Minutes[*]

Senate Committee on Finance and Planning
Tuesday, January 29, 1996
3:15 - 5:00
Room 229 Nolte Center

Present: Fred Morrison (chair), David Hamilton, (substitute for) Gary Malzer, Catherine French, JoAnne Jackson, Richard Pfutzenreuter, Peter Robinson, Charles Speaks, Craig Swan, James VanAlstine

Regrets: Thora Cartlidge, Gerald Klement, Patricia Ferrieri, Benjamin Senauer

Absent: Bruce Bromberek, Jason Frick, Robert Kvavik

Guests: Greg Brown (Office of the General Counsel), Terry O'Connor (Controller)

[In these minutes: possibility of creating separate corporation for University support services]

Public-Private Partnerships

Professor Morrison convened the meeting at 3:20 and said the agenda consists of the report on public-private partnerships by the "Partnerships Program Committee," chaired by Mr. Paschke and upon which Professor Robinson served as a representative of this Committee.

In response to an initial query from Professor Morrison, Ms. Jackson said there is at present no plan to take the proposal to the Board of Regents.

The initial problem taken up by the Partnerships Program Committee was that of the lack of capital funding for ancillary operations. They are trying to identify other ways to support non-academic services so that the support does not impinge on funding for academic programs; one area for investigation is public-private partnerships.

This does not mean outsourcing, Ms. Jackson said, although that could be an element of the proposal; in this case, it is more a case of a University partnership with itself. There would be a segment of the University with a different charter, a different board of governors; could it expand the funds available? The University has about $70 million in bonding capacity available (that could be used without affecting the credit rating). If the state is asked for capital funds, it will require the University to pay for 1/3 of construction costs. That 1/3 will consume the $70 million very rapidly, Ms. Jackson said. There are needs for dormitories, parking ramps, and renovation of Coffman Union; if included in the University's capital request, they will reduce the ability of the University to improve classrooms, deal with Jackson-Owre-Millard-Lyons, and possibly other capital needs.

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Professor Robinson then reported that the meetings were open, people said what they believed, and issues were hashed out. People who are responsible for the ancillary services feel under pressure to function responsibly and are trying to think of solutions to raise the money they need. There was clearly only one model being considered by the Partnership Committee, however, and that is a separate 501(c)(3) organization. Other solutions were apparently thought about earlier and discarded.

The problems are clear. The University has been forced to operate with fewer dollars than it needs in order to do what it wants to do. The University has robbed Peter to pay Paul for many years. If a new 501(c)(3) organization is created, it would separate revenue-producing units from the University, which would be run by a board devoted to promoting the financial good health of those units. It would do so by increasing rates and cutting costs. This would remove from University officials decision-making about costs to students, such as for housing, and there would be no central control over the cost of attending the University. The idea of separation is not a good one, he maintained.

If the University's bonding limit can be raised by creating a separate organization, Professor Robinson said, that would be a positive result, but it would also reduce the capacity of the University to move funds around and would increase the balkanization of the institution.

Professor Robinson reported that he had learned, to his surprise, that the state has NEVER supported ancillary operations, and that he cannot understand why it would not do so.

In his view, he said, the solution creates worse problems than the ones it solves. It potentially creates a decision-making crisis in the University, it restricts the ability of the administration to move capital funds around, and it is not clear a separate organization will permit the University to raise its debt limit.

This proposal is put on the table after a lot of discussion, Ms. Jackson said, in order to go to the next step, which is to do a more detailed case for change and to put the choices and their implications in front of everyone. The case for change must clearly identify for all parties the issues. The areas which are most critical to understand are in the areas of performance objectives for the new organization, capital implications and restraints on the new and existing organization, and who the decision-makers are and how they relate to one another.

Ms. Jackson said a recent decision about converting the MRRC to student housing was a response to a crisis, and they are trying to create a situation where that CRISIS need not occur. The committee highlighted problem areas; there ARE problems, and none of the solutions appear to be without problems either. Seeking more state money would be a possibility, but that would simply mean the University had to give up something somewhere else in its request.

One Committee member said the proposal seems to operate on the assumption that separating some significant University assets into another organization creates the basis for borrowing additional money, while the assets remaining with the University will be used to support the same level of University borrowing as before.

Ms. Jackson said that question is being evaluated. Knowing the elements that go into ratings for bonds, she said some level of assets can be removed and not adversely affect the rating. For example, selling the Hospital means the University's bond rating will go up, because while the Hospital was cash-producing, it was also risk-producing. If one removes risk-producing assets, the rating can be increased. Housing is high-risk; it is not clear at what level students will not pay, or the issue may be related to the cost of tuition.

Professor Robinson said he had asked the same question; one answer about revenue streams from auxiliary services is that the revenues are not sufficient to support the services themselves, so they contribute nothing to the overall bond rating of the University. In that case, said one Committee member, they are a charge to the rest of the University, drawing cash to pay overdrafts. If they do not receive enough money, and are in a separate corporation, they must obtain revenues, which will come through rate increases or decreased costs, Professor Robinson concluded.

One Committee member inquired about Parking; Ms. Jackson said it is subsidized: surface lots are cash-producing, underground parking loses money. She noted that the campus master plan calls for more underground parking, and that there was no reference in the master plan to the financial implications for parking. This raises questions about the thoroughness of the master plan, it was said, and whether it should be implemented. It also depends the time horizon, which is over 50 years, Ms. Jackson noted.

The proposal is largely a capital-generating exercise, not a revenue-generating one, it was said; is that what was intended? Ms. Jackson said not, that the two must be balanced; there cannot be generation of capital without the revenue to support it. There is talk on campus of adding housing and renovating Coffman; one wonders if this proposal would facilitate those aims.

Considering the new organization in its operating aspects, it seems to be a strange, large public utility, said one Committee member, composed of a variety of unrelated activities that are each related to the University but not each other. One question is, why not break them up and have a parking corporation, a housing corporation, and so on, and contract the activities out? Are there cross-subsidies? Efficiencies in management? On the latter, it would seem not, because the same skills are not required for the various activities.

Ms. Jackson said the point needed to be considered, and the economic viability of a real estate development corporation or service corporation reviewed. If there were a real estate development corporation for the "south mall," a quadrant that has unique problems and attributes, it could lead to development--but one could also say a primary issue is to tie food services together across the campus.

Mr. Brown commented that he had been asked to vet problems and solutions, by Ms. Jackson, and a new corporation is one of many solutions to the University's capital needs for ancillary services. There are also significant operating issues that need to be addressed. Capital needs may drive things, but a corporation is not the only solution.

One Committee member expressed concern that the new organization would be more unresponsive to everyone with a captive market, insulated with an isolated Board of Directors not responsible to the academic community, that could perpetuate problems and not resolve anything except the problem of the need for capital. It would also be possible to split the operations from the capital need, and continue to have the organizations run by University people.

Ms. Jackson agreed this was possible; a new corporation need not run everything, but could serve as a financial vehicle. The issues must still be addressed, she maintained. If the corporation were to outsource parking, there would still be a need to address human resource and control issues.

This sounds like Intourist, commented one Committee member; it ran restaurants and everything else, and provided lousy service. This organization could have no impetus to provide quality service and would be insulated from responding to academic programs. It would be better to have a profit-making service with standards, that could be docked, or for the University to do it itself.

Would the University have representatives on the governing board? When the University had representatives on the supercomputer board, the result was a disaster because of the University representatives; they were responsible, and not, to the University. Ms. Jackson agreed, and said that is why detailed performance objectives must be agreed to by all, and not have the corporation simply generate $100 million in capital funds. Generating capital is simply a MEANS to achieve the performance objectives, which must stipulate things such as "there will be X number of reasonably-priced rooms."

What have other institutions done, asked one Committee member? There is information in the report, it was said; some are so economically viable they are stand-alone businesses supporting the institution.

A question was raised about the "south mall"; Ms. Jackson said there are three distinct projects in the south mall: Coffman, the parking ramp, and housing, the costs of which, added together, are a very large number (just under $100 million). If they are linked, and there were a south mall development, would there be a different way to approach them? Perhaps they would only cost $80 million, Ms. Jackson said; she is not advocating an $80 million expense, but if the projects are to be completed, $80 million is better than $100 million.

What guarantee is there the academic point of view will be loudly heard in a new corporation, asked one Committee member? Ms. Jackson said she has asked Marcia Fluer, Director of University Relations, to bring students and academics together to be sure that objectives are clearly defined. Such an effort would not work without the support of constituents.

If one considers recent history of parking, recalled one Committee member, it has been difficult to deal with rates, and Assistant Vice President Tschida said he did not even need to come to the Committee to vet figures. That caused apoplexy on the Committee, but rates went up anyway. A separate corporation will lead to higher rates than at present. It has been said the University does not charge market rates, which is true, but people at the University are not PAID market rates, either. A private corporation could say it has the responsibility to raise money, and makes no guarantees about rates.

The case with housing might be parallel, perhaps more severe, said another Committee member. People must pay for parking; with housing, parents or students could look at the combined price of tuition and housing, and decide to give up University housing. What has happened elsewhere? There have been agreements that any increase above a certain percent have to be approved by the institution (which owns the land), Ms. Jackson reported. Housing studies show students want to be on campus--up to a certain price; the demand is not inelastic.

The underlying issue is control and accountability, it was said; that must be pursued, and there must be links between academics and control that can be changed. Students must also be involved, Ms. Jackson said, because 50% of the support for Coffman comes from student fees; without those fees, Coffman would NEVER be viable. It would be inappropriate to direct student fees to Coffman if the union were private, said one Committee member--unless they controlled one-half the square footage, Ms. Jackson responded.

The committee talked a lot about control, Professor Robinson reported. The bond rating of a corporation depends to a large degree on the extent to which it can prove it is independent. It must be independent, and seen to be, to get a favorable rating, so caveats about control cannot exist. If there is a firewall between the organization and the University, which gets a 0.5% improvement in the interest rate, and a 0.4% improvement with 85% control, the University can live with the .4 if the economics are acceptable, Ms. Jackson said. There has to be modeling to see what price must be paid for what level of control. If the University says it must have control, and there is no improvement in the bond rating, the units could be set up as the operations division run by the Board of Regents.

Ms. Jackson commented that a lot of universities have subsidiaries to deal with business; Mayo has or had 37 at one point. Who controls the money, asked one Committee member? Normally, the charter would say that certain funds are returned to the University. If it loses money, it goes bankrupt and the corporation returns to the University.

The question of permitting the organization to be for-profit could also be examined, Ms. Jackson said in response to a query from a Committee member.

Professor Morrison, hearing no more questions, adjourned the meeting at 4:15.

-- Gary Engstrand

University of Minnesota