

**MINNESOTA STATE COLLEGES AND UNIVERSITIES
BOARD OF TRUSTEES**

Agenda Item Summary Sheet

Committee: Finance, Facilities and Technology **Date of Meeting:** March 19, 2008

Agenda Item: Minnesota State Colleges and Universities System and State
Economic Outlook for FY2010-2011

Proposed
Policy Change

Approvals
Required by
Policy

Other
Approvals

Monitoring

Information

Cite policy requirement, or explain why item is on the Board agenda: The purpose of this annual report is to provide the Board of Trustees with preparatory information as it begins to consider the FY2010-2011 Minnesota State Colleges and Universities' operating budgets and determine the institutional tuition structures.

Scheduled Presenter(s): Karen Kedrowski, System Budget Director
Judy Borgen, Associate Vice Chancellor for Budget

Outline of Key Points/Policy Issues: The presentation provides an overview of the economic and financial outlook for the Minnesota State Colleges and Universities for the FY 2010-2011 biennium.

Background Information:

**BOARD OF TRUSTEES
MINNESOTA STATE COLLEGES AND UNIVERSITIES**

INFORMATION ITEM

**Minnesota State Colleges and Universities System
and State Economic Outlook for FY2010-2011**

BACKGROUND

The Department of Finance prepares formal forecasts of state revenues and expenditures in February and November each year as required by state law. Forecast information is used by the Governor and Legislature to ensure that enacted budgets remain on track and in balance, and to plan for future budgets. Forecast information is also used by bond rating agencies and other financial analysts to review the state's financial health.

The February 2008 forecast was released on the 28th and projects the state budget deficit for the current biennium at \$935 million. The purpose of this report is to provide the Board of Trustees with a general economic and financial update and outlook for the Minnesota State Colleges and Universities and the state of Minnesota for the FY2008-2009 and FY2010-2011 biennia. This can be viewed as preparatory information to be used by the Board of Trustees as it begins to consider the FY2010-2011 Minnesota State Colleges and Universities' operating budget request.

Forecast Fundamentals

The forecast provides revised revenue and expenditure estimates for the current biennium based on the most recent information about the national and state economic outlook, and caseload, enrollment and cost projections. That updated revenue and expenditure information is also used to revise the planning estimates for the FY2010-2011 biennium. Expenditure estimates in most areas are shown at the level of the appropriations made by the 2007 legislature for FY2008-2009, plus any authorized spending carried forward from prior years. Entitlement programs such as K-12 education, intergovernmental aids, health care, and family support are forecast based on expected changes in eligibility, enrollment and average costs. Wage and price inflation is not included in the projected expenditures for FY2010-2011. The forecast only reflects current law and does not reflect the Governor's budget recommendations, any potential legislative action, or the passage of any pending constitutional amendment dedicating an increase in state general fund revenues to specific uses.

Economic Outlook

With the nation faced with a housing slump, higher energy prices, employment decline, and tightening credit markets, economists are forecasting the real GDP to decline during the first two quarters of 2008, putting the U.S. in a mild recession. The federal stimulus package is expected to help the economy the last half of 2009. There is concern that inflation could be emerging as a new problem. Recent Bureau of Labor Statistics (BLS) data for January indicated that CPI inflation rose to 4.3 percent over the past year. Food and energy price increases were the primary reason for the

increase in CPI. The core inflation (which excludes food and energy) rose to 2.5 percent which is above the 1 to 2 percent comfort zone.

Economic indicators suggest that Minnesota's economy is also descending into recession for the first half of 2008. Minnesota's narrow base of job creation is a continued concern. During the past year, Minnesota has had negative employment change in six of the 11 major industrial sectors. The housing slump is impacting Minnesota harder due to the state's disproportionately large exposure to housing-related industries including plywood and engineered wood product, truss, window, and other building materials manufacturing.

Housing is critical to Minnesota's outlook. The housing market is still in a decline with no clear sign of it moderating. The median sale price of single-family houses, condominiums and townhouses in the Twin Cities metro fell by 8.9 percent in January from a year earlier. The number of foreclosures more than doubled in the last three months of 2007 from one year earlier. In the Twin Cities metro home sales were down 21.3 percent in January from a year earlier, and permits for new home construction declined 39.7 percent between the fourth quarter of 2007 and the same period one year earlier. It is estimated that Minnesota's annual decline in housing permits between 2006 and 2007 will be the largest decrease in over 20 years.

Non-farm Employment is forecast to decline 0.5 percent in 2008. A modest growth is forecast in the first half of 2009 with more accelerated growth in the last half of 2009. In 2010, Minnesota employment growth is forecast to match its U.S. counterpart.

2008-2009 Budget Update

The forecast state's general fund budget deficit for the current biennium is \$935 million, which is \$562 million more than forecast in November and \$1.228 billion from end-of-session. The deficit is 2.7 percent of total general fund spending of \$34.7 billion. State general fund revenues are projected to be \$530 million less than the November forecast and \$1.27 billion less than end-of-session estimates, a decrease of 3.8%. Expenditures are forecast to grow an additional \$64 million over the November forecast and \$130 million from end-of-session, an increase of 0.4%. Table 1 shows the forecast change in revenue and expenses from end-of-session.

Table 1

FY2008-2009 General Fund Forecast Compared to End-of-Session

(\$ in millions)	End-of-Session	November Forecast	February Forecast	Total Change	% Change
Beginning Balance	\$ 2,106	\$ 2,245	\$ 2,245	\$ 139	
Revenues	\$ 33,812	\$ 33,072	\$ 32,542	\$ (1,270)	-3.8%
Expenditures	\$ 34,588	\$ 34,654	\$ 34,718	\$ 130	0.4%
Reserves	<u>\$ 1,036</u>	<u>\$ 1,036</u>	<u>\$ 1,003</u>	<u>\$ (33)</u>	
Balance	\$ 294	\$ (373)	\$ (935)	\$ (1,228)	

Since the end-of-session the largest decline in forecast revenues is in corporate receipts (\$456 million), sales tax (\$322 million) and individual income tax (\$282 million). The decline in corporate receipts represents 36 percent of the \$1.270 billion decline. The large decline in corporate receipts is attributed to lower corporate estimated tax payments through November, decline in the outlook for corporate profits, and higher than expected corporate tax refund payments for tax year 2006. The decline in individual income tax is due to slower growth in wages and declines in non-wage income such as capital gains realizations and interest and dividends.

The \$130 million growth in expenditures is due to increases in K-12 education, property tax aids and credits, and health and human services with an offsetting savings in debt service.

FY2010-2011 Planning Estimates

The projected planning estimates for FY2010-2011 now show a structural shortfall of \$1.086 billion as compared to an end-of-session structural balance of \$1.137 billion. As specified in current law, projected spending does not include general inflation which would add an additional \$ 1.04 billion to spending estimates for the next biennium assuming 1.9 percent increase per year. (Table 2)

Table 2

FY2010-2011 General Fund Planning Estimates

(\$ in millions)	End-of-Session	November Forecast	February Forecast	Total Change	% Change
Projected Revenues	\$ 36,843	\$ 35,713	\$ 35,044	\$ (1,799)	-4.9%
Projected Spending	<u>\$ 35,706</u>	<u>\$ 35,924</u>	<u>\$ 36,130</u>	<u>\$ 424</u>	1.2%
Difference	\$ 1,137	\$ (211)	\$ (1,086)	\$ (2,223)	
<i>Estimated Inflation (CPI)</i>			\$ 1,040		

The FY2010-2011 planning estimates do not include the impact of the omnibus transportation finance bill that was overridden by the Legislature after a veto by the Governor. The legislation contains \$2.8 million of additional spending in FY2008-2009 and reduces general fund revenues by an estimated \$77 million in FY2010-2011.

System's Economic Outlook

The state economic outlook has a significant influence on the System's economic future. Slightly more than half of the System's general fund is supported by state appropriation. With a deficit forecast to be \$935 million in the current biennium, the Governor and Legislature will need to consider options for balancing the budget. According to the Department of Finance, the forecast is

troubling but can be fixed. Any action taken to balance the budget should allow room for change between now and the November forecast in case the economic outlook worsens. The state's reserve is not automatically drawn down as a result of the deficit. The Governor does have authority to unilaterally un-allot appropriations. To do so, the law requires that he first draw down the state's "rainy day" fund. He has given no indication that he intends to do so and has announced intention to release supplemental budget recommendations in the coming days.

The System's FY2009 operating budget that the Board will act on at its March meeting was developed with revenue estimates consistent with earlier planning forecasts and labor contract settlements exceeding the planning estimates of 3.25 percent. The Board limited tuition increases to a maximum of 3 percent at the universities and 2 percent at the colleges. Central funds were used to provide revenue equal to 1 percent for universities and 2 percent for colleges in FY2009. The System's operating budget may well be negatively impacted by the forecast deficit of \$935 million. The Governor's supplemental recommendations will be the first indication of impact. The Legislature will also consider actions to balance the FY2008-2009 budget and is expected to complete its work in early May. Any impact to the System's operating budget will be discussed between the Chancellor, senior staff, and presidents with recommendations presented to the Board when more is known

Discussions will soon be underway regarding the System's FY2010-2011 operating budget request. With a projected \$1.086 deficit in FY2010-2011 before consideration of cost inflation, it will be a difficult legislation session in 2009. The November 2008/February 2009 revenue forecasts will set the stage for deliberations. As the operating budget request is developed, the Chancellor, presidents and the Board will need to consider the state's economic outlook, the impact of the current labor settlements, planning estimates for the next round of labor negotiations, and the role of tuition in the budget request.

Staff will return in May with final legislative outcomes and any necessary recommendations.

Date Presented to the Board: March 19, 2008