



February 24, 2023

Dear all,

For our University to thrive, we must have a sustainable budget model that has enough flexibility to allow for innovation and agility, and yet enough predictability so that we can meet our core missions and support our phenomenal faculty and staff members. In our journey to change the trajectory of our financial situation from the unstable present state to a sustainable financial future, it is critically important that we work together as one team. Thank you for joining me in these challenging but necessary initiatives.

I recognize that the hard work we have already undertaken to rebalance the budget and reshape some of our operations has raised questions throughout the organization. We have worked to keep you updated over the last months through the regularly scheduled budget meetings with updates at CADs, CCC, ALC and PC, in addition to many one-on-one and small group conversations. Of course, please reach out directly if you still have pending questions. I want to reassure you that we are moving thoughtfully and deliberately, taking into consideration your feedback and then moving forward in the best interest of strengthening Penn State.

Below, I share with you our current financial situation, how we got here, what we are doing to address the challenge, and how we will move forward. I hope this provides, in one place, an overview of this complex situation.

What is our current financial situation?

- Currently, we have a \$140 million structural budget deficit within the \$3 billion Education and General (E&G) Funds budget. (For further information on the budget breakdown: see [video at the end.](#))
- Last year, the administration initially brought forward a \$245 million deficit budget, which the Board of Trustees would not support. The proposed budget included aspirational asks along with standing budget requests.
- Last year, the Board charged me with balancing the budget — a very appropriate request for a board with fiduciary responsibilities — by July 2025.

How did we get here?

Like many other institutions across the country, Penn State continues to navigate a difficult fiscal environment. There are a number of internal and external factors, which have led us to our current predicament, including, but not limited to:

- Significant inflation that continues to drive up costs.
- Even outside of inflation, rising costs across industries are increasing costs of “doing business.”
- State funding is lower than it was 12 years ago and has remained unchanged for the last 4 years.
- The lowest per-student funding of any state-related institution in Pennsylvania for more than 50 years.



- Tuition freezes in three of the last five years without sufficient organizational change to counterbalance the loss of revenue.
- Lower enrollments (and thereby lower revenues) across our 24 campuses, at least partially due to the pandemic.
- The continued impact of the worldwide pandemic, which cost Penn State more than \$400 million.
- A historical budget model that was underfunding some units and overfunding others, creating imbalances that are unsustainable.

How are we addressing the financial challenges?

There is an important detail to make clear — driving the urgency of the situation — our institutional reserves. In June 2022, the University had \$350 million in reserves and was using those reserves to fund commitments of more than \$100 million a year. This means that without changing our practices, we would reach a point where we would not be able to fund core operations like payroll, utilities, etc. in three years. That is not an option for an institution like Penn State. We must be a leader in operational excellence, just like we are a leader in research excellence, student success and many other areas. The Board of Trustees responded to the structural deficit by approving a larger tuition increase in fall 2022 with the agreement that we would stop spending and committing our central and unit reserves at unsustainable levels and would balance the budget by 2025. The Board also approved a \$140 million deficit budget for fiscal year 2023 with the expectation that we would present budgets with smaller deficits for fiscal years 2024 and 2025 in July 2023. The message was clear that the University must take steps to reduce expenses.

This budget deficit, the internal and external pressures we face, the exhaustion of our institutional reserves, and the direction of our Board of Trustees have necessitated that we take swift action to ensure Penn State has a bright and thriving future. I know we are up to the challenge.

The budget model

Let me be very clear: At this moment, while the overall institution is not in a financial crisis, I do understand these changes will have a significant impact for some units. It also is important to acknowledge we are introducing a new budget model while also trying to address a structural budget deficit — doing both simultaneously is significant, and I know you are working through challenging circumstances and decisions.

As an institution, we have been spending more money each year than we bring in, which has put us in a vulnerable state. The solution is to come together to manage our costs and to run our organization more efficiently, while continuing our pursuit of new revenue. We will remain focused on our institutional missions of research, teaching, service and outreach — and be steadfast in our values of excellence and community, among others.

Our first major initiative to address the budget shortfall is the implementation of a new formula-based budget model designed to be adaptable to help Penn State leaders make budget planning decisions, now and in the future. The model allocates funding to units based on student credit hour production, student headcount, and research productivity, among other variables. The type of model is very similar to many of our peer Research 1 universities, however, ours is customized to our unique institution. As a



reference, the variables are similar to those used by other Research 1 universities like Michigan, Ohio State, George Washington, Rutgers, Temple, Penn, Washington University, and the University of Arizona, just to name a few.

However, it is important to remember our unit leaders have autonomy and flexibility on how best to use the allocations they receive.

A few key points regarding the budget model:

- The budget model allocates tuition and state appropriations, which make up only a portion of the Education and General (E&G) Funds budget.
- The allocation assigned through the central budget model is in addition to other sources of revenue such as gifts, endowments, grants, sales and services, and contracts.
- We have set aside strategic funds to supplement budgets, in select cases, as we know that the new budget model will never be able to fully capture every nuance for every unit. For example, if a college or department must maintain a high student-teacher ratio or have small class sizes because of specialized teaching, clinicals or equipment needs, we may be able to offer strategic fund support. These funds are available to the president, provost and vice president for Commonwealth Campuses to supplement allocations, especially for units where the model cannot account for complexities or extra costs. Over the next couple of months, we will continue our conversations with deans and chancellors regarding the allotment of these funds to direct toward specific unit needs, priorities and areas critical to the University's long-term success.
- **The new budget model will continue to be updated and evolve as our leadership works through and analyzes data.**

There is one important caveat to the above. Many units will not receive a cut in their base central budget allocation greater than 4% (which is in line with past across-the-board rescissions); however, some units are addressing significant historical financial issues, in which case they will have additional needed reductions in spending. My team is working on a unit-by-unit review with executives in each of these units to explore avenues to support their operations and uphold teaching and research through strategic funds.

As I have shared before, we are focused on a multi-pronged approach to **reduce costs, find efficiencies and enhance revenues** — all of which require changes in some of the ways we currently operate. We cannot reduce our \$140 million budget deficit without some impact across every area of the University.

How can we reduce costs?

While it is an unfortunate reality that to confront our budget deficit and responsibly move forward, and very difficult decisions will be required, it is also true that we can continue to prioritize our mission and preserve our legacy of excellence. First, we need to assess our units. *What is helping to drive us closest to our goals? What is truly essential to ensure our students receive a world-class education, that our faculty continue to produce impactful research, and that our staff feel respected and well-compensated in their roles?* Once we know what must be preserved, we then must determine what we can eliminate, optimize or streamline.



Through this process, it is very possible that some units may have to reduce employee numbers, evaluate or delay program launches, defer purchases or improvements (this does not include lab/research equipment needs), and/or restructure the unit. *Can any positions be eliminated to allow for investment and focus on students or faculty research?* As indicated above, every unit is unique, as some face substantial cuts while others will make small reductions in the short term before seeing increased revenues in future years; these tough decisions need to be made unit by unit.

It was a strategic decision not to do an across-the-board reduction or rescission like had been done in previous years. Across-the-board cuts do not bring us closer to our goals as an institution, nor do they address the underlying issues that necessitated the rescissions in the first place. Still, the consequence of not doing across-the-board cuts means that not every college or unit will be impacted in the same way. **Decisions are difficult, but I am here to help you find the least disruptive ways to preserve and advance the core of our academic enterprise.** We can assist you in working through this from a financial aspect, from a personnel perspective, and from an academic excellence position. Together, I believe we can accomplish our goal of putting Penn State on a firmer financial footing, which will ultimately allow the University to thrive in its mission of teaching, research and service.

Will the things that make Penn State unique still exist after we address the budget deficit?

Absolutely. This is an amazingly resilient university with truly phenomenal people. In tough times, we do not abandon who we are at our core. Instead, we use our foundational values to guide our actions, we create feedback loops to intervene when things go wrong, and we work together to achieve greatness. Our values of excellence, discovery, responsibility, respect, community and integrity will drive our approach and our decision-making. We will continue to prioritize our commitments to be an extraordinary institution for students to receive a world-class education; creating space and opportunity for world-class researchers to engage in asking big questions and solving significant problems in an interdisciplinary way; to academic and research excellence; and to being an employer of choice.

There are countless people, programs and traditions that make Penn State special, and we will continue to make sure we center them in our work and prioritize them in our transformation. For example, the new budget allocation model dedicates:

- Funding to research in an amount equal to 100% of recovered facilities and administration costs (F&A) to the research enterprise.
- Funding to the Commonwealth Campuses and supports our commitment to access and to making Penn State a place for all learners.
- Strategic funds for units with high student contact time like the arts and nursing.

Key Questions:

I appreciated the recent conversation I have had with research leaders, as well as the thoughtfulness and candor of this group. I have received additional research-focused questions, which I answer below. Please don't hesitate to reach out to discuss these in more detail. **We also are looking to schedule a research-focused town hall this spring and more information will be forthcoming.** I hope we can continue this critical dialogue, as I believe wholeheartedly we all want what is best for Penn State and for our students, faculty and staff.



1 — Is there a reason we can't use our \$350 million University reserves to cover our structural deficit?

We may need the reserve to cover a wide range of expenses — from legal settlements, uninsured losses, a decline in tuition revenue or state funding — and we never want to deplete the reserve. Our reserve factors into our financial rating, which impacts our creditworthiness, our reputation and our accreditation. While \$350 million in reserves sounds like a large number, it is actually small for an institution of Penn State's size and scope. For example, the pandemic cost the University \$400 million in lost revenue and expenses. So, you can see how quickly a \$350 million reserve can be depleted.

2 — Why is the current \$140 million deficit a concern given the University is an \$8.4 billion operation and when budget deficits of this size have been approved by the Board of Trustees in the past?

While Penn State has an \$8.4 billion operating budget, almost half of the total budget belongs to Penn State Health and is not available to the University. The \$140 million deficit is not based on the total \$8.4 billion enterprise, but instead on the \$3 billion Education and General Funds budget. The Education and General Funds budget is what we use for salaries, benefits, utilities, maintenance, and expenses that go into the day-to-day operations of Penn State (if you would like further context, revisit this article and particularly the [video at the end](#)). While I cannot speak to past budgets, if we continue with the previous budget model and continue to operate with this sizeable deficit, we will exhaust our reserves — the old model is not sustainable.

3 — How will Penn State continue to prioritize and enhance interdisciplinary research collaboration, our world-class education and commitment to excellence?

I do not want to change what makes Penn State so unique — our interdisciplinary culture and collaboration that we are known for is a key part of what sets us apart. We will continue to strengthen our commitment to interdisciplinary research and to our institutional support for the talented faculty and scholars who are the backbone of our research enterprise. One of the reasons I came to Penn State was the existing rich, collaborative research environment, and I see so much potential moving forward. I want to find ways to increase investment in research over time, but we must create space in the budget to make these critical investments to continue to grow our impact. Our mission is teaching, research and service, and the bulk of our money goes to teaching and research. As we move through this challenging budget shortfall, we are doing everything we can to protect our mission, including through a number of changes to increase savings, boost efficiencies and increase revenues as part of our central operations.

A primary reason our interdisciplinary culture is so strong is because we attract and hire faculty, department heads, deans, chancellors and institute directors who prioritize and excel at cross-disciplinary work. The new budget model keeps funding flat for the Office of the Senior Vice President for Research for fiscal years 2024 and 2025, which means the budget model continues to support our institutes' ability to fund co-hires. Reductions in colleges' allocations will have an impact, and some colleges might not be in the position to fund hires or co-hires in the next year or two; **however, the budget deficit is to blame, not the budget model itself.** Deans, department heads and institute directors can — and should — continue to look for ways to collaborate and leverage their funds for more co-hires and to seed the new, cutting-edge research activities.

We also have provided a research allocation to the colleges that is based on their research expenditures.



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If we continue to grow our research expenditures as projected, the colleges will see that reflected in their allocation through the formula in the budget model.

My administration and I, and members of the Board of Trustees, are committed to not jeopardizing our position as a pre-eminent research institution. We will continue to support all faculty so they can continue to focus on their work and have impactful research careers.

As we [have shared](#), the new budget allocation model prioritizes research, including ways that are different from before:

- Research incentive funds (RIF) provided to colleges and campuses have been included using the same calculation as in past years.
- An equivalent amount of all facilities and administrative (F&A) costs are now allocated to the provost and Office of the Senior Vice President for Research to fund faculty start-ups and much of the research enterprise.
- An additional research incentive of \$28.5 million is included in the allocation and provided to the colleges and campuses using a three-year average of their research expenditures. This research incentive calculation includes non-research expenditures from instruction and public service/outreach that recover F&A costs to encourage continued sponsored activities.

4 — I'm a faculty member interested in growing a robust research program. Should I come to/stay at Penn State?

Yes. As you know, faculty rely on start-up dollars to begin their research projects, which is critically important not only to their own professional paths in the academy but also to Penn State's ability to innovate and increase the standing and impact of our research enterprise. We will continue our commitment to early-career support.

Again, I want to thank you for your leadership as we work together to balance the University's financials and modernize its operations. I truly believe that when these processes are completed in the years ahead, we will have strengthened this great University, allowing it to continue to prosper and grow for years to come. Please know that we will continue to keep you informed of any developments. We are always here to assist in any way possible.

Below please see the additional guidance on sharing this email and providing updates to your teams. I hope we can discuss this further at ALC on Monday.

Sincerely,

Neeli Bendapudi