Minutes*

Senate Committee on Finance and Planning
Tuesday, May 20, 2008
2:00 – 3:45
238A Morrill Hall

Present: Judith Martin (chair), Jon Binks, Adam Faitek, Steve Fitzgerald, Lincoln Kallsen, Joseph Konstan, Russell Luepker, Mikael Moseley, Kathryn Olson, Richard Pfutzenreuter, Justin Revenaugh, Michael Rollefson, Warren Warwick, Aks Zaheer

Absent: Rose Blixt, David Chapman, V. V. Chari, Ruonan Ding, Thomas Klein, Kathleen O'Brien, Terry Roe, Gwen Rudney, Thomas Stinson, Michael Volna, George Wilcox

Guests: Orlyn Miller (Capital Planning and Project Management); Senior Vice President Frank Cerra

[In these minutes: (1) thank-yous; (2) six-year capital plan; (3) Medical School finances; (4) 2008 legislative outcome]

1. Thank-Yous

Professor Martin convened the meeting at 2:00 and noted that Professor Chapman rotates off the Committee after this year and that Ms. Olson has resigned from the University to take a job in the private sector. She thanked both Professor Chapman and Ms. Olson for their service on the Committee.

2. Six-Year Capital Plan

Professor Martin turned to Messrs. Kallsen and Miller to lead a discussion of the six-year capital plan.

Mr. Miller began by noting that the Regents policy directs the administration to develop a six-year capital plan. There are two parts to the plan, the capital improvement BUDGET for year one and the capital improvement PLAN for years 2-6. Year one, the capital improvement budget, includes projects over $500,000 with complete predesign and fully funded; they move into design or construction. Mr. Miller reviewed some of the projects that are included in the capital improvement budget for 2008-09: at Morris, a renewable-energy research center, Gateway Building renovation, and renewable energy projects (that are part of the plan to make the campus energy self-sufficient by 2010); on the Twin Cities, some of the projects include the science-teaching and student-services building, Social Sciences Tower renovation, CMRR expansion (the first phase—of four—of the biomedical research facilities authority approved by the legislature), stadium food service and tribal plaza, the outreach center on the north side. All campuses will receive repair & replacement funds as well as HEAPR funds.

Of the total $289.4 million capital budget, 50% will be covered by State of Minnesota debt, 31% by University debt, and the remainder from self-supporting funds, University funds, grants and gifts, and so on.

* 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 potential additions to the list, projects that are "almost there, but not quite." This list of items tells the Regents that they may see them as capital budget amendments during the year. The list includes, on the Twin Cities campus, a new cancer center, expansion of the Veterinary Diagnostic lab, steam infrastructure enhancements, and a land-care facility.

Mr. Miller next explained the process by which projects get on to the six-year plan; the primary drivers, for potential projects, are programmatic needs identified through compacts or the strategic-positioning process, and facility conditions, identified through the Facility Condition Assessment. The staff reviews potential projects and, using the primary drivers as well as financial constraints, project logistics, and space issues, develops a recommendation on what should be included in the six-year plan for the central officers; the list is revisited often.

Mr. Miller reviewed the planning principles (which have not changed) and noted these elements of the principles:

1. Capitalizing on unique opportunities that are aligned with academic and service unit priorities
2. Ensuring that investments in existing facilities and infrastructure contribute to renewal, preservation, and restoration objectives and are aligned with the priorities of the capital plan
3. Giving preference to projects that create flexible space, improve space utilization, and reduce operational cost
4. Advancing the guiding principles of the master plan and sustainability policies
5. Protecting the University's financial position by keeping capital expenditures within the projected debt capacity limits. (This item falls to Vice President Pfutzenreuter to keep an eye on.)

There has been much discussion of #3 and the need for flexibility and collaboration, especially in research, Mr. Miller said. Professor Martin asked if anyone has asked for flexible space that can serve more than one part of the University. Mr. Miller indentified three that have: the physics and nanotechnology building, the institute on energy and the environment (talked about by several colleges), and medical devices within biomedical engineering. These kinds of facilities get away from department control but there are a lot of issues about who manages them, who pays for them, who occupies them, and so on.

Mr. Kallsen then noted a sentiment that Associate Vice President Kvavik has expressed: "What we build and how we build our facilities demonstrates to the State of Minnesota and the nation our commitment to be a pioneer in how we teach, how we create new fields of research, and how we generate new knowledge for the benefit of the citizenry." His point, Mr. Miller said, is that the University needs to be more visionary about its capital plan. Capital planning needs to move from being project based (in the past) to zone-based (at present) to academic neighborhoods (in the future), from discipline/department-based to college based to interdisciplinary based, from departmentally controlled to college controlled to collaboratively controlled, and from alignment with department goals to college goals to institutional strategic goals. There are management challenges to moving to academic neighborhoods with interdisciplinary, collaboratively-controlled space aligned with strategic goals, Mr. Miller observed.

Discussion turned to facilities to support and improve student retention and graduation rates ("exceptional students"). In addition to residence halls on the coordinate campuses and creation of "premier learning environments" in Folwell and Northrop and through classroom renewal, they include expansion of recreational sports facilities on the Twin Cities campus. On the last, Mr. Kallsen reported that the President has recommended a student fee for capital enhancements but a committee of the Regents expressed reservations and asked the administration to come up with alternative plans or a

revised proposal. Without the fee support, there is no current financial strategy to expand recreational sport facilities.

With respect to "exceptional faculty and staff," the idea is to support faculty scholarship and interactions with students and citizens through facilities such as Folwell Hall, the Northside facilities, Bell Museum renovation for the College of Design, and renovation of labs. To help with faculty-staff retention and satisfaction, there are projects such as the remodeling of the Social Sciences Tower and Cooke Hall.

In terms of "exceptional organization," HEAPR and other funds will be spent and other projects will assist in achieving the goal (e.g., OIT data center, intermodal transit center, and East Gateway parking facilities). In terms of the data center, there are now a lot of servers all over the campus, many of which may not be secure and may have inadequate air-conditioning. The new facility will be the first dedicated space to house servers. If they consolidate servers, Mr. Miller said, there will easily be a 50% energy saving and about ten times less likelihood of service interruption.

Mr. Rollefson asked if the consolidation included academic computing; Mr. Kallsen said he did not know if it included digital storage or the libraries. Mr. Rollefson inquired whether the Supercomputer Institute would need to move. Mr. Kallsen said he would ask Vice President Cawley.

Professor Konstan said his department had considered moving its data storage to OIT but learned that it is very expensive. If the University decides to consolidate in order to save money, there must be oversight by users so that the decision does not create a financial burden for departments. The capital plan process is not the place to determine if that is the best decision for the University He suggested the plan should also try to envision data needs for the next 10-15 years. Mr. Miller agreed and said there will be room for expansion—and pointed out that it is likely information will be more and more condensed. Ms. Olson said there may be higher costs up front but that there would be a lot of benefit to the University for the long term to have the servers consolidated.

Professor Luepker inquired about the status of the Supercomputer Center on the West Bank. Mr. Miller said the University had sold the facility because after careful analysis of its physical condition (water infiltration, deteriorating walls), the conclusion was that that building was not worth the investment.

Professor Warwick asked about backup. Mr. Kallsen said the Committee needed to talk with Vice President Cawley about the details of the new OIT facility.

The Committee turned next to the list of items on the six-year plan. Although the 2009 legislative session will be for operating rather than capital budgets, the University does intend to make a modest capital request, for an additional $25 million for HEAPR funds and for funding for a new Bell Museum of Natural History. Committee members asked a few questions about some of the items.

-- Why is it the University's responsibility to fund the intermodal transit center (in 2014)? The light-rail station will be the responsibility of the Central Corridor project, Mr. Miller said, but this building will serve University bus transfer and parking needs. However, since the facility will also serve other transit functions, some capital and operational costs may be shared with Metro Transit.

-- Professor Konstan said he assumes there will be a state component to the Rochester campus building, now in planning and development but with no source of funds identified. How will that mesh with the

commitment that the University would not take funds from other campuses for Rochester? The facility is in planning and development because the University has not answered that question, Mr. Kallsen said. It is conceivable the state would fund a facility at Rochester whether the University requests it or not. Professor Konstan said he would be more comfortable with the project if it were a separate request.

Professor Martin thanked Messrs. Kallsen and Miller for the presentation.

3. Medical School Finances

Professor Martin welcomed Senior Vice President Cerra to discuss the finances of the Medical School and the Academic Health Center (AHC).

Dr. Cerra distributed copies of a set of slides and began by explaining the partnerships the AHC has with Fairview and other organizations. The health sciences schools live in the health-care marketplace: they must compete for contracts and patients and are subject to all of the rules and regulations of the health-care industry. Workforce development means something different in the AHC because they have a DUTY to produce health professionals; the federal government has determined that Minnesota is disadvantaged in dentistry, primary care, and mental health, and is number one in the country in health disparities. They cannot deal with those problems by producing more of the same kind of professionals in the same way to work in care delivery in the same way; so, there is a lot of emphasis on interdisciplinary work and in developing new models of improving health status and preventing and treating disease.

The AHC is on a pathway of convergence with Fairview Health Systems. The University has about 18% of the membership of the Fairview system board, so it has influence but not control. The University has 51% of the governing bodies of the University of Minnesota Medical Center and the University of Minnesota Children's Hospital, subordinate boards that are responsible for the management of the hospital and children's hospital. The link between the AHC and Fairview is University of Minnesota Physicians, the second-largest group of medical specialists and subspecialists in the state. The AHC also has close educational and clinical relationships with Allina Health Systems, HealthEast, HealthPartners, HCMC, Regions, North Memorial, and so on.

The AHC has a range of different kinds of faculty (clinical scholars; clinical track), from those who do work that qualifies for tenure to those who practice and teach. The educational model for doctors and health professionals is highly experiential; they have students in over 1700 sites around the state, each one of which has faculty (non-paid) in the community. There are about 4000 such faculty, each of which costs the AHC about $3000, and there is a task force at work now trying to develop a taxonomy of these appointments.

Dr. Cerra turned next to the Medical School budget. The 2006 budget was $574 million, of which 40.2% comes from the Faculty Practice Plan (UMP). Without the practice plan there is no Medical School, he commented. Sponsored research provides another 27.3% and non-sponsored programs provide the remaining 32.5%. Of the last, the sources (percentages) are these:

8.6 state funds
4.5 tuition
3.3 indirect costs
8.3 affiliated hospitals
4.2 gifts and endowments
3.6 all other.

There are challenges with some of these items. State funding is flat; Medical School tuition is third-highest in the nation, indirect-cost funds are NIH-dependent, and gifts and endowment income is flat (as is evident, a $300-million endowment doesn't contribute very much to Medical School revenues).

The practice plan pays clinical salaries, Dr. Cerra said; they use an XYZ salary system, with X the state funds, paying the base salary, Y as augmentations and the like, and Z the clinical-practice income. Professor Konstan asked if the University sets the salaries or if the faculty are paid for work. They pay by work units, Dr. Cerra said, RVUs (relative value units) that have a determined value, but the units are not comparable across fields (a surgery RVU might be worth more than a primary care RVU). If a faculty member has an opportunity to get a grant, does he or she take a pay cut, Professor Konstan then asked. They may, Dr. Cerra said, and added that most research funding in the Medical School is in the clinical departments, so adjusting effort for clinical faculty is a challenge. Each year they must allocate effort for faculty members. The challenges for the practice plan include declining reimbursement rates, thin margins (which are being squeezed by the federal government and by insurance companies), and competitive salaries. Professor Luepker concurred with the last point, reporting that he sees faculty who leave the AHC and double their income in private practice. Faculty are now in a seller's market, Dr. Cerra agreed, and one big issue for the AHC is space—a problem that will begin to be solved with the new biomedical facilities that have been authorized.

The practice plan has seen a significant increase in revenues since 2000 (from about $100 million to about $240 million), but operating costs have increased in parallel, from about $70 million to about $200 million), so the academic support provided by plan to the Medical School has been flat. The practice plan does make contributions to the Medical School that substantively cross-subsidize the educational costs for students and provide the added resources to pay for the cost of performing research (the direct and indirect costs of federally sponsored research do not cover the total cost of research).

Sponsored award revenues have risen or been flat since 1999, although they declined in 2006 (the latest year for which data are available). The awards from NIH rose slightly between 2001 and 2005. The cross-subsidy for doing NIH research is about 20% and for all other grants it is about 30% (that is, it costs the Medical School that much additional money for each grant beyond the direct and indirect funds received for the sponsored research). The AHC generates sponsored project awards for about 1/2 of the research portfolio of the University. The Medical School is the single largest generator of sponsored project awards in the University.

The Medical School has also seen a loss of research-intensive faculty, Dr. Cerra reported. In 1994 it had 539 tenured and tenure-track faculty; in 1999 it had 448, and in 2006 it had 486. For non-tenure-track clinical faculty, the numbers were 99, 169, and 312, which fits with the growth of the increase in clinical practice. There is, however, more stress on the clinical faculty because the faculty that teach also do the research and the clinical practice.. The total number of faculty has thus increased, from 638 to 798. Professor Zaheer asked if they will make up the gap with clinical-science faculty; Dr. Cerra said they would but they are hiring more tenured and tenure-track faculty in basic, translational and clinical sciences so they can do the necessary applied health research. He said he needs to work with faculty governance to explain what they are trying to accomplish with the various types of faculty appointments. Hiring tenured and tenure-track faculty is a priority because that is what the Medical School needs.. When the Medical School hires a new department head, the cost may be $25-30 million, but that includes perhaps a number of faculty lines, and they must work across the AHC to identify funding.

Medical School tuition was #2 in the country in 2006 and is now #3. Dean Powell has implemented a guaranteed cost-of-tuition plan in order to be more competitive: starting with the incoming class of 2004, the tuition is fixed for that class. Tuition remains less than 5% of the Medical School revenue, and even an increase of 10% would bring in only $791,000. Thus, tuition does not support the cost of education (pays for about 25-30% of it) and increasing tuition is not a major revenue producer.. Tuition in the Medical School, Dr. Cerra observed, buys a degree, it does not pay for credit hours.

Taking 2002 as a base year, state support for the Medical School has increased only slightly, and if adjusted by the Higher Education Price Index, it has actually fallen a little and then remained flat.

The core of the mission is producing the next generation of providers. Achieving this mission relies heavily on experiential/service-based learning in both academic and community settings, requires a recruiting and learning strategy to understand and meet workforce needs, requires connectivity between education and the care-delivery model, has costs in excess of tuition, fees, and state support, creates increasing amounts of student debt, and requires new partnerships among the professions and with communities. The number of required clinical (experiential) hours per student varies across AHC units; in the Medical School, it is 4500; in Dentistry it about 1800; in Nursing it is about 1000; Pharmacy is about the same as Dentistry, and in Veterinary Medicine it is about 2400. These clinical hours are required for accreditation in order to ensure the students have the needed competencies. These clinical hours include very small student-faculty ratios.

Of the direct costs of medical education, about 30% is paid for by state funds, about 25% by tuition and fees, and the remainder by the practice plan, and other revenue sources. The practice plan is needed to pay for a much smaller portion of the cost of education in nursing and dentistry, by comparison. But debt is becoming a major barrier to health-professional education. The total cost to deliver a Medical School degree in 2006 was calculated to be about $350,000. Tuition costs about $90,000, but the average student debt at time of graduation is about $125,000. The average starting salary for family-practice physicians is about $190,000 after the residency is completed. The return-on-investment of those numbers is about 24 years, and one reason there is a shortage of family-practice physicians is because few want to take on that kind of debt, particularly with the existing reimbursement rates for primary care work. The situation in dentistry is even worse: the average debt at graduation is about the same as that of medical students but the starting salary is about $90,000.

Professor Konstan asked if the debt grows between the time a student graduates and completes the residency. The interest starts accumulating when the student obtains the loan, Dr. Cerra said; some begin to pay off the loans during the residency while others use various methods of refinancing and paying the debt. Professor Konstan said it would be helpful to be able to compare the rates of debt and income in other fields.

Dr. Cerra briefly reviewed the under-served areas of the state, which includes the Twin Cities (e.g., about 15 blocks on either side of the I94 corridor). Professor Martin asked if there has been any legislative pressure because of the shortage. Dr. Cerra said they have written two big reports for the legislature outlining plans and accomplishments. They are making progress, but do need more primary-care providers. There is also need for a different care-delivery model as a large group of the population gets older; the legislation just adopted sets the stage for making the necessary changes in the future.

Dr. Cerra next reviewed the increasing costs of new and remodeled facilities. He identified a number of facilities and costs to the Medical School (e.g., MCB, $3.8 million, Cancer Center $5.2 million, CMRR $3.6 million, and so on). Most of the costs were offset by central appropriations.

The health-care system is not a free market, Dr. Cerra told the Committee. There is low reimbursement and they cannot generate the margins they need to support new facilities. What the University has been able to do is work with Fairview to begin work on a new children's hospital and new clinics. Professor Konstan commented that it sounds like the labor situation for graduating doctors is bleak and working conditions are not attractive, and it is also more expensive to hire good people for the University. In his field, computer science, by comparison, industry positions are not getting worse. Are these two different kinds of markets? They are, Dr. Cerra said. Doctors have no problem getting jobs but the working conditions have changed with declining reimbursements and enormous paperwork requirements because health care is so heavily regulated. Getting through a day can be a pain, Dr. Cerra said, and a doctor has to see a patient every nine minutes in order to break even.

One of the increasing costs the Medical School faces is compensation. Right now 60% of the faculty are paid less than the 50th percentile of their American Association of Medical College peers; this includes clinical salaries. The practice plan pays the clinical salaries, the Dean's tax, and supports some academic salaries. Central allocations, including tuition, pay for about 25% of faculty salaries. The Medical School funds the other 75%, from the practice plans and grants. This is part of the reason the Medical School faces a structural budget problem. The mandated 3.5% increase in salary and fringe benefit for 2007 created a need for an additional $3.9 million for the Medical School. There is an additional impact on sponsored programs in the about of about $2.7 million, some of which cannot be recovered from the grants, and the Medical School "subsidizes" the University's fringe benefit pool in the about of about $1.9 million annually. In addition, the uncompensated administrative costs of graduate medical education total about $8.1 million.

As a result, the Medical School is cutting about $4 million from its budget and will also receive additional University funds to help solve the structural problem.

The Medical School goals include moving into the top 20 "through innovative research excellence in targeted areas of neuroscience, infectious disease and immunology, diabetes, cardiovascular and pulmonary medicine, and cancer." It also aims to be an innovative leader in medical education and to provide exemplary clinical-care delivery by collaborating with faculty and partner hospitals to improve education and care outcomes. The cost of getting into the top 20 is being developed with a new financial model and should be know in the fall. Professor Zaheer asked what the ranking depends on and where the Medical School is now. There is only one measure that counts in ranking medical schools, Dr. Cerra said, and that is NIH funding. During the 1980s the Medical School was ranked in the mid-teens; it slid to the 30s, and is now about #25.

Dr. Cerra outlined what would be needed to achieve the Medical School goals. They include investment in facilities (expansion of CMRR, new heart and cancer research buildings, clinic facilities renewal, and renovation of existing research space), department head recruitment, 53 new faculty to return to the 1994 level and 175 to achieve the goal of being in the top 20, competitive faculty salaries, and funding to address the structural budget imbalance caused by graduate medical administrative costs and graduate student stipends (which may require budget-model adjustments). Professor Konstan asked if the NIH's support for multiple PIs was changing the plan for interdisciplinary programs. They expect 40-50% growth per year, Dr. Cerra said, and mostly in interdisciplinary programs. The programs started in the AHC but now include IT, CBS, CLA, and can be extended to Law, CFANS, and the Carlson School, and the work is also carried out in University-wide institutes.

Dr. Cerra next reviewed briefly the elements of achieving the goal of being a top-20 medical school in a top-3 public research university. They include focused areas of research and investment,

major emphasis on interdisciplinary research with other colleges, implementing a plan to deal with the structural budget problem, productivity improvements (there is room for improvement in the NIH dollars per faculty but they also need additional faculty and facilities), cost reductions and internal reallocation (which is well under way), an all-funds financial plan, and increased research capacity.

Professor Luepker recalled that Dr. Cerra had talked earlier with the Committee about the structural deficit and said that Dean Powell was going to develop a plan to deal with it. Dr. Cerra said the structural shortfall was identified in 2006 but he is not sure that the problem of the root causes of the recurring structural problem is solved. They need to investigate it further and it appears to swing over the years. Until they find a new financial model, they will continue to develop different approaches. Before the 2006 analysis they did not know they had the problem, and the goal is to fix it permanently.

Professor Martin asked if there is a subsidy to the AHC from the rest of the University. There is, Dr. Cerra said, but the subsidies run both ways. The AHC receives fewer O&M funds but the fringe pool goes the other way. He said there are two ways to look at the issue: one can spend time trying to undo the flow of funds that has occurred over the years or one can go forward, use an all-funds approach, and try to identify a model to sustain the Medical School and allow growth. There is a need to get past what happened in the past.

Professor Martin thanked Dr. Cerra for his report.

4. 2008 Legislative Outcome

Vice President Pfutzenreuter next reviewed for the Committee the outcome of the 2008 legislative session.

-- For the current year, the legislature reduced the appropriation by $6.150 million, a one-time (non-recurring) reduction. The University was given wide discretion in how to make the cuts; they will probably be made through a targeted cut and use of central reserves. (Regents policy requires a reserve fund equal to 4% of the appropriation; some of the funds will be used for this cut.)

-- The 2008-09 appropriation was also reduced by $6.150 million, but this is a recurring cut. This reduces the starting point for the next biennial appropriation and will probably mean the University will delay spending in some areas.

-- There was an additional base reduction of $2.55 million beginning in 2010, so the total base reduction will be $8.7 million. In both cases of the base reduction, the University has the discretion to take the funds from either general operations or restricted state specials, but there will be discussions with the Department of Finance about where the reductions will be made.

-- The legislature also included language about tuition: "The Board of Regents must not increase student tuition or fees beyond the amounts currently planned." This represents a sincere signal that the legislature is not happy with the proposed 7.5% increase and would really like the University to take another look, Mr. Pfutzenreuter said, which the President will do.

Professor Martin asked if the legislature had ever said anything about tuition before. Not that he could recall, Mr. Pfutzenreuter said, but it is a sincere expression of concern. Professor Konstan asked if the President is concerned about the University's constitutional autonomy.

With the state budget-deficit forecasts, could there be future reductions, Professor Zaheer asked. Mr. Pfutzenreuter said they have done contingency planning, ranging from no cut to the original proposal from the Governor to cut $27 million. There is a worry that another shoe will drop as the state budget gets worse and there is discussion about creating a budget solution of more than the $8.7 million in order to take the cuts now, and not dropping the tuition increase, in order to protect against a bad revenue forecast in November. That could solve some structural problems the University may face. There is no chance the additional 2% increase in tuition will now be considered, however.

Mr. Rollefson observed that retrenchment was already part of the plan. It was, Mr. Pfutzenreuter said, and they have not changed the contingency plan that would have responded to a $27-million cut. There was both reallocation and investment delays; since the cut is less than $27 million, it may be that some investments may be put back in the budget.

Professor Konstan asked if being prudent and cautious would invite the legislature to make further cuts because the University has demonstrated it can handle them. Mr. Pfutzenreuter thought not.

Mr. Pfutzenreuter reported that the MNSCU budget was reduced $1 million in the first year and $7.6 million in the second, and their base appropriation was reduced $7.7 million. Professor Zaheer asked about the ratio of the cut to the total MNSCU budget compared to the ratio for the University. Mr. Pfutzenreuter said that the proportional cut to MNSCU may be slightly larger when University funding from all state sources is considered.

Professor Martin thanked Vice President Pfutzenreuter for the update, and adjourned the meeting at 4:15.

-- Gary Engstrand

University of Minnesota