Whitebirch & The Art and Science of Multi-Year Financial Projections

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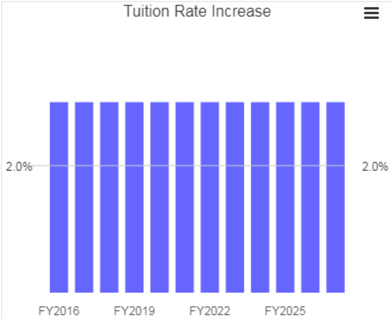
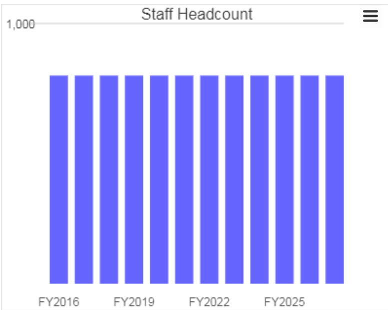




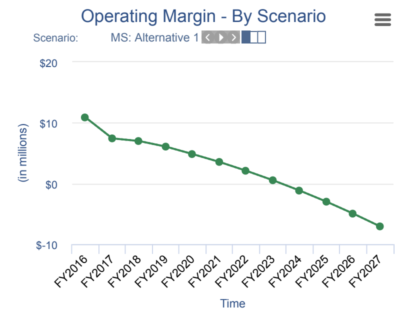
Why Do Multi-Year Projections?

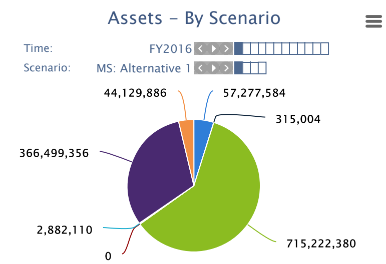
A **multi-year financial projection** is a forecast of your institutions's balance sheet and income statement over a defined period of time (normally around 10 years) based on a specific set of assumptions.

The projections do not need to be done for each individual account, but should be at a sufficient level of detail to facilitate planning and decision making around the following questions:

- **Operating position:** Can we generate sufficient revenues annually to meet all expenditures and not incur deficits?
- **Structural position:** Are we structurally balanced such that recurring revenues meets recurring expenses, or is our balance predicated on actions that have a short-term benefit?
- **Strategic Goals:** Will we have the financial resources to deliver desired services over time and respond to changing needs and preferences?

Your annual audit, annual budget and multi-year financial projection provides a good picture of your past, present, and future financial position.






Review Multi-Year Planning
Analyze Historicals
Establish a Baseline Projection
Develop Alternative Assumptions & Initiatives
Plan for What-Ifs
Perform Scenario Comparisons
Develop Financial Story

The Whitebirch Higher Education On-Demand platform helps you establish and refine your **multi-year financial projection** by guiding you through a step-by-step process. Please reference the flow charts that are incorporated throughout the tool as a guide for how to conceptualize this process, incorporate best practices, and consider all relevant aspects of the exercise.

Establishing The Baseline Projection

Step 1: Define baseline projection

By definition, the baseline projection shows what your financial story will be absent significant changes and prior to corrective action.

Your baseline projection is like the diagnosis your doctor gives you after a physical. It reflects your current condition, given the major underlying factors.

Step 2: Review historical trends and major fiscal drivers

Step 3: Start with the most recent audit

Step 4: Apply growth assumptions

Step 5: Review the baseline projection

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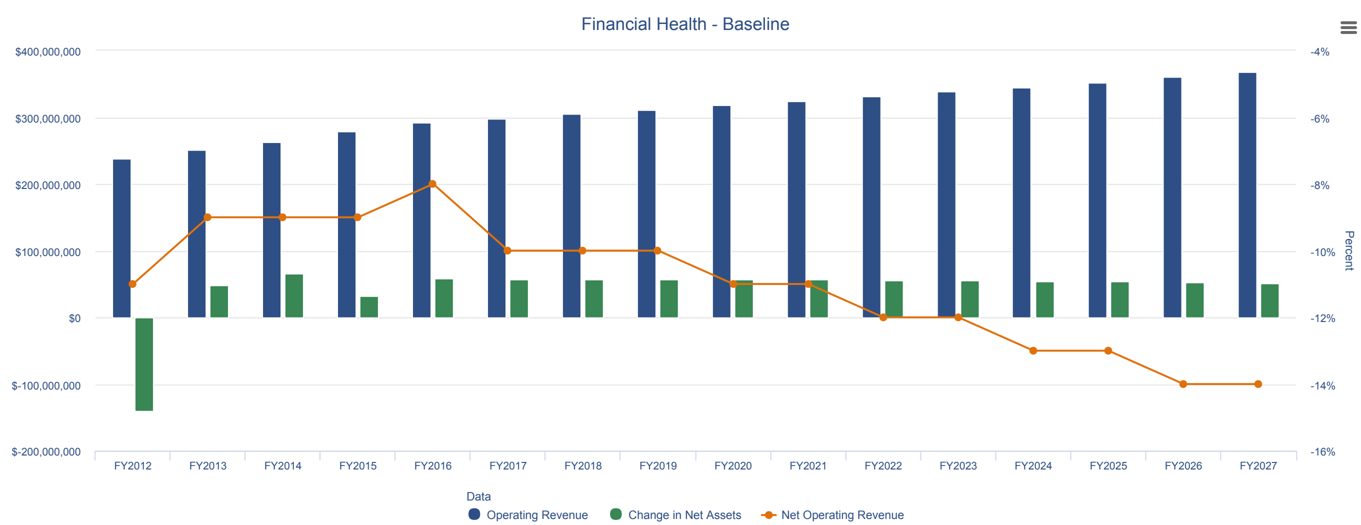
What is the Baseline Projection?

We recommend starting with a baseline projection showing what your financial story will be absent significant changes.

For revenues, this means you wouldn't assume changes in pricing, spending policy, large fee increases, or gift campaigns. For expenditures, you wouldn't assume new hiring or layoffs or wage increases that are out-of-line with recent results.

Your baseline projection is like the diagnosis your doctor gives you after a physical. It reflects your current condition, given the major underlying factors. Then the treatment recommends corrective action in response to the diagnosis.

Your baseline projection is usually driven by large revenues and expenditures, such as net tuition revenue and compensation. Within the Whitebirch platform, you can show how changes to these lines drive your overall performance.



What Do I Need to Build the Projection?

Here are the basic building blocks you'll need to develop your projections:

- **Historical revenues and expenditures:** Usually you would start with 3-5 years of historical information to provide a starting point for calculating growth trends. It's okay if you don't have immaculate, detailed, consistently organized and electronically formatted data. Start with what you have and what you know.
- **Debt service schedule** for bonds, leases, etc.
- **Non cash adjustments** for depreciation, amortization, etc.
- **Policies:** Do you have policies that restrict the annual growth of rate increases or how the money can be used? Do you have revenues or expenditures that are automatically indexed to something else (e.g. CPI)?

What drives my projection?

Your growth assumptions are the backbone of the baseline projection. For revenues and expenditures, you'll calculate growth rates that project how they will change over time. You can start with the simple mathematical calculation (what was the average annual growth rate for X over the past 3-5 years?) and then apply management insight. For lines with fixed schedules (e.g. debt service, existing depreciation), you will be able to enter those known values.

- **Factor out one-time spikes or plunges:** You may have non-recurring events that skew your averages (large gifts, asset sales, debt issuances, and capital spending).
- **Factor in programs that are limited in duration:** Do you have a campaign that expires during your projection period? Will you have a temporary change in staffing levels?
- **Account for major changes in service delivery** that make the early years in a period less relevant

You'll apply the growth rates to a fixed starting point and project them through whatever period is most helpful.

Growth Rate Resources

There are useful resources that can inform your growth rate calculations, though you'll still need to weight them against historical trends and your insight into why the numbers have changed.

- **Integrated Postsecondary Education Data System (IPEDS)** – Provides data on enrollment growth, institutional prices, student financial aid, graduation rates and much more from institutions that participate in federal student aid programs.
- **National Center for Education Statistics (NCES)** – What are the trends in the cost of college education?
- **Consumer Price Index (CPI) (US Bureau of Labor Statistics)** – How much will the cost of X increase?
- **The Kaiser Family Foundation** – Provides annual survey on employer health benefit costs.

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Reviewing Your Baseline Projection

The baseline projections will help you discuss your institution's goals within the context of its financial resources.

- Is there a deficit? Is it a one-time problem or something structural?
- How are the drivers of our financial performance changing? Are they in balance? Is our operating margin growing or shrinking?
- Do we want to change where we're spending our limited resources?
- Can we increase rates at the current pace? If not, where will the additional revenue come from?

The baseline projections should also help you identify specific areas for corrective action, allowing you to go beyond anecdotal evidence and invest your time and energy where it will make a difference.

Sensitivity Analysis

Beyond the baseline, there may be a series of other variations of your assumptions to conisder.

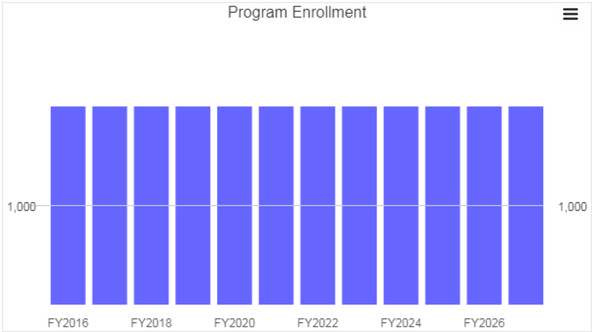
What if there are changes to the economic environment? The Whitebirch platform provides you with ability to consider "what-if" scenarios, such as an optimistic or pessimistic scenario. Using a set of coherent assumptions, these scenarios allow you to perform sensitivity analyses and "stress test" your baseline projections.

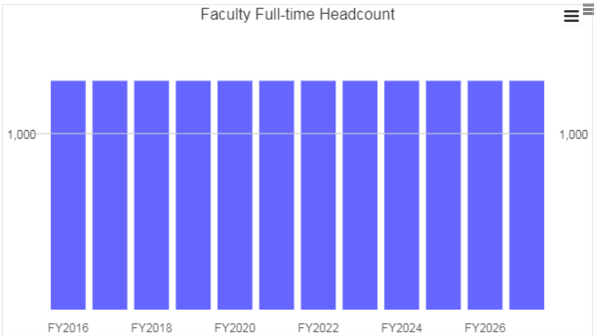
Example: **Optimistic Scenario**

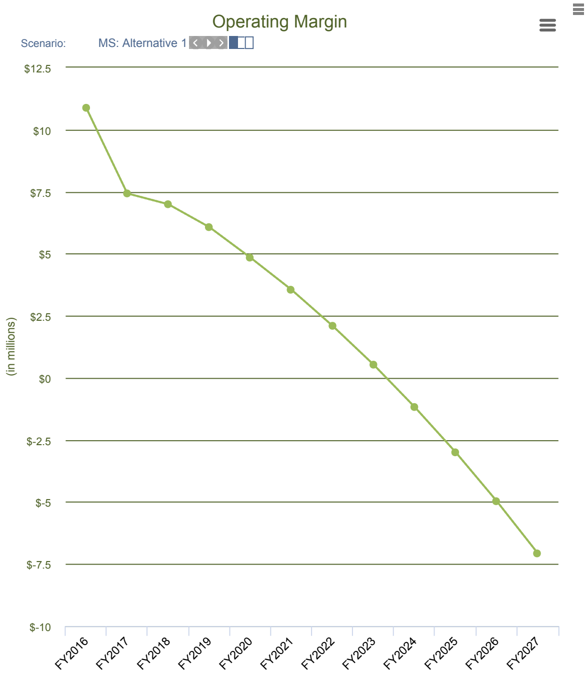
- In an expansion phase of the business cycle, your revenues will likely grow at a higher rate, but your compensation demand will be higher, resulting in increased across-the-board wage increases. Inflationary increases continue to drive your operating expenditures, but your higher investment returns and giving may help offset some of these increases.

Example: **Pessimistic Scenario**

- Alternatively, in a recession, your revenues are likely slowing down since they are mostly sensitive to the broader economic conditions. You might have a difficult time meeting enrollment targets, and donations and investment returns might suffer. At the same time, your operating expenditures might slow down with inflation growing at a slower rate, but you might have certain fixed costs that are unaffected. In addition, a low interest-rate-environment during a recession may present favorable borrowing conditions to help fund key initiatives on campus.


Program Enrollment
1,000
1,000
FY2016
FY2018
FY2020
FY2022
FY2024
FY2026


Faculty Full-time Headcount
1,000
1,000
FY2016
FY2018
FY2020
FY2022
FY2024
FY2026


Operating Margin
Scenario:
MS: Alternative 1
(in millions)
$12.5
$10
$7.5
$5
$2.5
$0
$-2.5
$-5
$-7.5
$-10
FY2016
FY2017
FY2018
FY2019
FY2020
FY2021
FY2022
FY2023
FY2024
FY2025
FY2026
FY2027

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From Diagnosis to Treatment

Once you have a baseline projection and discuss the related challenges and opportunities, you can move to the next step – **developing initiatives to change the projection**.

Guiding questions: Given this baseline assessment and our goals, what kinds of initiatives should we pursue, and what is the likely financial impact of those initiatives?

Your goal is to **develop a menu of options**, with as many quantified as possible, that represent a well-rounded approach to achieving and maintaining balance. Approaches would typically involve some (or all) of the following:

- Management and productivity initiatives
- Debt restructuring
- Cost recovery (fees and service charges)
- Workforce strategy
- Program prioritization
- Alternative revenue sources

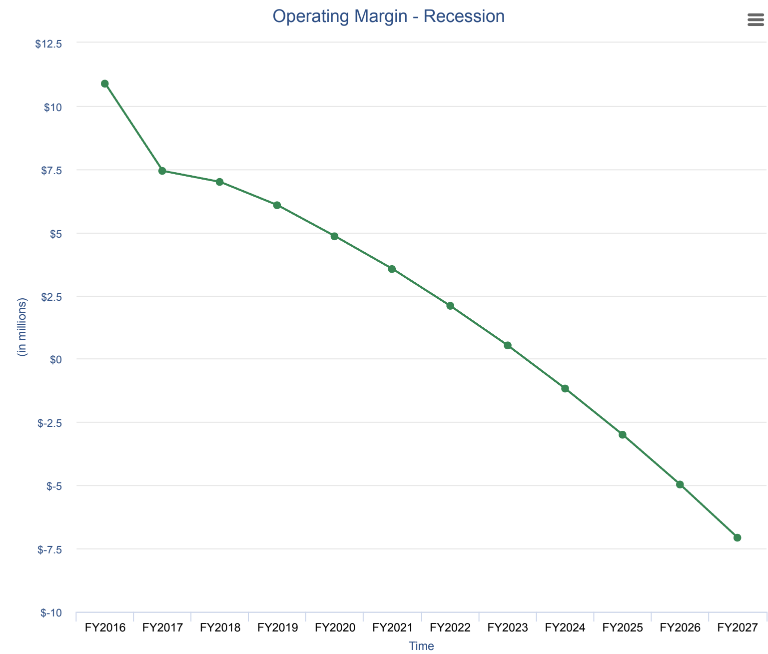
Scenarios

MS: Alternative 1

MS: Alternative 2

MS: Recession

MS: Baseline



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Why Bother?

Reason No. 1: It's a better way to bridge the gap

Many institutions face structural challenges. Revenues suffer due to enrollment, pricing, and aid constraints. Meanwhile expenses rise because of salary demands, health insurance costs, energy costs, etc.

One-year budget cycles are not an ideal way to address systemic challenges:

- Short-term strategies often yield short-term benefits that expire or may even increase your deficit in out years
- Looking exclusively at the short term horizon limits appreciation and understanding of long term challenges
- The options for addressing structural imbalance are much better before cash and current-year shortfalls arrive. Multi-year planning allows you to **move away from "putting out the next fire"**

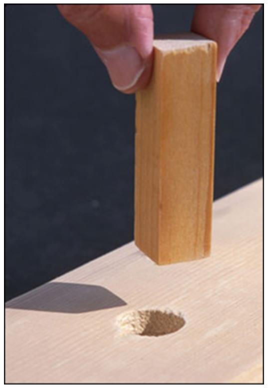
Why Bother?

Reason No. 2: It changes the budget conversation

Budget processes are often stressful and tense because scarce resources lead to an “us versus them” dynamic among department heads, provosts, management, etc.

Using a multi-year perspective changes the conversation:

- You can present the challenges to interested parties from a broader perspective and challenge people to think beyond their departmental boundaries
- Revenue projections help you determine what you can afford before you begin processes that will set your expenses for several years (e.g. issuing debt, compensation increases)
- Multi-year planning allows you to talk about which investments are worth making down the road in addition to which reductions you need now



Why Bother?

Reason No. 3: It's considered a best practice by industry experts

“Multi-year financial and capital plans exist where future issues are identified along with possible solutions. Well-documented and realistic assumptions support the plans, and the plans are used for drawing up budgets to support a strong commitment to financial discipline."
– Standard & Poor's

“We believe that strategic planning and implementation, institution risk management and strategic financial analysis are inherently linked. In order to meet the mission, the Institution prepares and implements a strategic plan that has a series of action steps to attain the goals."
– Strategic Financial Analysis for Higher Education Vol 7