Minutes*

Senate Committee on Finance and Planning
Tuesday, September 21, 1999
3:15 – 5:00
Room 238 Morrill Hall

Present: Charles Campbell (chair pro tem), Dan Feeney, Catherine French, Cynthia Gillett, Gerald Klement, Eric Kruse, Terrence O'Connor, James Perry, Terry Roe, Charles Speaks, Susan Carlson Weinberg

Regrets: Stephen Gudeman, Jean Bauer, Wendell Johnson, Michael Korth,

Absent: Richard Pfutzenreuter, Jane Phillips, J. Peter Zetterberg

Guests: Georgina Stephens (Treasurer)

[In these minutes: University debt; construction update; Aramark food service]

1. University Debt

Professor Campbell convened the meeting at 3:15 and welcomed Ms. Stephens. Ms. Stephens related that she had been asked to join the Committee to talk about the University's debt levels.

She distributed a handout containing graphs and data on the University's debt. She noted the following:

-- On June 30, 1998, the University's outstanding debt totalled $328.5 million. On June 30, 1999, it totalled $533.3 million. The increase represents the University's commitment to the capital plan. Of that debt:

-- For the 1999 debt figure, 83% represents University bonded debt, 9% represents State-issued bonds (the two of which are fixed rate debt), and 8% represents University variable rate debt. The University fixed-rate debt carries 4.44% interest, the University variable rate debt carries a current rate of 3.62%, and the State-issued debt rate is 5.33%. The University obtains a better rate than the State.

Rating agencies very much like organizations with debt that is heavily fixed rate; most organizations aim for about a 60/40 split, fixed/variable rate debt. The University has a high fixed rate because about a year ago, it appeared that fixed rates were about as low as they were ever going to go, so much of the variable rate debt was converted to fixed rate. As fixed rates rise, and as the University issues additional debt, the ratio will move closer to 60/40 because more of the debt will be variable.

Ms. Stephens then explained how some outstanding debt is converted from fixed to variable, and vice-versa, through Lehman Bros. Lehman obtains the money at a lower rate than what the University

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then pays for a fixed rate, but if the rates rise, the University retains its fixed rate while Lehman is on the hook for the difference. Asked what happens if the intermediary, Lehman Bros., goes broke, Ms. Stephens said that possibility is the reason one picks the banker carefully. Lehman Bros. has been around a long time. And as for why the University does not obtain money directly from other lenders, the reason is that the University would then have to pay over 5%.

Ms. Stephens then drew the attention of Committee members to a schedule of debt payment (principal and interest), illustrating how the existing debt would be paid off (by 2034). She noted that not all of this debt is paid for out of central funds; much of it comes from units that generate revenue to pay the debt, such as parking and athletics. A graph demonstrated how the debt would be reduced. In response to a question, she said that perhaps 80-90% of the debt came from revenue-producing sources, and that only a small amount came from O&M funds; she promised to provide the Committee with data on how much of the debt service came from O&M or other central funds.

Committee members and Ms. Stephens understood, however, that the University would most likely not reduce its debt to zero; as old debt is paid off, new debt will be assumed for additional capital projects.

Asked what proportion of the University's budget is debt, Mr. O'Connor explained that the total budget is about $3 billion, so with $533 million in debt, the total debt amounts to about 1/6 of the University's budget. One Committee member related that he understood the University to have an unusually large amount of construction in progress, and wondered if that increased the University's risk. Ms. Stephens said the University is near its debt capacity limit; Mr. O'Connor added that the University could assume more debt, but at the cost of risking its high debt rating. There is in addition a prestige factor in having a AA debt rating, Ms. Stephens told the Committee; of the top 20 schools in NIH funding, virtually all have a AA rating. She said she would NOT make the argument that there was a causal or correlational relationship. Even if debt were issued for a project that generates revenue, she pointed out that rating agencies look at more than revenues.

The current and projected debt included funding for the 2000 capital request, so would not increase the debt beyond what is deemed prudent for the University.

The Committee asked that it be provided information about debt levels at peer institutions.

One Committee member said it was reassuring to learn that much of the projected debt service will be covered by cash flows from enterprises generating revenue. Professor Campbell then thanked Ms. Stephens for meeting with the Committee.

2. Update on Construction Projects

Professor Campbell next welcomed Vice President Eric Kruse to report on the status of construction projects.

Mr. Kruse distributed a number of handouts and maps describing the various projects underway. Committee members discussed various elements of some of the handouts.

-- In some cases, a design-build process has been used, which is typically faster. The Ford/Murphy project will be done six months (a semester) early, which also means that additional finishing work can be done on the project. The drawback to design-build is that projects move at a speed with which many are unaccustomed, and it requires that decisions be made promptly.

Mr. Kruse said he believed that the quality of the work in a design-build process is actually BETTER, because the University knows at the outset what it will get from the contractor and because the contractor has more responsibility. There have also been few change orders. He agreed that it is necessary to have the right management in place effectively to use a design-build process.

Mr. Kruse explained, in response to a question, that when savings are achieved, they are normally put into the project, with daily decisions made by people in the program and in Facilities Management. It would be possible to use the savings for other projects, but that has not been done; the funds have been used for things that could otherwise not have been funded. (For example, the savings permitted the purchase of all new windows for Murphy Hall--an expense that would have come up in the near future anyway, so this represents a savings in the future.) Rarely are the amounts so great, he added, that it would make much of a difference in other projects.

-- The construction projects have recently received some bad press from the DAILY. Is there any information being made available to let students know that these projects will not just be for students on campus six years from now? Mr. Kruse said these themes are being promoted continually with the alumni and the DAILY. The media, however, seem not to have found this point newsworthy.

-- What is in the wings? The items on the capital request, which have been reviewed by the Committee. It will also be necessary to set priorities in order to deal with the $1.25 billion list of projects that have been proposed, because the University will not be able to afford all of them.

In general, Mr. Kruse said, the projects are on schedule and on budget. What people see now, he added, is the beginning of the worst period of construction, and it will last about a year and a half.

As for the next capital budget, there should be lists prepared that the Committee could review within the next two or three months.

Professor Campbell thanked Mr. Kruse for his report.

3. Meeting with Aramark Officers

Professor Campbell next reported to the Committee on a meeting and he and Professor Perry had attended with representatives from Aramark; most of those who had been invited to a meeting in the spring were, for some reason, not invited to this meeting. There were also four students at the meeting who asked good questions. The students had toured Boston area colleges that are served by Aramark, and were impressed by what they saw. They were not impressed with the service at the University. But Boston University has used Aramark for over 20 years, and has just renewed its contract for another 11. The difference there is not the price, but better food and more variety.

The issue for him, Professor Campbell related, is that he heard at this meeting the same things he heard at the meeting last spring, only from a slightly higher level in the company. They had teams look over what is going on, and promised improvements. There have been some improvements, it was said, but Aramark has done little to make them known.

Professor Campbell said he asked directly if the contract itself were a problem; Vice President Boston was strongly of the view that the problem is with the Aramark team, and that it has been unresponsive. Aramark also acknowledged that there was a problem, Professor Perry added. They view the contract as favorable, and although they are now losing money, they expect to make money in the future. They also want to do better, because Aramark is interested in expanding its role in campus services and does not want to develop a bad reputation from its offerings at Minnesota. One Committee member maintained that siphoning off the beverage profits, because of the Coke contract, had to have an effect on food service economics, even though Aramark has not said so.

It was agreed that the Subcommittee on Twin Cities Facilities and Support Services would ask to speak again with Vice President Boston and Associate Vice President Campbell. Professor Campbell said this is a big issue and he hoped the Subcommittee could make progress.

Having no more business, Professor Campbell adjourned the meeting at 4:25.

-- Gary Engstrand

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