

**TITLE:** 2024-2026 Postsecondary Education Budget Recommendation  
Postsecondary Institution Operating Request

**DESCRIPTION:** The Finance Committee recommends the Council approve the proposed 2024-2026 Postsecondary Institution Operating Funds Request.

**PRESENTER:** Eric Farris, Chair of the Finance Committee

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**COMMITTEE REVIEW & APPROVAL**

The Finance Committee reviewed and approved the Postsecondary Institution Operating Funds Request during its September 11, 2023, meeting. A summary of the requests approved were:

- Total General Fund appropriations of \$1,109,285,500 in fiscal year 2024-25 and \$1,134,385,900 in fiscal year 2025-26 to support public postsecondary institution operations.
- Appropriations of \$81,925,100 in 2024-25 and \$109,233,300 in 2025-26 for an inflation adjustment to help offset some of the largest increases in higher education costs in decades. Additionally, that inflation adjustment funds be excluded from funding models going forward, so full benefit will accrue to recipients of the funds without reducing opportunity for performance funds
- Appropriations of \$22,692,900 in 2024-25 and \$22,692,900 in 2025-26 for performance funding to provide incentives for institutions to increase student success and course completion outcomes and continue making progress toward the state's 60X30 attainment goal.
- Appropriations of \$1,499,100 in fiscal year 2024-25 and \$1,499,100 in 2025-26 to provide a sufficient amount of recurring state General Fund to meet the federal matching requirement for Kentucky State University's land-grant program.
- Appropriation of \$2,107,500 in fiscal year 2023-24 (i.e., a current year appropriation) to complete the state's matching obligation for fiscal years 2022-23 and 2023-24, due to KSU's land-grant program being under matched in the current year and last year.

**SUPPORTING INFORMATION**

The primary way that Kentucky finances its public postsecondary system and supports the teaching, research, and public service missions of individual colleges and universities is by

providing state General Fund appropriations for campus operations. These funds, along with tuition and fee revenue, support Education and General (E&G) expenditures on campus, including faculty and staff salaries, fringe benefits, student financial aid, utilities, building maintenance, libraries, student support services, and numerous other operating expenses. When available, these funds also finance strategic initiatives that support attainment of the state's student success goals and objectives of the Council's *2022-2030 Strategic Agenda for Postsecondary Education*.

- *Council staff recommends total General Fund appropriations of \$1,109,285,500 in fiscal year 2024-25 and \$1,134,385,900 in fiscal year 2025-26 to support public postsecondary institution operations.*

As can be seen in Table 1, the recommended total General Fund appropriations represent increases of \$101,701,400 in 2024-25 and \$126,801,800 in 2025-26 or 10.1% and 12.6% increases, respectively, compared to the 2023-24 net General Fund base.

**Table 1: Components of 2024-2026 Operating Funds Request**

Funding Category	Fiscal Year 2023-24	Fiscal Year 2024-25	Fiscal Year 2025-26
2023-24 Net General Fund <sup>1</sup>	\$1,007,584,100	\$1,007,584,100	\$1,007,584,100
Base Adjustments:			
KERS Subsidy Reductions		(\$4,415,700)	(\$6,623,500)
Adjusted Net General Fund	\$1,007,584,100	\$1,003,168,400	\$1,000,960,600
Additional Budget Requests:			
Inflation Adjustment		81,925,100	109,233,300
Performance Funding		22,692,900	22,692,900
KSU Land Grant Match	2,107,500	1,499,100	1,499,100
Total Operating Request	\$1,009,691,600	\$1,109,285,500	\$1,134,385,900
Dollar Change	\$2,107,500	\$101,701,400	\$126,801,800
Percent Change	0.2%	10.1%	12.6%

<sup>1</sup> Each institution's enacted General Fund appropriation minus debt service (HB 1, 22 RS), and minus \$1,799,700 at KCTCS to reflect a reorganization of the Kentucky Board of Emergency Medical Services (KBEMS). Includes \$97,307,100 in the Performance Fund.

See Attachment A for a breakdown of the operating funds request by institution. Major components of the request include beginning base, base adjustments, and additional budget requests for an inflation adjustment, performance funding, and KSU's land-grant program. Each of these components is described in detail below.

## Beginning Base

In most budget years, a postsecondary institution's beginning base is simply the enacted General Fund appropriation in the second year of the biennium, minus debt service. Beginning with the 2018- 2020 biennium, the approach for determining the beginning base changed, due to the advent of performance funding and subsequent distribution among institutions of funds that had been appropriated to the Postsecondary Education Performance Fund. For two biennia, 2018-2020 and 2020-2022, the beginning base was calculated by adding each institution's regular appropriation to its distribution from the Performance Fund and subtracting debt service.

Beginning with the 2022-24 biennium, the approach for calculating the beginning base changed again, back to the method used prior to 2018. This more recent change was prompted by a change in performance funding statute (KRS 164.092), which stipulated:

1. The certified amounts distributed from the performance fund to the institutions are nonrecurring funds that shall not be included in the institutions' base budget amounts submitted in their biennial budget requests.
2. The certified amounts distributed from the performance fund in the previous fiscal year shall be included in the performance fund's base budget amount submitted by the council in the biennial budget request.

Given this direction from the General Assembly, the method used by CPE staff for calculating the beginning base for the 2024-2026 biennium is each institution's enacted General Fund appropriation in 2023-24, minus debt service for that same year.

**Table 2: Calculated Beginning Base by Institution**

	<b>A</b>	<b>B</b>	<b>C</b>	<b>(A - B - C)</b>
Institution	2023-24 Enacted Appropriation	Debt Service Adjustments	Other Adjustments	2023-24 Net General Fund
UK	\$303,669,300	(\$17,338,500)	\$0	\$286,330,800
UofL	134,223,800	(6,767,000)	0	127,456,800
EKU	81,901,300	(8,464,000)	0	73,437,300
KSU	28,690,800	(870,000)	0	27,820,800
MoSU	49,762,400	(5,434,000)	0	44,328,400
MuSU	51,707,100	(4,189,500)	0	47,517,600
NKU	57,655,000	(5,407,500)	0	52,247,500
WKU	83,951,300	(6,360,000)	0	77,591,300
KCTCS	187,833,700	(12,487,500)	(1,799,700)	173,546,500
Perf. Fund	97,307,100	0	0	97,307,100
<b>Total</b>	<b>\$1,076,701,800</b>	<b>(\$67,318,000)</b>	<b>(\$1,799,700)</b>	<b>\$1,007,584,100</b>

As can be seen in Table 2, in 2023-24, the net General Fund base is calculated by subtracting debt service and other adjustments from each institution's 2023-24 enacted General Fund appropriation. Figures shown in the Enacted Appropriation column in Table 2 were obtained from the *2022-2024 Budget of the Commonwealth* (HB 1, 22 RS). Figures shown in the Debt Service Adjustments column were obtained from that same source. The General Fund baseline calculated by CPE staff has been validated using numbers generated by Office of State Budget Director (OSBD) staff for the upcoming biennium.

## **Base Adjustments**

Base adjustments are technical in nature and typically relate to changes in existing state obligations for postsecondary education, such as increases or decreases over time in General Fund bond supported debt service that is located at the institutions. For the upcoming 2024-2026 biennium, CPE staff and Office of State Budget Director officials agree that appropriations for postsecondary institution debt service, an adjustment reflecting a Kentucky Board of Emergency Medical Services (KBEMS) reorganization (HB 777), and scheduled Kentucky Employees Retirement System (KERS) subsidy reductions (HB 8) represent necessary and appropriate base adjustments.

## Debt Service

Prior to 1998, when General Fund supported bonds were issued to finance the construction of public postsecondary facilities, the resulting liability was accounted for at the institutional level and the General Assembly provided funding for debt service, which was included in campus base budgets and line-itemed in appropriations bills. Over time, as new debt was issued and mature debt retired, changes in debt service obligations occurred making periodic adjustments to the base necessary to reflect these changes.

Following passage of the *Kentucky Postsecondary Education Improvement Act of 1997* (HB 1), debt service for newer postsecondary projects (i.e., those constructed after 1997) has typically been located in the Finance and Administration Cabinet's budget.

In the enacted *2022-2024 Budget of the Commonwealth* (HB 1, 22 RS), the postsecondary institutions received \$811.9 million in bond funds to support new and expanded space projects and \$683.5 million in bond funds for asset preservation projects, and KCTCS received \$16.5 million for a renovation project. As shown in Table 2 above, debt service on these bonds totaled \$67.3 million in fiscal year 2023-24 and was included in the enacted appropriation of applicable institutions.

- *It is anticipated that \$67,318,000 included in enacted appropriations of Kentucky public postsecondary institutions in fiscal year 2023-24 to support bonds for new capital construction and asset preservation projects authorized for the current biennium will be transferred to the Finance and Administration Cabinet to begin the new biennium in accordance with common practice.*

### KBEMS Reorganization

On April 8, 2022, the Governor signed HB 777 (Acts Chapter 126), which made the Kentucky Board of Emergency Medical Services (KBEMS) an independent agency of state government and changed membership of the board. In addition, the bill required KCTCS to transfer all existing state general fund moneys appropriated to the board, all federal funds, all moneys collected by the board, all equipment owned by the board, and instructional supplies, equipment, funds, and records associated with KBEMS to the newly created board.

In the 2022-2024 enacted budget, KCTCS received General Fund appropriations of \$1,799,700 each year to support KBEMS operations, which were line-itemed as a mandated program. Due to passage of HB 777, KCTCS was required to transfer these funds each year to the newly constituted KBEMS. The transfer in 2023-24 has been reflected as a base adjustment (see Column C, Other Adjustments in Table 2).

### KERS Subsidy Reductions (HB 8)

Another category of base adjustments that is scheduled to occur during the 2024-2026 biennium stems from statutorily required KERS subsidy reductions. In 2021-22, Kentucky comprehensive universities (except for NKU) and KCTCS transitioned to a fixed-dollar allocation method of determining employer pension contributions. Based on actuarial calculations, the General Assembly appropriated \$22,099,200 to participating institutions in the 2021-22 budget bill (HB 192), which was intended to cover 100% of the costs associated with that transition. That same year, the legislature enacted HB 8, which called for 10% reductions in the subsidies each year of the 2022-2024 biennium.

Beginning in 2022-23, Section 7(6)(b) of HB 8 called for a reduction of 10% per year over five years of the pension subsidies provided in 2021-22. The planned reductions were delayed by one year, so they began in 2023-24. The statute still calls for the subsidy to be reduced to 70% in 2024-25, a reduction of \$4.4 million, and to 60% in 2025-26, a reduction of \$6.6 million compared to the current year subsidy. As can be seen in Table 3 below, the \$19.9 million KERS pension subsidy provided in 2023-24 is slated to be reduced to \$15.4 million in 2024-25 and to \$13.2 million in 2025-26. The planned decrease in KERS pension subsidies will reduce the net General Fund base of impacted institutions each year of the upcoming biennium as shown in Table 3.

**Table 3: Planned Reduction in KERS Pension Subsidies (HB 8)**

Campus	Fiscal Year 2023-24	Fiscal Year 2024-25	Subsidy Reduction	Fiscal Year 2025-26	Subsidy Reduction
EKU	\$8,023,100	\$6,240,200	(1,782,900)	\$5,348,700	(2,674,400)
KSU	503,400	391,500	(111,900)	335,600	(167,800)
MoSU	4,411,800	3,431,400	(980,400)	2,941,200	(1,470,600)
MuSU	2,929,600	2,278,500	(651,100)	1,953,000	(976,600)
WKU	3,237,200	2,517,900	(719,300)	2,158,200	(1,079,000)
KCTCS	765,200	595,100	(170,100)	510,100	(255,100)
Totals	\$19,870,300	\$15,454,600	(\$4,415,700)	\$13,246,800	(\$6,623,500)
Subsidy	90%	70%		60%	

- *It is anticipated that the net General Fund base of five comprehensive universities (excludes NKU) and KCTCS will be reduced in total by \$4,415,700 in 2024-25 and \$6,623,500 in 2025-26 in accordance with HB 8 statutory requirements.*

These subsidy reductions would normally be the equivalent of a budget cut for participating institutions. However, CPE staff learned in early September that there will be cost savings associated with campus pension payments in 2024-2026 that for most institutions will completely offset the reduced appropriations called for by HB 8.

### **Additional Budget Requests**

Over the past five months, CPE staff has engaged in discussions with multiple stakeholders to identify funding components to include in the Council's *2024-2026 Postsecondary Education Budget Recommendation* that address the most pressing resource needs of Kentucky's public postsecondary system and provide the highest return on state investment. Using a collaborative process involving CPE staff and campus leaders, a consensus was reached that the highest priorities for institutional operating funds in the upcoming biennium are additional appropriations for an inflation adjustment, performance funding, and KSU's land-grant program (see Table 4).

The request for inflation adjustment funds will help institutions offset some of the largest increases in higher education costs in 20 years and allow the Council and campus officials to maintain affordability and access for Kentucky citizens. The performance funding request is well aligned with the state's 60x30 college attainment goal and objectives of the Council's *2022-2030 Strategic Agenda*. The requested funds for KSU's land-grant program are necessary to meet a federal matching requirement.

**Table 4: Additional Budget Requests**

Funding Component	Fiscal Year 2023-24	Fiscal Year 2024-25	Fiscal Year 2025-26
Additional Budget Requests:			
Inflation Adjustment		\$81,925,100	\$109,233,300
Performance Funding		22,692,900	22,692,900
KSU Land-Grant Program	2,107,500	1,499,100	1,499,100
<b>Total Additional Requests</b>	<b>\$2,107,500</b>	<b>\$106,117,100</b>	<b>\$133,425,300</b>

Each of these funding components is described in more detail below.

### Inflation Adjustment

According to the *Commonfund Institute*, the cost of running a college, measured using the Higher Education Price Index, grew by 5.2% in fiscal year 2021-22, representing the largest one-year increase since 2000-01. Colleges experienced higher costs across all factors of production, with utilities up 43.1% (compared to a five-year average annual increase of 9%) and supplies and materials costs increasing by 21.5% (compared to 6% five-year average annual increase). Among the factors that comprise the HEPI, faculty salaries rose the least, by 2.1%.

In mid-August, the *Commonfund Institute* reported that the HEPI is expected to grow by 4.4% in fiscal year 2022-23. When combined with the 5.2% increase the year before, this represents 9.6% growth in college costs over two years, or 4.8% per year on average. That is double the average annual rate of growth over the previous nine years, when the HEPI grew by 2.4% per year. Furthermore, according to a recent analysis conducted by Moody's, high inflation will continue to challenge colleges through at least the end of fiscal year 2024 (Moody's Investors Service). Analysts are predicting that rising costs of labor, food, utilities and construction will require higher education leaders to reprioritize how campus resources are allocated and force difficult choices.

Kentucky postsecondary institutions are facing some of the largest increases in higher education inflation in two decades. The HEPI has grown by a combined 9.6% over the past two years. Moody's is projecting that higher education institutions will continue to face high inflation through fiscal year 2023-24. To provide some sense of scale, a 9.6% inflation factor applied to a system total \$2.0 billion Education and Related expenditure base is \$192.0 million. Substantial investment in higher education is needed to offset rising costs and help the Council and campus officials maintain affordability and access for Kentucky citizens

Another cost factor, which may be unique to Kentucky, but certainly is one that will exacerbate the impact of inflation, is expected increases in state run fire and tornado insurance premiums. In mid-August, CPE staff was notified by Office of State Budget Director (OSBD) staff that state Fire and Tornado Insurance premiums are set to increase by 151% next year.

As can be seen in Table 5 below, between this year and next, state fire and tornado insurance premiums are set to increase by \$31.3 million in total or 151%. A mandated cost increase without concomitant funding is the equivalent of a budget cut. The budgetary impact of this cost increase is largest at MuSU (-4.4%) and smallest at KCTCS (-2.7%). The system average impact is the same as a 3.4% budget cut on a \$910.3 million net General Fund base.

**Table 5: Change in State Fire and Tornado Insurance Premiums**

Institution	2023-24 Net General Fund	State Fire and Tornado Insurance Premiums				Budget Impact
		2023-24 Premium	2024-25 Premium	Dollar Change	Percent Change	
UK	\$286,330,800	\$6,606,000	\$16,550,600	\$9,944,600	151%	-3.5%
UofL	127,456,800	3,206,200	8,032,800	4,826,600	151%	-3.8%
EKU	73,437,300	2,076,300	5,201,800	3,125,500	151%	-4.3%
KSU	27,820,800	546,100	1,368,100	822,000	151%	-3.0%
MoSU	44,328,400	1,179,000	2,954,000	1,775,000	151%	-4.0%
MuSU	47,517,600	1,374,800	3,444,400	2,069,600	151%	-4.4%
NKU	52,247,500	1,263,500	3,165,500	1,902,000	151%	-3.6%
WKU	77,591,300	1,448,700	3,629,500	2,180,800	151%	-2.8%
KCTCS	173,546,500	3,080,500	7,718,000	4,637,500	151%	-2.7%
Total	\$910,277,000	\$20,781,100	\$52,064,700	\$31,283,600	151%	-3.4%

In light of recent budgetary challenges and those still to come, CPE staff and campus leaders ask that the Council include in its 2024-2026 budget recommendation a request for additional operating funds of \$81.9 million in fiscal year 2024-25 and \$109.2 million in 2025-26 to help institutions offset some of the largest increases in higher education inflation since 2001. The request represents an across-the-board 9.0% increase in the first year of the biennium and a 12.0% increase in the second year on each institution's 2023-24 net General Fund base. If authorized, these funds will help Council and campus officials maintain affordability and access for Kentucky citizens.

- *Staff recommends appropriations of \$81,925,100 in 2024-25 and \$109,233,300 in 2025-26 to help offset some of the largest increases in higher education inflation in decades.*
- *In addition, staff recommends that inflation adjustment funds be excluded from funding models going forward, so full benefit will accrue to recipients of the funds without reducing opportunity for performance funds.*

If authorized, the requested inflation adjustment funds will help the Council and campus officials maintain affordability and access for Kentucky students and families. Between 2008 and 2022, reductions in state support and mandated increases in employer-paid pension contributions strained campus budgets and placed upward pressure on tuition and fees. Although Council adopted tuition and fee ceilings resulted in relatively low year-over-year increases, resident

undergraduate sticker prices increased steadily during this period and were sizable in aggregate. Additional base funding supporting campus operations will help institutions offset the effects of inflation, relieve strain on operating budgets, and help the Council and institutions continue to minimize tuition increases and maintain affordability and access in the upcoming biennium.

### Performance Funding

On March 21, 2017, Kentucky's Performance Funding Bill (SB 153), which passed the House and Senate with no changes, was signed into law by the Governor. The newly created statute (KRS 164.092) represented the culmination of a six-month effort by a working group of campus presidents, the Council president, and the Governor and legislative leaders (or their representatives), to develop a rational model for distributing state General Fund appropriations among public universities and KCTCS institutions.

Now in their seventh year of operation, university and KCTCS funding models have been used to distribute \$42.9 million in fiscal year 2017-18, \$31.0 million in 2018-19, \$38.7 million in 2019-20, \$15.0 million in 2020-21, \$17.3 million in 2021-22, \$97.3 million in 2022-23, and \$97.3 million in 2023-24 among the institutions, using rational criteria imbedded in the funding formulas. In terms of process, the General Assembly appropriated funds to the Postsecondary Education Performance Fund (PEPF) in each of those years, CPE and KCTCS staffs ran their respective funding models and certified the resulting distribution of funds to the Office of the State Budget Director, and distributions to institutions were completed through the quarterly allotment process.

Since the adoption of performance funding, the number of degrees and credentials produced by Kentucky postsecondary institutions has grown at an average annual rate of nearly 3.0 percent, which exceeds the growth rate needed (i.e., 1.7% per year) for the state to achieve its goal of increasing educational attainment of working age adults to 60% by the year 2030. In addition, numbers of underrepresented minority degrees and credentials and completions in STEM+H fields are growing at unprecedented rates.

- *Council staff recommends appropriations of \$22,692,900 in 2024-25 and \$22,692,900 in 2025-26 for performance funding to provide incentives for institutions to increase student success and course completion outcomes and continue making progress toward the state's 60X30 attainment goal.*

If the requested appropriations are authorized, it is anticipated that the funds will be placed in the Postsecondary Education Performance Fund, pending application of the funding models by CPE and KCTCS staffs and distribution of funds among institutions in accordance with statutorily prescribed formulas. Given that the General Assembly appropriated \$97,307,100 to the PEPF in 2023-24 and given that KRS 164.092 requires those funds to be recurring to the Performance Fund and not campus base budgets, if the requested funds are authorized by the General Assembly, the new balance in the fund will be \$120,000,000 in 2024-25.

## KSU Land Grant Match

Kentucky State University (KSU) is an 1890 land-grant institution. As such, it is eligible to receive federal grant funds appropriated by Congress each year to support land-grant research and cooperative extension activities subject to provisions of the grants. These funds must be matched by the state on a dollar-for-dollar basis to ensure that KSU will continue to receive its full allotment of federal funds. The matching requirement is an obligation of the state, not Kentucky State University. Other sources of federal funds and tuition and fee revenue cannot be used to meet the match.

In 2023-24, KSU is eligible to receive \$10,381,000 in United States Department of Agriculture (USDA) administered grants to support its land-grant program. Currently, KSU has \$8,881,900 in General Fund appropriations in its base to meet the matching requirement, resulting in a funding gap of \$1,499,100 in 2023-24. The university also had a funding gap of \$608,400 in 2022-23, which was not requested by KSU or matched by the Commonwealth. For the upcoming budget session, CPE staff and campus officials ask that the Council include in its 2024-2026 recommendation a request for \$2,107,500 in 2023-24 (i.e., a current year appropriation) and \$1,499,100 in fiscal years 2024-25 and 2025-26 to fully meet federal matching requirements.

- *CPE staff recommends appropriations of \$1,499,100 in fiscal year 2024-25 and \$1,499,100 in 2025-26 to provide a sufficient amount of recurring state General Fund to meet the federal matching requirement for Kentucky State University's land-grant program.*
- *In addition, because KSU's land-grant program is under matched in the current year and was under matched last year, staff recommends an appropriation of \$2,107,500 in fiscal year 2023-24 (i.e., a current-year appropriation) to complete the state's matching obligation for fiscal years 2022-23 and 2023-24.*

If the requested funds are authorized, it is recommended that they be appropriated directly to Kentucky State University. Since KSU's land-grant program has been designated as a mandated program by the Kentucky General Assembly and the Council on Postsecondary Education, it is anticipated that the total amount of state funds provided to the program in the upcoming biennium will be line-itemed in the 2024-2026 budget bill and excluded from the institution's allocable resources in future iterations of the performance funding model. Finally, these funds will reinforce the effectiveness and impact of outreach, service, and applied research of KSU's land-grant program.