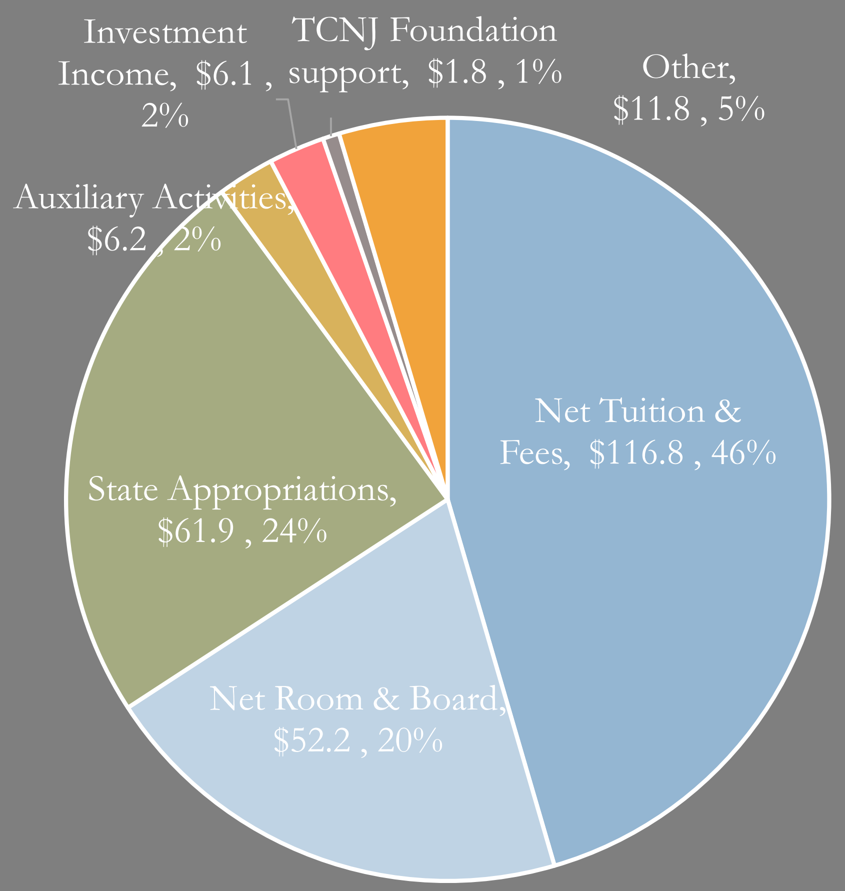
- Preserve and increase the value of endowment funds
- Maximize the long-term total rate of return
- Assume a level of risk consistent with prudent investment practices for such funds.

Asset Class	Min.	Target	Max.	Current	Publics Like TCNJ
Equities	35%	50%	65%	55%	58%
Fixed Income	20%	30%	50%	26%	26%
Alternatives	0%	15%	30%	13%	15%
Cash	0%	5%	30%	6%	1%



TCNJ Financial Status

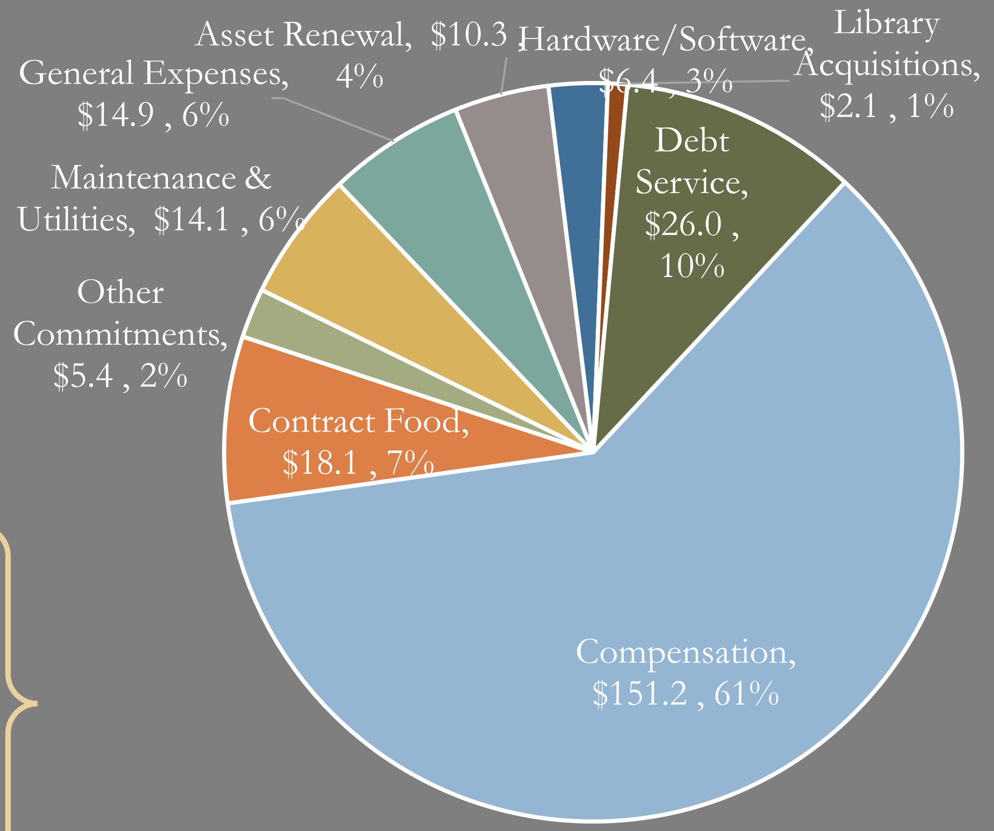
Only ten percent of revenues from other than families or the state; over two-thirds of expenditures go to compensation or debt.



FY20 Revenues = $256.7M

- ❖ *Strategic Projects, $2.0M*
- ❖ *Transfer to Reserves, $5.3M*
- ❖ *Operating surplus, $.9M*

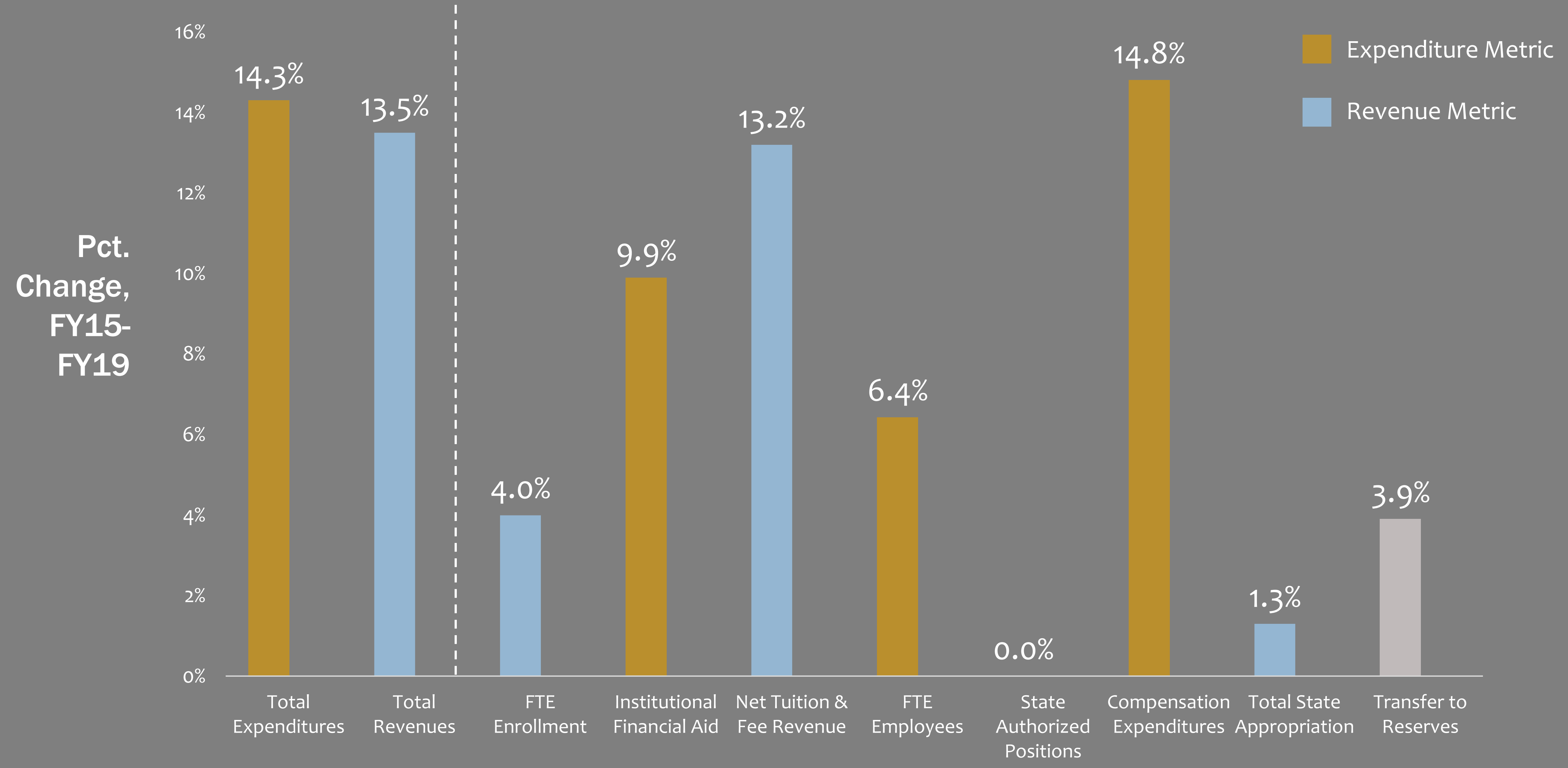
Δ = $8.2M Surplus



FY20 Expenditures = $248.5M

TCNJ Financial Status

Over past five years, TCNJ expenditure metrics outpaced revenue metrics.



TCNJ Financial Status

In all, our finances are strong, but challenges loom.

Financial Strengths	+ Healthy levels of financial reserves + Limited dependency on State funding + Proven track record to execute in challenging economic conditions + Comprehensive multi-year operating budget planning tool with what-if scenarios + Conservative debt structure; rapid repayment of current debt
Financial Challenges & Opportunities	– State operating support as a percentage of the budget has declined – Outcomes-based funding formula may negatively affect TCNJ – Ambitious capital plan with limited debt capacity – Price sensitivity and affordability concerns limit limit tuition & fee increases – Constraints on enrollment growth of traditional student cohort

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