



**Senate Finance Higher Education
Subcommittee**

Interim Report

December, 2008

SENATE FINANCE COMMITTEE

80th Legislature

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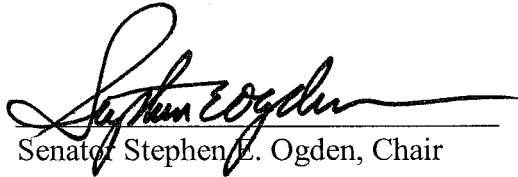
January 7, 2009

The Honorable David Dewhurst
Lieutenant Governor of the State of Texas
Capitol Building, Room 2E.13
Austin, Texas 78701

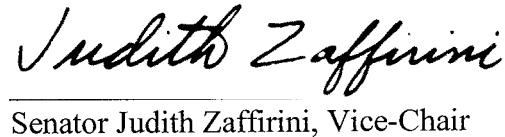
Dear Governor Dewhurst:

The Senate Finance Committee is pleased to submit the final interim report with recommendations of the Senate Finance Subcommittee on Higher Education for consideration by the 81st Legislature in preparation for the regular session.

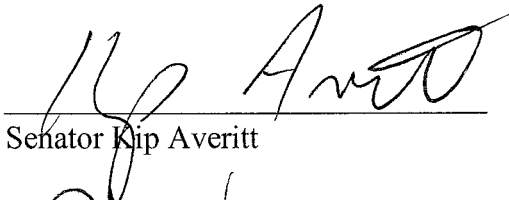
Respectfully submitted,



Senator Stephen E. Ogden, Chair

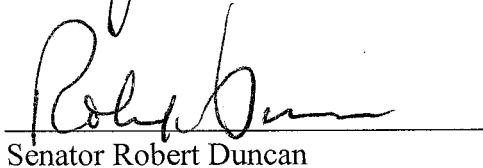


Senator Judith Zaffirini, Vice-Chair

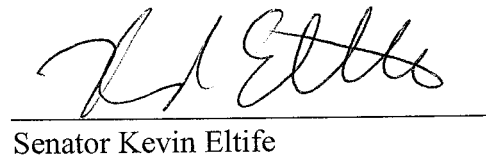


Senator Kip Averitt

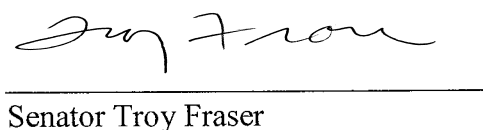
Senator Bob Deuell



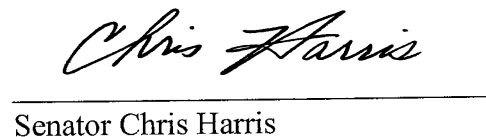
Senator Robert Duncan



Senator Kevin Eltife



Senator Troy Fraser



Senator Chris Harris



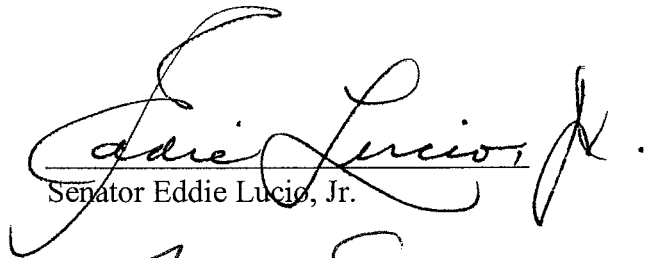
The Honorable David Dewhurst

January 7, 2009

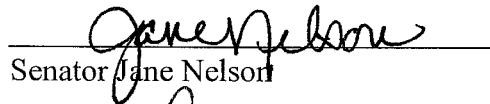
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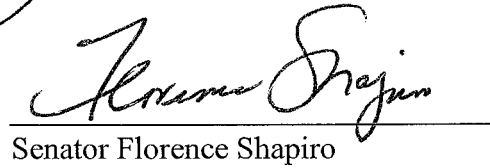
Senator Juan "Chuy" Hinojosa



Senator Eddie Lucio, Jr.



Senator Jane Nelson

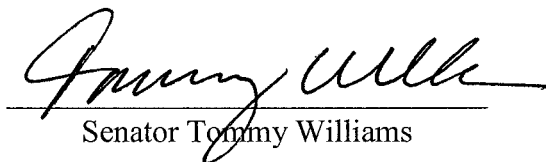


Senator Florence Shapiro



Senator Royce West

Senator John Whitmire



Senator Tommy Williams



*The Senate of
The State of Texas
Austin, Texas 78711*

January 7, 2009

The Honorable Judith Zaffirini
Chairwoman, Senate Finance Subcommittee on High Education
P.O. Box 12068
Capitol Station
Austin, Texas 78711

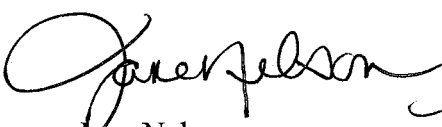
Dear Chairwoman Zaffirini:

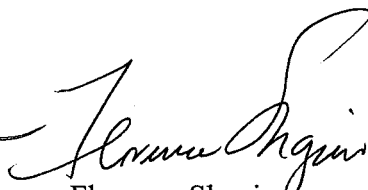
Thank you for your hard work on the important issues before the Senate Finance Subcommittee on Higher Education this interim. The subcommittee considered many issues that will be critical to the future of higher education and the State of Texas.

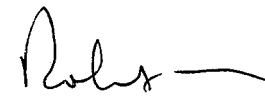
The reports prepared by subcommittee staff provide an outstanding background on the topics examined. The recommendations proposed set out a positive course for discussion during the coming session. However, while we endorse most of the proposals made, we are not necessarily committed to all the recommendations. Our signature on these reports is a reflection of our support for an ongoing discussion of these topics.

Thanks again for your hard work and commitment to the endeavors of higher education.


Yours very truly;


Jane Nelson


Florence Shapiro


Robert Duncan


Kip Averitt


Tommy Williams


Chris Harris



The Senate of The State of Texas

SENATE COMMITTEES:

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Intergovernmental Relations

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Senator Royce West

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President Pro Tempore

2006

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Dial 711 for Relay Calls

January 7, 2009

The Honorable Judith Zaffirini

Chairman - Senate Finance Higher Education Subcommittee

Sam Houston Building, Room 315

Austin, Texas 78701

Dear Chairman Zaffirini:

It has indeed been a pleasure to serve with you on the Senate Finance Higher Education Subcommittee. Your leadership has afforded me the opportunity to share my perspective on the myriad of higher education finance issues that we were charged with addressing, and for that I thank you.

The report provides many positive recommendations that will improve higher education finance in Texas and therefore, I'm happy to sign it. However, I do find it necessary to submit a letter outlining my concern with a certain portion of the report.

I disagree with the statement that "there is not conclusive evidence that tuition deregulation has created overwhelming access problems to higher education." As tuition increases, Texas students are "priced out" of higher education. I'm concerned that, during the time the Coordinating Board collects pertinent information, thousands upon thousands of students will leave higher education or never darken their doors.

In the span of just four days last summer, three of our major metropolitan newspapers - *The El Paso Times*, *The Houston Chronicle*, and the *San Antonio Express News* - ran stories about college tuition and the difficulty that many middle and lower-income families are having affording the dream of higher education. Collectively, they painted an alarming picture of Texas's future.

The Advisory Committee on Student Financial Assistance estimates that in the first decade of this century, financial barriers will keep nearly two million low- and middle-income college qualified high school graduates from attending college.



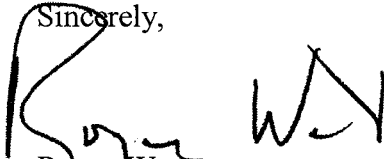
The Honorable Judith Zaffirini
Page 2
November 28, 2006

According to the Bureau of Labor Statistics, **90%** of the fastest-growing jobs in the new information and service economy will require some postsecondary education.

We cannot take away the key to our students' success. Education is the key and tuition deregulation, in part, is hindering our students accessibility to an affordable higher education.

As always, I appreciate your leadership of the Senate Finance Higher Education Subcommittee and your dedication to higher education in Texas.

Sincerely,

A handwritten signature in black ink, appearing to read "Royce West". The signature is stylized and somewhat cursive.

Royce West
State Senator
District 23

cc: The Honorable Steve Ogden
Chairman - Senate Finance Committee
Capitol Building, Room E1.038
Austin, Texas 78701

Senator Judith Zaffirini
Chair



Senator Robert Duncan
Senator Steve Ogden
Senator Florence Shapiro
Senator Royce West

Senate Finance Higher Education Subcommittee

January 7, 2009

The Honorable
Steve Ogden, Chair
Senate Finance Committee
P.O. Box 12068
Austin, TX 78711

Dear Senator Ogden:

The recommendations outlined in the report of the Senate Finance Higher Education Subcommittee are based on extensive testimony at six hearings and suggestions from representatives of state agencies, institutions of higher education, and other interested persons. To build consensus while developing this report, briefing sessions were held, discussion drafts were circulated, and feedback was solicited from senators and their staff members. All senators were invited to participate and to recommend invited witnesses, and all feedback was considered and incorporated. This is to respond to issues raised when the Senate Finance Committee considered the report at its Jan. 7 hearing.

Although drafts were routed to subcommittee members regularly, the final draft was distributed to the full committee at the same time as the joint report of the Subcommittee on Property Appraisal and Revenue Caps. It would have been submitted earlier, but unfortunately, my injury delayed my work.

The statement that only representatives of higher education institutions were given the opportunity to testify before the Subcommittee regarding Interim Charge Three (Tuition Deregulation) is unfounded. The schedule of interim hearings and the interim charges that would be considered at each hearing were posted months in advance and were available via the Texas Senate web site. What's more, public testimony was welcomed and solicited for every interim charge, including tuition deregulation. Chairs of higher education governing boards, who set tuition policy at their campuses, were invited to testify before the Subcommittee so that members could ask questions and hold them accountable. Dr. Raymund Paredes, Commissioner of Higher Education, also was invited to provide a statewide perspective.

Letter to Senator Steve Ogden
January 7, 2009
Page 2

The report's findings that data are insufficient to conclude whether tuition deregulation has affected enrollment adversely were based on testimony of Dr. Paredes and his staff. What's more, as noted on pages 42 and 43 of the report, according to data available at the Texas Higher Education Coordinating Board,

enrollment at both two- and four-year institutions *have far exceeded growth projections that were formulated prior to 2003*. . . . Public [four-year] university enrollment grew from 472,818 in the fall of 2003 to 497,195 in the fall of 2007 (*a 5.2 percent increase in enrollment*). Although enrollment in both are not in line with meeting the goal of *Closing the Gaps* for participation, both community colleges and public universities have made increases in the number of minority students attending higher education since the passage of tuition deregulation. (Emphasis added.)

Also questioned was the definition of "adequate" and the recommendation to "consider additional incentive funding for FY 2010-11 only after providing adequate base funding and continue to monitor the effectiveness of the FY 2009 incentive funding on student success." Adequate funding is funding sufficient to cover enrollment growth and inflation. This definition of "adequate" and the recommendation are consistent with the position and priorities of every university chancellor as articulated in the enclosed copy of their December 9, 2008, letter. While I incessantly have championed policies to increase timely graduation, providing incentive funding without funding the costs of core operations would only increase pressure to raise tuition unnecessarily. I believe we should allocate scarce resources to help keep tuition as low as possible and not adopt policies that exacerbate the problem.

Respectfully submitted,



Judith Zaffirini

Enc: December 19, 2008, letter from university chancellors

December 19, 2008

The Honorable David Dewhurst
Lieutenant Governor
State of Texas
P. O. Box 12068
Austin, TX 78711

The Honorable Tom Craddick
Speaker
Texas House of Representatives
P. O. Box 2910
Austin, TX 78768

The Honorable Steve Ogden
Chair, Senate Finance Committee
P. O. Box 12068
Austin, TX 78711

The Honorable Warren Chisum
Chair, House Appropriations Committee
P. O. Box 2910
Austin, TX 78768

We request your consideration of the fundamental principles below as you prepare the introduced version of the Appropriations Act.

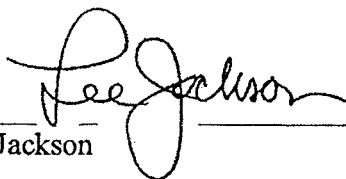
We need additional funding that is distributed through the current formula structure. This should fund enrollment growth and increased costs of doing business which are the top priorities for the institutions we serve. The level of general revenue funding will determine the level of tuition our institutions will need in order to cover the balance of our necessary costs. We request you provide this "base" funding before other appropriations.

We appreciate your leadership and past support for higher education, and look forward to working with you and your staff during the 81st Legislative Session.

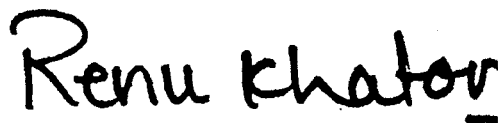
Respectfully,



Kent R. Hance



Lee Jackson



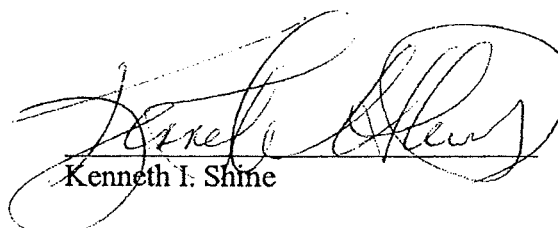
Renu Khator



Charles Matthews



Michael O. McKinney



Kenneth I. Shine

Please direct questions and comments to:

Senator Judith Zaffirini, PhD, Chair
Senate Finance Higher Education Subcommittee
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Austin, Texas 78711
512/463-0121

Interim Report prepared by:

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Vincent Cho, Policy Analyst
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Richard Gonzales, Research Assistant

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**Senate Finance Higher Education
Subcommittee**

Interim Report

December, 2008

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Acknowledgements

The Senate Finance Higher Education Subcommittee thanks the following for their assistance during our interim hearings and contributions to the writing of this report:

Texas Higher Education Coordinating Board
Texas Public Universities and Systems
Legislative Budget Board
Texas Education Agency

Patsy Spaw, Secretary of the Senate
Scott Caffey, Senate Committee Coordinator
Rick De Leon, Senate Sergeant-at-Arms
Sharon Scarborough, Senate Media Director
Senate Publications and Printing
Texas Legislative Council
Senate Research Center

The report was made possible by the leadership of the Subcommittee members and the contribution of their dedicated staff:

Warren von Eschenbach, Brent Whitaker, and Vincent Cho, representing
Senator Judith Zaffirini
Porter Wilson, representing Senator Robert Duncan
Sarah Hicks, Daniel Harper, and Amy Jeter, representing Senate Finance
Committee and Senator Steve Ogden
Susan Strzelec, representing Senator Florence Shapiro
Colin Coe, representing Senator Royce West

Andrea Sheridan and John Opperman, representing Lieutenant Governor
David Dewhurst
Rick Travis, Daniel Estrada, Sarah Keyton, Greg Owens, Susan Sherman,
and John Wielmaker, Legislative Budget Board

The Subcommittee also appreciates the numerous stakeholders for their involvement in developing this report, especially those who provided testimony during public hearings.

Recommendations

Senate Finance Higher Education Subcommittee December, 2008

Charge One—Funding

Review and make recommendations regarding the structure and organization of higher education, focusing on funding of the current higher education system, including financing capital projects for general academic institutions and for health-related institutions and changes to funding flagship research universities such as The University of Texas at Austin and Texas A&M at College Station. Determine the adequacy of formula funding to support basic functions as well as supporting critical statewide needs and improvements on the various methods of funding research. Reviews should include institutional structures that maximize efficiencies and incentive structures that increase the number of graduates. A review of funding formulas should also include the application of proportionality of state contributions for higher education employee health benefits.

Based on expert testimony received during subcommittee hearings and consultation with institutions of higher education, the Subcommittee makes the following recommendations regarding Interim Charge One for the Legislature's consideration:

Recommendation One

Pursue politically feasible ways to align more rationally the structure and organization of higher education, and require collaboration between free-standing universities and university systems to realize economies of scale.

Recommendation Two

Create a State Matching Set-Aside Fund for maintenance and repair projects.

Recommendation Three

Maintain the phase-in of the cost-based matrix with the goal of full implementation by 2010.

Recommendation Four

Consider the results of the Legislative Budget Board's (LBB) pharmacy cost study in determining whether to provide supplemental funds to general academic teaching institutions.

Recommendation Five

Limit the phase-in of changes to formula funding for general academic teaching institutions and community and technical colleges to no more than 10 percent based on semester credit hours (SCH) completed and direct the Texas Higher Education Coordinating Board (THECB) to study its impact on institutions' ability to achieve the goals of Closing the Gaps.

Recommendation Six

Continue to support basic research and increase funding for the Advanced Research Program (ARP) and the Research Development Fund (RDF).

Recommendation Seven

Require that a portion of the Advanced Research Program (ARP) funds be used to support and provide research opportunities for undergraduate students.

Recommendation Eight

Expand and strengthen opportunities for researchers to collaborate within and across university systems and to partner with private universities and industry representatives where appropriate.

Recommendation Nine

Consider additional incentive funding for FY 2010-11 only after providing adequate base funding and continue to monitor the effectiveness of the FY 2009 incentive funding on student success.

Charge Two—Financial Aid

Review state student financial aid programs (TEXAS Grants, B-on-Time) and provide assessment of the programs' effectiveness and future funding needs.

Based on expert testimony received during subcommittee hearings and consultation with institutions of higher education, the Subcommittee makes

the following recommendations regarding Interim Charge Two for the Legislature's consideration:

Recommendation One

Ensure that the least advantaged students receive the greatest benefit from state grant funds.

Recommendation Two

In order to make more efficient use of scarce resources, consider adding additional merit components to the state financial aid programs in a manner that does not impact low-income students adversely.

Recommendation Three

Strengthen college work-study programs and workforce development.

Recommendation Four

Increase student and family awareness of college costs and TEXAS Grant eligibility.

Charge Three—Tuition Deregulation

Study the effects continued tuition deregulation will have on college enrollment and accessibility.

Based on expert testimony received during subcommittee hearings and consultation with institutions of higher education, the Subcommittee makes the following recommendations regarding Interim Charge Three for the Legislature's consideration:

Recommendation One

Direct the Texas Higher Education Coordinating Board to collect all information pertinent to determining if higher tuition is limiting access to higher education.

Recommendation Two

Formalize the relationship between the amount of funding provided by the State and the amount of tuition and fees charged by an institution.

Joint Charge—Higher Education Authorities

Review the status, effects, and success or failure of higher education authorities operating under Chapters 53, 53A, and 53B, Education Code, and nonprofit corporations carrying out the functions of higher education authorities under those chapters. Make recommendations regarding any necessary changes in the statutes and administration of same. (Joint charge with Senate Finance Committee)

Based on expert testimony received during subcommittee hearings and consultation with institutions of higher education, the Subcommittee makes the following recommendations regarding Interim Joint Charge for the Legislature's consideration:

Recommendation One

Chapter 53 Higher Education Facility Authorities for Public Schools bond and loan agreements should require the same scrutiny as Tuition Revenue Bonds, and the Governor, Lieutenant Governor, Speaker, and Legislative Budget Board should be given notification about bonds issued under Chapter 53.

Recommendation Two

Amend Chapter 53A to clarify the distinction between educational facilities and athletic facilities.

Recommendation Three

Restructure the boards of Higher Education Facility Authorities to expand membership and require regular meetings.

Introduction

On January 29, 2008, Lieutenant Governor David Dewhurst issued the following interim charges to the Senate Finance Higher Education Subcommittee:

1. Review and make recommendations regarding the structure and organization of higher education, focusing on funding of the current higher education system, including financing capital projects for general academic institutions and for health-related institutions and changes to funding flagship research universities such as The University of Texas at Austin and Texas A&M at College Station. Determine the adequacy of formula funding to support basic functions as well as supporting critical statewide needs and improvements on the various methods of funding research. Reviews should include institutional structures that maximize efficiencies and incentive structures that increase the number of graduates. A review of funding formulas should also include the application of proportionality of state contributions for higher education employee health benefits.
2. Review state student financial aid programs (TEXAS Grants, B-on-Time) and provide assessment of the programs' effectiveness and future funding needs.
3. Study the effects continued tuition deregulation will have on college enrollment and accessibility.
4. Review the status, effects, and success or failure of higher education authorities operating under Chapters 53, 53A, and 53B, Education Code, and nonprofit corporations carrying out the functions of higher education authorities under those chapters. Make recommendations regarding any necessary changes in the statutes and administration of same. (Joint charge with Senate Higher Education Subcommittee)

This Interim Report was developed under the direction of Senator Judith Zaffirini, Chair, Senate Finance Higher Education Subcommittee. To build consensus among the members, briefing sessions were held, discussion drafts were circulated, and feedback solicited from senators and their staff members, higher education officials, and other interested persons. The report

includes background, an overview of the testimony received, and recommendations by the Subcommittee. Unless otherwise noted, all charts, graphs, and tables were created from information provided by the Legislative Budget Board, the Texas Higher Education Coordinating Board, Texas Education Agency, and higher education institutions.

Charge One: Funding

Review and make recommendations regarding the structure and organization of higher education, focusing on funding of the current higher education system, including financing capital projects for general academic institutions and for health-related institutions and changes to funding flagship research universities such as The University of Texas at Austin and Texas A&M at College Station. Determine the adequacy of formula funding to support basic functions as well as supporting critical statewide needs and improvements on the various methods of funding research. Reviews should include institutional structures that maximize efficiencies and incentive structures that increase the number of graduates. A review of funding formulas should also include the application of proportionality of state contributions for higher education employee health benefits.

Charge One: Funding

The Senate Finance Higher Education Subcommittee was charged with a myriad of issues related to higher education, including reviewing and making recommendations regarding the structure and organization of higher education, formula funding, capital funding, research funding, incentive funding, and the application of proportionality for higher education employee health benefits. This report reviews the committee's findings and makes recommendations for the state in light of these considerations.

Purpose and Background

Higher Education Structure and Organization

The system of administration and governance for higher education in Texas has evolved over the years. The original system of grouping institutions under one board began in 1911 as the State Board of Normal Schools.¹ This system originally consisted of six normal schools and teachers colleges and ultimately became the Texas State University System. Other university systems evolved and grew rapidly, including The University of Texas System (UT) and Texas A&M University System (TAMU), the two largest university systems in Texas today. Other university systems include the Texas Tech University System, the University of Houston System, and the University of North Texas System. Additionally, there are four free-standing universities: Midwestern State University (Wichita Falls), Stephen F. Austin State University (Nacogdoches), Texas Southern University (Houston), and Texas Women's University (Fort Worth).

In 1982 Governor Bill Clements convened a task force to investigate the varied governance structures in Texas higher education institutions. In 1987 the Select Committee on Higher Education reported that "the diversity and rapid growth of the Texas system of public higher education are not being managed efficiently."² They recommended that realignment in the governance of higher education institutions would create better access for Texas citizens.³ By 1991 the Committee on Statewide Governance of Higher

¹ Texas Comptroller of Public Accounts, "Breaking the Mold: New Ways to Govern Texas," Texas Performance Review, July 1, 1991.

² Temple, L. (Chairman.) *Report of the Select Committee on Higher Education*, February, 1987.

³ Ibid.

Education implemented those recommendations with the creation of system regent boards, and the latest reissue of rules and regulations for these boards was adopted in 2004.

Today each university system is governed by its own board of regents. These boards are each composed of nine members who are appointed by the Governor, confirmed by the Texas Senate, and facilitated by a chair and vice chair. Regents typically serve six-year terms that are staggered so that three will expire on February first of odd-numbered years. No more than two appointees from a single senatorial district can serve simultaneously. In 2005 the legislature directed the Governor also to appoint a non-voting student regent for a one-year term.

The 50 community college systems in Texas are governed by trustee boards whose members are elected locally. Stewardship of their state funds is vested in individual institutions and their respective governing boards.

At the top of the governance structure, with varying types of authorities over the many systems and institutions, is the Texas Higher Education Coordinating Board (THECB). It was created by the Texas Legislature in 1965 to "provide leadership and coordination for the Texas higher education system to achieve excellence for the college education of Texas students."⁴ Its mission is to organize the flow of information and resources among all Texas institutions of higher education. The THECB is charged with ensuring a unified, efficient approach to higher education.

Capital Funding

Generally institutions use capital funding for purposes such as new construction, repairs and rehabilitation of existing assets, land acquisition, equipment, and library materials.⁵ There are three basic sources of capital funding for institutions of higher education in Texas: the Permanent University Fund (PUF), Higher Education Assistance Fund (HEAF), and Tuition Revenue Bonds (TRBs).

Most institutions in The University of Texas System and the Texas A&M University System benefit from the Permanent University Fund (PUF). The PUF was established in the Texas Constitution of 1876 via an appropriation

⁴ House Bill 1 (1965).

⁵ Texas Higher Education Coordinating Board, "Overview: Permanent University Fund (PUF) and Higher Education Assistance Fund (HEAF), March, 2008.

of land grants, and today the PUF still owns 2.1 million acres of land in 24 counties. Most of its assets, however, are securities held by the fund. Returns from the PUF investments are deposited into a separate account, known as the Available University Fund (AUF). Because the PUF may issue bonds to support construction projects, one use of the AUF is to pay the principal and interest due on these bonds. Other institutions not benefiting from the PUF may be served by the Higher Education Assistance Fund (HEAF), which is funded via appropriations by the Texas Legislature for higher education. These include health-related institutions, Texas State Technical College institutions, and other universities.

Tuition Revenue Bonds (TRBs) are another source of capital funding.⁶ The Texas Legislature authorizes issuance of these bonds, and requests are evaluated by the THECB. In past practice the Legislature has approved reimbursement to the institutions for payments made to retire the tuition revenue bonds and appropriated funds to pay the debt service. This process also is monitored by the Governor, Lieutenant Governor, Speaker of the House, Legislative Budget Board (LBB), Bond Review Board, and Attorney General.

Formula Funding

Texas has an array of higher education institutions and funding needs. Public higher education institutions funded by the state include thirty-five universities, fifty community college systems, four technical colleges, two state colleges, and one technical institute. In addition, Texas funds the Baylor College of Medicine, nine public health-related institutions, and eight agencies in the Texas A&M System that conduct research and other programs in agriculture, engineering, transportation, and science. Given their unique purposes and needs, general academic institutions, community colleges, and health-related institutions are funded via different formulas.

Two funding formulas and a supplement provide approximately 80 percent of state funding for public general academic institutions. One formula addresses instruction and operations, while the other addresses infrastructure. General academic institutions also receive funding via special item funding and tuition revenue bonds.

⁶ Texas Higher Education Coordinating Board, "Overview: Tuition Revenue Bonds," March, 2008.

Community and technical colleges receive nearly all of their state appropriations via formulas based on classroom contact hours. Community colleges also are supported by local property taxes and by tuition and fees.

Health-related institutions receive state general revenue allocations via a combination of formula funding, special items, and tuition revenue bonds. Additionally, hospitals receive revenue generated by medical services. The Baylor College of Medicine receives funding equivalent to the cost of public medical school education.

In 1997 the 75th Legislature revised the formulas used to fund general academic institutions by developing and implementing an Instruction and Operations matrix intended to reflect the statewide average cost of instruction for the various disciplines and levels offered at Texas public universities. In 2002 the THECB directed its University Formula Advisory Committee to conduct a cost study to validate the relative weights contained in the matrix. The 79th Legislature (2005) adopted this cost-based matrix, but phased in the matrix over three biennia, with the goal of full implementation by 2010. The intent of phasing in the matrix was based on the desire to transition institutions into the new cost-based matrix while enabling the Legislature to monitor the effects of these changes.

Research Funding

The state funds research through several initiatives designed to support various components of research activity. These programs include the Advanced Research Program (ARP), the Research Development Fund (RDF), the Emerging Technology Fund (ETF), the Competitive Knowledge Fund (CKF), the Cancer Prevention and Research Institute (CPRI), special item funding, and indirect cost recovery. These are described below.

The Advanced Research Program. In 1987 the 70th Legislature created the ARP to provide a competitive, peer-reviewed grant program to support basic research and enhance research activity. All faculty members from public higher education institutions, including health-related institutions, are eligible to submit grant proposals, which are reviewed by the THECB. ARP funds often are used as matching funds to attract additional external funding. Since its creation the ARP has provided more than \$185 million and 1,520 awards, providing research opportunities for approximately 6,000 graduate

and 4,000 undergraduate students. For the 2008-09 biennium the ARP was funded at \$16.4 million.

The Research Development Fund. In 2003 the 78th Legislature combined the Texas Excellence Fund and the University Research Fund to establish the RDF to support and enhance universities' research infrastructure. All public institutions, except UT-Austin, Texas A&M University, and Prairie View A&M University, are eligible to receive RDF funding. Funds are distributed via a formula (based on restricted research expenditures for the prior three years) and can be used to support various research activities, such as laboratory and equipment upgrades, graduate student tuition, travel grants, and funding for individual projects. For the 2008-09 biennium the RDF was funded at \$80.9 million.

The Emerging Technology Fund. In 2005 the 79th Legislature appropriated \$200 million to create the ETF to support the commercialization of research, increase applied technology research capabilities, and create new jobs. All institutions of higher education are eligible for ETF funding. The ETF provides three major areas of investment: 1) incentives for entities to collaborate with higher education institutions on emerging technology projects with an economic benefit, especially commercialization; 2) awards matching funds from external research sponsors, especially proposals that accelerate commercialization into production; and 3) funds to acquire or enhance research superiority via recruiting faculty members who have commercialization experience. Any public higher education institution is eligible for the ETF, though priority is given to emerging technology projects that will enhance Texas's global competitiveness. Since its creation, the ETF has allocated more than \$110 million in grant funds to Texas companies and universities. For the 2008-09 biennium the ETF was funded at \$165 million.

The Competitive Knowledge Fund. The CKF was created in 2007 by the 80th Legislature to enhance the support of research faculty for the purpose of instructional and research excellence. Eligibility is restricted to general academic teaching institutions with total research expenditures of more than \$50 million and is allocated based on a formula of \$1 million for each \$10 million in research expenditures between 2003 and 2005. For the 2008-09 biennium, only Texas A&M University, Texas Tech University, the University of Houston, and UT-Austin were eligible. For the 2008-09 biennium the CKF was funded at \$93.2 million.

The Cancer Prevention and Research Institute. In 2007 Texas voters approved a constitutional amendment creating the CPRI and providing \$3 billion over 10 years for the initiative. All higher education institutions are eligible for CPRI grants. Grants will be distributed to institutions and advanced medical research facilities to research the causes of and cures for cancer and to provide cancer research facilities, research therapies, protocols, and treatments for cancer. Recipients of the grant funding must have funds equal to 50 percent of the requested grant. The first grants will become available in 2010 and will continue until August 31, 2020.

Special Item Funding. The Texas Legislature provides direct appropriations to higher education institutions to support specific programs or activities. Examples of special item funding include the Superconductivity Center at the University of Houston and the Obesity, Diabetes, and Metabolism research program at UT Southwestern Medical Center at Dallas. The Legislature appropriated approximately \$260 million for research special items for the 2008-09 biennium.⁷

Indirect Cost Recovery. Prior to 2003 Texas public academic universities were permitted to retain only 50 percent of the amount they received for administrative costs from external research grants. The 2003 Legislature, however, allowed institutions to retain all of these funds. This change has resulted in an estimated \$230-\$290 million increase in research funding since fiscal year 2004.

Incentive Funding

In 2007 the 80th Texas Legislature appropriated \$100 million to the THECB for incentive funding in fiscal year 2009. Executive Order RP-67 (2008) established the Task Force on Higher Education Incentive Funding.⁸ Its work was intended to complement that of the Select Commission on Higher Education and Global Competitiveness, which was established by the 80th Texas Legislature (2007) via House Concurrent Resolution 159.

Specifically, the Task Force was charged with making recommendations for incentive funding for public institutions. Especially important would be the Task Force's perspective regarding how to reward institutions for aligning

⁷ Testimony provided by the Texas Higher Education Coordinating Board to the Senate Finance Higher Education Subcommittee, July 23, 2008.

⁸ Select Commission on Higher Education and Global Competitiveness, "Report from the Task Force on Higher Education Incentive Funding," August 26, 2008.

with the state's economic and educational goals. These recommendations would serve two purposes. First, they would guide the THECB's use of incentive funds, especially as they related to the objectives of HCR 159. Second, they would be considered by the 81st Legislature (2009) while making decisions about incentive funding for the 2010-11 biennium. Accordingly, the Task Force's perspective is particularly relevant to the current interim charge.

Proportionality

Central to the debate about funding community college employee health benefits is the proportional cost-sharing between the state and the institutions, also known as “proportionality.” It is the method used to define the state’s obligation to pay for employee health benefits. According to the LBB, proportionality is used to maximize balances in general revenue by aligning the salary funding source with the benefits funding source.⁹ This budgetary principle requires that payments for salaries and associated benefits be proportional to an institution’s sources of income. In other words, the state’s obligation to pay for benefits is limited to those employees whose salaries are paid with state general revenue.

While this principle is not expressed in statute, it has become a standard element in recent state budgets, including the fiscal 2008-09 general appropriations act. Rider language in Art. 9, Sec. 6.08(a) of HB 1 holds that “unless otherwise provided ... payment for benefits from appropriated funds, including ‘local funds’ and ‘education and general funds,’ ... shall be proportional to the source of funds.” Sec. 6.08(b) specifies that unless otherwise authorized, funds appropriated from general revenue may not be used for employee benefit costs, or other indirect costs, associated with salaries or wages paid from a source other than general revenue.¹⁰ The Legislature historically has “otherwise provided” by appropriating money for group health insurance to community college employees without regard to their salaries’ revenue source.

The controversy lies in the interpretation of proportionality and in determining which community college employees are eligible to have their group health insurance benefits paid by the state. All public higher education

⁹ Legislative Budget Board, “Apply Proportionality to State Contributions for Public Community College Employee Health Benefits,” *Staff Performance Review*, January, 2005.

¹⁰ House Bill 1, 2007.

institutions and state agencies determine the proportional cost-sharing split for employee benefit costs. The Legislature, however, never has applied proportional cost-sharing to fund the state's share of community college employee benefits.

Testimony

The Senate Finance Higher Education Subcommittee heard testimony regarding this charge on June 25, July 23, and August 20, 2008. The hearing included invited testimony from the following persons:

June 25

- Dr. Mike McKinney, Chancellor, Texas A&M University System
- Dr. Baker Pattillo, President, Stephen F. Austin State University
- Susan Brown, Assistant Commissioner, Planning & Accountability, THECB
- Susan Sherman, Budget Analyst, LBB
- William Powers Jr., President, The University of Texas at Austin
- Dr. Elsa A. Murano, President, Texas A&M University
- Dr. Raymund Paredes, Commissioner, THECB
- Dr. George C. Wright, President, Prairie View A&M University

July 23

- Dr. Raymund Paredes, Commissioner of Higher Education, THECB
- Dr. David Gardner, Deputy Commissioner, THECB
- Dr. Don Birx, Vice President for Research, the University of Houston
- Kambra Bolch, Associate Vice Provost for Undergraduate Programs and Policy, Texas Tech University
- Bill Morrow, Chair, ETF Advisory Committee and Chair and CEO, CSIdentity and Fusion Mobile
- Dr. Brent L. Iverson, Professor, Department of Chemistry and Biochemistry, The University of Texas at Austin
- Guy Diedrich, Vice Chancellor for Technology Commercialization, Texas A&M University System
- Dr. Dennis Stone, Vice President for Technology Development, The University of Texas Southwestern Medical Center at Dallas

- Dr. Mauro Ferrari, Director, Research Center for NanoMedicine in The Brown Foundation Institute of Molecular Medicine for the Prevention of Human Diseases
- Tommy Harlan, CEO and Founder, Emergent Technologies

August 20

- Dr. Raymund Paredes, Commissioner of Higher Education, THECB
- Dr. David Gardner, Deputy Commissioner, THECB
- Dr. Millicent Valek, Chair, Texas Association of Community Colleges and President, Brazosport College
- Dr. Richard Rhodes, Chair-Elect, Texas Association of Community Colleges and President, El Paso Community College
- Dr. William "Bill" Holda, Secretary-Treasurer, Texas Association of Community Colleges and President, Kilgore College
- Dr. Reynaldo Garcia, President & CEO, Texas Association of Community Colleges
- Roberto Zarate, Chair, Community College Association of Texas Trustees and Trustee of Alamo Community Colleges
- Kitty Boyle, Vice Chair, Community College Association of Texas Trustees and Trustee of Dallas Community College District
- Alan Kaplan, Treasurer, Community College Association of Texas Trustees and Trustee of Austin Community College
- Chris Adler, Secretary, Community College Association of Texas Trustees and Regent Chair of Del Mar College
- Michael Bettersworth, Vice Chancellor for Technology Advancement, Texas State Technical Colleges

Some witnesses also submitted written materials, and these were considered in the writing of this report.¹¹

Findings

Higher Education Structure and Organization

There are advantages and disadvantages to being a member of a university system. University systems consolidate essential services and functions,

¹¹ These materials can be found at <http://www.senate.state.tx.us/75r/Senate/commit/c535/c535.htm>

allowing component institutions to benefit from economies of scale and enjoy services and goods that otherwise would be too expensive.

System offices provide centralized legal and audit services to ensure accountability and compliance; strategic planning; shared services; academic support in developing new degree programs; centralized cash, investment, and revenue debt management; risk management services; centralized facilities planning and construction oversight; assistance with patent, copyright, and technology commercialization services; and coordinated governmental relations operations. These consolidated services and functions provide many benefits, including greater ability to obtain grants; better bond ratings; broader diversification of assets, resulting in higher return potential and lower risk; lower financial and banking costs; and savings in insurance premiums. In addition, centralized managerial functions improve accountability and enhance strategic planning by allowing component universities to share best practices and develop intra-system benchmarks and measures. Some disadvantages include diminished contact between institutions and the governing board, loss of independence, increased administrative structure, and competition for resources and priorities among component institutions.

Similarly, there are advantages and disadvantages to being a free-standing university. The advantages are varied: Free-standing universities have greater local control because the governing board focuses on a single campus and develops policies tailored to its needs. The accessibility of the governing board and its close collaboration with the institution's administrators can result in expedited decision making. What's more, the governing board can assist the institution in campus planning, rather than focusing on system planning, and the institution does not compete with other component institutions for attention from their decision makers.

Free-standing institutions collaborate with other institutions. Stephen F. Austin University, for example, contracts with the Texas A&M University System for financial services so it, too, can benefit from the system's economies of scale. It also has developed collaborative academic and research programs with other institutions.

Disadvantages include the loss of benefits related to university systems including economies of scale, easy sharing of business and academic best practices, and diversification of assets and risks.

Capital Funding

Enrollment growth and repair and renovation of older buildings have created significant capital funding needs for higher education institutions. For fiscal years 2008-12, Texas higher education institutions propose spending \$17.8 billion on 841 projects with 67.4 million gross square feet of space to be acquired, constructed, or renovated. New construction projects account for \$12.8 billion, or 72 percent, of projected expenditures and will add more than 41.5 million gross square feet to facilities' inventories. The source of funding for a majority of these projects is unknown, though some institutions propose using TRBs and local funds to pay for some projects.¹²

Stable and predictable funding sources for capital projects facilitate institutional planning and expansion. In 2008 the Texas Higher Education Coordinating Board Strategic Planning Committee adopted recommendations to improve the process for funding capital projects, including raising the HEAF corpus target from \$2 billion to \$4.5 billion, creating a State Matching Set Aside Fund for maintenance and repair projects, and issuing general obligation bonds over a ten-year period to finance capital projects for higher education institutions.

Formula Funding

In 2007 the 80th Legislature appropriated approximately \$1 billion for higher education for the 2008-09 biennium. Community and technical colleges receive the majority of their funding via formula funding, while health-related institutions receive approximately 20 percent, and general academic institutions receive approximately 60 percent of state funding through formula funding.¹³ Although funding has increased steadily for higher education, appropriations per full-time student equivalent (FTSE)¹⁴ have decreased over the last several biennia due to enrollment increases.

¹² Texas Higher Education Coordinating Board, "A Summary of Campus Master Plans: FY 2008 to FY 2012," July, 2008.

¹³ Texas Higher Education Coordinating Board, "Formula Funding Recommendations for the 2010-11 Biennium" April, 2008, pp. 12, 32, and 56.

¹⁴ Billy Hamilton, "The Balance Wheel: A Report on Tuition, Appropriations, and the Affordability of Texas Public Higher Education," February, 2008, pp. 11-15.

In April, 2008, the THECB adopted formula funding recommendations for the 2010-11 biennium.¹⁵ In developing these recommendations, Commissioner Raymund Paredes appointed formula advisory committees for community and technical colleges, general academic teaching institutions, and health-related institutions. Each were charged with studying, evaluating, and making recommendations about various policies related to formula funding.

Community and Technical Colleges. The Community and Technical College Formula Advisory Committee (CTCFAC) was charged with: proposing a formula with appropriate levels of funding and financial incentives necessary to best achieve the four major goals included in the *Closing the Gaps*; considering whether the state should create new rates for developmental education classes taught in reading, writing, and math to include additional services required for student success while maintaining the integrity of the Report of Fundable Operating Expenses (RFOE) cost study; and making recommendations related to funding for group benefits by the state.¹⁶

The CTCFAC recommended that the Legislature establish full funding of the community and technical college formula as a priority; fund 100 percent of the formula, less tuition and fees, based on rates established by the FY2007 RFOE Cost Study using attempted contact hours; add 10 percent premium over the full formula funding rates for developmental contact hours; adjust future cost studies to separately capture the incremental costs associated with developmental education while conducting a review of positive outcomes gained at “Achieving the Dreams” schools in order to determine best practices; and continue to fund group health benefits in the manner it has historically.

The THECB adopted the CTCFAC recommendations with the following modifications: 1) fund 100 percent of the formula, minus collected tuition, using a phase-in approach over four years, transitioning from attempted to completed contact hours in 25 percent increments provided that the Legislature increase formula funding by at least \$400 million; and 2) trustee funds at the THECB for implementation of developmental education

¹⁵ Texas Higher Education Coordinating Board, "Formula Funding Recommendations for the 2010-11 Biennium," April, 2008.

¹⁶ Ibid, pp. 14-15.

programs that are proven to be successful in preparing students for college level course work in lieu of adding a 10 percent premium to the formulas.¹⁷

General Academic Teaching Institutions. The General Academic Formula Advisory Committee (GAFAC) was issued a number of charges related to formula funding, including exploring the advantages and disadvantages of establishing a mission-specific differential for distributing formula funds to universities; considering whether funding for the current Teaching Supplement might be more effectively employed by removing it from the Instruction and Operations Formula and adding it to the existing amount dedicated to incentive funding; recommending a new graduated award methodology for the current Small Institution Supplement; considering the optimal relationship between base formula funding and incentive funding; and continuing to refine the cost-based matrix.¹⁸

The GAFAC recommended completing the phase-in of the cost-based matrix methodology basing 95 percent on attempted Semester Credit Hours (SCH) and 5 percent on completed SCH; conducting a cost study of the direct expenses of pharmacy programs at general academic and health science centers and, if consistent with the results of the above study, requesting a pool of funding to be used to increase support for pharmacy programs at general academic institutions; retaining the Teaching Supplement as a part of the Instruction and Operations Formula; and adopting a graduated methodology to provide a "soft landing" for institutions who currently or previously qualified for the Small Institution Supplement. The GAFAC determined also that the differential weights for programs and levels account sufficiently for different missions and that base formula funding and incentive funding are separate and distinct, with no relationship between the two.

The THECB adopted some of the GAFAC recommendations with the following modifications: 1) phasing-in the change to basing formula funding on completed SCH over four years, provided that the Legislature increases formula funding by at least \$200 million; 2) considering the results of the LBB Pharmacy cost study carefully before making a decision about whether to seek an additional pool of funds; 3) discontinuing funding for the current Teaching Supplement portion of the Instruction and Operations Formula;

¹⁷ Ibid, pp. 14-15.

¹⁸ Ibid, pp. 33-37.

and 4) graduating the Small School Supplement starting at a fall headcount of 4,000 until it is completely eliminated once a headcount of 6,000 is reached.¹⁹

Health-Related Institutions. The Health-Related Institution Formula Advisory Committee (HRIFAC) was charged with a number of policy considerations, including proposing a set of formulas with appropriate levels of funding and financial incentives necessary to best achieve the four major goals included in the *Closing the Gaps*; reviewing the current I&O formula weights and determine if new weights should be requested; reviewing the current I&O programs and determine if any specialties need to be assigned separate weights; and reviewing the residency programs and their related number of years of residency required to determine an appropriate limit for the numbers of years of residency that should be funded through the Graduate Medical Education (GME) formula. The HRIFAC recommended restoring 2000-01 funding rates (without an inflation adjustment to the rates) for formulas over the next two biennia, increasing the GME formula funding rate, maintaining the I&O Formula weights for 2010-11, and limiting GME funding for a maximum of seven years for any funded resident. The THECB concurred with the HRIFAC recommendations.²⁰

Research Funding

Although research expenditure data show steady improvement over time, Texas still lags behind other key states in overall federal obligations and has seen declines in recent years. In terms of meeting the research goals of *Closing the Gaps*, there is some room for improvement. While federal obligations for research and development (R&D) in science and engineering increased 3.9 percent from FY 2004, Texas's share of national R&D obligations dropped from 5.6 percent in 2004 to 5.5 percent in 2005. In 2003, when Texas received 6.1 percent of national obligations, it seemed to be on course for meeting or exceeding the 2010 target of receiving 6.5 percent of the total federal obligations. Since 2003 obligations in Texas grew by only \$10.4 million (0.8 percent), while national obligations grew by 9.7 percent.²¹ In terms of meeting the goal of increasing research expenditures by Texas public universities and health-related institutions to

¹⁹ Ibid, pp. 33-37.

²⁰ Ibid, pp. 59-61.

²¹ Texas Higher Education Coordinating Board, "Closing the Gaps by 2015: 2008 Progress Report," July, 2008, p. 16.

\$3 billion by 2015, however, the state is on target and met the 2007 interim goal of \$2.2 billion.²²

Commercialization is an important aspect of any research program and should be encouraged and supported along with basic research. While Texas is considered a top-tier research state, it is not among the top states in terms of research commercialization. Commercialization benefits the state in two ways: It brings new discoveries to the market where they can be developed into new products or services to benefit society, and it spurs economic development by fostering the new business ventures that result. Barriers to commercialization include not being a central component of a university or university system's mission statement; not being a part of the research culture or expected of researchers; and not having an infrastructure that encourages collaboration and commercialization. Although institutions of higher education in Texas are addressing these barriers aggressively, and the culture is changing rapidly, targeted funding to expand and improve the commercialization infrastructure is needed.

Undergraduate research programs are effective in improving student retention and graduation rates, as well as in increasing students' likelihood to pursue graduate studies. According to a recent study, undergraduate students who were involved in research opportunities reported increased understanding of how to conduct a research project, increased confidence in their research skills, and better awareness of what graduate school is like.²³ Additionally, students were more likely to pursue a PhD as a result of undergraduate research opportunities and more interested in pursuing careers in Science, Technology, Engineering, and Mathematics (STEM).²⁴ Preliminary data from The Freshman Research Initiative at The University of Texas at Austin suggest that students involved in this program demonstrated improved retention at the university, college, and major levels for all cohorts; improved retention at the university, college, and major levels for most under-represented groups; improved grade point averages across all under-represented groups; and increased scientific activities and success.²⁵ Similar results are reported by The University of Texas at El Paso (UTEP). According to their Office of Institutional Research, 41 percent of undergraduate students of the 2005-06 graduating class participated in on-

²² Ibid, p. 17.

²³ Russell, et. al., "Benefits of Undergraduate Research Experiences," *Science*, April 27, 2007, p. 548.

²⁴ Ibid, p. 548.

²⁵ Shear, et. al., "Teaching through Research: The Freshman Research Initiative (FRI) at The University of Texas at Austin," Office of Institutional Research, The University of Texas at Austin.

campus research, scholarly, or creative projects with UTEP faculty for a purpose other than a grade. Of this group, 54 percent were first-generation college graduates. Fifty-one percent of first-generation college students who participated in on-campus research reported that they planned to attend graduate school, and 43 percent of this group enrolled as graduate students at UTEP by Fall, 2008.

Apart from the societal benefits of investing in research, such as discovery of new knowledge, technologies, and medical therapies, there are direct economic benefits. Investment in research leads to increased economic output, job growth, and increased earnings. The Association of American Medical Colleges, for example, found that its 500 or so member medical schools had a combined economic impact of \$451 billion, accounted for 3 million full-time jobs, and generated \$20 billion in state revenues.²⁶ A recent report estimates that every dollar of NIH funding expended by Texas universities generated \$2.49 in economic activity, thus contributing \$2.8 billion to the state's economy.²⁷ In addition, a robust research program allows higher education institutions to enhance their programs and build prestige so that they are better able to recruit and retain quality faculty and students.

Incentive Funding

The perspective of the Task Force on Higher Education Incentive Funding is particularly relevant to the subcommittee's interim charge.²⁸ The Task Force has issued recommendations regarding the THECB's use of incentive funding and how to reward Texas institutions for aligning to the state's workforce needs and economic and educational goals. Some of these recommendations have already been approved by the Governor, Lieutenant Governor, and Speaker of the House. Others were designed for consideration by the 2009 Texas Legislature specifically, and all are noteworthy.

The Task Force has recommended that the THECB allocate \$80 million to the Texas public general academic teaching institutions for teaching and educational excellence. Suggested measures for this goal include the number

²⁶ Tripp Umbach, *The Economic Impact of AAMC-Member Medical Schools and Teaching Hospitals*, January, 2007.

²⁷ Family USAs Global Health Initiative, "In Your Own Backyard: How NIH Funding Helps Your State's Economy," June, 2008, pp. 3-5.

²⁸ Select Commission on Higher Education and Global Competitiveness, "Report from the Task Force on Higher Education Incentive Funding," August 26, 2008.

of degrees awarded and increases in degrees awarded. Additional weights were given for at-risk students who are graduated in critical field areas. Further, the Task Force recommended that \$20 million be allocated as scholarships for Top 10 Percent graduates who are enrolled in state two- and four-year institutions and that an additional \$40 million be provided for an incentive program for public two-year institutions. These particular recommendations were approved by the Governor, Lieutenant Governor, and Speaker of the House and have been requested of the THECB accordingly.

What's more, the Task Force made recommendations regarding fiscal years 2010-11. These include the measures for teaching excellence, as well as incentives for increasing research productivity. Additionally, the Task Force also has outlined important recommendations rewarding community colleges and two-year institutions, such as rewarding performance on measures relating to certificate and associate's degree attainment, transfers to four-year institutions, and transfers to health-related institutions. Health-related institutions also would be rewarded. Measures would include those relating to the attainment of certificates or degrees, as well as the completion of medical residencies. Overall, these various recommendations would result in average annual increases for higher education incentives of \$478 million (11 percent over FY 2008-09 General Revenue appropriations to these institutions).

In summary, the Task Force presents a basic model for improving retention, time to degree, graduation rates, transfers from two- to four-year institutions, and other measures for success. Their recommendations are sensitive to critical workforce needs and state demographic trends and are an important first-step in developing a fair and effective incentive program.

Proportionality

In 2007 Governor Rick Perry vetoed \$154 million in health benefits for community colleges for having “violated this provision [of proportionality].”²⁹ The Governor, the Lieutenant Governor, and the Speaker agreed to restore the vetoed funds, apply proportionality to the restored funds, fund community college health care benefits at 97.5 percent of the

²⁹ Governor Rick Perry, “Proclamation regarding HB 1,” June 15, 2007. <http://governor.state.tx.us/news/proclamation/5286/>.

Employee Retirement System (ERS) reimbursement rate, provide transition funding to community colleges, and add community colleges to the rider in House Bill 1 authorizing \$100 million for incentive funding. Lieutenant Governor David Dewhurst charged the Senate Finance Higher Education Subcommittee with reviewing various methodologies for applying proportionality in future biennia. Accordingly, the following options are presented for consideration:

Option 1: Continue to fund community college health insurance benefits at 90 percent of the ERS reimbursement rate for all Instruction and Administration (I&A) employees, irrespective of the source of salary. The article IX rider would require conforming changes.

Option 2: Divide the amount of unrestricted general revenue appropriated to a community college by total salaries and multiply the quotient by the institution's total Higher Education Group Insurance (HEGI) cost.

Option 3: Divide the amount of unrestricted general revenue appropriated to a community college by the total salaries of employees eligible to receive benefits and multiply the quotient by the institution's total HEGI cost.

Option 4: Divide the amount of unrestricted general revenue appropriated to a community college by the total salaries of employees actually receiving benefits and multiply the quotient by the institution's total HEGI cost.

Option 5: Divide the amount of unrestricted general revenue appropriated to a community college by the total salaries of I&A employees paid with general revenue and multiply the quotient by the institution's total HEGI cost. (NOTE: This would require new salary data currently not reported by community colleges.)

Option 6: For options 2 through 5, subtract tuition and fees from unrestricted general revenue.

Charge One—Funding

Recommendations

The Senate Finance Higher Education Subcommittee makes the following recommendations for the Legislature's consideration:

Recommendation One

Pursue politically feasible ways to align more rationally the structure and organization of higher education, and require collaboration between free-standing universities and university systems to realize economies of scale.

- Some free-standing universities contract with university systems for financial and business services to benefit from the university system's economies of scale.
- University systems also can provide valuable resources for academic programs.

Recommendation Two

Create a State Matching Set-Aside Fund for maintenance and repair projects.

- Institutions would have the option to set aside up to 1.25 percent of their Educational and General (E&G) replacement value annually in order to receive an equal match of up to 1.25 percent from the state.
- The combined funds would be used only for preservation and maintenance projects.

Recommendation Three

Maintain the phase-in of the cost-based matrix with the goal of full implementation by 2010.

- The phase-in of the cost-based matrix methodology was adopted initially during the 2005 Legislative Session.
- The phase-in provides sufficient transition for institutions.

Recommendation Four

Consider the results of the Legislative Budget Board's (LBB) pharmacy cost study in determining whether to provide supplemental funds to general academic teaching institutions.

- Both the GAFAC and the THECB recommended conducting a cost study for pharmacy programs at general academic teaching institutions.
- The THECB noted in its recommendations that the LBB is conducting such a study.

Recommendation Five

Limit the phase-in of changes to formula funding for general academic teaching institutions and community and technical colleges to no more than 10 percent based on semester credit hours (SCH) completed and direct the Texas Higher Education Coordinating Board (THECB) to study its impact on institutions' ability to achieve the goals of Closing the Gaps.

- According to THECB data, an average of 94 percent of SCH attempted at general academic teaching institutions were completed in 2006.
- If the I&O formula for general academic teaching institutions for the 2008-09 biennium were funded based fully on SCH completed, it would have cost \$64 million to ensure that no institution received less funding than the previous biennium, \$32 million more than the hold harmless funding provided in 2007.
- If community college districts were funded based fully on SCH completed for the 2008-09 biennium, it would have cost \$32 million to ensure that no district received less funding than the previous biennium.

Recommendation Six

Continue to support basic research and increase funding for the Advanced Research Program (ARP) and the Research Development Fund (RDF).

- These funds provide the basic infrastructure to increase research productivity and recruit and retain quality faculty members.
- The RDF and the ARP allow institutions to leverage competitive federal research grants.

Recommendation Seven

Require that a portion of the Advanced Research Program (ARP) funds be used to support and provide research opportunities for undergraduate students.

- Undergraduate research enhances the learning outcomes of students and improves retention and graduation rates.
- Undergraduate research increases the likelihood that students will pursue post-baccalaureate degrees.

Recommendation Eight

Expand and strengthen opportunities for researchers to collaborate within and across university systems and to partner with private universities and industry representatives where appropriate.

- Collaboration makes more efficient use of resources and facilitates sharing ideas and findings.
- Incentives will help attract innovative faculty members and researchers.

Recommendation Nine

Consider additional incentive funding for FY 2010-11 only after providing adequate base funding and continue to monitor the effectiveness of the FY 2009 incentive funding on student success.

- Providing incentive funding without funding basic operations could have a negative impact on an institution's ability to achieve its mission successfully.
- The effectiveness of the 2009 incentive funding need to be studied before implementing this program fully.

Charge Two: Financial Aid

Review state student financial aid programs (TEXAS Grants, B-on-Time) and provide assessment of the programs' effectiveness and future funding needs.

Charge Two: Financial Aid

The Senate Finance Higher Education Subcommittee was charged with examining student financial aid programs. This report assesses their effectiveness and makes recommendations for the state in light of these considerations.

Purpose and Background

As tuition and fees at Texas public institutions and other institutions throughout the nation have continued to rise, concern has increased regarding higher education affordability. Even in instances where institutions have attempted diligently to limit increases to tuition rates, students have continued to face increasing burdens relating to the costs of living and inflation. Indeed, the costs of education, including textbooks, supplies, housing, child care, and transportation, can easily become unmanageable.

Equally important, however, the costs to the state for failing to adequately fund student aid programs could be even greater. Of great cause for concern are reports that students must reduce class loads, work longer hours, and postpone degree attainment due to rising costs. Further, concerns regarding the availability of affordable student loans, as well as the overall increase in how much students must now borrow in order to pay for their education, continue to persist.

The present interim charge relates to evaluating the effectiveness of financial aid programs in Texas, focusing especially on Towards EXcellence, Access and Success (TEXAS) Grants and B-on-Time (BOT) Loans. Both programs are intended to balance academic achievement with students' financial need. For instance, TEXAS Grants serve students from families earning \$39,000 or less and who complete the Recommended High School Program or Distinguished Achievement Program in an accredited Texas high school. Similarly, BOT loans incentivize high academic achievement via criteria for loan forgiveness, such as GPA standards and timely degree progress.

In 2007 the 80th Texas Legislature directed the Texas Higher Education Coordinating Board (THECB) to conduct a study examining state financial

aid programs and their effectiveness. Accordingly, the THECB contracted with an outside consultant, Higher Education Insight Associates (HEIA), to conduct the study. Given the relevance of this study to the Senate Finance Higher Education Subcommittee's interim charge, Commissioner Raymond Paredes was invited to present some of the report's preliminary recommendations.

Testimony

The Senate Finance Higher Education Subcommittee heard testimony regarding this charge on May 28, 2008. The hearing included invited testimony from:

- Dr. Raymund Paredes, Commissioner of Higher Education, THECB¹

Findings

The Commissioner's Evaluation of Financial Aid in Texas

Dr. Paredes reviewed the state and effectiveness of student financial aid programs in Texas. In terms of sheer millions of dollars, Texas has made progress in funding student financial aid, rising from being ranked fifteenth in 2000 to sixth in 2006. Without continued and dramatic increases in funding, Texas is unlikely to further improve its ranking significantly.

When it comes to the sources of financial aid and the balance between loans and grant aid, Texas ranks behind national averages. Students in Texas depend heavily on federal funds in comparison to those attending institutions in other states. The vast majority (76 percent) of the aid in Texas comes from federal sources, while the national average is only 58 percent. In addition, students in Texas rely heavily on loans. Sixty percent of student aid in Texas is from loans, compared to an average of 50 percent nationally. What's more, a similar lag also is reflected in the amount of grant aid offered to students. Thirty-nine percent of the aid in Texas comes from grants, compared to 49 percent nationally.

¹ Submitted written materials can be found at <http://www.senate.state.tx.us/75r/Senate/commit/c535/c535.htm>

Commissioner Paredes highlighted the challenges many Texans face in meeting the costs of higher education, regardless of income level. For instance, although most state grant aid goes to students with relatively low family income levels, more than 60 percent of these students must still take out loans. Families at all income levels struggle to meet the cost of higher education, and students from families that make more than \$60,000 a year are even more heavily dependent on loans to fund their education.

Commissioner Paredes evaluated specifically the TEXAS Grant program, arguing that supporting TEXAS Grants offers a high return on the investment. In fact, the graduation and persistence rates of TEXAS Grant recipients approaches the national average for all students. Because many TEXAS Grant recipients enter higher education less prepared academically or come from low-income households, these students' success serves as an important reminder for how financial aid can help close the achievement gap.

Dr. Paredes suggested that more work can be done to support this program. Since 2000, the state has invested more than \$2.5 billion in financial aid. Although these contributions are notable, funding for aid has not kept pace with population growth or cost. Importantly, Texas has the fastest growing college-aged population in the country, and many of these students will come from low income or underprivileged backgrounds. This fact cannot be ignored given that large numbers of students already fail to receive grant aid despite their eligibility. For example, of all the students eligible for TEXAS Grants, only 50 percent (approximately 90,000 students) actually receive an award. What's more, of all the students eligible for Texas Educational Opportunity Grants (TEOG), only four percent (approximately 6,000 students) actually receive an award. If Texas funded all students eligible for these programs during this biennium, it would cost the state an additional \$912 million.

Consultant's Findings and Recommendations

In accordance with Rider 49 during the 80th Texas Legislature (2007), the THECB commissioned a financial aid study. Dr. Paredes summarized its preliminary findings. The study examined BOT loan funding and the effects of adding merit components to TEXAS Grants. Although there is still much room for improvement, the state has made notable advancements, especially in terms of high school preparation, college-going rates, total enrollment,

and college graduation rates. What's more, financial aid programs appear to serve the students for whom they were designed, including minority and first-generation students.

Dr. Paredes also summarized the study's preliminary recommendations, which were intended to balance the needs of low-income families while also attending to the current gap in aid for middle-income households. For instance, in light of the positive impact that TEXAS Grants have had on persistence and graduation rates, the study recommended maintaining TEXAS Grants as the cornerstone program for a comprehensive financial aid system. In addition, it recommended developing a long-range plan for aligning and merging the Tuition Equalization Grant (TEG) and the TEOG with the TEXAS Grants to form one comprehensive financial aid program based on family financial strength and academic merit.

The report specifically calls for restructuring TEXAS Grants to include a need plus merit model for awards. Under this model, awards also would be distributed across the lowest three income quintiles, thus including middle-income families often challenged by financial need. Similarly, the report made recommendations regarding BOT loans, which currently target students from low-income families. BOT loans award both academic achievement and timely completion of degrees. In addition to expanding funding to include new awards, the report suggested retargeting the loans to the top fourth and fifth income quintiles, or those earning more than \$61,685 a year. Without substantial across the board increases in funding, these recommendations could result in less funding for low-income families and more attention to needy middle-income households.

Finally, Dr. Paredes recommended expanding work study programs, especially where organizations may contribute to their funding. The benefits of work study mentorship and other valuable work experiences, especially in engineering or teaching, were highlighted. Compared to other forms of aid, work study yields the best results in graduation rates.

Analysis

This section offers additional considerations regarding the testimony heard by the Higher Education Subcommittee. First, it highlights the importance of expanding financial aid programs in Texas. Second, it suggests caution regarding how these aid programs might be expanded or restructured.

Dr. Paredes testified that although Texas has made progress in funding financial aid at higher levels, students remain heavily dependent upon federal funds. In this respect, Texas lags behind other states when compared across various measures, including reliance on loans or availability of grant aid. Indeed, more can be done to ensure that aid programs reach more students. Both low- and middle-income families are faced with unmet need and must borrow to fund their children's education. In addition, large numbers of students fail to receive grant aid despite their eligibility. Clearly, the positive effect of current financial aid programs on student achievement and persistence highlights the need to expand funding for current aid programs.

Care must be taken, however, to ensure that other restructuring, especially of currently successful programs, is necessary and relevant to the future prosperity of higher education. For instance, Dr. Paredes suggested restructuring current aid programs in Texas to meet the needs of more middle-income households. This is associated with debates about the use of college entrance exams, such as the SAT or ACT, as merit criteria. Undoubtedly, middle-income families face tremendous financial challenges when paying for higher education, including a heavy reliance on loans. Concerns have been raised, however, regarding whether such changes would come at the expense of other needy families.

With the help of TEXAS Grants and BOT loans, Texas has made great steps in proving that low-income students, students of color, first-generation, and other non-traditional students can achieve at high levels if given access to higher education. Dr. Paredes testified about the current success of these programs. Given their proven records, measures should be taken to ensure that funding for low-income students will continue to grow, and that any consideration of additional merit components does not inadvertently filter out students who might otherwise benefit from need-based aid. Accordingly, changes in programming should not unduly risk the state's record of closing the gaps via such need-based types of aid.

Charge Two—Financial Aid

Recommendations

The Senate Finance Higher Education Subcommittee makes the following recommendations for the Legislature's consideration:

Recommendation One

Ensure that the least advantaged students receive the greatest benefit from state grant funds.

- Current programs, such as TEXAS Grants, TEOG, and BOT loans, serve as a testament to the benefits of need-based aid in ensuring student success.
- Accordingly, TEXAS Grants should be the cornerstone of the state's financial aid system, and BOT loans should continue to serve full-time students.
- Texas currently lags behind other states in providing grants and other financial aid.

Recommendation Two

In order to make more efficient use of scarce resources, consider adding additional merit components to the state financial aid programs in a manner that does not impact low-income students adversely.

- Care must be taken to ensure that merit criteria do not unintentionally constrain access to higher education for low-income and minority students.
- Other changes to student financial aid programs should also take into account the particular needs of community colleges and their diverse missions.
- Any transition to additional merit-based criteria should be research-based using university and community college data about student participation and success.

Recommendation Three

Strengthen college work-study programs and workforce development.

- Work study programs broaden students' access to higher education, ensure their persistence, and expose them to new skills and experiences.
- In 2007 the 80th Texas Legislature expanded work study programs such that students could also work as peer mentors and tutors, increasing both institutional capacity and college access.
- Workforce development programs can be targeted to support students majoring in high-need disciplines.

Recommendation Four

Increase student and family awareness of college costs and TEXAS Grant eligibility.

- Alternative approaches, such as online financial aid tools, may help serve this end.
- The state's contribution to student aid also should be clearly recognized on institutional award notifications.

Charge Three: Tuition Deregulation

Study the effects continued tuition deregulation will have on college enrollment and accessibility.

Charge Three: Tuition Deregulation

The Senate Finance Higher Education Subcommittee was charged with examining effects continued tuition deregulation would have on college enrollment and accessibility. This report assesses tuition deregulation's continued effects and makes recommendations for the state in light of these considerations.

Purpose and Background

As tuition and fees at Texas public institutions and other institutions throughout the nation have continued to rise, concern has increased regarding higher education affordability. At issue and the purpose of this report is to look at whether effects of tuition deregulation have contributed to this continuous increase and what impact affordability has had on accessibility.

The earliest discussion of tuition deregulation in Texas began in 1984 but did not result in any bills. In 2003, with passage of House Bill 3015 (Morrison/Shapiro) the Legislature granted tuition-setting authority to public university governing boards to provide flexibility to Texas's public universities by allowing them to establish their own tuition rates. Tuition deregulation came about as a response to the state's estimated \$10 billion shortfall. Prior to the 78th Legislative Session in 2003, Texas was one of only a few states that retained legislative oversight of tuition setting authority. At that time, only Texas, Florida, California, Louisiana, and Washington State afforded their state legislatures complete control over tuition rates. What's more, thirteen states operated with a statewide tuition coordinating agency; 23 states granted tuition setting powers to the governing boards of individual university systems; and 14 states allowed individual university institutions to establish their own tuition rates.

The cost of attending a higher education institution depends on tuition and fees, room and board, books and other living costs. Tuition itself is divided into three types: statutory tuition, designated tuition, and board authorized tuition.¹ Authorized under Section 54.051 of the Texas Education Code,

¹ Texas Higher Education Coordinating Board, "Tuition Deregulation," p. 1, accessed at: <http://www.thecb.state.tx.us/reports/PDF/1527.PDF>.

statutory tuition is determined by the Legislature. The current rate is \$50 per semester credit hour. Designated tuition varies by institution and is authorized under Section 54.0513 of the Texas Education Code. This section "authorizes institutions other than public community colleges to impose on any graduate or undergraduate, resident or nonresident student, an additional tuition charge that the governing board of the institutions considers necessary for the effective operation of the institution."² Board authorized tuition is allowed under section 54.008 of the Texas Education Code and allows boards to set rates for graduate programs up to at least twice that of undergraduate and to differentiate among programs.³

Based on information collected from institutions of higher education, the Texas Higher Education Coordinating Board (THECB), and various other sources it is projected that an additional \$1.7 billion would have been needed to be appropriated by the Legislature to offset tuition and fee increases and vetoed funds during fiscal year 2008-09. Of the \$1.7 billion, \$939 million would be needed for four year public institutions. Based on future planned tuition and fee increases, an additional \$1.6 billion would be needed to maintain the cost of higher education for fiscal year 2010-11 to fiscal year 2007-08 levels. Of this, \$930 million would be needed for four-year public institutions.

A more recent analysis conducted by the Texas A&M University System on behalf of and reviewed by all the other university systems' finance offices found that during the 2006-07 biennium the amount spent on the core educational and student programs was \$9.1 billion and that the majority was paid for with state appropriations and tuition and fees.⁴ The amount spent during the 2008-09 biennium on the same programs was \$10.4 billion, an increase of \$1.2 billion. Assuming an average annual growth of 1.48 percent in full time student enrollment among all 35 general academic universities and a 3.7 percent annual inflation rate, the analysis projects a similar increase in expenditures forward to the 2010-11 biennium. Based on that projection, the legislature would have to invest \$960 million in additional funding to maintain "status quo" in core educational and student support programs over the current 2008-09 biennium to keep tuition and fees flat. Their study concludes that if state appropriations do not increase

² Ibid.

³ Ibid.

⁴ Texas A&M University System, "Appropriations and Tuition and Fees are Interdependent," White Paper, p. 1.

enough to cover the projected increase in expenditures, tuition and fees would have to bear the remaining share of the expenditures for these core functions. This is one reason that tuition deregulation will be revisited by the 81st Texas Legislature.

Testimony

The Senate Finance Higher Education Subcommittee heard testimony regarding this charge on May 28, 2008. The hearing included invited testimony from the following persons:

- Dr. Raymund Paredes, Commissioner of Higher Education, THECB
- Susan Brown, Assistant Commissioner, Planning and Accountability, THECB
- Scott Caven, Chair, The University of Texas System
- F. Scott Dueser, Chair, Board of Regents, Texas Tech University System
- Bernie Francis, Chair, Board of Regents, Texas State University System
- Joe Max Green, Chair, Board of Regents, Stephen F. Austin State University
- Bill Jones, Chair, Texas A&M University System Board of Regents
- Glenn Lewis, Chair, Board of Regents, Texas Southern University
- Charles Matthews, Chancellor, Texas State University System
- Mike McKinney, Chancellor, Texas A&M System
- Gayle W. Strange, Chair, Board of Regents, University of North Texas System
- Welcome W. Wilson, Chair, Board of Regents, University of Houston System

Written testimony submitted by some witnesses also was considered in the writing of this report.⁵

Findings

Other than anecdotal testimony, there is no conclusive evidence that tuition deregulation has created overwhelming access problems to higher education.

⁵ These materials can be found at <http://www.senate.state.tx.us/75r/Senate/commit/c535/c535.htm>

However, it should be cautioned that not enough time has elapsed nor enough data are available to determine the long-term effects on enrollment. In the case of tuition in Texas, from fall, 2003, through fall, 2007, average cost including tuition and fees rose 53 percent (based on 15 semester credit hours).⁶ This reportedly caused some students to take fewer hours, enroll in two years versus four years, and in some cases defer college. This sharp increase in tuition caused what many testified to as "sticker shock." Dr. Raymond Paredes testified that tuition has risen much faster than the national average and Texas now meets or exceeds the national average for tuition. Billy Hamilton, in his report *The Balance Wheel: A Report on Tuition, Appropriations and the Affordability of Texas Public Higher Education*, references The College Board's *Trends in College Pricing* report and states that nationally the average tuition and fees at four year universities is \$6,185, while the average cost in Texas is \$6,437 for the 2007-08 school year.⁷ He further cites the THECB's data indicating a 157 percent increase in tuition in the last decade.

One factor complicating the issue of access is that of financial aid. House Bill 3015 (2003) required universities to set aside 15 percent of tuition charges in excess of \$46 per student credit hour for financial aid programs as an offset to tuition increases.⁸ An additional five percent of undergraduate resident designated tuition is required to be set aside to fund the B-On-Time (BOT) Student Loan Program.⁹ Because each student financial aid package is tailored to the individual student it is unclear the impact increased financial aid has had on low- to middle-income students in relation to tuition increases. In terms of need-based aid, according to the THECB, the percentage of financial aid in relation "to the cost of attendance has remained at approximately 55 percent, leaving a significant financial burden on students and their families."¹⁰

As stated, limited data and the length of time since the passage of tuition deregulation has prevented the THECB from a full analysis of deregulation's impact to access. However it is worth noting that enrollment at both two-

⁶ Ibid., p. 2.

⁷ Billy Hamilton, *The Balance Wheel: A Report on Tuition, Appropriations and the Affordability of Texas Public Higher Education*, February, 2008, p. 8.

⁸ Texas Higher Education Coordinating Board, "Tuition Deregulation," p. 2, accessed at: <http://www.thecb.state.tx.us/reports/PDF/1527.PDF>.

⁹ Ibid.

¹⁰ Texas Higher Education Coordinating Board, "Report on Student Financial Aid in Texas Higher Education for Fiscal Year 2007," p. 16, accessed at: <http://www.thecb.state.tx.us/reports/PDF/1562.PDF>.

and four-year institutions have far exceeded growth projections that were formulated prior to 2003.¹¹ Community colleges grew from 518,597 in the fall of 2003 to 568,760 in the fall of 2007 (a 9.7 percent increase in enrollment).¹² Public university enrollment grew from 472,818 in the fall of 2003 to 497,195 in the fall of 2007 (a 5.2 percent increase in enrollment).¹³ Although enrollment in both are not in line with meeting the goal of *Closing the Gaps* for participation, both community colleges and public universities have made increases in the number of minority students attending higher education since the passage of tuition deregulation.¹⁴ The relationship between increased enrollment and increased tuition cannot be determined at this time, nor can a shift in economic class of those attending.

In light of the data available, it is unclear if tuition deregulation has affected access, whether based on income level, gender or ethnicity. Enrollment continues to exceed projections, even those forecast prior to tuition deregulation. What can be determined is that "the increase in price has been faster than the rate of growth in higher education cost inflation and faster than the average growth in tuition and fees at public universities nationally."¹⁵ This sharp price increase coupled with uncertain financial aid has made higher education "increasingly difficult to afford for many low and middle income students without incurring large amounts of debt."¹⁶ At what point tuition outweighs the benefits of a secondary education and individuals choose other options is not known. Although there is no conclusive evidence at the time of this report's publication, there is increasing concern about the long-term effect that tuition deregulation could have on college enrollment and accessibility if tuition and fees continue to rise. The 81st Legislature (2009) undoubtedly will address this issue extensively. The debate should focus on the interrelationship between the level of state funding and future tuition rates.

¹¹ Texas Higher Education Coordination Board staff response to legislative request for information from Brent Whitaker, Oct. 7, 2008, pp. 1 and 2.

¹² Ibid.

¹³ Ibid.

¹⁴ Ibid.

¹⁵ Billy Hamilton, "The Balance Wheel: A Report on Tuition, Appropriations and the Affordability of Texas Public Higher Education," February, 2008, p. v.

¹⁶ Ibid.

Charge Three—Tuition Deregulation

Recommendations

The Senate Finance Higher Education Subcommittee makes the following recommendations for the Legislature's consideration:

Recommendation One

Direct the Texas Higher Education Coordinating Board to collect all information pertinent to determining if higher tuition is limiting access to higher education.

- Currently, insufficient data is available to determine the impacts of tuition deregulation.
- Information collected should include a study of all costs related to the cost of higher education.

Recommendation Two

Formalize the relationship between the amount of funding provided by the State and the amount of tuition and fees charged by an institution.

- Tuition and fees and state appropriations are the major revenue sources for core instruction and operations.
- It is important to acknowledge the interdependence of state appropriations and tuition and fees.

Joint Charge: Chapter 53, 53A and 53B

Review the status, effects, and success or failure of higher education authorities operating under Chapters 53, 53A, and 53B, Education Code, and nonprofit corporations carrying out the functions of higher education authorities under those chapters. Make recommendations regarding any necessary changes in the statutes and administration of same. (Joint charge with the Senate Higher Education Subcommittee)

Joint Charge: Chapter 53, 53A, and 53B

Lieutenant Governor David Dewhurst charged the Senate Finance Committee and the Senate Higher Education Subcommittee with reviewing the status, effects, and success or failure of higher education authorities operating under Chapters 53, 53A, and 53B. The Senate Finance Committee Chair, however, delegated the full committee's responsibility to the Senate Finance Higher Education Subcommittee.

Purpose and Background

Higher education authorities were authorized by House Bill 1233 (Higher Education Authority Act) of the 61st Texas Legislature (1969) as a joint public/private partnership to encourage lender participation in the Federally Insured Student Loan Program.¹ Authorities were created to issue tax-exempt bonds and to use the proceeds to then purchase student loans from commercial lenders. Having been amended, this portion of the code is divided into three sections, Chapters 53; 53A; and 53B, which apply not only to the original purpose of student lending, but also to educational and housing facilities for public and private educational institutions.

Chapter 53 and 53A Higher Education Facility Authorities for Public and Private Schools.

Because federal law prohibits a nonprofit 501c(3) educational institution from issuing tax exempt debt, Chapters 53 and 53A create Higher Education Facility Authorities. These authorities fall under a section of the Internal Revenue Code that "permits the issuance of tax exempt debt by a state, a political subdivision of a state, and by constituted authorities acting by or on behalf of a state or political subdivision."² They typically are incorporated by a city or town and revenue or other obligation bonds are issued via a nonprofit corporation.³ Chapters 53 and 53A do not require a geographical relationship between issuer and borrower. Facilities that are eligible under Chapter 53 and 53A "are educational facilities, housing facilities and any facilities incidental, subordinate or related to or appropriate in connection

¹ Senate Research Center.

² Testimony of Thomas K. Spurgeon.

³ Texas Attorney General staff response to legislative request for information from Brent Whitaker, April, 2008.

with an educational facility or housing facility."⁴ Obligations are typically those of the issuer, not of the borrower. These tend to be "limited obligations of an issuer payable solely from payments received from a borrower pursuant to a loan agreement between the issuer and the borrower, which identifies the specific revenues that will be available to repay the bonds."⁵

The Texas Attorney General's representatives provided the following list of Chapter 53 and 53A Higher Education Authorities registered in Texas:

01. City of Alamo Heights, Texas Higher Education Facilities Corporation
02. City of Ames Higher Education Facilities Corporation
03. Anson Education Facilities Corporation
04. City of Austin, Texas, Higher Education Authority, Inc.
05. Beasley Higher Education Finance Corporation
06. City of Brownwood, Texas Higher Education Facilities Corporation
07. City of Bryan Higher Education Authority
08. City of Cameron Education Corporation
09. Capital Area Cultural Education Facilities Finance Corporation
10. Crawford Education Facilities Corporation
11. Danbury Higher Education Authority, Inc.
12. Dickinson Education Finance Corporation
13. Education Finance Corporation
14. Fate Higher Education Facilities Corporation
15. FW Higher Education Finance Corporation
16. City of Georgetown, Texas Higher Education Finance Corporation
17. City of Harlingen, Texas Higher Education Facilities Corporation
18. Heart of Texas Education Finance Corporation
19. City of Houston Higher Education Finance Corporation
20. Hudson Oaks Education Finance Corporation
21. Italy Higher Education Facilities Corporation
22. Keller Higher Education Facilities Corporation
23. La Vernia Higher Education Finance Corporation
24. Longview Higher Education Authority, Inc.
25. Lubbock Educational Facilities Authority, Inc.
26. Manvel Education Facilities Corporation
27. Metropolitan Higher Education Authority, Inc.

⁴ Ibid.

⁵ Ibid.

28. Midland Higher Education Facilities Corporation
29. Milford Higher Education Facilities Corporation
30. Northeast Higher Education Facilities Corporation
31. City of Olmos Park, Texas Higher Education Facilities Corporation
32. Orchard Higher Education Finance Corporation
33. City of Pharr, Texas Educational Facilities Finance Authority
34. Raven Hills Higher Education Corporation
35. Red River Education Finance Corporation
36. Richmond Higher Education Finance Corporation
37. Ross Higher Education Facilities Corporation
38. City of San Antonio, Texas Education Facilities Corporation
39. City of San Antonio, Texas Higher Education Authority, Inc.
40. San Leanna Education Facilities Corporation
41. City of Seguin Higher Education Facilities Corporation
42. Shavano Park, Texas Higher Education Facilities Corporation
43. Sherman Higher Education Finance Corporation
44. Southwest Higher Education Authority, Inc.
45. Splendor Higher Education Facilities Corporation
46. Stamford Higher Education Facilities Corporation
47. City of Tatum, Texas Higher Education Facilities Corporation
48. City of Terrell Hills, Texas Higher Education Facilities Corporation
49. Texas Charter School Corporation
50. Texas Dormitory Finance Authority, Inc.
51. Texas Public Finance Authority Charter School Finance Corporation
52. Texas Student Housing Authority
53. Texas Student Housing Corporation - Denton Project
54. Texas Student Housing Corporation - MSU Project
55. Trinity Higher Educational Facilities Corporation
56. City of Universal City, Texas Education Facilities Corporation
57. Waco Education Finance Corporation
58. Wallis Higher Education Facilities Corporation

Chapter 53B Higher Education Loan Authorities

Higher education authorities were authorized as a joint public/private partnership to encourage lender participation in the Federally Insured Student Loan Program. Authorities are organized as non-profit corporations that contract with a bank or a non-profit corporation to serve as a trustee for the bond issue.⁶ Student loans purchased with the bond proceeds are held by

⁶ 66th Legislature Higher Education Authorities Subcommittee, Touche, Ross and Co.

the trustee in the trustee's name.⁷ Authorities use several market tools in issuing bonds and notes. More than 99 percent of the amounts provided to Texas students and parents through the Federal Family Education Loan Program are provided by private lenders, non-profit lenders, and secondary markets.⁸

Beginning in 2007 and continuing through 2008, credit issues at the national economic level have dramatically affected higher education loan authorities' ability to secure funding for additional loans. This crisis results from a combination of factors, including federal policy and the sagging capital market. Of great importance has been the subprime mortgage crisis, which negatively impacts federally insured loans, private student loans, and all credit programs.⁹ In effect, non-profit lenders, non-traditional lenders, and the capital markets are unable to secure additional loans. What's more, traditional lenders, such as banks, often use these same non-profit and non-traditional lenders as secondary lenders to leverage additional capital.¹⁰ In short, traditional banks will begin to have similar problems if secondary markets are unable to purchase banks' loans.¹¹

A following is a list of those authorities operating under Chapter 53B Higher Education Authorities:

1. South Texas Higher Education Authority
2. North Texas Higher Education Authority
3. Panhandle-Plains Higher Education Authority
4. Brazos Higher Education Service Corp.

Testimony

The Senate Finance Higher Education Subcommittee and Senate Higher Education Subcommittee heard testimony regarding this charge on April 23, 2008. The hearing included invited testimony from:

⁷ Ibid.

⁸ Testimony of George Torres.

⁹ Testimony of George Torres.

¹⁰ Ibid.

¹¹ Ibid.

- Patricia Beard, Chief Executive Officer (S. Texas Higher Education Authority), Edinburg, TX
- Kathryn Bryan, Executive Director (North Texas Higher Education Authority), Arlington, TX
- David Dickson, Vice President for Financial Affairs (St. Edward's University), Austin, TX
- Tom Griess, Deputy Assistant Attorney General (Office of the Attorney General), Austin, TX
- Dr. George Martin, President (St. Edward's University), Austin, TX
- Jimmy Parker, Executive Vice President (Panhandle-Plains Higher Education Authority), Canyon, TX
- Thomas K. Spurgeon, (McCall, Parkhurst, and Horton L.L.P.), San Antonio, TX
- Ellis Tredway, Executive Vice President (Brazos Higher Education Service Corp.), Austin, TX

Some witnesses also submitted written materials, and these were considered in the writing of this report.¹²

Findings

Although Higher Education Facility Authorities have existed for some time, lack of state oversight has resulted in several instances of financial hardships for some cities and institutions. Specifically, few issuances under the Chapter 53 Public Higher Education Facility Authorities have been brought to the Legislature's attention, and in many instances have cost the borrowing institution far more than the financial benefit of using this type of financing. Between 1999 and 2004, 25 such issuances occurred.¹³ The Texas State System was one of the first systems in Texas to recognize this lack of benefit and has since ended its Chapter 53A agreements. Even so, Chapter 53A Private Higher Education Loan Authorities are often lawful and serve as important financial tools for private universities and colleges. Because the state does not provide infrastructure or formula funding to these private entities, Chapter 53A is one of the few external financial tools available for the construction of new facilities. Chapter 53B Higher Education Loan Authorities, during favorable market conditions, function as intended by the Legislature, and play an important role in the student loan market. All

¹² These materials can be found at <http://www.senate.state.tx.us/75r/Senate/commit/c535/c535.htm>

¹³ Texas Attorney General staff response to legislative request for information from Brent Whitaker, April, 2008.

current problems in the financial markets are the result of national economic policies, and states have little or no influence in resolving them.

The Attorney General's Office provided the following list of bonds filed for review and approval under Chapters 53 and 53A.

01. Anson Higher Education Facilities Corporation Student Housing Revenue Bonds (The University of Texas at Dallas, Waterview Park Project) Series 2002 (\$54,365,000)
02. Anson Higher Education Facilities Corporation Student Housing Revenue Bonds (Odessa College Project) Tax-Exempt Series 2002A Bonds (\$7,120,000) and Taxable Series 2002B (\$195,000)
03. City of Brownwood, Texas Higher Education Facilities Corporation Higher Education Revenue Bonds (Texas State Technical College-Sweetwater, Texas Project) Series 1999 (\$1,500,000)
04. City of Cameron Education Corporation Student Housing Revenue Bonds (Southwest Texas State University Project) Series 2000 (\$19,900,000)
05. Crawford Education Facilities Corporation Student Housing Revenue Bonds (Weatherford College Project) Series 2004A (\$9,410,000)
06. Crawford Education Facilities Corporation Variable Rate Demand Parking and Revenue and Refunding Bonds (University Parking System Project) Series 2004A (\$34,105,000) and Series 2004B (Taxable) (\$1,210,000)
07. City of Houston Higher Education Finance Corporation Variable Rate Demand Housing Revenue Bonds (University Courtyard Project) Series 2000A and Taxable Series 2000B (\$11,070,000)
08. City of Houston Higher Education Finance Corporation Variable Rate Demand Revenue Bonds (Tierwester Oaks and Richfield Manor Project) Series 2003A (\$22,165,000) and Series 2003C (Taxable) (\$3,045,000)

09. City of Houston Higher Education Finance Corporation Variable Rate Demand Parking Revenue Bonds (University Parking System Project) Series 2004A (Taxable Until Tax-Exempt Conversion) (\$9,165,000) and Series 2004B (Taxable) (\$335,000)
10. Keller Higher Education Facilities Corporation Student Housing Revenue Bonds (University Courtyard Apartments Denton, Texas Project) Series 2001A (\$34,770,000) and Taxable Series 2001B (\$395,000)
11. Raven Hills Higher Education Corporation Student Housing and Educational Facilities Revenue Bonds (Bobcat Village LLC, Southwest Texas State University Project) Series 2001A (\$43,830,000) and Series 2001B (\$230,000)
12. Raven Hills Higher Education Corporation Student Housing Revenue Bonds (Cardinal Village LLC, Lamar University Project) Series 2001A (\$12,855,000) and Series 2001B (\$290,000)
13. Raven Hills Higher Education Corporation Student Housing Revenue Bonds (San Marcos Hall LLC, Southwest Texas State University Project) Series 2001A (\$19,990,000) and Series 2001B (\$300,000)
14. Raven Hills Higher Education Corporation Student Housing Revenue Bonds (Cardinal Village LLC, Lamar University Project) Series 2002A (\$14,985,000) and Series 2002B (\$310,000)
15. Raven Hills Higher Education Corporation Student Housing Revenue Bonds (Texan Hall LLC, Angelo State University Project) Series 2002A (\$18,310,000) and Series 2002B (\$375,000)
16. Raven Hills Higher Education Corporation Student Housing Revenue Bonds (San Marcos Hall LLC, Southwest Texas State University Project) Series 2003A (\$22,940,000) and Series 2003B (\$320,000)
17. Raven Hills Higher Education Corporation Student Housing Revenue Bonds (Cardinal Village LLC, Lamar University Project) Series 2003A (\$20,655,000) and Series 2003B (\$255,000)

18. Richmond Higher Education Finance Corporation Student Housing Revenue Bonds (Bayou Student Housing, LLC, University of Houston Project) Series 2003A (\$21,000,000) and Series 2003B (\$330,000)
19. City of San Antonio, Texas Education Facilities Corporation Adjustable Rate Demand Revenue Refunding Bonds (The University of Texas at San Antonio, Phase I Dormitory Project) Series 2003A (\$4,180,000)
20. City of San Antonio, Texas, Higher Education Authority, Inc. Educational Facilities Revenue Refunding Bonds (The University of Texas at San Antonio, Phase I Dormitory Project) Series 1996 (\$6,475,000)
21. Texas Dormitory Finance Authority, Inc. Student Housing Revenue Bonds (Temple Junior College Foundation Project) Series 2001A (\$10,810,000) and Taxable Series 2001B (\$480,000)
22. Texas Student Housing Corporation, Denton Project Student Housing Revenue Bonds (University of North Texas Project) Series 2001 (\$29,105,000) and Subordinate Series 2001B (\$5,250,000)
23. Texas Student Housing Corporation, MSU Project Student Housing Revenue Bonds (Midwestern State University Project) Series 2002 (\$14,540,000)
24. Texas Student Housing Authority, Student Housing Revenue Bonds (Austin, Texas Project) Senior Series 2001A (\$34,175,000), Junior Series 2001B (\$2,470,000) and Subordinate Series 2001C (\$3,000,000)
25. Texas Student Housing Authority, Student Housing Revenue Bonds (Jefferson Commons at Town Lake Project) Series 2002A-1 (\$19,480,000) and Series 2002A-2 (\$5,670,000)

Joint Charge—Chapter 53, 53A, and 53B

Recommendations

The Senate Higher Education Subcommittee makes the following recommendations for the Legislature's consideration:

Recommendation One

Chapter 53 Higher Education Facility Authorities for Public Schools bond and loan agreements should require the same scrutiny as Tuition Revenue Bonds, and the Governor, Lieutenant Governor, Speaker, and Legislative Budget Board should be given notification about bonds issued under Chapter 53.

- Little or no oversight currently exist for entities created under Chapter 53.
- While not an obligation of the State, it is a financial expense to the borrowing institution, and ultimately could render institutions in need of additional state aid.
- The Governor, Lieutenant Governor, Speaker, and Legislative Budget Board are notified when other bonds, such as general obligation bonds and revenue bonds, are issued.

Recommendation Two

Amend Chapter 53A to clarify the distinction between educational facility and athletic facility.

- The Attorney General's Office currently approves athletic facilities on a case-by-case basis, and only if the institution can show how it will be used for educational purposes.
- Private universities and colleges have limited financing options for these types of facilities.

Recommendation Three

Restructure the boards of Higher Education Facility Authorities to expand membership and require regular meetings.

- Currently, officers and employees of cities are prohibited from serving on the facility authorities board.

- Currently, many boards do not meet after the initial issuance of debt. As a result, a crisis is compounded when meetings are needed but board members have moved or are cannot be located.

Conclusion

In response to the four charges issued by Lieutenant Governor David Dewhurst, the Senate Finance Higher Education Subcommittee herein submits 18 recommendations for consideration by the 81st Texas Legislature.

These recommendations are intended to ensure that more qualified students have access to an excellent higher education and that Texas colleges and universities remain affordable. Implementing these recommendations also will strengthen our universities' research infrastructure and capabilities so Texas remains competitive economically and academically. The state's investment in higher education is a key component to meeting the increasing demands of a growing population and a diversified workforce and to ensuring that the state achieves the goals of *Closing the Gaps*.