

Introduction

Several changes to the outcomes-based funding formula used for Tennessee’s public universities and community colleges began affecting higher education budgets in fiscal year (FY) 2023-24. This legislative brief describes each of the changes and also provides background information about the formula and the process by which it is reviewed and changed.

Background

What is the outcomes-based funding formula?

The outcomes-based funding formula was created by the Complete College Tennessee Act of 2010.¹ The formula is primarily overseen and approved by the Tennessee Higher Education Commission (THEC), which consists of the three state constitutional officers and commissioners from across the state.^A

The formula is administered and evaluated by THEC staff, who are full-time higher education experts working in support of the commission. Tennessee Code mandates that “the commission [THEC] shall develop and utilize an outcomes-based funding formula model to ensure the fair and equitable distribution and use of public funds among state institutions of higher education.”² It also requires that THEC and the statutorily required formula review committee (FRC) “shall review the funding formula components, as well as identify needed revisions, additions, or deletions to the formula. The committee shall also ensure that the funding formula is linked to the goals and objectives of the [state’s] master plan” for higher education.³

The funding formula is intended to encourage public universities and community colleges to prioritize certain outcomes among their students. “Outcomes” refers to the measured results of an institution such as number of degrees conferred, six-year graduation rate, and student progression through their degree requirements.⁴ The formula also emphasizes achieving outcomes among certain “focus populations” such as low-income students, students in high-need fields, and adult students. More information about outcomes and focus populations can be found beginning on page 4.

The formula is briefly reviewed annually as required by statute and subject to a full review process every five years. The first version of the formula went into effect in 2010 and continued through FY 2015-16. The second version, the 2015-2020 funding formula, began impacting institution budgets beginning in FY 2016-17 and was intended to continue through FY 2020-21 when the third version (the 2020-2025 formula) would become effective. However, the COVID-19 pandemic caused delays to the 2020-2025 formula, which shifted its initial impact from FY 2021-2022 to FY 2023-24. This timeline and the delays surrounding the 2020-2025 funding formula are explained further on page 7.

The annual review of the funding formula allows for technical adjustments to be made between the full five-year review cycles. This allows THEC commissioners, THEC staff, and the FRC to monitor potential issues in the formula and propose necessary changes for immediate impact. In contrast, the five-year review allows for policy changes to be made to the formula.

^A The Commission is composed of nine voting members appointed from the general public, each serving six-year terms and representing the Grand Divisions of the State equally. Of these nine members, three are appointed by the General Assembly and six are appointed by the Governor. The state constitutional officers (Comptroller of the Treasury, State Treasurer, and Secretary of State) serve as ex-officio voting members. Additionally, one voting student member serves a one-year term and the Executive Director of the State Board of Education serves as an ex-officio non-voting member. Tennessee Higher Education Commission, The Commission, <https://www.tn.gov/thec/about-thec-tsac/commission-members0.html>.

Multiple stakeholders are involved in discussing, reviewing, and changing the formula. These stakeholders include THEC commissioners and staff, FRC members (largely composed of higher education institution leaders), THEC Working Group members (i.e., delegates for FRC members in both higher education institutions and state administration), legislators on the Finance and Education committees from both chambers of the General Assembly, and the state’s constitutional officers and their staff, as well as representatives and administrators from higher education. See Appendix A for a list of THEC, FRC, and Working Group members.

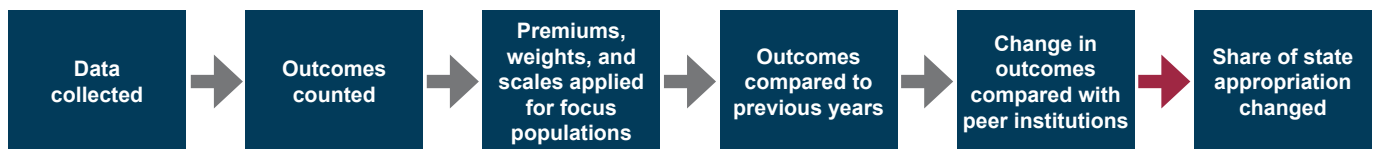
The formula review process includes steps such as reviewing the current formula, developing recommended changes, monthly meetings between THEC staff and the Working Group, FRC meetings with institution leaders, and meetings with the House and Senate Education and Finance Committees.

The steps for determining funding under the outcomes-based funding formula are:

- Collecting data – This requires universities and colleges to submit required data on relevant outcomes to THEC staff.
- Counting outcomes – After obtaining all the necessary data from institutions, THEC staff can count each outcome at each university or college.
- Applying premiums, weights, and scales for focus populations – Once each outcome is counted, a technical process using different premiums and weights (i.e., rewards for achieving certain outcomes overall and among a given focus population) can be applied to each measured outcome and can be scaled so that outcomes with different measurements, like graduation rates (less than one when measured) and training hours (measured in the thousands) do not have outsized or downsized impact.
- Comparing outcomes to performance from previous years – The weighted and scaled outcomes are then compared with the average outcomes from previous three years to determine the improvement or decline at each institution.
- Adjusting performance scores based on comparisons to other institutions – After growth or decline is measured, these rates are compared with other institutions across the state.
- Changing the appropriation shares for each institution – Upon completion of all of these steps, the recommended shares of state higher education appropriations are presented to THEC members.

See a visualization of this process in Exhibit 1.

Exhibit 1: Outcomes-based funding process



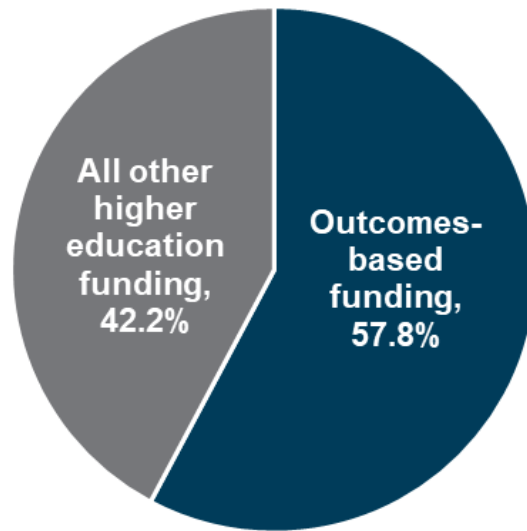
Source: THEC FY 2023-24 Formula one-pager.

Tennessee’s public higher education institutions will receive a total of \$5.7 billion from all funding sources in FY 2023-24, including from federal and other sources.⁵ The state government will spend a total of \$2.7 billion on higher education at public institutions in FY 2023-24.⁶ More than half, or \$1.6 billion (58 percent), of the state’s proposed funding on higher education will be distributed to institutions based on the outcomes-based funding formula.⁷

This 58 percent accounts for most of institutions' regular operating budgets as well as initiatives passed by the legislature.^B The remaining 42 percent is used for research, program initiatives at universities and community colleges, capital maintenance, lottery funded scholarship programs, as well as other programs and initiatives.⁸ These fall outside of regular operations or do not directly fund institutions.^C

Capital projects, which include new projects, maintenance, and improvement, are not allocated via the formula.^{9,10} Public funding sources can include, but are not limited to, annual capital maintenance appropriations and legislative initiatives.¹¹

Exhibit 2: More than half of state funding for higher education is allocated using the outcomes-based funding formula



Total Tennessee state higher education funding | FY 2023-24

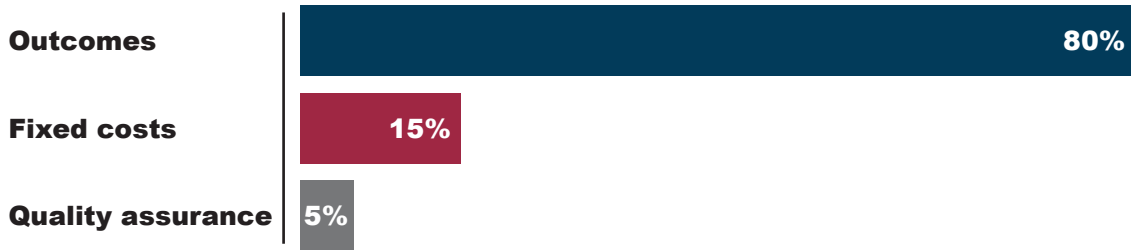
In addition to Tennessee, 26 other states have some form of an outcomes-based funding formula.¹² However, Tennessee's model differs from most other states because such a large portion of higher education funding is allocated through the formula. In FY 2021-22, Tennessee had the third highest proportion of funding allocated by outcomes in the country (behind North Dakota and Ohio). Most other states using outcomes-based funding formulas allocate only a small portion of their funding through the formula. This makes Tennessee an outlier in how it operates its formula.

The formula is composed of three components. The largest component is outcomes (80 percent of the formula), which reward results that help support strategic priorities of the state, such as more graduates in high-need fields. The second largest component is fixed costs (15 percent), which relate to expanding, renovating, and updating campuses and their facilities. The smallest is quality assurance (5 percent), which is a form of performance funding that rewards universities and colleges for the quality of the services they provide to students.

^B Outcomes-based funding accounts for 71 percent of all general recurring higher education funding, excluding governor's initiatives and lottery funded initiatives. Additionally, in FY 2023-24 the outcomes-based formula will account for 93 percent of formula unit funding. The remaining roughly 7 percent funds a salary increase, an inflation adjustment to costs, and insurance cost increases, all of which are to be included in the formula in future years. The 7 percent also includes legislative initiatives. With these items considered, in FY 2024-25 the formula will account for 98 percent of formula unit funding barring any other changes.

^C In FY 2023-24, specialized units, which includes research, medical, agricultural, and other similar programs at universities and community colleges account for a total of \$598 million. Lottery funded programs and scholarships are one of the largest areas, accounting for over \$440 million. These scholarships include programs like the Tennessee HOPE Scholarship, Tennessee Promise, Tennessee Reconnect, to name a few. Capital maintenance accounted for \$50 million, which is identical to the previous fiscal year.

Exhibit 3: Tennessee's funding formula is primarily composed of outcomes



Note: Based on 2020-25 funding formula.

The outcomes used to determine funding under the formula are primarily centered around indicators of student progress and completion of academic milestones (e.g., degree completion and student progression). These outcomes, with a special emphasis on certain focus populations (e.g., low-income and adult students) are averaged across a three-year period, compared with past results, and compared with other peer institutions to determine each university or college's funding for the following fiscal year.

Outcome measures vary between community colleges and state universities, as shown in Exhibit 4.

Exhibit 4: Outcomes for community colleges and state universities

Community college outcomes	University outcomes
<ul style="list-style-type: none">• Students accumulating 12 credit hours• Students accumulating 24 credit hours• Students accumulating 36 credit hours• Associate degrees conferred• Long-term certificates conferred• Short-term certificates conferred• Dual enrollment• Job placements• Transfers to universities with 12 credit hours• Workforce training/contact hours• Awards per 100 full-time equivalent students	<ul style="list-style-type: none">• Students accumulating 30 credit hours• Students accumulating 60 credit hours• Students accumulating 90 credit hours• Bachelor's degrees conferred• Associate degrees conferred• Masters and Ed. Specialist degrees conferred• Doctoral and Law degrees conferred• Research, service, and sponsored programs• Six-year graduation rate• Degrees per 100 full-time equivalent students

Source: THEC FY 2023-24 Formula one-pager.

Universities receive additional funding through the formula when they prioritize and help three groups of students – or focus populations – achieve academic progress: adult students, low-income students, and a new focus population to the 2020-2025 formula: students in high-need fields. Community colleges also receive additional formula funding for academic progress of the same three focus population student groups plus a fourth group – students who are academically unprepared.

Who is responsible for overseeing the funding formula?

THEC commission members and staff oversee and implement the outcomes-based funding formula. THEC staff work with the FRC, the Working Group, and the General Assembly to create and adjust the formula. The Formula Working Group and THEC staff are involved in the early stages of any proposed changes to the formula. THEC staff and the Formula Working Group members submit any proposed changes to the formula to THEC, the FRC, and relevant House and Senate Committees for review. Upon review by these individuals and groups, final recommendations are presented to THEC commissioners for their approval.

Changes between the 2015-2020 and 2020-2025 formulas

Adopted changes

Exhibit 5: Changes included in the 2020-25 Formula

Outcome metrics	Focus populations	Fixed costs
Definitional adjustment to "workforce training/contact hours" for community colleges	Introduction of workforce investment premiums for high demand fields	Fixed cost formula streamlined
Definitional and scaling adjustments to associate degrees for universities	Out-of-state low-income students included with in-state low-income students	Proportion of the funding formula dedicated to fixed costs decreased from 22% to 15%

Source: THEC 2020-25 Outcomes-based Formula Changes.

THEC made various changes to the funding formula during the 2020-2025 review cycle, which became effective beginning in FY 2023-24. These changes can be considered in four different categories: outcome metrics, focus populations, fixed costs, and other changes. The adjustments THEC made in each of these categories are explained in more detail **below**.

The changes to the outcome metrics include:¹³

- ***Adjusting part of the definition of “workforce training/contact hours” for community colleges.*** THEC modified the definition of “workforce training/contact hours” to “remove secondary training activities provided by certified trainers.” Some community colleges provide certifications or training to students seeking to become trainers (e.g., students seeking to become OSHA Authorized Outreach Trainers). This change removes the requirement to report how much training the newly certified trainers are providing, if any, after completing their own training or certification. This is intended to focus the outcomes on the results of the community college and its students, rather than including the results of students post-completion.
- ***Changing the definition and scaling for associate degrees for universities to ensure associate degrees are used only as an outcome if it is the stop-out degree (i.e., a degree after which a student will not return to school for at least a year) for students.*** The commission’s changes to associate degrees at universities addressed a previous shortcoming in the outcome metrics, which rewarded universities for producing graduates with an associate degree then moving them toward a second graduation with a bachelor’s degree. This rewarded certain universities for double counting these students using both metrics, which was not the intention. The original intent was to reward production of associate degrees as a terminal, or stop-out, degree, not as a steppingstone to a bachelor’s degree.¹⁴ This change began impacting institutions’ budgets in FY 2022-23 prior to other changes in FY 2023-24.

The changes to focus populations include:

- ***Adding a new workforce investment premium to the formula for students in universities and community colleges who complete an undergraduate degree or award in a “high-need academic program” (including programs in subjects like STEM and healthcare) to address labor market needs in the state.*** This change was made at the request of the governor’s office to better align the formula with the strategic master plan for the state. It was designed to reward universities and community colleges for having more students in degree programs, which will develop needed skills for the state labor market.

- ***Counting out-of-state students with in-state students when calculating the outcomes of low-income students at universities and community colleges.*** This change was made to avoid penalizing universities and community colleges for accepting low-income students from out-of-state. Previously, when rewarding universities and colleges for outcomes among low-income students, the institutions received the rewards for helping low-income students who were Tennessee residents, due to certain data limitations which have now been addressed. This now rewards universities and colleges, especially those near Tennessee’s borders, for helping and developing low-income students regardless of their state of permanent residence.

The changes to the fixed cost component of the formula include:

- ***Streamlining the fixed cost components of the formula by eliminating the incentive to create new buildings.*** This was done by shifting the focus of the component to square footage and usable equipment “while eliminating utilities, rent, and the premiums for older space” from the formula. The previous formula encouraged colleges and universities to create new buildings rather than renovate older buildings (20 years old or older).
- ***Reducing the influence of fixed costs by decreasing its formula share from 22 percent to 15 percent.*** The 7 percentage points removed from fixed costs were then shifted to the outcomes component of the formula.

Other changes to the formula:

- ***Recalibrating the weights and scales of the various outcomes to improve the technical aspects of calculating funding levels from the formula.*** Each outcome, focus population, and metric of the funding model is assigned varying levels of weight and scale. These determine the levels of rewards for achieving one or several outcomes with one or more focus populations. These weights and scales require adjustments in order to ensure the formula remains fair and does not create adverse incentives or disincentives.

Changes considered, but not adopted

Not all of the changes to the outcomes-based funding formula proposed by THEC staff and the Working Group in 2021 were adopted by THEC. One proposal would have changed the graduation rate-related outcome for universities from a six-year graduation rate (the percentage of students who complete an associate or bachelor’s degree after six years) to a four-year graduation rate. The intention behind this proposed change was to encourage on-time graduation (i.e., in four years).

THEC staff and the Working Group originally proposed the change but withdrew the recommendation from the 2020-2025 version of the formula after concerns were raised by various FRC stakeholders and higher education leaders that the number of students who take six years to graduate would make this an unrealistic goal. Although THEC staff addressed the concern, they decided against recommending the change for this cycle. THEC staff and the future Working Group may propose this change for the next version of the formula (the 2025-2030 version) after gathering more data and research. Similarly, THEC staff explored the potential to introduce a three-year graduation metric to community colleges to replace the existing four-year metric but also determined not to recommend this change to the Commission at the time.

A second proposal, which was considered but not recommended, was to eliminate the fixed costs component from the formula. Some THEC members, as well as THEC staff, expressed support for further reducing the size of fixed costs as a formula component or removing it entirely in the future. THEC and its staff ultimately decided to leave fixed costs as a formula component but reduced its size from 22 percent of the total formula to 15 percent and streamlined the requirements.

Timeline of changes to funding formula 2020-2025

Any major changes to the outcomes-based funding formula are scheduled to occur every five years. For this reason, the outcomes-based formula is often referred to relative to a five-year period (e.g., the 2015-2020 formula) when a specific version of the formula is in place. While referred to in five-year periods, formulas are not limited to these years of operation. For example, THEC did not plan to begin the review of the 2015-2020 funding formula, which would inform changes for the 2020-2025 formula, until early 2020. The review and approval process would then have continued through early 2021.

The COVID-19 pandemic postponed the review of the funding formula from 2020 until 2021. Delaying the review process meant a delay in the implementation of the changes as well, most of which will first affect budgets for FY 2023-24. During FY 2022-23, THEC continued using the 2015-2020 formula largely unchanged. Exhibit 6 shows a timeline of the review process for the 2020-2025 formula.

The 2020-2025 version of the outcomes-based formula will likely remain in place through the end of FY 2025-26. The review and approval process for the next version of the formula (2025-2030 version) is scheduled to begin in 2025. Any resulting changes to higher education funding would be submitted for implementation to higher education institutions during FY 2025-26 and incorporated into university and college budgets in FY 2026-27. Despite these considerations, the current formula is still referred to as the 2020-2025 funding formula. The subsequent formula will be referred to as the 2025-2030 outcomes-based funding formula.

Exhibit 6: 2020-25 Outcomes-based funding formula timeline

Early 2020	5-year review (to go into effect in FY 2021-22) begins
Mid 2020	5-year review pauses due to the COVID-19 pandemic
March 2021	5-year review continues
March-June 2021	Formula Working Group meets monthly to discuss proposed changes
July 2021	Formula review committee meeting
July 2021	THEC meeting (formula change to associate degrees approved for implementation)
September 2021	Formula review committee meeting
Winter 2022	Recommendations presented to House and Senate Education and Finance Committees, as required by TCA 49-7-202(h)
May 2022	THEC meeting (2020-2025 formula changes approved for implementation in FY 2023-24)
Summer 2022	THEC staff implements changes and revisions
Fall 2022	Institutions submit data under new definitions
November 2022	THEC staff presents FY 2023-24 budget recommendation to THEC members
December 2022	THEC-approved FY 2023-24 budget submitted to the Governor and General Assembly for inclusion in the state 2023-24 budget

Endnotes

¹ 106th General Assembly, 2010 Regular Session, House Bill 7008.

² Tennessee Code Annotated 49-7-202(f)(1).

³ Tennessee Code Annotated 49-7-202(g)(2).

⁴ THEC, Outcomes-Based Funding Formula, One Page Overview, 2023, https://www.tn.gov/content/dam/tn/thec/bureau/fiscal_admin/fiscal_pol/obff/2023-24/Outcomes%20Based%20Funding%20Formula%20Overview%20-%20One%20Page.pdf.

⁵ State of Tennessee, Governor's Recommended Budget, Fiscal Year 2023-24, Feb. 6, 2023.

⁶ Tennessee Higher Education Commission, Breakdown of Outcomes-Based Formula Components Impact on 2023-24 State Appropriations, 2023, https://www.tn.gov/content/dam/tn/thec/bureau/fiscal_admin/fiscal_pol/app/2023/2023-24%20Formula%20Component%20Analysis_Based%20on%20Governor%27s%20Budget_website.pdf.

⁷ Tennessee Higher Education Commission, OBF Follow-Up Questions, email and attachment, August 21, 2023.

⁸ Ibid.

⁹ Tennessee Higher Education Commission, FY 2023-24 THEC Capital Budget Disclosures, Accessed August 25, 2023.

¹⁰ Tennessee Comptroller of the Treasury, An Explanation of the Outcomes-Based Funding Formula (2015-2020), November 2020, p.18, <https://comptroller.tn.gov/content/dam/cot/orea/advanced-search/2020/OBFprimer.pdf>.

¹¹ Tennessee Higher Education Commission, OBF Follow-Up Questions, email and attachment, August 21, 2023.

¹² State Higher Education Executive Officers Association, 2022 SHEF (State Higher Education Finance) Report Data, 2023.

¹³ THEC, 2020-2025 Outcomes-Based Funding Formula Changes, 2023.

¹⁴ Tennessee Higher Education Commission, Summer Quarterly Meeting, July 22, 2021, recording available at <https://www.tn.gov/thec/about-the-tsac/commission-members0/commission-meetings/commission-meeting-archive/2020-commission-meeting-archive/summer-2020-commission-meeting.html>.

Appendix A: Commission members involved in the 2020-25 formula changes

Tennessee Higher Education Commission (as of May 2022)		
Name	Grand Division	Title
Whitney Allmon	West Tennessee Commission Member	Commissioner
Evan Cope	Middle Tennessee Commission Member	Chairman
Nancy Dishner	East Tennessee Commission Member	Commissioner
Tre Hargett	Secretary of State	Secretary
Pam Koban	Middle Tennessee Commission Member	Commissioner
David Lillard	State Treasurer	Treasurer
Sara Morrison	State Board of Education	Commissioner
Jay Moser	East Tennessee Commission Member	Commissioner
Jason Mumpower	Comptroller of the Treasury	Comptroller
Tara Scarlett	Middle Tennessee Commission Member	Commissioner
Vernon Stafford	West Tennessee Commission Member	Commissioner
AC Wharton	West Tennessee Commission Member	Commissioner
Dakasha Winton	East Tennessee Commission Member	Commissioner

2020-25 Formula Review Committee		
Name	Institution	Title
Randy Boyd	University of Tennessee	President
Butch Eley	Department of Finance and Administration	Commissioner
Glenda Baskin Glover	Tennessee State University	President
Catherine Haire	Legislative Budget Office	Senate Budget Analysis Director
Rep. Patsy Hazlewood	Tennessee House of Representatives	Chair, House Finance, Ways, and Means Committee
Jessica Himes	Legislative Budget Office	House Budget Analysis Director (beginning July 2021)
Emily House	Tennessee Higher Education Commission	Executive Director
Sen. Brian Kelsey	Tennessee Senate	Chair, Senate Education Committee
Michael Licari	Austin Peay State University	President
Sidney McPhee	Middle Tennessee State University	President
Peter Muller	Legislative Budget Office	House Budget Analysis Director (ending June 2021)
Jason Mumpower	Comptroller's Office	Comptroller
Brian Noland	East Tennessee State University	President
Phil Oldham	Tennessee Technological University	President
M. David Rudd	University of Memphis	President
Flora Tydings	Tennessee Board of Regents	Chancellor

Name	Institution	Title
Sen. Bo Watson	Tennessee Senate	Chair, Senate Finance, Ways, and Means Committee
Rep. Mark White	Tennessee House of Representatives	Chair, House Education Administration Committee

2020-2025 Formula Working Group		
Name	Institution	Title
Patrick Boggs	Legislative Education/Finance Chairs	Research Analyst for House Education Administration Committee
Lori Bruce	Tennessee Technological University	Provost and Vice President for Academic Affairs
David Butler	Middle Tennessee University	Vice Provost for Research and Dean of Graduate Studies
Chris Cimino	University of Tennessee, Knoxville	Sr. Vice Chancellor of Finance and Administration
Crystal Collins	THEC staff	Sr. Director of Fiscal Policy
Lynne Crosby	Austin Peay University	Sr. Vice Provost and Assoc. Vice President of Academic Affairs
Bruce Davis	Legislative Budget Office	Budget Analyst in the Office of Legislative Budget Analysis
Russ Deaton	Tennessee Board of Regents	Executive Vice Chancellor of Policy and Strategy
Steven Gentile	THEC staff	Chief Policy Officer
Danny Gibbs	Tennessee Board of Regents	Executive Vice Chancellor of Business and Finance
Jerry Hale	University of Tennessee, Chattanooga	Provost and Sr. Vice Chancellor for Academic Affairs
Tracy Hall	Southwest Tennessee Community College	President
Michael Hoff	East Tennessee State University	Assoc. Vice President of Planning and Decision Support
Raaj Kurapati	University of Memphis	Chief Financial Officer
Ron Loewen	University of Tennessee System	Asst. Vice President for Budget and Planning
Michael Maren	Legislative Education/Finance Chairs	Research Analyst for Senate Education
Petra McPhearson	University of Tennessee, Martin	Sr. Vice Chancellor for Finance and Administration
Tony Niknejad	Governor's Office	Policy Director
Laurence Pendleton	Tennessee State University	General Counsel
Lauren Spires	Comptroller's Office	Higher Education Resource Officer
Greg Turner	Department of Finance and Administration	Education Budget Coordinator
Russell VanZomeren	THEC staff	Director of Fiscal Policy



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