

# Funding the California Community Colleges: Funding Formula

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ACADEMIC SENATE  
for CALIFORNIA COMMUNITY COLLEGES

# Overview

- Current Funding Formula (Where \$ Comes From)
- Department of Finance/Governor's Proposal
- CBO Workgroup
- CCLC Workgroup
- Outcomes Based Funding
- Next Steps



# Current Funding Formula

Currently, most funding is through a combination of FTES and a base allocation.

Base = \$/College + \$/Center + additional for rural college districts

FTES =  $\frac{[(\text{\#students at census}) \times (\text{hours per week}) \times (\text{term length})]}{525}$   
Census Enrollment                      WSCH

$[(40 \text{ students}) \times (3 \text{ hours per week}) \times (17.5 \text{ week semester})] / 525 = 4 \text{ FTES}$

$4 \text{ FTES} = 4 \times \$5,150 \text{ General Fund Apportionment Rate} = \$20,600$

# Current Funding Formula

Not every course is funded through census apportionment, irregular offerings and noncredit are funded through Daily Student Contact Hours tracked throughout the term.

Local student fees and property taxes are deducted from the total allocation and the state pays the difference.

There is also significant non-general fund money tied to FTES generation for lottery and special programs such as SSSP, Scheduled Maintenance and Library Materials, etc.



# Department of Finance Recommendation

In January, the Governor and Dept. of Finance released the Governor's budget that included a revision to the funding formula to start a conversation in the system about funding:

- 50% Base Grant FTES
- 25% Supplemental Grant based on College Promise Grants and Pell Grants
- 25% Supplemental Grant based on #degrees and certificates, completion in 3 years, and ADTs



# Department of Finance Recommendation

Dept. of Finance acknowledged that this was a starting point for the discussion but they insisted some form of outcome based funding was necessary from their point of view.

Prior to the release of the DoF framework, the Chancellor had requested the Chief Business Officers create a framework for new funding possibilities.

The Chancellor also called on the CEO Board of the Community College League of California to investigate and make a recommendation to him at the January 2018 Consultation Council meeting.

# Department Of Finance Recommendations



- Initial Recommendations would have resulted in 49 districts below the break-even line and an economic impact in excess of \$200M.

# Advisory Workgroup on Fiscal Affairs

- Outgrowth of the SB361 workgroup convened by CCLC
- Reconstituted by Chancellor Brice Harris in 2013
- Started looking at other state funding models in Dec. 2016
- Was charged by Chancellor Oakley in Fall, 2017 to start looking at outcomes-based models
- Chancellor Oakley engaged Lumina Strategy Labs to assist
- Reviewed funding models for Florida, Ohio, Tennessee, Virginia, and Washington



# Funding Formula Principles

- Align with system's goals and priorities related to student success, equity, and access.
- Funding should be linked with these factors in order to incentivize improved outcomes.
- Be fair, transparent, and easy to understand.
- Provide sufficient predictability and stability to support college/district operational costs and sound financial planning.
- Balance a focus on outcomes with the need for reasonable funding stability.



# Funding Formula Principles

- Recognize the diversity of regional and local needs.
- Support historically under-represented students with more funding to close gaps and increase completion outcomes.
- Marry an increase in accountability for outcomes with increased flexibility, such as relief from regulatory requirements and categorical funding restrictions.
- Be phased-in over multiple years in order to allow for a smooth transition to the new model



## CEO Workgroup through CCLC – Guiding Principles

- Recognize the necessity of building institutional capacity to improve student outcomes by increasing community college base funding prior to implementation of a new funding formula;
- Integrate the enrollment and academic progress of economically disadvantaged populations with a formula that balances access, equity, and success for all students;



## CEO Workgroup through CCLC – Guiding Principles

- Provide two years of program transition funding at a new, higher base level while the formula's metrics are analyzed and refined to ensure their efficacy in advancing student equity, inclusion, and success;
- Adequately define equity metrics to most accurately represent all economically disadvantaged students (e.g. low income, CalWORKs, students with disabilities, foster youth, AB 540) and to identify their respective needs for Guided Pathways;



## CEO Workgroup through CCLC – Guiding Principles

- Enhance funding predictability with a three year average for base funding and by assigning Summer FTE to the fiscal year in which instruction was held;
- Progressively phase out transition funding to fully implement access, equity, and success metrics by 2025;
- Recognize the diversity of regional and local factors;
- Establish a funding formula oversight council to conduct annual analyses and to make recommendations for adjustments that advance equity-minded student success through improved fiscal stewardship.



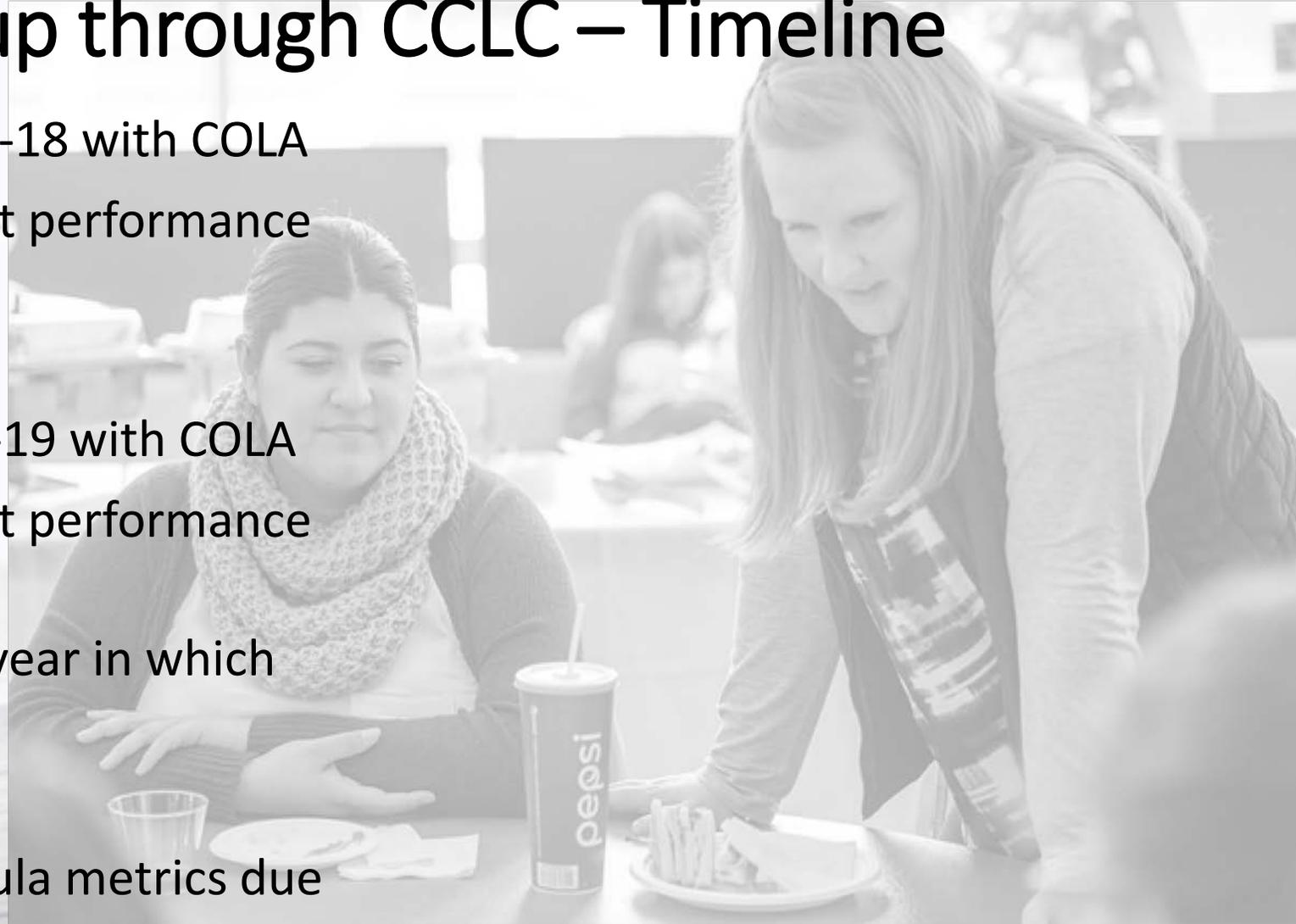
# CEO Workgroup through CCLC – Timeline

Year 1: 2018-19 Hold Harmless to 17-18 with COLA

- One-time funds to recognize district performance under Equitable Success metrics

Year 2: 2019-20 Hold Harmless to 18-19 with COLA

- One-time funds to recognize district performance under Equitable Success metrics
- Summer FTE assigned to the fiscal year in which the final day of instruction was held.
- Report on analysis of funding formula metrics due to the Board of Governors.



# CEO Workgroup through CCLC – Timeline

Year 3-7: Gradually Phase in Equitable Success until 25% of funding is through this mechanism and 75% remains Access funded.

Equitable Access Metrics based on Progress, Completion, Transfer, Employment and Earnings with a bonus points for economically disadvantaged student attainment

Need to adjust metric weighting to eliminate losses to districts.

<https://www.ccleague.org/funding-formula-workgroup>

# The Problem with Outcomes Based Funding

- Multiple Research Studies fail to conclude that funding outcomes changes success rates. One example is from the Century Foundation at: <https://tcf.org/content/report/why-performance-based-college-funding-doesnt-work/>
- Lessons from K12 outcomes funding correlated most strongly with funding and zip code



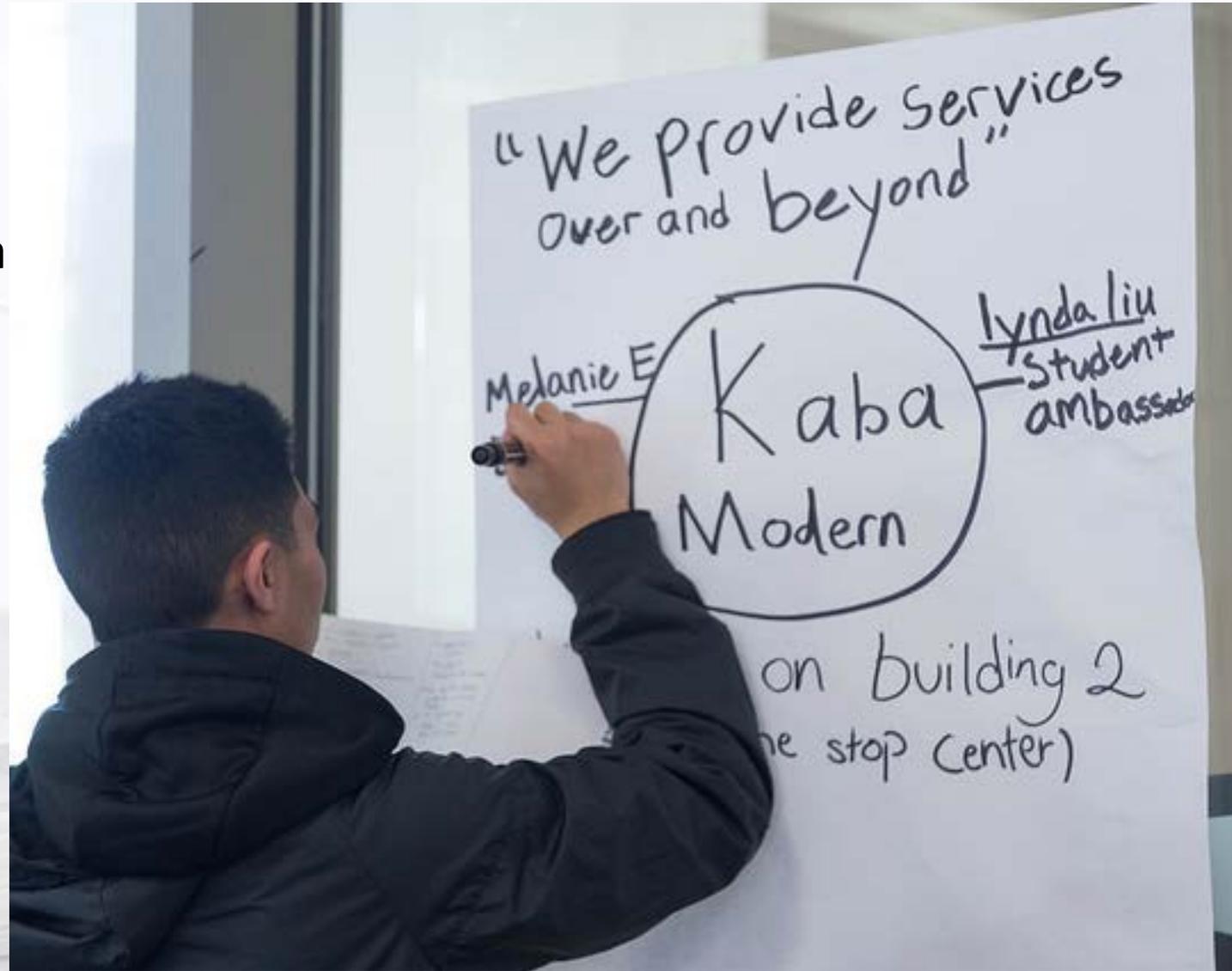
# Next Steps

- Consultation Council was not supportive
- The Assembly and Senate are not supportive of this effort.
- According to the DoF, the Governor is firmly behind the Chancellor's Office proposals.
- AB2767 (Medina) Calls for a study of funding models
- CBO and CEO Workgroups continues to meet.
- Chancellor's Office will provide next scenario Friday.

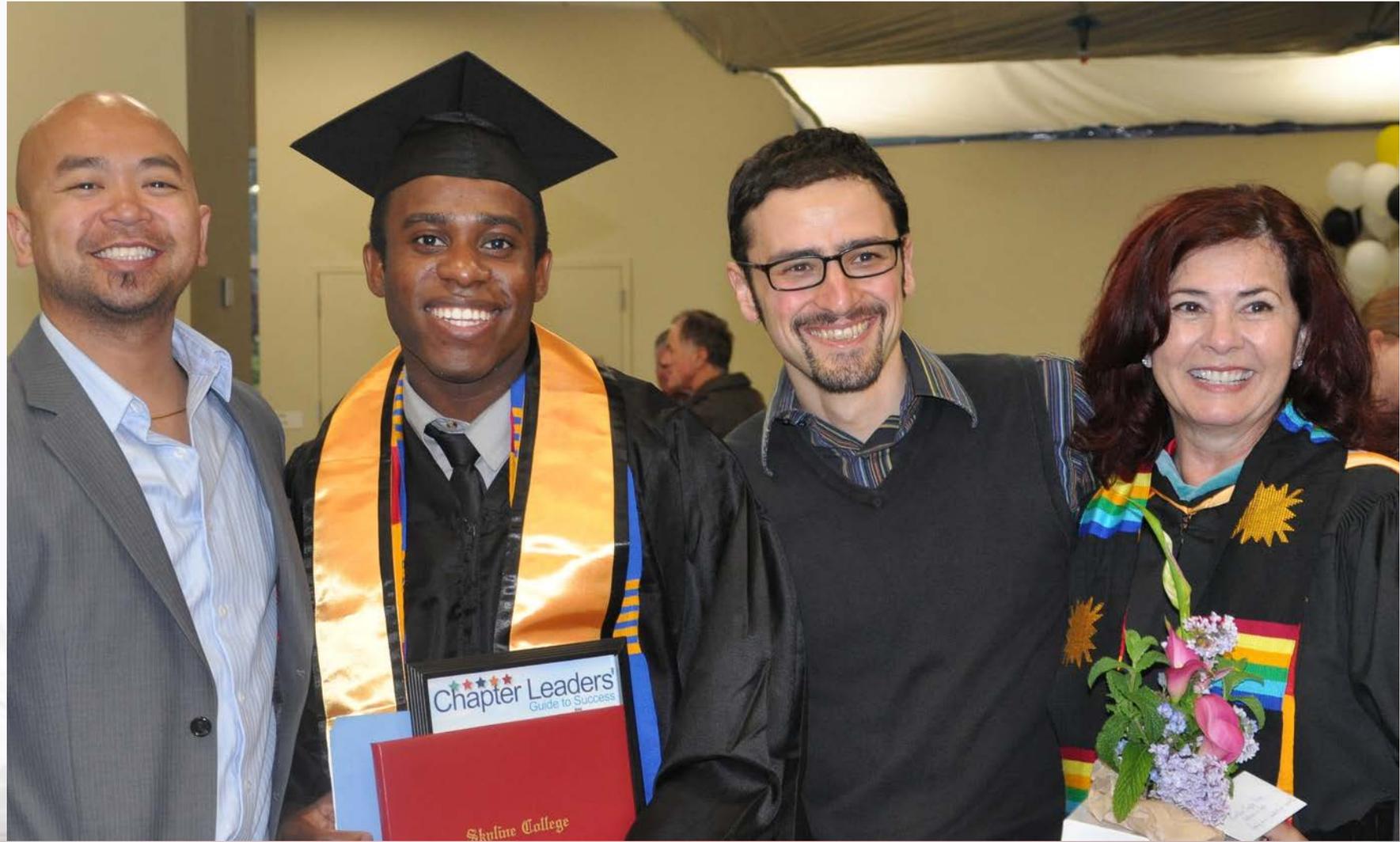
# Next Steps

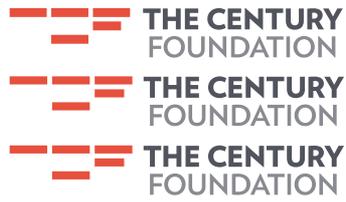
However, the Chancellor's Office continues to push for a change to the funding formula. One current proposal is:

- Pull out special admits (concurrent enrollment, inmate ed, noncredit non-CDCP) and fund as usual
- 50% access with 3-year averaging of FTES
- 30% on need (Pell, 1<sup>st</sup> Generation...)
- 20% on performance (ADTs, transfer, transfer level math and English, regional living wage and wage increase)



# Thank You





REPORT HIGHER EDUCATION

# Why Performance-Based College Funding Doesn't Work

College Completion Series: Part Four

MAY 25, 2016



NICHOLAS HILLMAN  
CONTRIBUTOR

For the better part of the past century, elected officials have sought ways to improve the performance of public sector operations, such as fire departments, libraries, health clinics, job training programs, elementary schools, and traffic safety.<sup>1</sup> Interest in performance management has only grown over time, to the point today that it is nearly impossible to talk about government finance without also talking about performance. The idea of attempting to measure outcomes and paying for those results is compelling because of its simple logic. Proponents believe setting clear performance goals and tying funding to them will create incentives for public organizations to operate more efficiently and effectively, ultimately resulting in better delivery of public services. Fire departments, they reason, should not be funded according to the number of engines they own, but according to the number of fires they put out. Hospitals should be funded not by the number of patients admitted, but by the health outcomes of their patients. Schools should not be funded by the number of teachers they employ, but by each teacher's contribution to student learning.

In recent years, advocates seeking to increase the number of college graduates in the United States have promoted the idea that states should finance their public universities using a performance-based model. Supporters of the concept believe that the \$75 billion states invest in public higher education each year<sup>2</sup> will not be spent efficiently or effectively if it is based on enrollment or other input measures, because colleges have little financial incentive to organize their operations around supporting students to graduation.<sup>3</sup> When states shift to performance-based funding, it is hoped, colleges will adopt innovative practices that improve student persistence in college.<sup>4</sup> The appeal of performance-based funding is “intuitive,” its proponents argue, “based on the logical belief that tying some funding dollars to results will provide an incentive to pursue those results.”<sup>5</sup>

However, while pay-for-performance is a compelling concept in theory, it has consistently failed to bear fruit in actual implementation, whether in the higher education context or in other public services.

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However, while pay-for-performance is a compelling concept in theory, it has consistently failed to bear fruit in actual implementation, whether in the higher education context or in other public services. Despite the logic, research shows that tying financial incentives to performance measures rarely results in large or positive outcomes that are sustained over time.<sup>6</sup>

Why doesn't it work as hoped? One of the earliest investigations of the topic was a 1938 book, *Measuring Municipal Activities*, by Clarence Ridley and Herbert A. Simon, in which they evaluated performance systems in police and fire departments, libraries, parks, public utilities, and public health organizations.<sup>7</sup> Starting with what they expected to be the easiest activity to measure—fire departments—the authors quickly ran into difficult questions about how best to measure performance. They found the seemingly simple task of putting out a fire was actually quite complicated. For example, the bulk of a fire department's time and resources are not spent putting out fires; rather, it is in planning, practicing, and maintaining equipment in order to be ready for responding to a call. Once a fire occurs, some will be easier to put out than others depending on the size of the fire, type of building structure (residential, industrial, and so on), time of day, weather conditions, and even quality of a department's equipment. Consequently, answers to basic questions about what counts, how it is counted, and who is responsible for producing an outcome become difficult to answer even in seemingly straightforward contexts. It may be easy to measure whether a fire has been extinguished, but the process through which that outcome was performed varies in complex ways.

Their fundamental conclusion was similar to what we continue to find today: *using outcomes as a management tool is difficult because public services are delivered through*

*complex organizations where tasks are not routine and are inherently difficult to define and measure.* Notably, Simon later went on to win the Nobel Prize in Economics for developing the theory of bounded rationality, arguing that data generated by performance incentives do “not even remotely describe the process that human beings use for making decisions in complex situations.”<sup>8</sup> Performance-based funding regimes are most likely to work in non-complex situations where performance is easily measured, tasks are simple and routine, goals are unambiguous, employees have direct control over the production process, and there are not multiple people involved in producing the outcome.<sup>9</sup> In higher education, it may be easy to count the number of graduates, but the process of creating a college graduate is anything but simple.

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...Performance-based funding is likely to be effective in only limited circumstances, and that states should instead emphasize *capacity building* and *equity-based funding* as alternative policy tools for improving educational outcomes.

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This paper applies lessons from performance management literature to the field of higher education, exploring the assumptions behind performance-based approaches to financing. It summarizes research on performance-based funding in higher education, which has generally shown weak evidence of positive impact. The paper concludes that performance-based funding is likely to be effective in only limited circumstances, and that states should instead emphasize *capacity building* and *equity-based funding* as alternative policy tools for improving educational outcomes.

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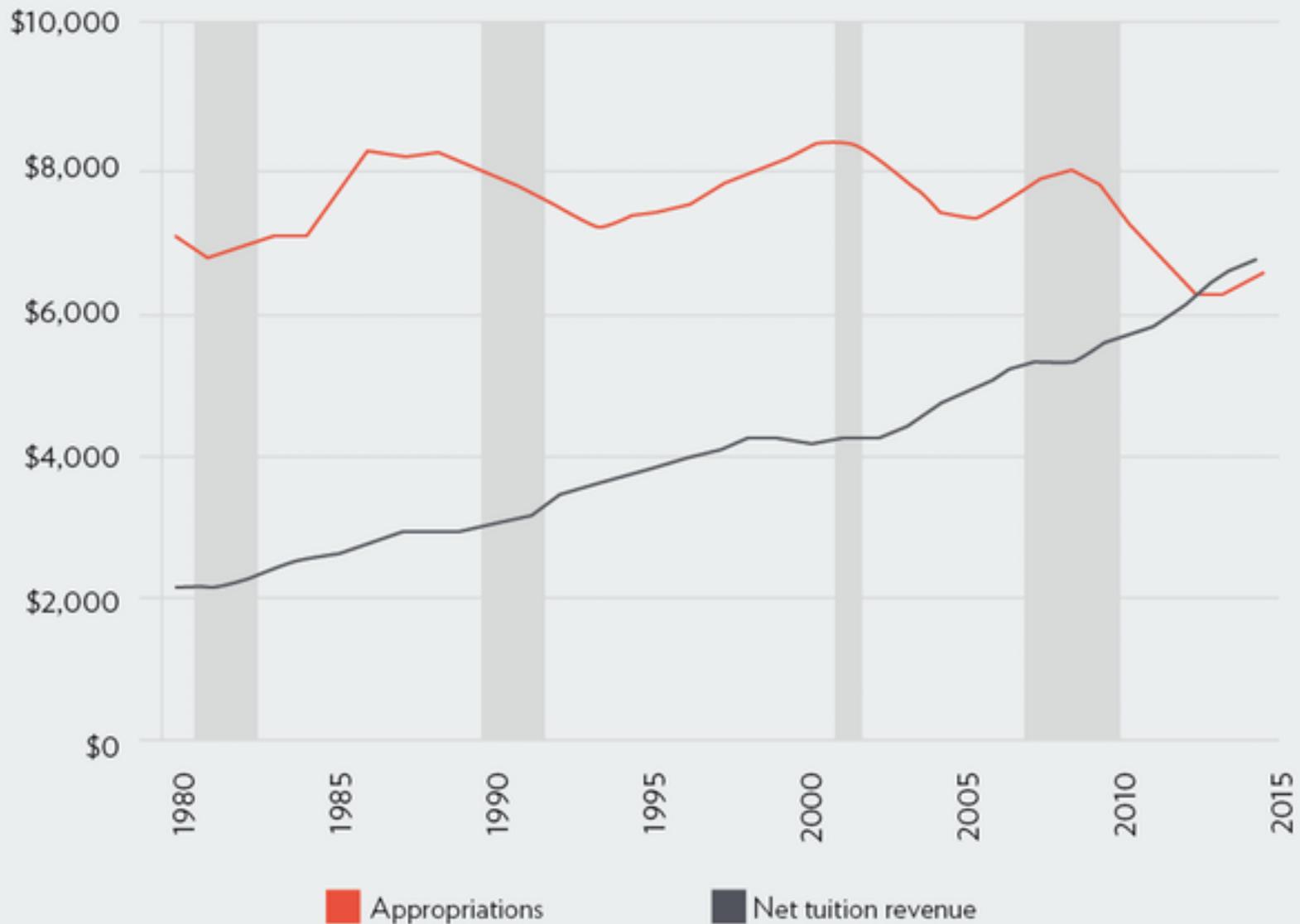


## What Is Performance-Based Funding in Higher Education?

When states allocate funds to individual colleges or to systems, the largest budget items include faculty and staff salaries and benefits, and campus operations and maintenance. These budgets are often set based upon historical trends and fixed costs, resulting in an incremental approach to budgeting in which the prior year's budget serves as the primary determinant of the current-year budget.<sup>10</sup> While incremental budgeting offers a degree of predictability, it may not be responsive enough to the changing needs of various campuses. This is why many states also embed formula funding into their budget models, where appropriations are based on a number of metrics such as enrollment growth, credit hours taken, and classroom square footage. Incremental and formula funding are the most common ways states allocate funds to higher education, but the reemergence of performance-based funding is changing that landscape.<sup>11</sup>

For the past three decades, state spending on higher education has been a shrinking pie. Today, state appropriations per student are lower than they were in the 1980s since state support has failed to keep pace with enrollment demand. As states divest, they have pushed costs onto individual students and families in the form of higher tuition. As shown in Figure 1, public colleges now get more money from students' tuition dollars than from state appropriations. As a result of these funding trends, there is greater pressure for colleges to show they are making the most of their scarce public support.

FIGURE 1. PER-STUDENT TRENDS IN STATE APPROPRIATIONS AND NET TUITION REVENUE, 1980–PRESENT



Source: State Higher Education Executive Officers, "State Higher Education Finance," 2015, <http://www.sheeo.org/projects/shef-%E2%80%94-state-higher-education-finance>.

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The trend toward greater tuition reliance and reduced state support does not bode well for improving college completion for two reasons. First, research consistently shows that a \$1,000 increase in tuition is associated with approximately 5 percent lower enrollment.<sup>12</sup> As state support declines and tuition rises without being offset by additional financial aid, we can expect fewer students to persist through college. Second, colleges that have fewer

resources also have lower graduation rates and students take longer to finish their degrees. State appropriations help colleges serve students by offering better academic support services, lower faculty-to-student ratios, and reducing tuition—all of which are shown to be effective ways to increase degree attainment.<sup>13</sup> If a college does not have adequate financial resources to support student success, then it becomes even more difficult to meet performance goals. Many of our nation's lower-income, working class, and racial/ethnic minority students are enrolled in colleges that have the fewest financial resources, suggesting performance-based funding models could exacerbate inequalities if they do not account for this context.

Performance-based funding has emerged in the context of tight state budgets as a way to encourage efficiency and to make colleges responsible for their own destiny: those that fail to perform will lose more of their funding. Performance-based funding has developed in two distinct waves. The first occurred in the 1990s when eighteen states adopted early versions of performance-based funding. Some of these states (South Carolina) did away with incremental budgeting and used performance formulas to allocate 100 percent of their appropriations. Most others allocated performance funds as a bonus program, where colleges would compete for additional funds that were separate from their base budget. These early programs were popular with legislators, but were discontinued when political parties turned over and economic conditions weakened in the early 2000s. Consequently, several states discontinued their policies throughout the early 2000s, with only a handful keeping the policy in place.

The second wave of performance-based funding began around 2010 when several states adopted (or readopted) new versions of the old policy, as shown in Figure 2.

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Today, thirty-two states (see Figure 3) operate with performance-based funding policies for their public institutions of higher education. The resurgence of this policy is remarkable considering the history of performance-based funding, in which two-thirds of all states that experimented with the policy discontinued it at some point in time.<sup>14</sup> The resurgence in



The more recent round of performance-based reforms have been rebranded by advocates as “outcome-based,” and are supposed to be guided by seven principles, according to a firm providing assistance to many of the states employing performance-based funding:<sup>15</sup>

- Align incentives with state priorities
- Focus on completion
- Prioritize traditionally underserved students
- Hold all sectors accountable to the policy
- Differentiate metrics by mission and sector
- Tie significant amounts of funding to performance
- Build funding into base budget, then phase-in

By following these principles, the advocates argue, state performance-based funding efforts will create the conditions where colleges now produce significantly more college graduates. By focusing attention on completions, the logic goes that colleges will adopt strategies for improving student outcomes while also “aligning institutional spending priorities with those of the state.”<sup>16</sup>

Recognizing the importance of a flexible approach that acknowledges the ways that needs vary across campuses, the strategies that emerge from performance-based funding will vary from campus to campus, depending on each college’s financial capacity and resources available to develop new programs or improve existing ones. For example, some campuses might use technology and predictive analytics to identify and reach out to students who are struggling academically. Other campuses might provide new ways to deliver development education or allocate financial aid in order to retain and graduate more students. The

theory is that by being clear about the goal, the experts at the campus level can figure out how to get there, incentivized by the funding tied to the goal.

## It Isn't Working—Why Not?

Despite the compelling logic behind paying for performance in higher education, research comparing states that have and have not adopted the practice has yet to establish a connection between the policy and improved educational outcomes. To date, there are twelve quantitative evaluations of state performance-based funding (see Table 1). There is remarkable consistency in the findings, all of which were conducted using different research techniques, spanning different periods of time, and examining various policy outcomes. Researchers typically examine how the policy affected graduation rates or the total number of degrees and certificates produced each year. These are the ultimate outcomes of performance-based funding, yet researchers have also examined intermediate outcomes like retention rates, selectivity, and resource allocation.

TABLE 1. SUMMARY OF QUANTITATIVE RESEARCH ON EFFECTS OF PERFORMANCE-BASED

	Authors*	Outcome	Years studied
1	Shin & Mitlon (2004)	Graduation rates	1997-01
2	Volkwein & Tandberg (2008)	Accountability score	2000-06
3	Shin (2010)	Graduation rates & research funds	1997-07
4	Sanford & Hunter (2011)	Graduation & retention rates	1995-09
5	Rabovsky (2012)	Revenues & expenditures	1998-09
6	Radford & Rabovsky (2014)	Graduation rates & degrees	1993-10
7	Hillman, Tandberg, & Gross (2014)	Bachelor's degrees	1990-10
8	Tandberg & Hillman (2014)	Bachelor's degrees	1990-10

9	Tandberg, Hillman & Barakat (2015)	Associate's degrees	1990-10
10	Hillman, Tandberg, & Fryar (2015)	Associate's degrees & certificates	2002-12
11	Umbricht, Fernandez & Ortagus (2015)	Degrees, diversity, & admissions	2003-12
12	Kelchen & Stedrak (2016)	Revenues, expenditures, & financial aid	2003-12

Source: Compiled by author from the studies listed in note <sup>17</sup>

Across this body of research, the weight of evidence suggests states using performance-based funding do not out-perform other states—results are more often than not statistically significant. The most instructive findings come from case studies of Indiana, Pennsylvania, Tennessee, and Washington, all of which based their policies on the seven principles identified by advocates. In Indiana, universities have become more selective and less diverse while also not improving degree production. In Pennsylvania, universities did not produce more degrees even after operating under performance-based funding for nearly a decade. After Tennessee increased the financial incentives and redesigned its policy, universities did not improve their graduation or retention rates. And in Washington, the state's community colleges responded not by producing more associate's degrees but by increasing short-term certificates. Despite each state having goals related to improving college completions, their performance-based funding policies have not yet achieved the desired results.

Studies that use national samples rather than state-specific cases arrive at similar conclusions. In most of these national studies, states employing performance-based funding either decreased their degree productivity or they simply do not out-perform other states. In some cases, colleges responded to performance-based funding by enrolling fewer low-income students while spending more on non-needy students. Despite the weight of evidence pointing largely to null or negative effects, one study found positive effects on degree completions after several years of implementation. After about seven years, states

using performance-based funding produced about 0.05 standard deviation more bachelor's degrees than other states. While positive, this effect size is quite small and delayed when compared to other interventions that have larger and more immediate impacts on degree completion.

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In 2015, states actually saw *fewer* students graduate from college than in previous years despite the fact that most states provide incentives for colleges to improve performance. How could this be?

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In 2015, states actually saw *fewer* students graduate from college than in previous years despite the fact that most states provide incentives for colleges to improve performance. How could this be? How could educational attainment actually drop when the majority of states have created incentives to do just the opposite? Interestingly, the findings presented above are consistent with other performance management literature, in which performance regimes have been characterized as a “triumph of hope over experience” and results often do not follow from performance incentives.<sup>18</sup> This is likely due to flawed assumptions embedded in the pay-for-performance logic.

To begin, proponents believe that traditional input-oriented funding models provide little to no incentive to increase completion. They claim colleges will underperform in the absence of incentives and that “public finance literature undergirds the idea that incentives and alignment to objectives matter.”<sup>19</sup> Still others argue that “colleges and universities have had few financial incentives to prioritize student success.”<sup>20</sup> From this perspective, states that *never* adopted performance-based funding should produce graduates at far lower rates than that of states using performance-based funding. But the evidence presented earlier shows that states without performance-based funding produced degrees on par with (and sometimes better than) those using performance-based funding. Even in the absence of explicit performance goals and financial incentives, colleges increased degree completions when provided with additional resources.

In other words, public sector organizations can indeed produce positive outcomes even when financial incentives are not present. In fact, there are many cases in which performance declined when high-stakes performance incentives were introduced into complex organizations. When hospitals moved toward performance pay models, they did not improve health outcomes for patients. Despite the financial incentive, surgeons became more likely to avoid sicker patients, have higher rates of misdiagnosis, and even cancel operations or extend wait times.<sup>21</sup> In elementary education, where the goal was to increase test scores, teachers became more likely to teach to the test in response to high-stakes performance accountability.<sup>22</sup> In workforce development, local job placement centers had the goal of improving employment stability but did not significantly improve the labor market outcomes for displaced workers even when the incentive system encouraged long-term outcomes.<sup>23</sup>

## The Assumptions Don't Match the Reality

For the logic of performance-based funding to result in actual improved outcomes, there are at least three assumptions that must hold true: the incentives must encourage low-performing institutions to improve, there must be a clear pathway for achieving better results, and the changes must be sustainable. As explained below, in higher education, none of these assumptions hold true.

*Assumption 1: Incentives encourage low-performing institutions to improve.*

One of the most common themes found in the qualitative evaluations of higher education performance-based funding is that low-resourced colleges struggle to meet performance goals. Consequently, they may lose funding and actually have less capacity to make educational improvements. This funding loss can result in a performance paradox in which states demand performance, yet do not provide colleges with the resources to perform. As a result, high-performers may be the most likely to benefit and low-performers may struggle to keep pace. To the extent this occurs, it would only exacerbate existing inequalities in the postsecondary finance system.

These inequalities have emerged in other fields. For example, high-achieving and wealthier K-12 schools have been found to excel in state performance accountability systems.<sup>24</sup> Similarly, schools that already had high accountability ratings were more likely to receive funds and thus achieve even greater improvement.<sup>25</sup> Examples are not limited to education: hospitals and health care providers that were already performing well were in strong financial shape consistently outperformed others.<sup>26</sup> In higher education, it is likely that the colleges already performing well will have the resources necessary to respond and adapt to the performance regime. Those with the least resources may struggle to respond if they do not have the staffing, experience, or financial capability to adopt or implement new retention and completion initiatives. In order to give colleges an equal chance at competing for performance funds, it is necessary to ensure colleges are competing on equal footing where those with the fewest resources are not unfairly penalized for not having the capacity to respond. Even if a funding formula differentiates according to mission or enrollment profile, it is important to assess whether the institution has the necessary resources (financial, personnel, technological, and so on) to implement effective practices to improve performance.

*Assumption 2: There is a clear pathway for achieving results.*

Incentive regimes work best when tasks are routine, non-complex, and when there is only one principal and one agent involved in delivering a service. In this environment, a manager is able to design and enforce a performance contract with an employee: if the employee does not perform, they do not get paid. This performance model has been found to work well in some industries, such as the classic example of windshield installation, where agents have direct and unambiguous control over the production process.<sup>27</sup>

However, in public sector organizations the tasks are rarely routine or non-complex, and there is rarely just one principal and one agent involved in delivering a service. Students interact with any number of administrators, faculty members, and peers on a daily basis, meaning that the production of a college graduate is a collaborative task in which no single person is responsible for achieving a goal on their own. Unlike installing a windshield, the

process is neither automated nor under the direct and unambiguous control of a single person. In fact, windshield installers may find the external incentives to motivate their behaviors, while college administrators and faculty members may be more intrinsically motivated to perform. Two decades of research on public sector motivation show that high-stakes external pressure can actually “crowd out” intrinsic motivation, reducing the likelihood of performance.<sup>28</sup> In this context, weak financial incentives are preferable to high-stakes incentives.

To complicate the task even further, the pathway from policy goal to policy outcome is not linear. Even straightforward goals are actually quite ambiguous to achieve. For example, getting a student to graduate from college seems straightforward—they simply need to accumulate enough credits over time and be in good academic standing to receive a degree. But in reality, there are a number of pitfalls along the way that can deter a student from completion, just as there are a number of people on campus (faculty member, staff, administrator, and so on) involved in the student’s ultimate success. For a performance-based funding system to work, it would need to isolate each individual’s unique contribution to the ultimate outcome. How to achieve this without crowding out public service motivation and in a way that can disentangle the value-added of one individual over any other is unclear and not without drawbacks.

*Assumption 3: Effects will be sustained over time.*

Proponents often refer to performance-based funding as a “game changer” that will usher a new era of success for public higher education.<sup>29</sup> However, experience from other sectors shows that when results occur, they are often only short-term and not sustained over time. The most common example comes from evaluations of the federal Job Corps, which initially showed positive impacts but the impacts declined over time.<sup>30</sup> These job training and placement centers produced short-term employment results that did not last beyond eighteen months.<sup>31</sup> Similarly, hospitals that operated performance-based funding policies saw short-term impacts that, within about five years, began to decline.<sup>32</sup>

One of the leading reasons results do not last over time is because the data generated from performance regimes may not be useful in professional practice. While there is some evidence that colleges are using performance data, it occurs in uneven ways depending on campus cultures and capacities.<sup>33</sup> This means performance regimes likely will not change internal operations in ways that induce long-term change. To change these internal operations, states should pursue training of campus officials so they are better able to use data to guide decision-making. But before trying to change internal operations, it is important for states and colleges to have a good sense of what precisely is the problem in need of change and exactly what data is needed to help solve that problem.

## A Way Forward

Taken together, each assumption has some degree of face validity that intuitively appeals to how policymakers think colleges and universities will respond to performance incentives. But in light of the research findings both inside and outside of higher education, there is good reason to be skeptical of each assumption since they may not hold true when it comes to increasing educational outcomes. To date, there is little empirical or theoretical support behind performance-based funding in higher education, yet states continue to adopt and expand their efforts even when the weight of evidence suggests performance-based funding is not well suited for improving educational outcomes. Fortunately, there a more promising direction states could adopt to achieve better results.

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Colleges that have more financial capacity are in the best position to serve students well; in fact, funding per student is one of the strongest predictors of college graduation.<sup>34</sup> As states divest from public higher education, they shift the financial responsibility onto students in

the form of higher tuition. Rather than stemming this tide, performance-based funding may actually reinforce this race to the bottom in that colleges that have the greatest capacity are those that will be most likely to perform well. If this occurs to a high extent, then financial incentives are a blunt policy instrument not well designed for improving college completions. Instead, states should focus on building the resource capacity of the lowest-performing colleges and then allocate funds according to performance-oriented needs.

A corollary to state financial aid policy may be an instructive way to think about performance-based funding and its consequences. Paying colleges according to how well they perform on various metrics is not dissimilar from the way states allocate “merit-based” financial aid based on students’ academic performance. While merit-based aid is politically popular, it is an inefficient way to allocate resources since it primarily benefits students who would already do well in college regardless of the aid. In a similar vein, performance-based funding is likely to benefit colleges that already have the greatest likelihood to perform well. Instead of allocating scarce financial resources in this way, it would be more efficient and effective to target subsidies to colleges and universities that have the greatest financial need.<sup>35</sup>

A “need-based” funding model for colleges and universities would target resources to institutions serving the most underrepresented student populations. After all, the problem with college completion is not that elite or highly selective colleges are under-performing, but rather that campus resources are insufficient in many of the public institutions that low-income, working class, and racial/ethnic minority students attend. Building these schools’ capacity to better serve such students would be a far more effective and promising way to increase college completion. Some states using performance-based funding have incorporated diversity into their funding models, but this is bound to be insufficient if diversity and equity is not at the forefront of finance reform. By *prioritizing* equity, rather than embedding it within a funding formula, states will be in a better position to improve educational outcomes.

Shifting away from this “merit-based” performance regime toward a “need-based” equity-

funding system could address many of the shortcomings noted in this paper. By focusing on closing inequalities, building the service capacity of colleges with the fewest resources, and supporting the professional development of professionals involved with educating students, states will be more likely to improve the performance of their public colleges and universities. Experience and evidence shows that this approach would be a more promising strategy for improving college completions. After all, allocating scarce funds to colleges that are already performing well will only reproduce inequalities. Targeting scarce resources to those that have the greatest needs and the least current capacity will likely yield better results. This would usher in a new era of state funding that prioritizes results by prioritizing equity: a radical proposition in a higher education landscape that has for too long rewarded inequality.

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This report is the fourth in a series on College Completion from The Century Foundation, sponsored by Pearson. The views and opinions expressed in this paper are those of the authors and do not necessarily reflect the views or position of Pearson.

## Notes

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## FUNDING FORMULA WORKGROUPS

### DRAFT - RECOMMENDATIONS

### MARCH 14, 2018

**An effective California community college apportionment funding model will meet the following principles:**

- Ensure access to quality public postsecondary education statewide
- Recognize and support enhanced access and success for underrepresented and economically disadvantaged students
- Reward progress on relevant student success and equity metrics
- Support student efforts to reach academic and professional goals in a timely manner
- Support and reward transfer to any accredited public and independent university
- Strengthen Career Education for working Californians
- Moderate the effects of the formula on districts during a recession
- Provide sufficient predictability and stability to support college/district operational costs and sound financial planning
- Balance a focus on outcomes with the need for reasonable funding stability.
- Recognize the diversity of regional and local needs
- Is phased-in for a smooth transition to the new model

### Context

On January 10, 2018, Governor Brown released a 2018-19 state budget proposal that included its *Student-Focused Funding Formula*. The framework for the new apportionment model includes District **Base Grants** contingent on FTES enrollment comprising **50 percent** of the formula; **Supplemental Grants** based on the number of low-income students districts enroll reflecting two factors: 1) enrollment of students who receive a College Promise Grant fee waiver; 2) enrollment of students receiving a Pell Grant. The Supplemental Grants comprise **25 percent** of the total. **Student Success Incentive Grants** include: 1) the number of degrees and certificates granted; 2) the number of students who complete a degree or certificate in three years or less; 3) funds for each Associate Degree for Transfer granted by the college. Student Success Incentive Grants comprise **25 percent** of the total. Finally, during the first year of implementation districts would be held harmless to 2017-18 levels.

The Governor maintains that the current enrollment-driven formula fails to capture the comprehensive mission of California's community colleges (CCCs), and the countercyclical nature of district enrollment. Moreover, as of late February 2018, 32 districts are in stability, and there has been approximately \$80 million of unused growth funding during the last two years. Furthermore, the Board of Governors seeks a funding formula that aligns with the aspirational goals in the *Vision for Success*.

In late January, Chancellor Oakley requested the Chief Executive Officers of California Community Colleges (CEOCCC) Board convene a small group of CEOs to make recommendations for a new formula by mid-March. Chancellor Oakley also requested the standing Workgroup on Fiscal Affairs, who has been analyzing this issue since September 2017, to review and provide input to the recommendations provided below in order to share additional considerations for a new funding formula.

## **Recommendations**

Through adoption of a new funding formula, policymakers have an opportunity to encourage not only a greater focus on success, but also to prioritize equity and inclusion. Properly structured and adequately funded, a new funding model has the potential to move to a more accountable and stable system, ensuring that students have access to affordable, high-quality community colleges.

One essential element of effective implementation and sustainability of a funding formula concerns ongoing research and analysis. Consistent, data-informed analysis offers policymakers and practitioners a means to better understand the consequences of the metrics and the overall efficacy of the formula. It also permits the necessary adjustments and updates to the funding mechanism that legislative and higher education oversight entities throughout the US currently employ. Such analysis and review is especially important in a state with such a wide-ranging diversity of districts, regions, communities, and student populations, and one in which billions of dollars in state resources are in play. To that end, it is recommended that Chancellor Oakley establish a process for an annual review and analysis of the funding formula and, beginning in fiscal year 2019-20, a subsequent report on findings to the Board of Governors by March of each year. This key recommendation set a plan in place for an equity-focused funding model while enabling necessary adjustments to meet the principles outlined above for an effective funding model.

### ***Framework***

Central to the recommendations herein is the recognition that persistent attainment gaps cannot be measured in a vacuum. In order to achieve an integrated and comprehensive focus on the enrollment and success of economically disadvantaged and underrepresented students, this proposal advocates for a funding formula with two primary categories: Equitable Success and Access.

### **Equitable Success**

Outcome metrics that fail to prioritize equity forestall an opportunity to better serve underrepresented and economically disadvantaged students. Incentives to achieve equitable

outcomes for focus populations means integrating socioeconomic and success metrics. By advancing a framework integrating both the enrollment and the success of underrepresented groups, a new formula can ensure equity and inclusion are at the forefront of district planning. Socioeconomic and success measures should not be treated separately but rather collectively with equity and success integrated and interdependent. A comprehensive set of indicators recognizes the value a community college education can add to an individual's life through transferability to a four-year university, skill attainment, employment, and earnings. The Equitable Success portion of the formula considers progress, completion, transfer, employment, and earnings; and it recognizes the successful outcomes of underrepresented and economically disadvantaged students within those metrics. Moreover, economically disadvantaged students are more accurately defined by using the Carl D. Perkins Career and Technical Education Act definition<sup>1</sup> which considers factors found in various funding initiatives such as the College Promise Grant, Pell Grant, CalWORKS, and WIOA criteria.

### **Access**

A key principle of the Workgroups has been the protection of educational access for individuals across all regions of California. The current funding formula for California community colleges is based on the annual number of full-time equivalent students (FTES). However, this approach fails to provide stable year-to-year funding, especially for small or rural community colleges that experience frequent enrollment swings.

The Workgroup recommends a funding formula that supports access but shifts away from an overreliance on growth. Under the proposed Access portion of the formula, districts would continue to receive a Basic Allocation, base FTES revenue, and FTES growth funding adjusted by the annual COLA. In addition, FTES restoration would be provided in the same manner as in the SB 361 funding formula.

Beginning in the first year of implementation (2020-21), and in order to accommodate varying degrees of growth and decline, FTES apportionment would be allocated based on the higher of: (1) the current year FTES, or (2) a three-year average based on the total funded FTES of the most recent three years. Use of a higher current year FTES allows districts to immediately address student demand and have the resources to meet those demands. The use of a three-year average rather than a single-year calculation to determine FTES caps and stabilization status insulates districts against wide enrollment swings and economic downturns. More importantly, a three-year average offers stability for purposes of planning, implementing new programs, and the continuation of sustainable and highly effective programs. Such a calculation would eliminate

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<sup>1</sup> Carl D. Perkins IV defines economically disadvantage and special populations as: individuals with disabilities; individuals from economically disadvantaged families, including foster children; individuals preparing for nontraditional training and employment; single parents, including single pregnant women, displaced homemakers; individuals with other barriers to educational achievement, including individuals with limited English proficiency.

the need for a stability factor. In the first year of implementation (2020-21), the Workgroups recommend FTES from summer courses be assigned to the fiscal year in which the final day of instruction for the course had been held. In addition, the basic allocation for the number of colleges and centers at each district should be increased to adequately support the requisite operating costs associated with serving students.

### **Categorical Structure**

Categorical programs have also been an important consideration of the Workgroups. Within California community colleges, there are 27 categorical programs with 10 designed to serve low-income students. Acknowledging elements of the Legislative Analyst Office's analysis, the Workgroups recommend a simplified and restricted program that supports accountability and local control. Specifically, the Workgroups recommend the integration of Student Success and Support Services, Basic Skills, and Student Equity into a restricted categorical known as the Student Equity and Success program. Key to this integration is the continued commitment to serving disadvantaged populations with equity-minded, student-centered services and supports. The restricted categorical structure enables the alignment of reporting metrics and maximizes services to students.

### **Using Metrics that Matter for Equitable Success**

The Workgroups addressed the metrics portion of the funding formula with the goals of keeping it simple, meaningful, equity-focused, and tied to student progress on an educational pathway. After considering an extensive list of possible data, five metrics are proposed: progress, completion, transfer, employment, and earnings. The formula would mirror, in many aspects, the 17% incentive funding employed by the Strong Workforce Program (SWP), with improvements based on experiences from the implementation of SWP, and some of the key performance indicators (KPIs) within the Guided Pathways framework. The formula uses data that are already collected and includes both credit and noncredit students. Points are assigned based on a student's progression towards Equitable Success metrics. Districts track the same metrics for all students and are recognized for the successful outcomes of economically disadvantaged students within those metrics.

Specifically, the Equitable Success portion of funding incorporates the following:

- **Measuring Transfers** – Since the CSUs and UCs lack capacity for all CC transfer-ready students, the revised definition includes unduplicated transfer-prepared and students that transfer to any accredited four-year public and/or private institution. The Workgroup recognizes the concern over the lag time in collecting data from the National Student Clearinghouse (approximately 18 months), and the lack of control CCs have in ensuring transfer. The definitions of *transfer ready* and *transfer prepared* were discussed along

with the effectiveness of these measures. In the recommended approach, points are assigned to all transfers to any accredited four-year university with additional points for students who transfer within three years, (since not all students are able to attend a CCC full time).

- Employment and Economic Mobility – Evidence demonstrates a positive correlation between education attainment and wage increases, and that students can earn wage increases even during poor economic times. In data modeling for the 17% Committee, small and rural colleges fared better when employment and earnings outcomes were included (as opposed to just enrollment and completion figures). Employment includes every student and certificate or degree type. Combining employment with wage gains captures all types of jobs and skill building. Still, as with transfers to private institutions, there is a time lag in collecting the data.
- Capturing Momentum Points – With the implementation of Guided Pathways, it is important to reward colleges for improving student progress and persistence. The metrics for progress recognize critical student advancement prior to achieving completion outcomes.

## **Implementation**

To ensure effective implementation of this proposal, the Funding Formula Workgroups are recommending a tiered implementation process beginning in fiscal year 2018-19. A thoughtful transition process is consistent with the implementation of major education finance reforms over the last twenty years, including SB 361 and the K-12 Local Control Funding Formula. Specifically, the implementation timeline would include two years of program transition and a sequential five-year phase-in of the Equitable Success metrics. This allows districts to plan and make data-informed adjustments that enhance student success. During the program transition period, districts would be allotted time to implement important reforms designed to increase retention and completion. These programs include Guided Pathways, Assembly Bill 705, and the integration of reporting requirements for certain categorical programs. During program transition, no districts would receive less funding than they did during the prior fiscal year. Outcome-focused metrics would be implemented in year three as outlined in the Equitable Success metrics (see Appendix) unless the Board of Governors proposes new measures after extensive research and simulations. The percentage allocated based on the Equitable Success metrics would increase by 5% each year until full implementation in 2025. It should be emphasized that each 5% increase represents approximately \$400 million in system-wide funding, more than enough to stimulate systemic change. At full implementation, over \$2 billion would be dedicated to the metrics outlined in the Equitable Success category.



**Timeline**

<b>Year 1: 2018-19</b>	<b>Hold Harmless to 17-18 with COLA</b>		
	<ul style="list-style-type: none"> <li>One-time funds to recognize district performance under Equitable Success metrics</li> </ul>		
<b>Year 2: 2019-20</b>	<b>Hold Harmless to 18-19 with COLA</b>		
	<ul style="list-style-type: none"> <li>One-time funds to recognize district performance under Equitable Success metrics</li> <li>Summer FTE assigned to the fiscal year in which the final day of instruction was held.</li> <li>Report on analysis of funding formula metrics due to the Board of Governors.</li> </ul>		
<b>Implementation of Equitable Success Metrics</b>			
Year	Access Metrics	Equitable Success Metrics	Estimated Equitable Success Dollar Amount
<b>Year 3: 2020-21</b>	<b>Access: 95%</b> 3-year average	<b>Equitable Success: 5%</b> 3-year average	\$419 Million
<b>Year 4: 2021-22</b>	<b>Access: 90%</b> 3-year average	<b>Equitable Success: 10%</b> 3-year average	\$838 Million
<b>Year 5: 2022-23</b>	<b>Access: 85%</b> 3-year average	<b>Equitable Success: 15%</b> 3-year average	\$1.3 Billion
<b>Year 6: 2023-24</b>	<b>Access: 80%</b> 3-year average	<b>Equitable Success: 20%</b> 3-year average	\$1.7 Billion
<b>Year 7: 2024-25</b>	<b>Access: 75%</b> 3-year average	<b>Equitable Success: 25%</b> 3-year average	\$2.1 Billion
<b>Full Implementation</b>	<b>75%</b> 3-year average	<b>25%</b> 3-year average	

**Evaluation of Impacts of the Funding Formula**

*Regulations:*

A comprehensive review of the new Equity-Focused Funding Formula necessitates an analysis that includes the impact of regulations such as the FON and 50 percent law. To consider the Formula’s efficacy and any unintended consequences, we recommend an analysis be done in Years one and two, with recommendations due by June 2020. The Workgroups also identified the following policy areas for consideration:

*Future Post Implementation Evaluation & Analysis:*

- Final adjustments of Equitable Success metrics
- Impact on noncredit programs (non-CDCP)

- Reporting alignment within other categorical programs not identified in this recommendation
- Programs addressing the needs of older students (25 years and older)
- District basic allocations to better reflect fixed operating costs associated with serving students

During the Program Transition period, the Chancellor’s Office should evaluate the Basic Allocation for a college and center at a district; and, specifically consider providing funding at more frequent threshold levels, as opposed to the current increase range of 10,000 FTES for the three existing step levels. Increasing this portion of Basic Allocation minimizes a focus on growth and more appropriately moves each district towards a focus on success. Further, overall the Basic Allocation amounts provided to each district should be increased to better support and align with the fixed costs associated with operating sites and centers.

## Conclusion

The Governor’s proposal for a new funding formula offers a means to highlight our students’ transformational academic achievements, and enables California community colleges to demonstrate our efficacy as comprehensive and results-oriented institutions of higher education. Primary goals of the aforementioned recommendations are to protect postsecondary education access for economically disadvantaged and underrepresented students, reward districts’ intentional efforts to advance student success and completion, provide predictable funding to support achievement of these outcomes and fiscal stability to support college/district operational costs and sound financial planning, and to recognize and support the comprehensive mission and indispensable role of California’s public community colleges.

## Addendum – DRAFT Equitable Success Metrics

METRIC	DESCRIPTION	ASSIGNED VALUE (points)	ASSIGNED VALUE/ ECONOMICALLY DISADVANTAGED* (points)
<b>Progress</b> students who take more units are more likely to complete	# of students who completed 24 academic credits in one year	0.5	0.75
	# of students who attained 48 CDCP contact hours in one year	0.5	0.75
	# of student who persisted to next term (Fall to Spring)	0.5	0.75

	# of student who complete a credit course	0.5	0.75
<b>Completion*</b> longer term awards yield stronger economic outcomes over time  *Highest award student completed per year	# of students who earned a credit certificate or degree	Cert 12-18 units = 0.5 Cert 18 to <30 units = 1 Cert 30+ units = 2 Associate Degree = 3 Bachelor Degree = 4	Cert 12-18 units = 0.75 Cert 18 to <30 units = 1.5 Cert 30+ units = 3 Associate Degree = 4.5 Bachelor Degree = 6
	# of students who earned a CDCP certificate	CDCP certificate <288 hours =1  CDCP certificate 288 hours or more = 2	CDCP certificate <288 hours = 1.5  CDCP certificate 288 hours or more = 3
<b>Transfer</b> faster time to transfer supports economic mobility	# of unduplicated transfer prepared and students who transferred to any accredited four-year institution	3	4.5
	# of unduplicated transfer prepared and students who transferred to any accredited four-year institution in 3 years	4	6
<b>Employment</b> stable employment signals that students learned necessary skills	# of non-transfer students who exited college and were employed one year later	2	3
<b>Earnings</b> improved earnings that lead to living wages are evidence of economic mobility	# of non-transfer students who earned an award or were skills builders, exited college, and improved their earnings within one year	2	3
	# of non-transfer students who earned an award or were skills builders, exited college, and attained the regional living wage within one year	2	3