Minutes[*]

Senate Committee on Finance and Planning
Tuesday, October 8, 1996
3:15 - 5:00
Room 238 Morrill Hall

Present: Fred Morrison (chair), Bruce Bromberek, Jason Frick, Gerald Klement, Robert Kvavik, Gary Malzer, Roger Paschke, Catherine French, Richard Pfutzenreuter, Peter Robinson, Charles Speaks, Craig Swan, James VanAlstine

Regrets: Benjamin Senauer

Absent: Thora Cartlidge, David Hamilton, Patricia Ferrieri

Guests: none

Others: Michael Berthelson (Budget and Finance), Susan Nemitz (Academic Affairs)

[In these minutes: biennial request; incentives for managed growth; public-private partnerships]

1. Biennial Request

Professor Morrison convened the meeting at 3:15 and asked Mr. Pfutzenreuter to review the biennial request. Mr. Pfutzenreuter distributed copies of the document and noted that the final version would be prepared by October 23. There have been only minor wording changes since the Committee last reviewed it, he said. He explained the process through which the request will go once it has been approved by the Board of Regents in the fall. Both he and Dr. Kvavik reported that they were guardedly optimistic about the prospects for the request; the reactions have been positive, including on the question of faculty salaries.

Professor Morrison reported on an email message received from an economist at Pennsylvania State, who estimated that the University would have to pay a 25% premium in faculty salaries were it to significantly alter its tenure code in the direction being proposed by the Board of Regents.

2. "Incentives for Managed Growth" (RCM)

Professor Morrison turned next to Dr. Kvavik for a continued discussion of RCM. He said he would bring the issue to the Senate Consultative Committee (SCC) on October 10, after which time the President will decide whether to approve the proposal. What statement should he make to SCC?

Dr. Kvavik first pointed out that the report focuses on four areas, and departs from RCM. He then

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

took questions.

-- There may be perverse incentives in the proposal. Units that have been strapped, with more students than its budget allows for, have high marginal costs but low average costs; they CANNOT expand. Those with a high average cost but low marginal cost--those with fewer students than they can support--will easily expand. Is this dilemma addressed in the report? Dr. Kvavik said decisions must recognize those factors and the budgets of units adjusted.

RCM will exacerbate the difficulties, and the central administration will say that it is all up to the units to resolve ("we wash our hands of the issue"). To say the plan is "revenue neutral" at first means this problem will not be addressed.

Mr. Pfutzenreuter and Dr. Kvavik both explained to the Committee why this problem was not addressed in the report (in part because the report does not try to deal with historical inequities that must be dealt with through the regular capital and annual budget processes). The focus, moreover, is on the colleges, not departments; the committee did not wish to take decision-making authority away from the deans and provosts.

These problems have built up over time and will need time to be corrected, it was said, but one would be more comfortable with the report if there was a commitment to deal with this problem over the next 4-5 years. The president and provosts will have to address it; they did not believe they could, Mr. Pfutzenreuter said. This proposal might help fix it, said Dr. Kvavik; members of the Committee demurred, unless the problem were made clear at the beginning.

One way to provide funds would be to impose a "franchise fee" on revenues to all units; that money could be used to fix imbalances not addressed in the report. To adopt that mechanism now, however, would provoke considerable opposition, it was noted.

The issue is simple, said one Committee member: CLA "is maxed out in most departments, with too few faculty. Growth is not an option." The institution must recognize that problem, Dr. Kvavik said. The problem is that unless there is a plan on how the state subsidy is used as a tool to address these issues, and with the turnover that occurs in Morrill Hall, there will be no understanding in the future of what was intended. There should be a list of known problems that must be addressed; the reluctance to address historical inequalities implies that they will not be addressed.

Mr. Pfutzenreuter said he was collecting a list of problems, and would add this to it. Dr. Kvavik commented that the last thing they wanted was "free enterprise for the poor and socialism for the rich" [departments].

-- Asked if models had been run, Dr. Kvavik said they had seen preliminary data only the day before (and there were problems with them). But the system does clearly put problems on the table very fast. One must be careful about how these data are handled, cautioned one Committee member. This system sorts out the streams of revenue, rather than having all revenue blended into one waterfall; the latter has made debate about funding impossible.

-- This system is being installed at the same time there is a new provostal system; what happens if the provosts don't agree? The President and Executive Council decide. The experience, however, is that the distribution of resources is flat, because everyone is in the room looking at each other.

-- The colleges are the bottom line, appropriately, said one Committee member. It is inevitable, however, that some aspects of this system will be passed on to departments. With nothing specified, each of the colleges are left to their own devices to implement RCM; there is a high potential for chaos. That will be a local decision, Dr. Kvavik said; the dean could drive the decisions down to departments, although they have not recommended doing so, because there will not be a meaningful data base and it will create mischief. But if they are free to do so, they will, it was said, and will do so in idiosyncratic ways.

If there are problems with this proposal that can be envisioned at the outset, it is better to try to address them as they become known, rather than implement the proposals and try to address them later.

-- One Committee member inquired about a possible distinction between the system and the players. One is troubled by the problem of turnover in Morrill Hall, and by the current Board of Regents. The system is ONLY as good as the players; when can the system assure outcomes that the players cannot tamper with? Dr. Kvavik agreed that the system will depend on astute leaders, the right goals, and the wherewithal to pursue them.

Underlying all of this is that central decision-makers have the state subsidy to deal with, and everything else will happen at the college level. If there are changes in the gross budgets, however, there could be unintended consequences in space and tuition. This proposal narrows central decision-making to the state funds. Dr. Kvavik said the proposal is to get central administration out of the business of the colleges, and to hire deans and give them the authority and resources to act. Checks on the colleges will come through the planning process. In the middle of things, one does not tamper with the actions of the field general. If the central administration is limited to broader priorities, by focusing on state funds, rather than using devices such as a strategic investment pool, the deans and faculty should be in a better position.

This raises the question of the extent to which colleges are staff to operate effectively in this system.

One hindrance to colleges, said one Committee member, is being told that the Form 16s and Form 17s, for hiring, will now require three full days in central administration for appropriate review. Professor Morrison said the Committee would take up this matter at its next meeting.

-- The purpose of these proposals is to deal with declining state funds; the University's share of funding (through reallocation) will grow a lot, but things like a strategic investment pool will not be relied upon. How will this be accomplished? The biennial request includes $100 million for new program initiatives over four years, Dr. Kvavik pointed out.

Managed growth is to be achieved either through revenue growth or expenditure cuts. Moreover, this is not to be accomplished solely through manipulating tuition revenues; it is an all-funds budget approach, and includes fund-raising and so on.

-- One item in the hand-out refers to a permanent academic committee to "monitor" the curriculum; is "monitor" sufficient? One dean (not in CLA) said his unit might begin teaching second languages; that should not be allowed. It could be changed to "regulate," Dr. Kvavik said; they have identified the problem but have not crafted language to address it. They believe there must be a regulator agency. It was noted that the Committee on Educational Policy has prepared a proposal for the Twin Cities Campus Assembly on October 16.

-- The administration cannot fathom the ingenuity that exists to get around the system, said one Committee member. Students will figure out ways as well, Dr. Kvavik noted.

-- There are two things confusing about this. There are incentives, which have the potential for all to benefit, and there is competition, which provides the opportunity for some to lose; with a fixed pool of resources, there must be losers if there is competition.

Professor Morrison inquired if the Committee wished to take action on the proposal; there was no motion to approve or disapprove it. One Committee member suggested he report on the changes that have been suggested. He said he would report to SCC that the Committee discussed the proposal and has made recommendations.

He thanked Mr. Pfutzenreuter and Dr. Kvavik for the presentation.

3. Public-Private Partnerships

Professor Morrison then called on Mr. Paschke to present the proposed public-private partnership policy.

Mr. Paschke distributed a draft letter appointing an ad hoc committee to investigate the possibility of public/private partnerships in the University's auxiliary services. He explained that as they have reviewed and researched the University's capital needs, and what those needs are for the support services, the amount required is "staggering." Examples are $50 million for new student housing, a new food service operation, $50 - 60 million in new parking facilities over the next four or five years, the Gateway Center, the renovation of Coffman Union, Northrop Auditorium, and so on.

The University cannot accommodate those needs, certainly not without coming into conflict with academic capital needs, so the Board of Regents has asked that other ways be explored. They looking at how the University might develop partnerships with the private sector to meet capital needs. In conversations with private developers about building parking ramps and residence halls, the University was told it would not work; existing University facilities are fully depreciated, while the new ones would not be. Private developers have real estate taxes and a return on their investment that they require, and therefore would have to charge much higher rates on new facilities of this type. The issue then becomes, who would use these facilities and pay the higher costs? The risk, it was said, is too large for this type of private development.

They have explored further, Mr. Paschke said, and explored other arrangements. Would it make sense for the University to set up a separate 501 (c) (3) entity [tax exempt] to take on capital projects, to take the burden off the University and to allow the projects to be self-funded? This entity could issue revenue bonds, and there would be no liability for the University; the University also has no debt capacity left, so cannot issue the bonds itself with having an adverse impact on its credit rating.

Professor Morrison, recounting his experience in teaching local government law, noted that these incentive financing schemes often collapse or have considerable problems. One worries that this is a shell game: the University does not have debt capacity for its capital needs, but spends $50 to create a new 501 (c) (3) organization, and it suddenly has the money it needs.

He also said there is a history in place: the Coke contract brought in a lot of money that was siphoned away from Academic Affairs without discussion and without participation. There are other examples of this kind of scheme being used irresponsibly. One needs to see University controls in place to ensure the money is used appropriately, rather than for building an empire in Finance and Operations.

Third, he said that to students, this might look like a way to raise a lot of different rates. If asked, the University can simply point and say "it's that corporation, not us," and the corporation won't talk to anyone about the rates.

It is to be hoped that the report from the ad hoc committee will have answers to these problems. But, Mr. Paschke said, there are examples in which this structure works very well, such as Ruminco, the University's tax exempt separate corporation for providing insurance coverage. It is self-sustaining, provides a dividend to the University, and is well managed. The specific concerns that have been raised are intended to be addressed through the work of the ad hoc committee. He pointed out that there is a faculty member and student member on the ad hoc committee; he also concurs with Senior Vice President Marshak's suggestion that the Finance and Planning Committee be asked to participate in the discussion.

In terms of a shell game, Mr. Paschke observed that there are examples of separate tax-exempt entities that work very well. Ruminco [the University's self-funded insurance company] is one; it is self-sustaining, provides a dividend to the University, and is well managed.

In terms of revenues, the objective is to generate revenues for all-University priorities, not to build empires, Mr. Paschke assured the Committee.

In terms of rates charged on various facilities under this structure, he said he could not address that issue immediately; it will have to be examined as the work takes place.

In the past, money has been taken out of parking and used for other purposes; parking then says it must raise rates. This kind of experience leads one to be dubious about these kinds of schemes, one Committee member concluded.

How does a separate legal entity change the funding situation, asked one Committee member? There is some wishful thinking going on, responded another; a corporation can borrow against its assets. There will be revenue bonds issued; the University's limits on issuing bonds are created by its revenue streams. There needs to be a clear answer whether the University's bonding capacity will shrink if housing and parking revenues are removed from the University. If so, the situation will not be different, there will just be different controls in place.

Mr. Paschke affirmed that there could be a transfer of assets, so the new entity might own the existing parking facilities and dorms. He pointed out that they are trying to address a problem. In the recent past, the use of bonding capacity has been for revenue-generating facilities such as the Hospital and hockey arena; this has meant there is no capacity to meet academic priorities. He said he did not know if the separate entity was the solution, but other institutions are exploring it and he would like to do so as well, and with the participation of the Committee.

Professor Morrison agreed that the Committee would participate, and he asked Professor Robinson and Mr. Bromberek to serve on the ad hoc committee. He thanked Mr. Paschke for the presentation, and then adjourned the meeting at 4:30.

-- Gary Engstrand

University of Minnesota