

## Conversations on Jesuit Higher Education

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Volume 48

Article 6

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September 2015

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### Recommended Citation

Laird, William G. (2015) "Best Practices in College and University Budgeting," *Conversations on Jesuit Higher Education*: Vol. 48, Article 6.

Available at: <http://epublications.marquette.edu/conversations/vol48/iss1/6>

# Best Practices in College and University Budgeting

By William G. Laird

**C**ritical to carrying out the mission of a Jesuit college or university is its financial health. Whether a small, local college or a big research university, the flow of money is a constant worry. My twelve years as chief financial officer at Loyola University Chicago (2002-2014) began right after a series of operating losses in the 1990s through 2002, made worse by a downturn in enrollment. There had been virtually no investment in the academic and capital infrastructure for many years. The first thing I was asked to do was to organize a new management team that could initiate a best practices business plan to insure for financial success and to initiate the needed human and capital resources to effectively provide for a quality Jesuit Catholic education.

What follows is a little of the history of righting the ship financially at Loyola University Chicago. My remarks come out of my experience at a Jesuit institution that is very large (now hovering around 16,000 students), is research intensive, and has three major and very diverse campuses in the Chicago area alone. Yet I think that what we learned over the years and what we put into place can be of use to any college or university.

## ***1. Enrollment Management***

The first thing our management team did was achieve a 16,000 student enrollment target, a population determined to be Loyola's maximum capacity considering its human and physical assets. By reorganizing the enrollment management operation, the student enrollment was regained and total students increased each year during the ten-year period.

## ***2. Conservative budgeting and financial forecasting***

A budget is an indicator of risk tolerance from conservative to aggressive. Aggressive budgeters are more likely to experience revenue shortfalls and expense overruns. A conservative budget protects the institution from unforeseen shortfalls and provides more stability in the operations. We kept realistic revenue assumptions while making sure expense assumptions were also realistic and reflected economic realities. Finally, each year we built some contingency reserves into the budget. A financially astute

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Loyola University Chicago

institution takes advantage of unforeseen opportunities and responds to unanticipated problems.

### ***3. Relative trust in the budget process***

The first thing to do was to restore trust by employing an open process with significant information sharing. We instituted a Budget Review Team (BRT) made up of the university president, CFO, provost, strategic planning committee, human resources, and capital planning. The BRT meets regularly to ensure that the budget and forecasting process is accurate and consistent with management plans and expectations. The BRT builds trust among the many players responsible for the fiscal health of the university.

### ***4. Faculty***

We immediately decided to tie budget bases and faculty salaries to teaching performance. The first operating surplus earned in 2004 was reinvested in fac-

ulty salaries to compensate for outstanding teaching performance. The provost and deans worked closely with us to assess faculty teaching productivity that could be measured in terms of credit hours taught. The credit hours were benchmarked with other peer institutions and standards were set for each college, school, and department for any full-time faculty member. The credit hours were also used as the basis of allocating net tuition revenue to each of the schools. Some budget bases were increased based on teaching productivity, as were the individual salaries of the teaching faculty.

### ***5. Self-sufficient operations***

Early on, LUC's management team determined that certain of the operations would be treated as self-sufficient business units. These units were expected to match revenue pricing with operating and capital requirements without drawing financial support from tuition-related activities. Examples of these self-sufficient operations included the internal bank, student housing, residential rental properties around

the university, our campus in Rome, and the Health Sciences. This insured that each entity pays for its share of debt service and capital expenses. These operations do not draw on the operational cash flow from tuition/teaching activities.

## **6. Capital budget and funded depreciation**

The amount of the annual depreciation expense is the first deposit to the capital budget and provides for significant cash flow to fund annual deferred maintenance and new construction requirements. In addition, operating surpluses can augment funded depreciation to pay for capital expenditures.

## **7. Internal bank to repay debt**

Sufficient cash flow is required to make the principal payments on outstanding debt. The management team established an internal bank to bill debt service payments to tuition-based and auxiliary-based budget entities (i.e., housing, health sciences, the Rome center). The debt service – billed and internally collected – provided the cash flow to retire the debt when it was due. Amounts billed are in advance of debt payments and remain as invested cash reserves to pay the debt. Because one of our campus locations is in the heart of a retail area in downtown Chicago, these internal billings were also augmented by rental receipts from leasing the first floor properties of the downtown campus and other land leases of Loyola property. In addition, Loyola's fixed rate debt is 86 percent of total debt with variable debt, amounting to 14 percent. A risky debt portfolio would contain a very high percentage of variable debt and a change in interest rates upward could result in unanticipated interest expense.

The internal bank bills the variable rate debt at a fixed rate of approximately 4 percent to the internal entities while paying current interest rate debt at .3 percent. This technique provided for an internal “swap” and allows the internal bank to retain more cash to repay the debt and does not expose the university to counter-party risk. In a nutshell, we put in place a way to pay off the external debt completely by 2043; the internal bank with reserves results in the debt being internally retired in 2029. This practice has been highly endorsed by Moody's Investor Services.

## **8. Optimum utilization of facilities**

LUC had a lot of underutilized properties, spread around the three campuses. We decided to sell some properties and consolidate operations elsewhere when applicable, which provided us cost savings. Proceeds from the sale of the Medical School and Hospital Administration Building, for instance, were used to repay debt, and related operating costs were also eliminated. Another property sold was the School of Education building in Wilmette, IL, a campus that was far from our three main campuses. With operating costs eliminated and personnel relocated to the downtown Water Tower Campus, the proceeds were used to repay debt. Using new LEED certified building techniques provided for savings in utility costs and added to the university's mission to be environmentally sustainable. Finally, we established a separate conference services operation that rented out vacant residence halls in the summer and generated savings for housing capital reinvestment requirements.

## **9. Reinvestment of annual operating surpluses**

Any residual operating surpluses were reinvested under the control of the CEO and were used to establish unrestricted or “quasi-endowed” endowments supporting a variety of needs: future operations, matching donors' gifts, and capital reinvestment. The operating surpluses were used to establish unrestricted endowments earmarked as “quasi-endowed” by the board of trustees.

## **10. Controlling endowment spending**

The board of trustees authorizes management to spend up to 5 percent of the endowment value for intended purposes. Spending for scholarships is usually at 5 percent. However, not every endowment account automatically gets 5 percent to spend, and the effectiveness of endowment spending is reviewed annually as part of the budget process. The total annual effective rate of endowment spending is less than 3 percent. The endowment asset allocation and investments made provide for sufficient liquidity to meet the annual spending need. The budget review team annually reviews all endowment spending prior to finalizing a budget for presentation to the Board of Directors.

These policies are well entrenched now at the university and are highly endorsed by our board of trustees. ■