Minutes[*]

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

Present:	Fred Morrison (chair), Charles Campbell, Arthur Erdman, Steve Fitzgerald, Lincoln Kallsen, Thomas Klein, Michael Korth, Judith Martin, Ian McMillan, Kathleen O'Brien, Kathryn Olson, Richard Pfutzenreuter, Justin Revenaugh, Karen Seashore, Charles Speaks, Alfred Sullivan, Kate VandenBosch, Susan Van Voorhis, Warren Warwick
Absent:	Calvin Alexander, Rose Blixt, Daniel Feeney, Joseph Konstan, Thomas Stinson, Michael Volna
Guests:	none

[In these minutes: (1) new budget model update; (2) 2006 capital budget and six-year capital plan]

1. New Budget Model Update

Professor Morrison convened the meeting at 2:30 and turned to Vice President Pfutzenreuter to lead a discussion of the new budget model.

Mr. Pfutzenreuter distributed copies of a set of briefing materials that had been used with President Bruininks a day earlier and began by outlining the proposed model, "earned income/full cost." Briefly, all tuition, the UM fee, and ICR will be allocated to the units that earn them (the model retains the 75/25 tuition split for students enrolled in one college taking courses in another). Unit-earned revenue would continue to accrue to the units, as at present. State special appropriations will be spent as required by law. The President will retain control of the state appropriation, including compact investments and other select institution-wide fees (e.g., undergraduate application fees, bursar fees). Units (academic and non-academic) will be charged for central services using a variety of rate-setting mechanisms, depending on the service. Academic compact investments will be funded by an "off the top" allocation from the state appropriation.

In terms of costs to be assessed to units (and the basis for the charges), these have been discussed with the Committee previously:

Facilities Management operations (proportion of assignable square feet)
Utilities (actual consumption)
Debt & leases (actual costs)
Office of Information Technology (headcount, employees and students)
Administrative service units, such as the President's office, the Provost's office, etc. (proportion of total expenditures).

Revenue allocations were noted above, with the President making an annual decision about allocation of the state funds and other select institutional fees.

[*] 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.

There are three different types of cost allocation that will be used:

-- consumption-based (e.g., utilities), which creates an direct incentive toward desirable behavior

-- cost-driver based (based on relative share of identified cost-driver variable, such as head count for information technology); the variable acts as a proxy for use and there is no measurement of actual use (e.g., how much time people are actually using email or the web)

-- common-good-based allocation (cost allocated based on a variable accepted as a reasonable measure of participation); there is no direct or primary connection to incentives, it is just a reasonable way to fairly allocate a shared cost.

Since the last discussion, the budget model committee has reached conclusions about recommending cost allocations in several additional areas.

-- research ($14 million in 2005-06): this includes the Office of the Vice President for Research, Sponsored Projects Administration, Patents and Technology Marketing, Sponsored Financial Reporting, and the Academic Health Center Office of Research. The variable used to allocate costs to units will be their proportion of sponsored research expenditures, based on a three-year rolling average (to minimize the impact of annual fluctuations). The charge will be a fixed percentage of sponsored research expenditures applied to all units (e.g., if research services cost 3% of sponsored expenditures, each unit will be charged 3% of its sponsored research expenditures). In response to a question, Mr. Pfutzenreuter said that the AHC Office of Research is included because, the case was, if it were not in the AHC, its services would have to be provided by the Vice President for Research.

-- libraries ($31.4 million in 2005-06): this is Twin Cities campus only. Costs will be allocated based on a study done in the early 1970s by faculty and is used by Institutional Research and Reporting. Library costs will be allocated to units based on weighting of faculty and staff:

2	lower division undergraduate
3	upper division undergraduate
4	professional student headcount
4	graduate student headcount
4	faculty headcount (broad definition?)

Headcount will be lagged one year. This measure will be revisited in the future to determine its validity.

Committee members discussed who should be included in the headcount of faculty; Mr. Pfutzenreuter agreed that the subject needed further investigation before a final decision is made. Mr. Klein said the question should be whether the individual (in whatever category of "faculty") triggers the use of the libraries, journal subscriptions, etc.

-- student services will rely on three different approaches, depending on the service/cost. Student finance administration and the registrar will be allocated on total enrollment. Admissions, orientation, pre-health advising, and student affairs will be allocated on undergraduate enrollment on the Twin Cities campus. Graduate school operations will be allocated based on graduate student enrollment on the Twin Cities and Duluth campuses.

-- general purpose classroom costs will be allocated on the unit's proportional share of total student credit hours (this is Twin Cities only). The model may be refined in the future to encourage improved management of classroom space.

The Committee discussed whether there should be adjustments in the formula depending on where the class is held (e.g., lab, classroom). Mr. Klein pointed out the principle of simplicity: it is possible to gain accuracy with more complexity, but the result could be so complex it cannot be understood. Nor, Mr. Pfutzenreuter said, should the system encourage teaching classes in labs in order to avoid using classrooms (or the reverse, Professor Morrison added, so labs are being taught in classrooms and there are no beakers available).

Discretionary investment pools exist in the budgets of the senior vice presidents, the Vice President for Research, the President's Office, and in a system-wide account for compacts. The proposal suggests that in the future determining the size of the compact pool will be part of the annual budget process; investment decisions will be built into allocations to academic units; there will be no separate pool funded in a central account but investments will be tracked and communicated and built into compact narratives. Determining the size of the vice presidential pools will be made each year and funded from state dollars; these pools will not be counted in the costs of the vice presidential office that are assessed to the units. Mr. Pfutzenreuter said, in response to a question, that this will be a more transparent process than is currently the case (when these investment pools are buried in the recurring allocation to the various offices). The Internal Revenue Sharing (IRS) tax will be abolished.

There were a number of special issues that the budget model committee offered comments on.

-- distribution of fringe benefit costs (medical, dental, tuition): distributed on per-head basis rather than as a percentage of salary (at present, those units with higher salaries pay more, those with lower salaries pay less, but to change the system would mean a significant redistribution of costs. This item is being held for further study.

-- enterprise assessment: the new budget model eliminates the IRS tax but the committee recommends that the current enterprise assessment continue as is to pay off the cost of current projects; in the future, these costs would likely be built into the Office of Information Technology costs. The current assessment will need to go through about 2011 or a little later. The best estimates now are that the University will not need new technologies until perhaps 2013 or 2014, at which time whoever is in these offices can deal with the question.

-- expenditure base for administrative service units pool: what funds should be included in the pool for allocating costs? The budget model committee recommends including all funds, which does not determine which funds will pay the bill. This includes restricted funds (gifts, endowments, etc.) as well as sponsored funds. The Committee asked to see the data on the size of the administrative service units pool. There was a question about inclusion of scholarship funds.

-- fully loaded costs: in allocating costs, should each cost pool (e.g., libraries) only reflect direct costs? The budget model committee recommends that allocated costs for a unit/service should include both direct costs and that unit's share of other costs (e.g., the charge for the libraries will include the facility and technology costs that are assessed to the libraries).

-- auxiliaries and Internal Service Organizations (ISOs): the budget model subcommittee recommends that certain auxiliaries (which includes units such as parking, housing, food services, the bookstores, and athletics in part) be allowed to opt out of facilities operations and maintenance charges because they currently have other arrangements that allows them to deliver services at lower costs. In the case of ISOs (e.g., fleet services), the budget model committee recommends excluding ISOs from internal charges because the complications that arise with respect to charging for research grants make it so difficult to allocate costs that it would not be worth the effort.

-- pushing the model to departments: should colleges be allowed or encouraged to push the model to the department level? The budget model committee recommends leaving that up to each unit, subject to explicit approval from the Budget Office and the central administration. What if the college wants to extend the model but the departments do not? The central administration will have to settle the issue, Mr. Pfutzenreuter said. It might work in some places but not others due to different cultures. Would a college be required to implement the model uniformly, if it chose to do so? Mr. Pfutzenreuter said he had not thought about that question but his sense is that a college would have to be uniform.

Professor Seashore asked if, with this revised budget model, there would be double taxation because of dual administrative structures in the Academic Health Center and the rest of the University. Are units paying for two infrastructures? The ultimate question is whether the rest of the University is subsidizing the Academic Health Center, or vice-versa. The budget model committee has talked about this, Mr. Pfutzenreuter said. They will look at all nine costs that are to be allocated (utilities, libraries, research, central units, student services, and so on) and array them by college to see who the biggest users of central services are. That will help to clarify who uses services. Professor Morrison suggested that one could add up the research expenses of the AHC units and those of the non-AHC units, look at the distributed costs, and see which group is paying the higher rate. Mr. Pfutzenreuter agreed but said they do not have those numbers right now. To separate them would mean additional costs and a separate allocation of costs for the AHC. Professor Seashore said they were not suggesting any change in the model, only that the Committee would like to see the data.

Mr. Klein asked if there would be a basic level of service for research that will be automatically provided to units, and the units then offered the option of buying additional services at a cost to the unit. And if so, is the AHC receiving the basic service or more? Mr. Pfutzenreuter said that Senior Vice President Cerra maintains the AHC will only receive the basic level as part of its costs. Who will engage that discussion, Mr. Klein asked? It was agreed that the Committee would invite Senior Vice President Cerra and Vice President Mulcahy to discuss assessment of research costs.

Vice President Pfutzenreuter reviewed the timeline for budget development, from the central perspective: administrative/support units will have to have budgets completed by early January in order that rates can be established for academic units. Academic units would receive budget instructions in late January, with final budgets prepared in April for presentation by the President to the Board of Regents in May and June. He also reviewed the next steps in the process, which includes implementation within the next two weeks or so. The new model will be presented to the Board of Regents in concept as a discussion item.

Several questions were asked.

-- What about public spaces in buildings? All space will be assigned to a unit, but some will be held (swing space) until it is assigned. Public spaces in buildings will be assigned in proportion to the assignable square feet a unit occupies in that building. (So central classrooms will be assigned a portion of the cost of the stairways in the buildings where the classrooms are located.)

-- Most discussions of common goods have focused on the libraries, so it is surprising to see it funded on a cost-driver allocation basis rather than as a centrally-funded common good. Mr. Pfutzenreuter said that all should support the libraries but they recommended that all units should provide proportionally reasonable support rather than funding the libraries "off the top." Professor Martin, who raised the point, then suggested that the terminology in the presentations be changed because the funding is not a "common good based cost allocation."

-- Have they thought about behavior changes that might occur as a result of the new model? If the charges are high enough, might colleges duck out of space to avoid the costs? The units cannot just abandon space; it must be taken by another unit. They will help units "sell" space, Mr. Pfutzenreuter said; Vice President O'Brien said the question is whether space can be aggregated to the point where it is usable by another unit, but she assured the Committee that individual departments and colleges would not have to become realtors.

-- The initial point of the model will be to allocate costs so that units can pay for them, Professor Campbell observed. If a unit is charged for something on the basis of headcount, it will be allocated enough money to pay that cost. But there could be perverse incentives, so a unit would reduce its headcount once it had the money.

-- What happens to units that, for example, teach in Rochester and Duluth; will they still be charged for the student credit hours they generate, even though the costs will not be incurred on the campus? Mr. Pfutzenreuter said those issues needed to be examined further. The general principle, Professor Seashore said, is that if a department takes classes to more convenient locations for students, the charges should be adjusted. The budget model assumes that all instruction takes place in dedicated University classrooms. There is also the question of whether distance education credit hours should be included in charges for classrooms, Professor Martin pointed out. Mr. Kallsen welcomed suggestions from the Committee for a better, but uncomplicated, way to distribute classroom costs.

Professor Morrison thanked Mr. Pfutzenreuter and Mr. Kallsen for the discussion, and asked them to move on to the next item.

2. 2006 Capital Request and Six-Year Capital Plan

Mr. Pfutzenreuter again distributed a handout and reviewed it with the Committee.

The draft capital request for 2006 totals $269 million, with the University contributing $63 million as its one-third share of new construction, the state contributing $126 million as its two-thirds, and an additional $80 million in HEAPR (Higher Education Asset Preservation and Renewal—building maintenance), which does not require a one-third match from the University. The total request for state funds is $206 million.

In addition to the $80 million in HEAPR funding, there is $189 million in project funds (Carlson School, Labovitz School of Business at Duluth, Science Teaching and Student Services (TC), Medical research building and infrastructure (TC), and regional centers and stations). Some of the money that constitutes the University's one-third will be privately-raised funds, not debt service. Professor Campbell observed that the two business school items on the request have not been in the six-year capital plan for six years.

Mr. Pfutzenreuter then explained the rather complicated elements that go into the calculation of the University's debt capacity and the factors that affect its bond rating. By Regents' policy, the University is to maintain its Aa bond rating. The rating agencies look at several factors: student demand, state support, the financial statement (liquidity, debt burden, and operating performance), and management performance.

Mr. Pfutzenreuter reviewed the University's current level of debt ($667 million, with an average interest rate of 4.48% and average life of 11.2 years) and the new debt to be issued ($63.8 million, because of decisions already made about capital projects). The 2006 capital request, if approved in any part, would also carry implications for additional debt. He said that the University's goal is to recycle its debt—sell its debt as cheaply as possible, pay it off as quickly as it can, and thus recycle debt capacity. Of the University's annual debt service (about $62.2 million in the current year), about one-half is paid by auxiliary units and one-half by the administration/units that contribute to a share of the required one-third.

There is a set of ratios used by rating agencies that Mr. Pfutzenreuter explained to the Committee. The upshot of the analysis is that the University is in good shape and that it could, theoretically, increase its debt, based on the data used in the ratios, without compromising its Aa rating. But the key question, Mr. Pfutzenreuter pointed out, is not the strength of the University's credit, it is the source of payment if additional debt were to be incurred. It would have to come from institutional revenues, earned income, fund-raising, unit reserves, project revenues, or federal funds. If the University is to spend more on debt because it has the capacity to increase its debt, there must be a decision that the debt payment is more important than something else. The President, other academic officers, and others must decide that question. And the University can create more or less debt capacity depending on what bond rating it wants. But the important question is how any increased debt will be paid.

Professor Morrison looked at the data and suggested that the University has the capacity to absorb about $5 million in increased debt service in the next six years ($10 million, but half would be for auxiliaries), which would mean about $50 million in debt. So rather than incurring an additional $63 million in obligations in the 2006 capital request, the data suggest the University can take on only about $17 million in debt for each of the next three biennia. And if there is an increased debt service, which will be charged to the units that get the new buildings, will the President increase the allocation of state funds to them in order that they can pay for the increased debt service?

Does the new budget model apply to the 2006 capital request, Professor Morrison asked? It applies to the 2005 capital budget, Mr. Pfutzenreuter said, but will honor previous agreements about units coming up with one-half of the University's required one-third contribution to costs. After that, however, the new rules will apply in full.

Professor Martin inquired what measure would be used for new facility operating costs, given what is know about spiraling utility costs. Vice President O'Brien said the projections are based on what they know today.

Mr. Pfutzenreuter promised to obtain for the Committee data on time contributed by each unit to the development of the new financial system.

Professor Morrison thanked Mr. Pfutzenreuter and adjourned the meeting at 4:05.

-- Gary Engstrand

University of Minnesota