Minutes[*]

Senate Committee on Finance and Planning
Tuesday, November 1, 2005
2:30 – 4:15
238A Morrill Hall

Present: Kate VandenBosch (chair pro tem), Rose Blixt, Charles Campbell, Arthur Erdman, Steve Fitzgerald, Dan Hennen, Thomas Klein, Joseph Konstan,[1] Michael Korth, Judith Martin, Ian McMillan, Kathleen O'Brien, Jacob Olson, Kathryn Olson, Richard Pfutzenreuter, Justin Revenaugh, Karen Seashore, Michael Sertich, Susan Van Voorhis

Absent: Fred Morrison, Calvin Alexander, Daniel Feeney, Lincoln Kallsen, Charles Speaks, Jeffrey Spevak, Thomas Stinson, Alfred Sullivan, Michael Volna, Warren Warwick

Guests: Julie Tonneson (Office of Budget and Finance)

[In these minutes: (1) budget instructions; (2) capital request and six-year capital plan financing assumptions; (3) faculty promotional salary increments]

1. Budget Instructions

Professor VandenBosch convened the meeting at 2:30 and began with a round of introductions for the benefit of the three new student members in attendance. She then turned to Vice President Pfutzenreuter and Ms. Tonneson to lead a discussion of the budget instructions.

Ms. Tonneson reviewed the proposed budget development timeline (from the central administrative perspective). The support units are to complete their budgets by early January, with initial instructions going out in early October. In middle and late November there will be meetings with the support units and final budgets will be submitted to the senor vice presidents and President for approval in January. The cost allocations, part of the new budget model, will then be incorporated in the budget instructions to academic units. Ms. Tonneson identified the support units that have received budget instructions

Academic units will receive instructions in late January, meeting will occur from February to early April, and the President will make budget recommendations to the Regents in May (for review) and in June (for action). In response to a query from Professor Korth, Ms. Tonneson affirmed that the coordinate campuses are considered academic units; their budgets will be due in the spring.

Ms. Tonneson itemized the contents of the budget instructions to the support units. They include an overview of the new budget model, identification of 2006-07 as a transition year, and planning parameters approved by the Regents last spring (3% salary increases, 6.5% tuition increases, a $15-million reallocation). They request information similar to what is required for compacts, such as mission, performance measures, goals, space and facilities issues. They are also required to provide a detailed description of all funds and asked to raise significant financial concerns.

The biggest part of the exercise, Mr. Pfutzenreuter said, is what the units will do if they do not receive the funds to deliver the salary increases. They have been asked what they will do in that case.

[*] These minutes reflect discussion and debate at a meeting of a committee of the University of Minnesota Senate; none of the comments, conclusions, or actions reported in these minutes represents the views of, nor are they binding on, the Senate, the Administration, or the Board of Regents.

[1] Not present but only because of technology problems, so not counted as absent.

Is the assumption the new budget model will be accepted, Professor Martin inquired? It is, Ms. Tonneson said; the President has approved it.

What kinds of things come up when units are asked about significant financial concerns, Professor VandenBosch asked? Software licenses for Information Technology, delivery of financial aid to students for Financial Aid, sufficient funding to take care of buildings for Facilities Management, and for smaller offices, the need to cut equipment or impose layoffs if they do not receive funding for salary increases.

Professor Campbell asked if the new budget model changes the way that fringe benefits are handled; it does not, Mr. Pfutzenreuter said.

Ms. VanVoorhis asked about funding for activities that are system-wide versus Twin Cities campus. If something is system-wide, Mr. Pfutzenreuter said, she (and others in similar positions) are responsible for bringing forward identification of a need; if it is something specific to a coordinate campus, it is their responsibility to bring it forward to obtain resources. That process may not be effective when coordinate campuses project costs that are part of a unit on the Twin Cities campus; Mr. Pfutzenreuter agreed that the compact discussions have not been well-connected with the support unit budgeting process.

This will be a difficult budget year, Mr. Pfutzenreuter told the Committee. There will be fuel cost problems, among other things, and the University will likely make a supplemental request to the state to deal with fuel costs. The budget also calls for a reallocation of $15 million, with many other things going on, the resources will be stretched. There is a $15-million investment pool in the capital budget for strategic positioning because they know things will happen that will require funds. They will also need a pool of funds to deal with things they don't know will happen.

In response to a question about saving money by "burning Cheerios," Vice President O'Brien explained that the University's steam plant is equipped to burn biomass in addition to coal and natural gas. One form of biomass the University has requested permission to burn is oat hulls, which are the byproduct of making Cheerios (made in northeast Minneapolis). The estimate is that the University would have saved about $4.5 million in fuel costs had it been able to burn oat hulls in the last year. Ms. O'Brien expressed confidence that the University would receive the permit to burn oat hulls, which would be environmentally and economically sound. There is also work being done at the Morris campus in both biomass and wind energy; the turbine activated last spring provides about 60% of the electricity needed by the Morris campus.

Could wind energy be tapped on the Twin Cities campus, Professor Martin asked? What they are finding, Vice President O'Brien said, is that there needs to be a particular kind of wind and that positioning is very important. This is a trickier business than one might think. They hope to increase the capacity at the Morris campus and save the energy for use elsewhere in the system.

Professor VandenBosch thanked Ms. Tonneson for her presentation.

2. Capital Request and Six-Year Capital Plan Financing Assumptions

Mr. Pfutzenreuter distributed copies of a handout and reviewed the financial assumptions underlying the upcoming capital request and six-year capital plan.

The 2006 capital request will total $269 million, of which the state is being asked to provide $206 million. Of the state funds, $80 million will be in HEAPR funds (building maintenance and renewal and which do not require a one-third University match) and $126 million will be for new building projects. The

University's required one-third match for new projects will be $63 million (which, under the new budget model, will be paid by the units that get the new buildings). The projects in the request, in addition to the $80 million in HEAPR funds, are:

-- $39 million for Carlson School expansion
-- $23 million for Labovitz School of Business at Duluth
-- $62 million for a science teaching and student services facility (to be located where the never-finished Science Classroom Building sits, on the east end of the Washington Avenue bridge across from the Weisman Museum)
-- $60 million for a medical biosciences building and infrastructure
-- $4.2 million for research centers and field stations.

Of the $63 million the University must contribute, fund-raising and debt will be used, but private funds and unit resources will reduce overall borrowing costs.

Mr. Pfutzenreuter reviewed the projected debt service and operating costs for the facilities requested in the 2006 capital request. Debt will peak at about $6.2 million in 2009 (it will be sold for 20 years at a project 5.5%); new building full operating costs will also occur in 2009, about $4.3 million per year (and increasing marginally each year thereafter). These buildings are adding square footage to the campus, he noted.

Professor Seashore inquired if there were any buildings coming off line. Vice President O'Brien asked her which ones she would like closed. She said that they continually try to determine which buildings should be invested in (e.g., Folwell, which is a campus icon) and which should not. They are considering taking some off line.

Mr. Pfutzenreuter next reviewed the factors that bond-rating agencies use to determine the University's rating, which affects how much it can borrow. There are four major factors: state support (40%), student demand (20%), management analysis (10%), and financial statement (30%; ratios that related to liquidity, debt burden, and operating performance). The University is a strong Aa institution. Mr. Pfutzenreuter explained the various debt ratios and debt capacity projections that the rating agencies use.

Debt service assumptions include retaining the University's Aa rating, following existing amortization schedules for existing debt, the University has outstanding debt of $667 million as of 6/30/05 at an average rate of 4.48% and average life of 11.2 years ("cheap and short"), that it will take on $59.9 million in new debt (previously- and newly-authorized projects, which is separate from the 2006 capital request), and so on.

The projected debt balances through 2012 show a peak in 2006 (because of the new debt being added) and then a decline (which assumes that no new debt will be incurred). A lot of the principal is paid down, Mr. Pfutzenreuter said, which is the intent, so that the University can recycle debt. The University's debt includes the Gateway center because it is an "affiliated organization" under accounting rules. The Gateway debt does not decline at all during this period because only interest payments are being made; there is a bullet payment due in the late 2020s (which presumably the Gateway Corporation is saving money for).

Of the current and projected debt service, roughly one-half is for auxiliary units and one-half is for academic facilities.

The upshot of the analysis of the debt ratios the bonding agencies use is that the University is well-positioned to take on increased debt, Mr. Pfutzenreuter said, because its credit is good and it does well on the measures used. He said he is reluctant to identify the University's debt capacity, because while one can quantify the financial ratios, "strength of management" and "state support" are less certain measures. But a robust debt capacity does mean the University can afford more debt—does it have the money for payments? Is it a priority to spend more on debt service? The major question is source of payment.

One of the growth assumptions that Mr. Pfutzenreuter touched on was a projected 7% growth in Foundation assets and a 5% increase in Medical Foundation assets. Professor Seashore asked what happens if those growth levels are not achieved. That is about what happened last year, Mr. Pfutzenreuter said, and if the asset were to grow more slowly, it would simply mean that the University's hypothetical debt limit would be a little lower. He said he is not uncomfortable with the 7% projection; it is about normal.

Is there any concern, given these assets, that some in St. Paul might believe the University should pay more than one-third of the cost of new buildings, Professor Martin asked. That is why he emphasizes source of payments, Mr. Pfutzenreuter said; the University needs to have the money. It could spend up to its debt capacity over the next 6-8 years, but will have to pay the debt, and a new president at some point down the road would want some money to spend. The Board of Regents will not want to spend up to the limit.

Professor Erdman asked about the 2006 capital request and the cost of buildings. That is part of the dilemma, Mr. Pfutzenreuter said: when one looks at what it will take to be among the top three public research universities, the price of research facilities is challenging. There are no more $20-million buildings; they all cost $60-70-80 million. One problem is state policy: the bonding bill can be no more than about $800 million, for the whole state. When the University brings 4-5 projects with high prices, it is difficult for them to compete with (for example, $3-million) projects spread around the state in legislators' home districts. The University struggles to pay for these buildings, and it will not get to where it wants to be if they have to compete with home-district projects. The University needs to think about finding ways to fund biomedical research buildings through the state so they are not competing with projects around the state in home districts.

The state wants to push the University as an economic engine, Professor Martin observed, and measure performance by patents and royalties and so on; is there a way to take these considerations into a separate category? The administration is thinking about this issue, Mr. Pfutzenreuter said, especially with respect to medical and bioscience research. How do private universities do this? What are other states doing? The privates use donors, but in general there were no answers to the questions. It seems like the state must buy in if there is to be any change in the model for funding medical research facilities, Professor Erdman surmised; Mr. Pfutzenreuter said he didn't see the funding coming through the normal budgeting process. The state will have to make a first-dollar decision to invest.

Is there any thought that the federal government might come up with some funds for these kinds of facilities, Professor Seashore asked? Mr. Pfutzenreuter suggested that the Committee speak with Mr. Engelen, the University's federal relations director, about the earmarking process.

With the new budget model, will there be a change in debt service, Professor VandenBosch asked? Mr. Pfutzenreuter noted that units that get the buildings pay the debt service. The President will have to decide if he is willing to provide the unit with additional funds to help pay the increased debt.

Mr. Klein asked if any of the strategic positioning task forces have an alternative funding model for medical research facilities in their charge. Mr. Pfutzenreuter said they have just begun to think about this, so not. Mr. Klein suggested that this could be part of a charge.

Professor VandenBosch thanked Mr. Pfutzenreuter for his presentation.

3. Faculty Promotional Salary Increases

Professor VandenBosch recalled that at a recent meeting, the Provost asked the Committee to develop a recommendation for changing the increments to be award to faculty when they are promoted from assistant to associate professor and from associate to full professor. The increments were set in 1993-94 and have not changed since: $1500 for promotion from assistant and $2000 for promotion from associate. Committee members were provided copies of the current policy, which can be found at http://www.fpd.finop.umn.edu/groups/senate/documents/policy/faccomp.html

The pertinent language of the policy is this:

PROMOTION INCREASES

> Beginning with the 1993-94 salary year, promotion from assistant professor to associate professor will be accompanied by an extraordinary $1,500 increase in base salary and promotion from associate professor to professor will be accompanied by an extraordinary $2,000 increase in base salary. It is intended that these promotional increments will be in addition to the annual salary increase award related to meritorious performance. The dean will set aside, from those funds provided to his/her unit for salary increase distribution, sufficient funds to cover these promotional increments. It is understood that the dean may also set aside funds from this overall pool to address special merit or retention purposes. It is intended that this promotion increment will receive inflation-related increases in future years.

When this was adopted, Professor Seashore said, it was a way to address inequities across colleges, a way to equalize treatment. There was some thought at the meeting that the amounts were floors, but a closer reading of the policy convinced Committee members that the policy stipulated an amount that had to be delivered.

Professor Seashore said she thought this was a poor precedent for faculty; it provided very little incentive for faculty not to move at the point they receive tenure (when they could then take a tenured position at another university). There is no easy way for a department to say that it likes a faculty member and wants to keep him or her. Why is there a bind, Professor Campbell asked; a department can deliver more money. The ability to do so varies by college, Professor Martin said. That was the concern the last time this came up, Professor Campbell said: how to deal with these promotional increments vis-à-vis regular merit raises. If there is less money available for merit raises, and the promotional increments are to come from the merit pool, there is even less then available for merit raises. This was supposed to come from a separate pool, it was thought, but the policy provides that the dean is set aside from the salary increase pool the money for promotional increments. This is a terrible policy, Professor Seashore concluded.

Ms. Blixt recalled that these raises were part of the budget instructions in the past but were left open to interpretation. Some units gave only the $1500 or $2000 while others saw these amounts as a floor. She said she had not seen the policy before, but that is the way most units do it.

Professor VandenBosch said there are two issues. One is the amount of the increase; the other is whether any of the policy language needs changing. (It was noted that any changes, if to be effective for the 2006-07 budget instructions, should be brought to the December 1 Faculty Senate meeting.) Professor Martin said it would be helpful to know what the practices have been in the colleges.

There is no separate pot of money, Professor Seashore pointed out again. The money comes out of the total faculty raise pool. This is a serious equity problem, especially in smaller colleges; there could be years when faculty only receive the minimum raise because of the impact of the need to deliver the promotional increments. The Committee could suggest that the President use some of his "chunk of money" for promotional increments, Professor Martin said, but Professor Campbell said he did not believe the President would have any chunk of money. Right now the President controls the O&M budget and he will continue to do so in the future, and the only difference is that there will be different algorithms. Then the question is whether there should be a separate pool of funds for salary increments, Professor Martin replied, although where the funding would come from is not clear. The Committee could suggest a source, Mr. Klein said. Professor Seashore said it should not be that everyone should lower the thermostat to reward their colleagues. Mr. Klein agreed but said this is just an idea unless the Committee can identify a source of revenue.

Professor Campbell said there is not a lot the Committee can do. The administration directs that salary increases will be, for example, 3% but the colleges must produce the money. They can also obtain approval to give additional increases. The Committee could set the scale of the promotional increments, which is insufficient, or it could articulate a policy which provides that the promotional increases must be IN ADDITION to the raises the University announces for everyone and that the dean must find the additional money. For small units, Professor VandenBosch said, the lumpiness of the raises is an important point—in some cases there might be several individuals who qualify while in other years there may be no one. That affects what the colleges are able to do. It is only lumpy if the promotional increases are figured on an annual basis, Professor Revenaugh said, but if the college sets aside money for a cohort, it could deal with the cost. That, however, is not permissible under the current language of the policy, Professor Seashore suggested; the language needs to be changed to give the deans more flexibility, and the amounts should also be changed.

In 1993, most salary money came from the President and legislature, Ms. Blixt noted. Now the colleges provide almost 100% of the salary money. If new amounts are adopted, it must be clear that they are a floor. And that they must be detached from the annual salary pool, Professor Seashore added.

Professor Erdman suggested that a small group of people bring recommendations to the next meeting. It was agreed that Professors Revenaugh and Seashore and Ms. Blixt would constitute an ad hoc subcommittee to draft revised language for the next meeting, with Professor Revenaugh as chair.

Professor VandenBosch adjourned the meeting at 3:50.

-- Gary Engstrand

University of Minnesota