Minutes[*]

Senate Committee on Finance and Planning
Tuesday, December 14, 2010
2:00 – 3:45
238A Morrill Hall

Present: Russell Luepker (chair), Jon Binks, Sarah Chambers, Devin Driscoll, Will Durfee, Lincoln Kallsen, Kara Kersteter, Lyndel King, Judith Martin, Fred Morrison, Richard Pfutzenreuter, Terry Roe, Michael Rollefson, Mandy Stahre, Thomas Stinson, Jeremy Todd, Michael Volna, Lori-Anne Williams, John Worden

Absent: Steen Erikson, Kathleen O'Brien, Paul Olin, Shruti Patil, Gwen Rudney, Karen Seashore, S. Charles Schulz, Aks Zaheer

Guests: Cynthia Kaiser (Minnesota Medical Foundation), Douglas Gorence (University of Minnesota Foundation Investment Advisors); Vice President Steve Cawley (Office of Information Technology), Professor Kathryn VandenBosch (chair, Faculty Consultative Committee)

[In these minutes: (1) state budget forecast; (2) University of Minnesota Foundation and Minnesota Medical Foundation; (3) update on EFS and 27 pay periods]

1. State Budget Forecast

Professor Luepker convened the meeting at 2:00 and announced wryly that the Committee would today receive good holiday news from Professor Stinson.

Professor Stinson distributed copies of slides with financial data and began by saying that the numbers had not changed since they were released on December 2. He expects to see a surplus of $399 million (about 1.3% of the budget) in the state budget at the end of the fiscal year (6/30/11), and he projects a deficit of $6.188 billion (16% of the budget) for the 2012-13 biennium. The $6.2 billion deficit takes into account the $399-million surplus. The projected deficit does not include inflation in expenses (but inflation is factored into the revenue forecast); if inflation were added to the expenditure projections, the projected deficit increases by another $1 billion. Professor Stinson said that for the Committee's purposes, the $399-million surplus for the current biennium is not important; it needs to focus on the 12-13 biennium, because that is where the money problems are.

The outlook for real GDP growth is modestly weaker through 2013. The November forecasts are lower in November of each year than in February. There was thought, after the November forecast, that the economy might be on a positive path, but the most recent jobs numbers have dampened that optimism; in November the economy did not add enough jobs to stay even with growth in the labor force. The impact of the federal tax compromise is mixed; some of its elements were in the forecast, but there has been a change in the payroll tax provisions that could mean 0.5 to 1.0% additional growth in real GDP in 2011, which would lead to more state revenue. It would not, however, be a lasting lift to the economy because much of the additional economic activity would be taken from 2012 and 2013, leaving the forecast for 2013 and beyond largely unchanged.

---

[*] 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.

Minnesota employment is recovering faster than the national average—but most states should be because the huge California economy is dragging the national number down. Minnesota lost 157,000 jobs from the peak to the trough in the economy but has gained back about 55,000. That is rapid growth in the state, but even if it continues it will take about two years to get back to where things were. Economists are calling the immediate past the Great Recession; the economy is out of it now but it is not recovering quickly.

FY2012-13 revenues are $904 million below earlier planning estimates, Professor Stinson said, but he has a little more optimism about the February forecast because of the federal tax compromise and the numbers he has seen. If there were to be an additional $1.8 billion in revenues, that would still leave a $4.4 billion state deficit. He emphasized that he is not OPTIMISTIC about the numbers, just slightly less pessimistic than he was earlier.

The expenditure forecast has been reduced for both the current and next biennium, Professor Stinson said, but the challenge is to explain the disparity between revenue growth and projected spending that is creating the budget gap. Revenues in FY2010-11 were 5% lower than in 2008-09; for FY2012-13 they are projected to increase by about 5% over 2010-11. Spending growth projected for 2012-13 is up by 27.5% ($8.3 billion) for 2012-13 over 2010-11. The major factors driving the increase in spending are replacing the federal stimulus funds, school shifts that reduced the 2010-11 spending, the school-shift buy-back in current law, one-time reductions made in 2010-11, and forecast growth in K-12, Health and Human Services, and other services of about 6 to 7%. About 70% of the last item is growth in Medicaid, typically for people with long-term care problems. The expenses are not growing 20%, as has been reported; the increase is more like 6-7%. There is still a $6.2-billion problem, but it is not accurate to point to huge increases in state spending as the cause. The outlook is not positive because there is a structural deficit; Professor Stinson provided projection for revenues and spending for FY12, 13, 14, and 15; FY12 has a projected gap of $4.3 billion; the subsequent three years have a projected gap that ranges from $2.2 to 2.7 billion. Those gaps do not include inflation.

The $6.2-billion shortfall is 16% of FY2012-13 projected general-fund spending, Professor Stinson noted again. The total spending is in these broad categories (in billions and percent of the total):

$11.9	30.9%	Health and human services
$3.5	9.1%	Property tax aids and credits
$15.6	40.5%	K-12 education
$2.9	7.5%	Higher education
$1.1	2.9%	Debt service
$3.5	9.1%	All other

Governor-elect Dayton has said he will not cut K-12 education; K-12 education and health and human services make up 72% of the budget, and health and human services is somewhat protected by maintenance-of-effort requirements in the federal stimulus law. Debt service is another 3%, which must be paid, so the remainder that is subject to greater cuts, the 25%, includes property tax aids and credits, higher education, and "all other." While the K-12 expenses can be shifted again, the next legislature and Governor will have a very difficult time.

Mr. Driscoll asked if the next Governor will be responsible for any unallotments. He will, Professor Stinson said, but that should not be an issue with the projected surplus of $399 million. The big problem is cash flow in February and March, when tax refunds are made.

Mr. Rollefson asked if there has ever been a bigger projected deficit. There has not, Professor Stinson said, although there may have been a larger one in the past on a percentage basis. The difference this time is that in the past, there was a supply of smoke and mirrors that could be used to address the deficits (e.g., the tobacco money, school shifts, and inflation had been taken into account), so the budget could be balanced without making fundamental changes in state government. The supply of smoke and mirrors at present is much more limited. .

Professor Martin reported that Professor Stinson was interviewed for a recent TPT program which featured discussion about a structural redesign of state government. Are there any ideas from that discussion that have any currency? No one knows, Professor Stinson said. There are a few people with a lot of experience in the new legislature, and there will be a new cabinet, and the Governor has some state government experience, but there are still many details to be worked out. He said he wonders if the Governor and legislative leaders fully realize the magnitude of the problem they face.

Will local budgets adapt, Mr. Worden asked? There is about $3 billion in smoke and mirrors that is currently available Professor Stinson said (not buying back the education shift and other steps that can be taken), but it is not possible to solve the entire deficit that way. Professor Morrison noted the projected deficits of approximately $2.5 billion per year in the next few years. If smoke and mirrors can deal with $2.5 billion in each biennium, that leaves $2.5 billion to be cut during each biennium. Professor Morrison also noted the three items Professor Stinson had suggested were more vulnerable to larger cuts: all other ($3.5 billion), property tax aids and credits ($3.5 billion), and higher education ($2.9 billion). Those three add up to about $10 billion; they will need to take a cut of 25% to get to the $2.5 billion in cuts required over the next two biennia. Professor Stinson said he was less optimistic than that; "all other" includes corrections, which will not be cut, so the pie is even smaller.

Professor Martin noted that one of the slides was headed "Without Significant Changes, Revenue-Expenditure Gaps Will Continue." Can there be any significant changes, she asked? Many people were elected on a promise of no tax increases, Professor Stinson said, but Governor Dayton is likely to veto any drastic cuts, so what will happen?

Apart from the allocation problem, Professor Durfee asked, are there other effects on the University from the forecast? Professor Stinson said he thought not in the short term. The quality of K-12 education is being affected, so there could be a smaller pool of qualified applicants to the University in the future. The University should focus on the appropriation, he said. There are a lot of things going on, and there will be many people trained in some areas (e.g., construction) who will not have jobs. How will they be trained for another job? That might be a role more appropriate for MnSCU than the University.

Professor Roe asked if the forecast would have much effect on bonding. Professor Stinson said there are two answers to that question. One, with respect to the State's bond rating, it will not make much difference. Two, with respect to the bonding bill, the Governor-elect has said he wants a big bill, as a way to put construction workers back to work. Professor Stinson reported that he has told Mr. Dayton that it makes a difference what the projects are: The job losses have not been in heavy construction (e.g., highways), they have been in the skilled trades and building construction. The question is how to design a capital budget to provide relief for those people. Buying land for a park does not provide jobs; improving trails does. For the skilled trades, asset preservation activities get the money flowing as fast as possible because architectural drawings and so on are not required. Professor Stinson said he did not know if that is the kind of bill the Governor will propose, but if he were preparing the bill, he would be thinking more about HEAPR funding than new buildings. But even then, if there were a capital budget of

$1 billion, only about 15% gets spent in the first year because of the planning process required for projects. The Governor will look for quicker action.

Professor Luepker asked if the budget compromise in Washington would have any impact on Minnesota. Professor Stinson said that the battle over federal tax rates would have no impact on the Minnesota revenue system because Minnesota taxes are independent of federal tax rates. Where it could have an impact is on capital gains; the forecast did not anticipate changes in capital-gains taxes, and if there are changes, they could add some funds to state revenues.

Professor Luepker thanked Professor Stinson for his report.

2 University of Minnesota Foundation and Minnesota Medical Foundation

Professor Luepker next welcomed Mr. Gorence and Ms. Kaiser to provide the Committee an update on the performance of the University of Minnesota Foundation and the Minnesota Medical Foundation. Both Mr. Gorence and Ms. Kaiser provided handouts for Committee review.

Mr. Gorence noted that he does not work for the University of Minnesota Foundation, but serves as the President and Chief Investment Officer for the University of Minnesota Foundation Investment Advisors (UMFIA), the investment-management subsidiary of the Foundation that reports to a separate governing board. He said that he could not provide the Committee information on the Foundation's plans.

Mr. Gorence reviewed the composition of the endowment pool of $1.3 billion: global equity, private equity, marketable alternatives, fixed income, and so on. Most of the funds are donor-related and come through the Foundation or one of the University's affiliates (the Arboretum, the Alumni Association, etc.). The endowment is composed of many investments, about 35% of which are illiquid—which are valued quarterly. The profile of the University's Foundation investments looks much like that of similar endowed institutions. In general, they try to obtain a better return on the funds by pursuing active strategies and by tying them up for a longer term.

Professor Luepker asked if they need to keep a certain percentage available in cash (4.8% of the funds are noted as being in cash). They keep a certain amount unencumbered, Mr. Gorence said. Liquidity has become a much bigger issue for endowments recently, but the Foundation came through 2008 reasonably well and was not forced to sell assets to meet its commitments.

Mr. Gorence also reviewed the 20-year growth of a $1 investment by the Foundation, beginning in 1990; he noted the return goal, the market benchmark, and the performance of Foundation funds. The Foundation has done better than its goal, and significantly better than the benchmark, since 1998. Over that 20-year period, asset allocation has changed, and the funds do not follow the market benchmark as closely as they once did because the portfolio is more diverse than it was in the past. Although the funds have done well through the recent financial turbulence, they have still not returned to their high point. One worry is inflation over the next 5-10 years, Mr. Gorence said; it is not a near-term issue but he said he is working with his board and the Foundation to better understand the ramifications and re-position investments for an inflationary economy.

The return goal is 6.0% annually plus the CPI. That is a stretch, Mr. Gorence said, and could only be achieved by taking high risks. He explained that his board will recommend to the Foundation that it change the long-term goal to 5%, which the Foundation will take into consideration in evaluating its spending policy.

Mr. Driscoll asked when they anticipate hitting the peak again. Mr. Gorence said he would like to answer the question, and his board is interested in getting back there as well. He looks at the markets every day and sees risks and rewards; they do not slavishly follow the markets but work with their managers to find better opportunities. Some of them take time to mature. So they don't chase the market, but work on a 5-10-year horizon. He said he believes they will catch up and surpass the earlier high point.

A 2009 study of rates or return ending 6/30/09 by the National Association of College and University Business Officers provided data indicating that UMFIA has done better than the median fund, especially over longer time periods.; it was about in the middle of the pack for endowments of $1 billion or more over ten years. They would have made more money in the last year if more of the funds had been invested in stocks, but those have also been more volatile in 2010; they need to be patient, Mr. Gorence concluded.

Ms. Kaiser, Chief Financial Officer and Vice President for Operations, next provided parallel information for the Minnesota Medical Foundation. She noted the allocation of assets and recalled that MMF now retains Commonfund to manage its assets, a decision made in the last two years. They have a comparatively small amount of funds (about $200 million), and Commonfund, which provides fund management and investment advice for non-profit endowments, provides investment opportunities that would not otherwise bet available to smaller endowments, thus allowing smaller endowments to participate in more diverse allocations similar to larger endowments.

They are pleased with the directions Commonfund has taken, but she noted final evaluation cannot be made on the basis of one year's performance, and MMF needs to see Commonfund perform through more market cycles and investment environments. Over the last year, MMF funds have performed better than the index and better than many larger institutions.

Professor Morrison prefaced his question with the comment that he did not mean it to sound hostile. He noted that that Professor Stinson had just provided the Committee a pessimistic view about the University's finances. Four weeks ago Mr. Mason provided a report on the University's endowment funds. The three of them (Mr. Mason, Mr. Gorence, Ms. Kaiser) are doing the same thing; what is the benefit? That is a cost-benefit question the University will need to start asking of many units.

Mr. Gorence said that the Minnesota Medical Foundation was established first, with its own governing board, and the University of Minnesota Foundation was established later, also with its own separate board, and the University has always had its endowment (managed by Mr. Mason's office). His sense is that his board leadership feels strongly about its own investment policies and fiduciary responsibilities. Initially, it was difficult for the Foundation to delegate responsibility to UMFIA; the decision to hire full-time professionals was a forward-looking step. He said he did not know how MMF and the endowment managers feel, but it does seem like Professor Morrison's question is an obvious one to ask.

Ms. Kaiser said that one gain from having three groups is diversification. There are different groups around the tables making investment decisions and bringing different approaches. The boards do have "due diligence" responsibilities, and while it would be possible to outsource all the investments to a common investing organization, the boards would probably have different allocation models and risk profiles as their respective missions vary. Ms Kaiser commented that the fees paid for investment are extremely competitive and she is not convinced that combining the portfolios would decrease these fees for MMF.

Professor Martin commented that the University will face a grim budget situation in the next couple of years, and there are only a few things it can do to respond. It can raise tuition, which may not be politically feasible, or it can try to raise revenue. What do they see as the prospects for fund-raising in terms of going beyond what they have traditionally done?

Ms. Kaiser said the good news is that they have more potential donors than can currently be developed, however this development requires the employment of fundraising staff. Cuts to the staffing model will decrease fundraising. It is a very direct relationship. Donors are skittish right now, so in many cases this is not the time to ask for donations, but rather to further develop the relationship with the donor so that when the donor is ready, they are in a good position. She said given required funding, she is optimistic they will be able to raise more money in the future. The University has incredible opportunities for donors who are interested in making a difference—the key is getting the message out and keeping the University's brand strong. Mr. Gorence said that while he is not in fund-raising, he agreed with Ms. Kaiser; he sees a lot of work going into development to raise more money, especially current gifts. He said that Mr. Goldstein, President of the Foundation, can provide the Committee with information on initiatives the Foundation is considering.

For many years the University thought of the funds from the Foundation as "gravy," Professor Martin commented, but it may not be able to continue to do so with funds disappearing. The problem, Ms. Kaiser responded, is that donors want their gifts to be the frosting on the cake—the investment that has impact and takes the University to the next level—not to replace other operating funds.

Professor Luepker thanked Mr. Gorence and Ms. Kaiser for joining the meeting.

3. Update on EFS and 27 Pay Periods

Professor Luepker next called on Vice President Pfutzenreuter to provide an update on improvements to the Enterprise Financial System and the administration's proposal for dealing with the problem of 27 pay periods that recurs about every 11 years. Professor Luepker also welcomed Vice President Cawley and Mr. Volna, both of whom joined the meeting at this point.

Vice President Pfutzenreuter noted that in January it will have been two and one-half years since EFS went live. They know, from feedback from many people in the University community, that they are unhappy with progress to date in implementing the system and that it is not meeting needs. He acknowledged that they have much more to do on EFS. He said he has developed what he thinks of as three "buckets" or topics that need to be addressed (and there is cross-pollination among the improvements):

1. Enhancements to financial reporting; this is a big issue.

2. A punch list of technical fixes that they need to pick up the pace on dealing with. The punch list includes some items that are so complex to solve because they are part of the core building blocks of the system, which leads to—

3. Architectural and structural issues (e.g., the chart of accounts, whether Human Resources should have one different from EFS), organizational design, workflow, and process issues.

The third bucket requires a step back in order to look at the thornier issues. One thought about the third bucket is to get peer review; there are a number of other large institutions using EFS (e.g., Iowa, Michigan, Ohio State). They may want to find out how those institutions are doing with EFS and what

Minnesota is doing right and wrong. They may consider hiring a consultant familiar with PeopleSoft (EFS is a PeopleSoft product) to look at the chart of accounts; it may be that there are things that could move directly from the third bucket to the punch list while there are other problems that involve core system issues. The University initially decided not to modify the system very much; that decision may need to be revisited, Mr. Pfutzenreuter said.

In dealing with the three buckets, the intent is to have users involved. He and Vice President Mulcahy will send a message to the University community, before the holidays, about the three buckets, and will get to work on them immediately after the first of the year.

With respect to reporting, they intend to take a two-pronged approach. Make enhancements and improvements to UMReports (which has its own punch list), and enhance the contents in the data warehouse. Business Intelligence is another tool that could help; it is time to expand participation in it and to do a pilot project with a substantial number of users in order to see if it will work as a reporting tool.

Professor Morrison asked if there is not a fourth bucket, system speed and performance. Vice President Cawley said that is an ongoing effort. They have staff working on it now. It needs review as a separate category, Professor Morrison maintained.

Professor Martin asked if they hear the same anxiety, frustration, and anger from their colleagues at Iowa and Michigan and Ohio State. Mr. Volna said he has had no recent feedback from them; when those schools went live with EFS in the late 1990s, it took them a lot of time to get to where they are now. He said they hope to learn from the experiences at the other institutions. Iowa put in a front-end system, Mr. Pfutzenreuter added. Mr. Cawley said he was involved in a peer review at Ohio State about five years ago; at that point they were just coming from the pain of EFS, so they have been settled for the last five or six years.

There could also be a question of adequate staffing levels, Mr. Pfutzenreuter said. Professor Martin said that what the Committee has heard is that the system works where units have created shadow systems, or in units that are less complex.

Ms. Stahre asked if there is any timeline for when certain problems will be fixed. They will have to, Mr. Pfutzenreuter said, but he is reluctant to provide one now because they do not have the entire punch list of fixes that are needed; they need to see the whole list and learn what users say is a priority. He noted that they were fixing CUFS up to within six or seven weeks of shutting it down; this is a constant process that is never done. Mr. Cawley said they are working on these issues now and will work on those deemed to be the highest priority.

Professor Luepker said he recognized that there are always fixes and changes; is there a target date when people will see substantial improvement? Mr. Pfutzenreuter said they have to figure out how much the fixes will cost and how much they can spend; after that is done, they can say what they will be able to get done.

Professor Durfee inquired what process they would use to obtain faculty views about the three buckets. Mr. Pfutzenreuter said that he, Vice Presidents Cawley and Mulcahy, and Mr. Volna meet every two weeks; they first group they met with on the reporting effort they asked to do more work because it was not clear how they would obtain user views. They need to get faculty and users on the steering committee that will be working on reporting. He said he would welcome volunteers; they want faculty with whom they can sit down and work out solutions. (There will be a steering committee for each of the

three buckets.) The intent is to do a pilot of the new tool with about 100 people, Mr. Volna said, and they'd like a subset of that 100 to meet with them.

Professor Durfee said he was more concerned about design than the pilot. A good process would obtain input in the design process. They need to go to various faculty offices and watch how people interact with EFS. Mr. Pfutzenreuter said they would do so. So did Mr. Cawley, who added that they will use an iterative process and ask people "here, how does this work?" Mr. Pfutzenreuter said they also want user and faculty views about Business Intelligence as an enhancement to UMReports.

Professor VandenBosch said, apropos the question of staffing levels, that that is a difficult problem to solve, because some units are flatter and thinner, and it isn't clear how the problems would be solved by adding more people. Anything they can do to relieve the workload per accountant would be welcome, especially during a time of financial constraint and units are scrutinizing every position. Mr. Pfutzenreuter agreed. They have no central service to help units with reporting, he said, and they will talk about having someone who knows Business Intelligence, UMReports, and the data warehouse dedicated to helping departments.

Does the staffing question include the number of authorized users and who can put data in the system, Mr. Driscoll asked? It is indirectly related, Mr. Volna said. They were very rigid about access early on, but have since relaxed the rules a great deal. To the extent that is not happening, he would like to know about it.

Professor Durfee asked if they had any sense for how improvements would be paid for. Mr. Pfutzenreuter said there are balances in some central units that can be used. They do not intend to go to the enterprise-tax pool (because the goal is to pay off the costs of the enterprise systems, and they will be paid off in 2016 if there are no additional costs, and they want to pay it off and end the tax). So it will probably be central balances that are used for consultants and developers. They will not go to the academic units.

Professor Luepker said the Committee appreciated the update and will continue to ask questions about progress.

Mr. Pfutzenreuter next took up the issue of 27 pay periods. He said that there is a working group looking at the questions; the group includes Professor Oakes, last year's Faculty Consultative Committee vice chair. The President has promised a fix.

The working group met a couple of weeks ago and thought about possible solutions for faculty and P&A staff; they believe the University must have a policy, so they will come forward with recommendations to consult on. (Another solution will be needed for hourly employees.) There will probably be four or five options, and they will talk to employee groups about them; the goal is to make a recommendation to the President. Mr. Pfutzenreuter said he hopes the options will be available by the end of January so that they can talk with the groups about what they prefer.

That sounds like a reasonable plan, Professor Martin said; she said she worries that they are working on a fix for next time that no one will remember. Their intention, Mr. Pfutzenreuter responded, is to put a policy in the policy library; some will not read it, and others will forget, but it will protect the University from potential grievances. Professor Morrison suggested it be put on the Notice of Appointment every year for everyone.

Ms. Stahre asked about paying everyone on the first and 15th of the month. That is a fix, Mr. Pfutzenreuter agreed, and is something the University can do for faculty and staff, but that system does not work for hourly employees. The University moved to biweekly payroll in order to avoid having two payroll systems. There is no perfect system, Professor Martin concluded.

Professor Luepker said he would put this back on the agenda in early February, and adjourned the meeting at 4:00.

-- Gary Engstrand

University of Minnesota