Minutes•

Senate Committee on Finance and Planning
September 8, 1992

Present: Irwin Rubenstein (chair), William Gerberich, Karen Geronime, Virginia Gray, Craig Kissock, Fred Morrison, Jeff von Munkwitz-Smith, Mary Sue Simmons

Guests: Rich Broderick (Footnote), Senior Vice President Robert Erickson, Assistant Vice President Susan Markham, Janet Warner (Finance and Operations)

1. Discussion of the Biennial Request

Professor Rubenstein convened the meeting at 3:15 and explained that he had been asked to serve as chair of the Committee after Professor Speaks concluded he would be unable to serve. He welcomed Committee members to the meeting and then explained that he will be meeting regularly with Senior Vice President Erickson to discuss issues; he invited Committee members to suggest agenda items that he could work with Mr. Erickson on preparing.

Professor Rubenstein then welcomed Mr. Erickson to the meeting, who greeted Committee members and expressed gratitude for the continuity of Committee membership. He distributed copies of slides used in the presentation of the issues surrounding the biennial request to the Board of Regents and began to explain them to the Committee.

The parameters of the request, as established by the State, are to assume 3.5% inflation for the biennium and to seek no additional funds; a "first look" by the State at budget proposals has been set for September 15--much earlier than data are normally requested. The University has concluded, Mr. Erickson said, that it cannot develop specific numbers for compensation increases, program cuts, and tuition because that creates an impossible situation--the numbers become the basis of the discussions (and fights). For some faculty and staff, salaries will depend on state decisions with unions; tuition has already been increased 9% for the last two years (more in some units); and there have already been a lot of program cuts, with nothing "easy" left.

What is needed, Mr. Erickson said, is a discussion by the University community, among it this Committee, on how to proceed. Any increase in state funding will be difficult to obtain, given a projected $837 million shortfall for the biennium and the possibility of substantially increased costs in K-12 education because of lawsuits concerning equality of district funding.

The appropriations to the University over the past three years has declined from $463 to $447 to $438 million--and the last figure includes $2+ million for the HealthRight bill for the University Hospital, so the last figure is actually $435 million in comparable terms. Tuition income, meantime, has increased from $137 to $151 to $172 million. The totals ($612, $611, and $623) represent an essentially "flat" budget, along with a considerable decline in actual purchasing power over the three years.

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At present the University has increased salaries by 5% over the last two years, has contracted faculty and staff by approximately 1,000, and has seen its Reallocation plan blunted. The administration wishes to continue Reallocation, but it will be difficult if there are additional cuts.

Infrastructure and facilities are a MAJOR problem that will have to be addressed. Maintenance and operations costs for new buildings coming on line (that is, INCREASES in costs, not the total costs) go from $889,000 during the current year to $4.365 million by the end of the 1994-95 year; debt service cost increases go from $2.854 million to $4.830 million during the same three-year period. The latter figure, Mr. Erickson reminded the Committee, was -0- only two years ago. The total increases for the three years (this year plus the next biennium) go from $3.7 to $7.3 to $9.2 million. The current-year increase of $3.7 million has been covered from contingency funds, but the additional increases in the future will force reallocation from other places in the system--these are annual, recurring expenses the University has not had before.

The University's assumptions, the context, for the request is that inflation is expected to be moderate (the Finance department assumes 3.5% per year); higher education remains a priority, but behind health care, the environment, and K-12 education; that the outlook is for slow economic improvement; and that there will be a projected State budget gap of $837 million. The State's reserves cannot be reduced any further, Mr. Erickson told the Committee, without forcing short-term borrowing.

Instructions from the Department of Finance call for requests from education at the 100% level of funding (i.e., no inflationary or other increases) but with the possibility of new initiatives. The University's budget, by formula agreement, will be slightly larger than in the current year because of adjustments to the base; these increases will be 0.33% and 0.56% for the two years of the biennium.

The key issues--the variables that can be worked with--are the state appropriation, tuition, compensation and inflationary increases, cuts/contractions and reallocation, and new initiatives. A plan will need to be fashioned from those factors.

Mr. Erickson then reviewed the history of University biennial requests and appropriations for the last twelve biennia; the lesson to be drawn, he said, is that being more aggressive does not necessarily lead to larger appropriations. But the question does arise: Should the University make an aggressive request, but with no hope of obtaining all of the funds, or start out with a reasonable request and then fight to maintain it?

The Committee then considered the various possibilities for the State's financial picture during the biennium and the University's share of the revenues based on the historical patterns.

There are several ways one can approach the biennial request. One is to seek to restore 1990-91 base funding in real terms (i.e., reflects inflation and restores cuts)--which would require a request of $168 million in increases, or 17% the first year and 21% the second year. With the $837 million deficit looming, the administration has concluded that the chances of obtaining such are increase are remote--but the numbers do demonstrate the true impact of the recent cuts and inflation on the University's budget.

A more realistic approach would be to request funds to stop the inflationary erosion and permit a few new initiatives in areas of outreach involving public health and the environment, and distance learning. Such a request would seek the 3.5% inflationary increases plus $11 million for new initiatives in the first year of the biennium ($12 million the second year). Position papers are currently being developed on these initiatives. Another part of such a request would be to seek the return of the last $6.5 million in ICR funds the legislature withholds, funds that would be used for infrastructure improvements (including libraries and computing as well as bricks and mortar). Under this alternative, the University budget would increase about 9% for the biennium. Mr. Erickson said it was his view the administration has the duty to submit a request like this in order to stop the erosion of the institution. Committee members briefly discussed ICR funds and the nature of the outreach initiatives that might be undertaken.

Another approach to the request would be to submit a request with no increase in funds and itemize the tradeoffs that would have to be considered among infrastructure needs, tuition, inflation, and further contraction. The tradeoffs include inflationary increases (salaries plus operating expenses) versus tuition, holding state income stable; for example, 1.0%/1.5% increases in salaries and expenses would require approximately 3%/3.5% tuition increases for the biennium. Providing 3.0%/3.0% increases in salaries and expenses would require corresponding 10%/9% increases in tuition.

The University, Mr. Erickson explained, intends to present tables and examples--such as the ones that were presented at this meeting--to the legislature and the University community; there needs to be a University discussion of these alternatives. Irrespective of what the legislature does, the results will have to be dealt with afterwards, and discussions must occur about the alternatives. Inflation/tuition tradeoffs, for example, of 2/2% and 5/5%, respectively, would leave a deficit of $6 million for the biennium--apart from the increases necessary for building maintenance and debt service. Recognizing inflation to the extent of 1/1/5% increases, with 3/3/5% tuition increases, would cause no deficit--again, except for increases in facilities costs.

Mr. Erickson inquired of the Committee its views on the approaches that have been laid out. He said, in response to one query, that there has been no indication of a separate salary bill; salaries would be paid from the funds appropriated. Some institutions, it was suggested, have been seeking to increase the enrollment of nonresident students, who are billed for the full cost of instruction plus slightly more; has the University considered such a strategy? There are, it was noted by another, a lot of different actions being taken around the country on tuition, cuts and closings, early retirements, and salaries.

Mr. Erickson related that the revenue sources of several midwestern institutions were recently examined; one shows by the choices one makes, he said, the changing character of the institutions. The institutions have different revenue sources, considering such things as a hospital, private, research, and other funds, and tuition. Changes in policies can make a difference over time; Mr. Berg has studied the impact of different tuition policies, for example. Other changes can also be effected; the University, for example, has substantially increased the amount of private funding it has obtained.

One question that arises, with respect to tuition, is whether or not there should be a closer relationship between the cost of instruction and tuition charged. A study allocating costs by unit and campus suggest that there has been no conscious policy. Programs in which non-resident tuition does not fund the full cost of instruction, for example, raise questions.

On the one hand, this picture seems too rosy, commented one Committee member; it is difficult to imagine how the legislature would be able fund increases for the University with an $837 million deficit. On the other hand, higher education has changed a lot over the last 12 biennia; the State University System is now larger than the University and the technical and community colleges have grown a lot.

The University needs to establish a clear picture of itself and its relationship to the other systems, one which identifies its role in the new world of higher education in the state.

Mr. Erickson said this would be at the heart of the two-year strategic planning process that Dr. Infante is now leading. Higher education is at a precipice, Mr. Erickson commented; major changes are coming, driven by funding constraints as well as by technological and telecommunications changes. A symphony in 1920 could only be heard by those present; today it can be heard simultaneously by virtually anyone on the globe. The University, as one of the top 20 research institutions in the country, must make those changes work for it. Today one can have a class originate at the University and be hooked up to Madrid, Paris, Rio de Janeiro, and Singapore--and it can be interactive. Such an effort is not cost-effective right now, but it soon will be. There is so much changing that the University must attend to planning, but must also bear financial parameters in mind.

The administration, he related, has wrestled about the right way to proceed; the University is obligated to tell its story, he said. After doing the best job they can, the institution will have to deal with the cards it is dealt.

There are two different problems involved, observed one Committee member. One is how the University positions itself in the political process; the present members of the administration have different lobbying styles than their predecessors and probably have simply to be honest in those styles. This is an issue that the administration must address. The second, more worrisome problem, is how to seek even modest increases but at the same time be prepared, next Spring, for the possibility the University will obtain less than it wants--how can planning take place without undermining the legislative presentation?

A major determinant of what the University will need, Mr. Erickson responded, is inflation and the compensation settlements here and nationally. In terms of balancing the factors involved, the Board of Regents has talked more about tuition than in the past, because it is seeing the cumulative effects of double-digit increases. The portion of instructional costs paid by tuition over the past three years has increased from 37 to 40 to 44% this year; it will not be easy to continue this pattern. The University is backing into a "Waldorf"-type plan. The danger, added one Committee member, that it is backing into a "high tuition, high aid" plan--but without the "high aid."

These are decisions the University community must be involved in, Mr. Erickson said; in the public sector, there should be no surprises and the administration is trying to make the numbers as transparent as possible. There are a limited number of choices available, he pointed out; one can work with tuition, program cuts, and compensation. The necessary discussion must occur over the next few months as the University goes through the process of presenting information to the State.

The Committee appeared to endorse the strategy Mr. Erickson had outlined.

2. Temporary Investment Program

Professor Rubenstein welcomed Ms. Janet Warner to the meeting to discuss the revived Temporary Investment Program (TIP). With the new CUFS system, she explained, there is a new structure to the TIP. The Finance office has been working with contacts in each of the college offices to establish the new plan, which would pay 3% on balances in excess of $15,000 and charge 5.5% interest on deficits in excess of $15,000; the 5.5% is the University's cost of borrowing funds. At present they are working on a pilot run to see how the units will be affected.

One Committee member expressed strong support for the plan, including charging interest on deficits, but voiced serious reservations about certain elements of it. That "balances" will be defined later is a cause for alarm; the definition of balances under the old system was the source of long and heated contention. Furthermore, when will fund balances be available to the units? As of July 31 they are not; how can a unit manage accounts when CUFS cannot provide balance information? And if central administration can calculate the balances, why does it not tell the units what they are? Finally, it is not clear how the $15,000 balances and deficits will be calculated. Inherent in the system are decisions to keep some accounts over-funded and others underfunded.

The idea, Mr. Erickson said, is to keep the program as simple as possible, which is a major reason the colleges were selected as the units focussed on. They can, internally, break out expenses. The University, however, rejoined one Committee member, works at the department level, not the college. The colleges, Mr. Erickson said, can make internal determinations any way they wish, but for the central administration to attempt to run the program at the department level introduces enormous complexity. By focussing on the college, account balances and deficits can be aggregated and flexibility can be provided to the units--the information about the internal unit balances will be available.

Account balances, Ms. Warner explained, were not expected to be available on CUFS until August or September; they are on track to provide them. There was somewhat heated discussion about whether or not, and when, balances would be available to units, and whether or not the information would be timely enough to make transfers to avoid charges under the TIP program. Implementation of this plan, while discussion of the definition of "balances" continues, will result in chaos, charged one Committee member. While in favor of the program, it is frightening to know that balances will be defined later. It is within three weeks of the end of the fiscal quarter and units have no definition of balance and no ability to learn if accounts are overdrawn and require transfers; units will be told they owe 5.5% on overdrafts that they do not know about.

It is for these reasons, Mr. Erickson explained, that the first run will be a trial, with no interest paid or charged. This is a transitional period, and units should have continuous balances soon. There is, it was asserted by one Committee member, no program in CUFS for balances that would be useful for the TIP program; a unit needs to call up four different numbers and then use pencil and paper to calculate balances. Asked why the computer could not calculate those balances, Mr. Erickson agreed that this is a problem that needs work.

The definition of balances, Mr. Erickson commented, is a technical issue that will be addressed; the purpose of this discussion was to take up the conceptual issues. There have been discussions about the level at which the program should operate, Ms. Warner added--college, department, or "org"; the colleges were selected to get the program going.

Committee members seemed to generally approve of the program, and accepted the proposition that the colleges were perhaps the appropriate place to start. Departments, however, are the management level in some colleges, and will not want to be forced to cover for others that do not manage well. There also appeared to be agreement that the system should NOT operate at the "org" level, because that admits the possibility of playing all kinds of games with accounts. Consideration should be given, however, it was said, to extending the system to departments in the future.

Implementation will be key, it was said, and the impact on the time required of departmental and collegiate administrators should be minimized. Units could spend a lot of time on this and end up saving very few dollars. Mr. Erickson noted that they have an accounting advisory group, comprised of representatives from the colleges, to help minimize the administrative issues at the college level. The system will not be perfect, he warned, but it is better to start and deal with discrete issues than to spend a lot of time trying to anticipate every problem.

Information should also be sought from college administrators, it was suggested, about CUFS and the costs shifted down to units; Professor Rubenstein said that might be the subject of a meeting of the Committee and representative college administrators. Mr. Erickson observed that CUFS has been installed but not yet implemented; the next phase is to move to decentralized operations and to look carefully at staffing needs.

One question, however, is whether or not the program does not deprive central administration of flexible funds it could use. Mr. Erickson explained that there had been a system in place which paid interest on balances but charged no interest on deficits, which led to very creative management on the part of many units. This plan provides more equity among units and permits them, with responsible management, to be paid for funds. He established a similar system at SuperValu, Mr. Erickson recalled, and it had a salutary effect on the entire organization. It is best to operate it at an aggregate level and to let the deans deal with the errant units that are costing the college money.

3. Discussion of the Steam Plant

Professor Rubenstein next welcomed Assistant Vice President Sue Markham to the meeting; she distributed several handouts on the progress of the steam plant changes.

There has been so much focus on other issues that it is desirable to focus on the economic ones as well, she explained. This involves over $700 million in public funds, because all University energy use is paid for from 0100 funds. This, she noted, is a dwindling source each biennium, so the University is using a greater and greater percentage of its legislative dollars for energy. The institution must be sure it has the flexibility to respond in the most prudent way possible to the circumstances--and fuel flexibility is CRITICAL in terms of saving money for the educational mission.

Overall, Ms. Markham said, the decision made was the one most fiscally responsible. The costs of the two alternatives were NOT equal when co-generation was considered; they were $30 million apart. And the carbon tax was factored in, she responded to a comment. The decision permits the University to make the most fiscally and environmentally sound choices; one can differ on the impact of the carbon tax, however.

The Committee's concern, Ms. Markham opined, should be about the University's financial position and being prudent and flexible--something permitted more by this option than any other. The University is being affirmative in its discussions with the community, she related, and the more she learns, the more she believes it appropriate.

The University is now negotiating with NSP to sell its excess capacity, which could bring in an additional $160,000 per year. They are also talking with the legislature, the Park Board, and the Historical Preservation Commission; the latter two groups were under pressure to oppose the University's decision but have decided not to after the discussions. There are opportunities to preserve a historic facility and to accelerate development of the river front--there is not the total opposition to the project that has been portrayed, Ms. Markham concluded.

There was some discussion of how the interim expenses of the project would be paid and whether or not units would be assessed part of the anticipated $3.5 million annual transition and upgrading costs for the next several years. There will not be charges to units except those which are support functions (the hospital, support services, etc.). It is not expected that there will be additional charges beyond those already budgeted, and major costs have been amortized over 25 years.

Mr. Erickson confirmed that the increased operations and maintenance costs he had discussed earlier in the context of the biennial requests did not include the costs of the steam plant. Ms. Markham pointed out that there are two items involved; the steam plant changes and the maintenance of the distribution system. The latter system must be maintained; the legislative auditor, several years ago, commented on the lack of charges and a rate system which would provide for the replacement of the distribution system (parts of which date to the 19th century). $3 million per year is now being set aside to capitalize the replacement cost that will soon be coming due--of the $300 million in deferred maintenance the University faces, $100 million is the steam distribution system.

The next step, Ms. Markham said, is the two years of environmental impact hearings. Asked if the hearing before Representative Vento meant that the application for the $55 million clean coal technology grant would be blocked, Ms. Markham explained that the state delegation in Congress appeared not to support such a block. Mr. Vento's interest is in the river front, Ms. Markham said; if one chooses any SINGLE criterion by which to judge the project and decision, one might have reached another conclusion. The Board of Regents considered a number of different factors in reaching its decision. The clean coal technology grant will be applied for. There is indeed a very real chance the University will obtain the money, Ms. Markham said. Examination of Foster-Wheeler plants in the east suggested that they are on the cutting edge of technology. Further, noted one Committee member, the federal government has decided to provide grants to reduce pollution inasmuch as there appears to be increasing reliance on coal as an energy source. Clean coal technology could increase efficiency by 30%, which would be a significant demonstration.

Professor Rubenstein thanked Mr. Erickson and Ms. Markham for joining the Committee.

The Committee adjourned at 5:10.

-- Gary Engstrand

University of Minnesota