

Minutes*

Senate Committee on Finance and Planning
Tuesday, April 20, 2004
2:30 - 4:15
238A Morrill Hall

Present: Charles Campbell (chair), Stanley Bonnema, David Chapman, Daniel Feeney, Steve Fitzgerald, Joseph Konstan, Michael Korth, Timothy Nantell, Richard Pfutzenreuter, Terry Roe, Charles Speaks, Alfred Sullivan, Kate VandenBosch

Absent: Calvin Alexander, Brittany McCarthy Barnes, Thomas Klein, Yi Li, Cleon Melsa, Kathleen O'Brien, Thomas Stinson, Susan Van Voorhis, Warren Warwick, Michael Volna, Susan Carlson Weinberg

Guests: none

[In these minutes: (1) legislative update; (2) revised debt policy; (3) biennial request planning; (4) internal taxes on gifts; (5) update on the 2004-05 budget (with a focus on graduate assistant fringe benefit rates)]

1. Report on the Legislature

Professor Campbell convened the meeting at 2:30 and turned to Vice President Pfutzenreuter for an update on the capital bonding bill. Mr. Pfutzenreuter reported the action of the House Capital Investment Committee, which recommended \$90 million in state funding for the University, compared to \$155 million requested by the University and \$77 recommended by the Governor. There is an additional \$20 million for the University in the Department of Employment and Economic Development appropriation for the partnership with Mayo. Since the House only recommends spending \$600 million, \$90 million for the University is a good start.

MNSCU, by comparison, was recommended to receive \$114 million, but it submitted a much larger request. MNSCU is recommended to receive about \$114 of \$300 million; the University \$90 of \$155 million.

2. Revised Debt Policy

Mr. Pfutzenreuter next explained that a number of Regents' policies are being updated. One of them is the debt policy, he reported, and he would like feedback on the proposed changes. He reviewed the changes.

One change involves a distinction between "core debt" and "special purpose debt." Right now all University debt is general obligation debt, which means that it has the full faith and credit of the University behind it. This proposal calls for two kinds of debt, general obligation debt and special purpose debt issued for a specific project and not backed by the full faith and credit of the University. For example, a hypothetical football stadium could rely on special purpose debt; the payment would rely on

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the income from the stadium. The goal is to preserve the University's core debt, which carries a better interest rate, for the academic mission and use special purpose debt for project-based expenditures supported by revenues. So is the collateral a stadium or a parking ramp, Professor Roe asked? It would be, Mr. Pfutzenreuter said, but the University would never allow a default on the debt. But this debt could carry a slightly lower rating and a slightly higher interest rate.

What does "full faith and credit" mean, Professor Chapman asked? That all of the University's resources are behind the debt, Mr. Pfutzenreuter explained. What is different about this proposal, Professor Chapman asked? The University has always used only general obligation debt, which carries the institution's full faith and credit.

What is the difference between core and special purpose debt interest rates, Professor Speaks inquired? The rates are so compressed right now that there is not much difference, Mr. Pfutzenreuter said; they calculated that the difference might amount to about \$46,000 per year at current rates.

Professor Konstan said he could imagine two purposes for the distinction between the two kinds of debt. One, some debt could be isolated; if a hypothetical stadium did not generate as much revenue as expected, the University could negotiate a longer repayment schedule (if it did not choose to bail out the costs). Second, if debt is segregated, would rating agencies say that the University does not have as much general obligation debt and help it keep higher ratings? Would agencies buy into the distinction, keep the University's rate low, and thus extend its debt capacity?

The distinction would extend the debt capacity, Mr. Pfutzenreuter agreed, but one of the principles in the new policy is that the University would never incur new debt that would affect the core debt rating. It might be possible to do more special purpose debt, but never so much that it would endanger the core debt rating. The University would talk with debt advisors and the agencies about this, Mr. Pfutzenreuter said. So this puts a subjective bound on debt capacity, Professor Roe said. Debt can be acquired until it would affect the University's AA rating, Mr. Pfutzenreuter agreed. That is current policy; this policy provides that for the hypothetical stadium, the University could issue debt and perhaps receive money over a number of years for naming rights, and pledge that income to debt retirement. So there can be greater risks with some kind of debt, Professor Roe said.

If the University's debt rating declines, how much of the decline is because of too much debt and how much because of other factors, Professor Konstan asked? What is the effect of a decline in state funds? Mr. Pfutzenreuter said that a lot is based on balance sheet ratings but more on the level of state support, so external factors can cause a slip in the rating. If the debt rating slips because of a decline in state funding or a decline in student demand, the University is free to issue all the debt it wants because it is no longer at the goal of AA. Mr. Pfutzenreuter said the policy would prevent the University from issuing any more debt until it regained the target rating level (unless the policy itself were changed).

Professor Konstan noted there is a change in life expectancy. At present, the University will not issue debt for longer than the expected life of what is being financed, but this policy provides that the debt can be issued for 120% of the expected life. Why the change? In part because the federal government allows it, Mr. Pfutzenreuter said, but the University has not issued any debt longer than the expected life of the facility. He said he cannot recall any time the debt life has exceeded the facility life.

Mr. Pfutzenreuter said he will be discussing the policy with the chair of the Debt Advisory Committee and there could be modifications to the policy; he promised to bring any significant changes to the Committee. He also invited Committee members to send him emails with any comments or suggestions about the proposed policy.

3. Biennial Request Planning

Vice President Pfutzenreuter reported next that the President asked Senior Vice President Jones to convene a group to think about planning for the biennial budget request and to develop principles that can be presented to the Regents in June. In May the administration will review for the Board the cuts that have been made and what will be brought forward this year; in June the President wants to start a discussion with the Board about the next biennial request. There will be a two-part approach: how to preserve and protect the current level of state support, and how define the best and most compelling arguments in support of the next request.

Professor Speaks inquired if there is still a Provost's Budget Advisory Committee, and if so, the difference in charge to it and Dr. Jones's committee. The Jones committee is just asked to develop principles and thoughts about messages, Mr. Pfutzenreuter said, not put together the biennial request. Once the principles have been accepted, then consultation with the Budget Advisory Committee, this Committee, and so on, will begin. This simply launches the effort a little earlier than usual. He said he did not know yet what group would turn the principles into the biennial request. The Jones committee consists of Robert Jones, himself, Julie Tonneson, Christine Maziar, Frank Cerra, Kathy O'Brien, and Donna Peterson. There are no deans or faculty because the group is simply doing some first thinking about messages.

Mr. Pfutzenreuter reviewed the timeline for the biennial request. The University is beginning the preparation process earlier this year. He noted that the University's actual state appropriation for 2003-04 was approximately the same as in 1998, in nominal dollars. The Department of Finance planning estimates for the next biennium project a state budget deficit, if inflation is included, of about \$1.3 billion. The amount could be higher if more funds are needed for high-profile programs. State general funds appropriations for the University as a percentage of total state funds has declined from about 8.5% in 1971 to less than 4% projected for the next biennium. There was a slight uptick in the graph of the percentages in the mid-1980s, but in general the line is steadily downward over the last 30+ years. Basically the University has only been able to affect the slope of the line, not its direction, Mr. Pfutzenreuter observed. In 2005, the state will provide about \$550 million and tuition revenues will total \$500 million; he said he expected that those two lines will cross in the next biennium.

Mr. Pfutzenreuter then reviewed the various ways the University has organized its biennial request in the past. The approach has varied, and been a mix over the years, but in general the University has had to be cognizant of the Governor's priorities and legislative priorities so that decision-makers will be receptive to the requests. Professor Konstan asked if there was any way to track the approaches to see if they made any difference. There is the "urban legend" that the University will always only get what MNSCU gets; funding for health care and prisons would probably provide a mirror image graph of the one for the University. Mr. Pfutzenreuter said that in general, when the state has a surplus, the University does well; when it has a deficit, the University does poorly. But it is nonetheless important that the University have an opportunity to talk about its request. The single biggest determinant of the appropriation, however, is whether the state has a surplus or a deficit.

Does it also depend on what the University asks for, Professor Konstan asked? Does the University make a mistake when it is respectful of the state's financial situation, or should it submit a big request every year and let the state debate what it will fund? In capital appropriations, Mr. Pfutzenreuter said, no matter the size of the bonding bill, the University gets about 15%. The fraction moves a little from one biennium to the next, but not much. The only factor is how big the bonding bill is.

If the University were to receive the House recommendation on the bonding bill, how much would that obligate the University to take off the top of the biennial request next year in additional expenses, Professor Speaks asked. The debt service would be about \$2.5 million and operating costs of the space would be about the same, Mr. Pfutzenreuter said.

What about other agencies funded by the state, given surpluses or deficits, Professor Campbell asked? State agencies suffer the most when there are deficits, Mr. Pfutzenreuter said; given the cuts that have been imposed on some of them, it is difficult to see how they can continue to carry out their tasks.

Is there any notion of how the perceived elasticity of tuition figures into the state decision about the University's appropriation, Professor Campbell asked? That was clearly a factor in the Governor's recommendation for the last biennium, Mr. Pfutzenreuter recalled; he explicitly said that back-to-back tuition increases of no more than 15% were acceptable. What does he think about the future, Professor Campbell asked Mr. Pfutzenreuter--can the University continue to raise tuition at double-digit rates? As long as the University takes care of needy students, Mr. Pfutzenreuter said, he doubted the state cares how far the University drives up tuition rates, because higher education is increasingly seen as a private benefit.

Professor Konstan asked if anyone had thought about using a chart with elected leaders showing the timescale of the return-on-investment in the University. It might show the amount that is returned to the state within a year (e.g., income taxes, sales taxes, etc.), then data on employment, higher incomes, and so on. Would it help the University's case if, for example, it could show each dollar returning to the state in taxes or reduced expenditures in seven years? Mr. Pfutzenreuter said such a chart has not been used, to his knowledge, but there has been talk in the Executive Committee about doing such a study.

If the University consistently receives about 15% of the capital appropriation and if state operating funding does not relate to the strategies, Professor Speaks asked, then what other than superstitious behavior causes the University to spend as much time on the request as it does? Mr. Pfutzenreuter said he believes the process the University goes through to develop the biennial request is good for the University community in that it helps build understanding and support. One could make it more of a marketing piece, and less a strategic planning document and process, but that would probably mean there was less understanding of it in the University and less underpinning for the request. Professor Speaks said he agreed with that statement if "University community" is defined as Morrill Hall, the deans, and a few governance committees; beyond that, he said he doubted that there was much understanding among the faculty about what is in the biennial request. There has been broader involvement some years and less in other years, Mr. Pfutzenreuter agreed.

All the average faculty member gets is a PR blitz about the campaign and a message saying "don't undermine it," Professor Konstan said. On the issue of whether themes work or if PR has an effect, the University should not conduct the study of doing nothing and seeing if it receives the money. But it is not clear that town meetings, telephone calls, etc., get money for the University. Mr. Pfutzenreuter contradicted Professor Konstan on the last point; he said they matter a lot for the capital budget. It is more difficult to see the effect on the biennial budget, but members of the legislature do get calls about the capital budget that have an effect. The Art Building would not have been funded without that kind of support, Professor Speaks observed.

The biennial request effort also leads to more education of legislators, Professor Campbell said, so they better understand the University's mission. There was a much poorer understanding of the mission 20-25 years ago than there is now. If nothing else, that puts the University in a better position to fend off its adversaries.

His question about the biennial request is about the Business Partnership model of shifting more of higher education funding into financial aid, Professor Campbell said. Mr. Pfutzenreuter said he has not heard much about it.

It would be discouraging to think of the preparation for the biennial request as a PR blitz, Mr. Klein said. Rather, it is an opportunity for the University to look at itself and to identify opportunities and how it might grasp them, both for the University and the state. It is good for the state and institution to think about these things. Mr. Pfutzenreuter agreed and said that going through the process is better than simply preparing a one-page request.

Professor Speaks said that he was aware that applications to the University have increased even with large tuition increases. Has the number of applications from MINNESOTA students increased? Mr. Pfutzenreuter said he believed the number of high school graduates peaks in the next few years and that the number of applicants from Minnesota has risen along with the total, but he suggested the Committee speak with Dr. Zetterberg to clarify the data.

4. Internal Taxes on Gifts

Mr. Pfutzenreuter turned next to the subject of IRS (internal revenue sharing) taxes on gifts; he said he has been increasingly hearing concerns expressed by the Foundation. When the administration calculates the IRS bill for a college, they look at all funds except sponsored research. The administration does not tax each revenue source; the total revenues are a proxy and the colleges typically (in 95-97% of the cases) send O&M money to pay the IRS assessment. One other source has been gift funds. The Foundation is concerned about donor perceptions that the University will tax some percentage of the money donated. That is the perception, even if not the reality.

Compounding the problem is the Regents' policy providing that donated funds may not be spent for anything other than the purpose intended unless there is a specific provision in the donation to allow other expenditures. The Foundation is worried, and it has seen requests from colleges for gift funds to pay the IRS even though the Regents' policy says the money must be spent for the intended purpose. There are, however, some general purpose gifts that could be used to pay the IRS bill.

People wonder what the right thing to do is. Mr. Pfutzenreuter said he is contemplating a letter indicating that if a college has a restricted gift, it cannot use the funds to pay the IRS bill. If there are unrestricted funds, the unit should contact the Foundation to be sure the money can be used for the IRS tax. If units are using gift money now, is that a violation of the Regents' policy, Professor Speaks asked? That needs an interpretation, Mr. Pfutzenreuter said. Who pays for overhead? It is a fuzzy line. The Foundation says it has been told to raise money to add a margin of excellence to the University; they assume the University is covering indirect costs. That is an important value for the University to pursue through Foundation fund-raising, but one must ask where the University is today. Tuition revenue will soon exceed state funds; can the University sustain private giving with no expectation that it will help with overhead costs? Some gifts carry a lot of overhead expenses (e.g., buildings); others do not. But the IRS is a poor tool to account for overhead costs.

Professor Konstan observed that overhead costs exist, no matter what revenue is used to pay them. But the University is very reluctant to say "no" to dollars; it takes the money and finds other sources to pay overhead costs. If the University does not attribute overhead to gift funds when they are received, the University is still obligated to pay the expenses. Most donations do not cover the full cost of

what they are donated to, Professor Campbell observed, so University funds are needed. This is an accounting issue, he commented. It is time to revisit the issue, Mr. Pfutzenreuter said. Today, when the University is increasingly dependent on tuition and sponsored research, and likely to be more dependent on private giving, how is it to cover overhead? Professor Campbell said tPage: 6
he same issue arises when contracts and grants are negotiated with reduced or no overhead charges. Mr. Pfutzenreuter agreed. Deans and faculty are getting better at getting ICR funds. It is true that donations carry extra costs, Professor Roe said, but the IRS is a crude instrument. If each college knew its overhead costs, there would be less controversy about who should pay. The problem is the crudeness of the instrument.

Mr. Pfutzenreuter said he will do some communication on the gifts issue because it is one that needs to be addressed.

5. 2005 Budget Update

Vice President Pfutzenreuter next reported that the 2004-05 budget will go to the Regents in May; all units have responded with tuition and ICR estimates as well as the impact of reallocation, base cuts, and the need to fund compensation increases. They are now trying to understand those reports. Departments sometimes do not do a good job of describing the pain of cuts. Professor Campbell said one reason may be that departments cannot articulate the pain until the cuts are delivered.

The biggest issue they heard about was the graduate assistant fringe rate, Mr. Pfutzenreuter reported. They are working on how it could be addressed and have done some modeling. The fringe benefit rate is going up 22%; to buy down the tuition rate increase costs about \$2.4 million (for all graduate assistants regardless of how they are funded). Professor Feeney recalled that this has been discussed before; is this a fringe pool issue again? What is driving the change? The Committee talked in the past about a direct charge system; is that a solution? Do units pay what fringes cost versus averaging the costs? In part the increase is due to an over-recovery in the past, so the excess has to be refunded through higher rates now, in accord with government regulations. The other part of it is the tuition increase. Would a direct charge system fix the problem? It would not stop the growth in rates, Mr. Pfutzenreuter said, but it would eliminate the volatility.

The tuition component is a transfer from the research budget to the teaching budget, Professor Roe said, and it is difficult to see why that is a burden to the University. It costs research grants, Mr. Pfutzenreuter said. They are being taxed, Professor Roe agreed, but part of the funds go back to the college. They are a tax on research, and since research funding is greater than tuition revenue, the University is risking a revenue stream by not remunerating the research accounts that generated the income in the first place. As long as tuition is used to balance the budget, one can say the same thing about undergraduate education, Professor Campbell pointed out.

Professor VandenBosch reported that she has seen the data for what it will cost to support a graduate student next year (a 12-month RA will be \$39,000 [including \$18,000 stipend, plus fringe, plus 48.5% ICR on stipend]) and a TA will be over \$25,000 for the academic year [at the same stipend rate]). With the increased tuition and stipends, the cost goes so high that faculty cannot support them so often choose to hire postdocs or technicians instead, which results in a net loss of tuition income to the University. She said she was also troubled, besides losing momentum in some graduate fields, by the fact that if one funds a RA, one pays double because a grant pays ICR on stipend, in addition to the cost of the tuition waiver. Moreover, when departments have to pay more for each TA, they can support fewer TAs. This may limit undergraduate course offerings and tuition revenues. The net impact on graduate

programs will be to weaken the University. She suggested that the University needs to look at graduate tuition separately from undergraduate tuition and use a different model. Professor Roe reported that in his department the number of RA offers has declined from an average of 15 to 5 this year.

Vice President Pfutzenreuter said that for the 2004-05 budget, the issue needs to be resolved within the next 5-6 days. There is a clear sense in the University that there should be some budget relief; the most effective way would be to subsidize the fringe pool, he said; that would require recurring funds. He said he would welcome other ideas on how to deal with the problem. If they target part of the payments to the unit, is that for paying overhead, Professor Roe asked? Then it is not so clearly a subsidy. Mr. Pfutzenreuter said that money from the compact pool and other O&M sources would be allocated to the fringe pool. It would be better to allocate the money to the units and let them figure out how to use it, Professor Roe said. Or they could do a targeted allocation to the units with problems, Mr. Pfutzenreuter said.

Professors Roe and VandenBosch agreed to draft a statement for consideration by the Committee. Within three days of the meeting, the Committee voted in favor of the following resolution:

The cost of tuition waivers for graduate assistants contributes to the already high fringe benefit rates for Graduate Assistants at the University of Minnesota. The University is now proposing a large increase in the tuition waiver rate for the coming fiscal year. The proposed increase to \$11.27 per hour from \$9.19 translates to a \$ 1,623 increase per academic year, almost 22%. On an academic year basis, the cost of combined fringe benefits, including health benefits and FICA costs, would therefore be charged at about 90% of the typical stipend rate.

The proposed increase poses an extreme hardship both for units that hire teaching assistants (TAs) and research assistants (RAs) and for faculty who hire RAs with extramural funds. With current budget limitations, departments may be forced to hire fewer TAs, which is likely to limit some course offerings. This could reduce undergraduate tuition revenues and impede graduation rates. Similarly, with fixed funding for RAships, programs can support fewer graduate students.

For faculty who hire RAs on grants, the situation is more complicated. The charging of tuition waivers against grants amounts to an internal transfer of funds from research accounts to teaching programs in a way that may not benefit research and graduate studies. Faced with a fixed budget, more faculty members will make the choice to hire a technician or post-doc who can be more productive than a graduate student for nearly the same cost. Moreover, it should be noted that for funding sources allowing maximum rates of indirect costs, the University already recovers ICR on stipends, an amount equaling \$9,700 for a \$20,000 stipend. Faculty resentment over the high cost of supporting students may affect retention of some of our most able researchers.

Graduate programs at the University of Minnesota already struggle to maintain the competitive assistantship rates necessary to attract top students. The proposed fringe benefit increase makes achieving competitive rates that much more difficult. We have seen evidence that this will lead to shrinking graduate programs, not only because it will be more difficult to recruit, but also because fewer assistantships will be made available. Therefore a graduate tuition rate hike will result in fewer graduate students, meaning fewer tuition dollars collected. Most

importantly, diminishing program size and student quality will adversely affect the University's research standing.

The Senate Committee on Finance and Planning strongly suggests that the University of Minnesota should examine this issue very closely before an increase in tuition waiver costs is proposed to the Regents. Strong graduate programs are essential to a strong research university. Therefore, for the longer term, we advise that the University should examine alternative models for supporting the cost of graduate tuition.

In terms of data for the University, Dr. Zetterberg will have the numbers, Professor Speaks said. As will Associate Dean George Green, Mr. Pfutzenreuter added.

Professor Campbell noted that there is a May 18 Regents' budget forum, at which he and Professor Martin will likely have time to speak. He said he would be willing to include this subject in his remarks.

Professor Feeney said that this brings up a concern: the Committee hears about the same problems every year and the University provides some short-term solution. The AHC Finance and Planning Committee is saying the institution should look for long-term solutions. The Committee has seen this fringe benefit pool problem forever; if there are solutions, someone should look for them. The Committee has been told it has 5 days this time--it can offer a statement for a short-term fix, but it should insist on a LONG-TERM solution. Part of the Committee's role is to seek solutions so problems are not recurring. One way to approach a long-term solution in this case is to look at what other universities do, Professor VandenBosch said. Anecdotally, she hears that Minnesota is on the high end of the scale in tuition charges. It would help to look at how other research-intensive universities support graduate students. Mr. Pfutzenreuter said the University should look at that after the budget is set.

Mr. Pfutzenreuter provided a brief stadium update, after which Professor Campbell adjourned the meeting at 4:10.

-- Gary Engstrand

University of Minnesota