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Minutes

Senate Committee on Finance and Planning
Tuesday, April 3, 2007
2:30 – 4:15
238A Morrill Hall

Present:

Judith Martin (chair), Jesse Andrist, Rachel Curtiss, Steve Fitzgerald, Darwin Hendel, Thomas Klein, Mikael Moseley, Kathleen O'Brien, Kathryn Olson, Richard Pfutzenreuter, Terry Roe, Nicholas Treat, Warren Warwick, George Wilcox, Aks Zaheer

Absent:

Rose Blixt, Daniel Feeney, Lincoln Kallsen, Joseph Konstan, Michael Korth, Justin Revenaugh, Michael Rollefson, Karen Seashore, Thomas Stinson, Michael Volna, John Ziegenhagen

Guests:

Associate Vice President Robert Kvavik; Associate Controller Denise Seck

[In these minutes: (1) six-year capital plan; (2) annual report on insurance and risk management; (3) central reserves fund report; (4) update on the biennial request]

1. Six-Year Capital Plan

Professor Martin convened the meeting at 2:35 and welcomed Vice President O'Brien and Associate Vice President Kvavik to discuss the six-year capital plan.

Vice President O'Brien said the Committee would be hearing a presentation similar to the one presented to the Board of Regents in March. In the capital planning process, there are two components to the six-year capital improvement plan: the capital improvement budget (year 1, 2006-07, which provides the actual funding for projects), and the capital improvement plan (years 2-6, which has been the process for about 18 years, is updated every fall, and is a rolling plan).
The updating of the capital improvement plan was postponed this year in order to be sure that it is aligned with academic priorities out of the strategic positioning process.

Vice President O'Brien explained the components of the capital improvement plan as well as the timeline leading to the next (2008) capital request to the state legislature.
She also reviewed the various stages of the capital improvement planning and oversight process, from potential projects (in the gleam of someone's eye) to preliminary review and program analysis to adding it to the six-year capital improvement plan to approval and implementation.
For potential projects, the primary drivers are programmatic needs and facilities conditions (an inspection-based assessment of all 28 million square feet of University property).

The second stage is one that includes a greater exploration of:

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program needs and facility conditions (regental and presidential priorities, strategic positioning goals, academic and service unit strategic directions, and compact initiatives)

-- financial constraints (health and safety concerns, ADA issues, building value, building systems) --- project logistics (prior planning or partial funding, project readiness, potential staging issues, and project interdependency)

-- space utilization issues (will it be new or renovated space?) (improves over all utilization, supports highest and best use of space/location, solves other space availability issues)

-- other considerations (geographic balance, historic status, master and precinct plan impact, and legal obligations).

Dr. Kvavik commented that there is a list of buildings that will not be missed and should be taken down; the cost of removal should be built into the capital request.
The University needs to have the discipline not to put people in them—and to tear them down.

Professor Martin asked if there is still a problem with the availability of swing space. Dr. Kvavik said there is and always will be. Vice President O'Brien added that some of the swing space is quite bad.

Professor Roe asked if it is easy to distinguish between new construction and renovation when it comes to the use of HEAPR funds.
Ms. O'Brien said that HEAPR has stringent definitions in state law, which the University is careful to follow. The University's R&R funds (about $11 million per year across the system) are more flexible.

Vice President O'Brien said, vis-à-vis the last three items in the list, that they do think about whether a building can be re-used and they do a multi-dimensional analysis. Some space is obsolete, Professor Roe said; the question is what to with it. Dr. Kvavik cited as an example the interest in building a biofuels research facility: to build it new would cost about $40 million, but the University would get a lot more bang for the buck doing that than putting the activity into an existing building on the St. Paul campus; the building could be remodeled, but it would not be as useful.
The University can build a new building—but then it still has a "sick" building that it must do something with or about.

Vice President O'Brien next touched on the principals that guide the six-year capital plan.

"The University Six Year Capital Plan is being developed to ensure long term academic excellence by:

Aligning capital projects with the established strategic positioning goals of:

- Recruiting and educating outstanding students
- Recruiting and supporting innovative, energetic world-class faculty and staff
- Enhancing and effectively using resources and infrastructure
- Inspiring innovation, exploration, and discovery

Capitalizing on unique opportunities that are aligned with academic and service unit priorities

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

Giving preference to projects that create flexible space, improve space utilization, and reduce operational cost

Advancing the guiding principles of the master plan and sustainability policies

Protecting the University's financial position by keeping capital expenditures within the projected debt capacity limits"

Dr. Kvavik then reviewed some of the projects that would be supported in the six-year capital plan that would help the University have exceptional students (e.g., TC science teaching and student services, classroom renewal, recreation center expansion, Northrop renovation to house, inter alia, honors programs, UMM library renovation to create a learning commons, a new UMM residence hall with learning spaces), exceptional faculty and staff (Folwell and Pillsbury Hall renovations, a new Bell Museum, and UMD civil engineering addition), excellent organization (HEAPR

funding, system-wide data center, UMM renewable energy projects), and exceptional innovation (Biomedical Sciences Research Facilities Authority, new science and technology building, energy and the environment, and renovation of the existing Bell Museum for the College of Design).

The data center caught the attention of Committee members. The project includes remodeling space to accommodate expanding needs for information technology operations, a secure facility for systemwide data distribution, improved utilization of space, and increased operational efficiency. Dr. Kvavik reported that at present there is 37,000 square feet being used for servers all over the campus, which means use of space, HVAC, electricity, etc. Vice President Cawley could provide the same service with 15,000 square feet and more security. Would putting them under Mr. Cawley take away independence from the units, Professor Martin asked? Not all of it, Dr. Kvavik said; a dean could decide to keep spending the money on the local server—but some of them the University MUST take down because of security risks; units will be able to get information from the central system. The site will be on Como Avenue
near Highway 280; Dr. Kvavik said that moving some administrative services to the periphery of the campus could lead to significant savings.

In terms of space needed for "exceptional innovation," Dr. Kvavik noted that there is a new Physics building slated for 2010, which would be able to support the nanotechnology initiative and other activities. The challenge the University has, and it must work with faculty on addressing it, is that a lot of multi-disciplinary fields need space the University does not have. Thought must be given to how to design space that is attractive for collaborators. As new research facilities are built, those kinds of activities must be kept in mind so that there is easy interaction among faculty, coffee shops, lounges, and so on, that encourage collaboration. Professor Martin said there is a caveat: the assuming is that if the University creates spaces where faculty would bump into each other, that will encourage collaboration—but faculty have to get out of their offices first, which most haven't time to do. Dr. Kvavik said that is a chicken & egg problem. The University also has to build more flexible research space, with movable HVAC and walls; Boston Scientific can do in three days what it takes the University 30 years to do. Professor Zaheer said he does research on communication and knowledge flow; there is a lot of research documenting the importance of informal space. Creating it would be one way to link space to strategic positioning.

Professor Zaheer asked if they are doing any benchmarking. Vice President O'Brien said that people at the University are active in their professional organizations in the Big Ten and beyond and they also have partners in local corporations to learn what can be adapted from their practices. In Facilities Management they are trying to do two things: (1) achieve more consistent performance and productivity, and (2) improve the product. Dr. Kvavik noted that benchmarking required better use of technology and space data to do more sophisticated analyses, and identify the metrics they need to decide what to do with a building (both qualitative and quantitative). To what extent is the building designed to support the program in it? What can the building do? There are also financial considerations: can the building be brought to the desired level of productivity (big lecture rooms versus smaller classes, lab space that can generate grant revenues, etc.)? It is a multi-dimensional analysis to identify intelligent use of the building.

Professor Roe asked what weight is given to ICR rates in deciding whether to invest in a building. Dr. Kvavik said ICR income is considered in some projects.
The Cargill building was funded by a significant gift and expected to generate ICR funds to pay off the debt. That is more common in biomedical bonding bills and it does enter the expectations about what the University can afford. It also jumped up on the list when the gift became available, Professor Martin observed. Has anyone done an analysis to see if the projections worked out, Ms. Olson asked?
That is a sore point, Dr. Kvavik said; there have not been post-construction audits about whether the building is being used the way it was said it would be used. That is why metrics are needed. So if a building jumps up on the list, Professor Martin said, the University should have data to support the higher priority. The internal budget model makes this more transparent, Ms. O'Brien said.

Dr. Kvavik told the Committee that they are looking at the capital as a portfolio and will consider buildings in an aggregate: should the University build these seven buildings rather than deciding one building at a time.

They also want to change the learning environment for students. They do not want to build traditional auditoria but rather spaces where students learn by doing that can be quickly adapted to different teaching approaches. He said he believes the new undergraduate science building will be the best in the country. They are also seeking a $3 million in funding every biennium to fix or upgrade classrooms.

Dr. Kvavik said the St. Paul campus is also being looked at. If the University brings in guests, such as international scholars, there is no place to stay, no shopping, and it is generally not an attractive place in terms of non-academic amenities.
Professor Roe said this is an environment problem, not a construction problem; some labs have not been touched in 30 years. Dr. Kvavik said there are several problems:
funding and the fact that the labs are built in a way that is hard to reconfigure them, which increases the financial problem. St. Paul has enough labs, they are just obsolete. To recruit outstanding faculty, the University remodels them one at a time, which is penny-wise and pound-foolish. The University needs to remodel groups of labs at a time.

Professor Hendel asked where UMR fits in the capital planning process. Vice President O'Brien said there is an amendment to the capital budget to fund an interim facility now and potential for additional space in 2010. The City of Rochester has voted to provide $4 million to assist in building out the interim facility. The initial assumption was the programs there would require 30,000 square feet; that number has now been revised to 50,000. It will cost $8 million ($4 million from the City of Rochester and $4 million from state funds designated for UM Rochester) to complete the build-out of an existing facility (a shopping mall) for the interim facility.

Professor Roe said that given the pace of change in science, designing buildings so that it is possible to cut costs and eliminate obsolete space is important.
Dr. Kvavik agreed; flexible buildings cost more up front but the life expectancy is greater. Professor Wilcox said that medical bioscience buildings built in the last ten years are very flexible, and they need not cost more.

Professor Martin thanked Vice President O'Brien and Associate Vice President Kvavik for their report.

2. Annual Report on Risk Management and Insurance

Professor Martin turned next to Associate Controller Denise Seck to provide the annual report on risk management and insurance.

Ms. Seck distributed copies of the annual report and explained that risk management and insurance are a subset of the University's financial activities; the report provides a comprehensive overview of how the University is doing. She said she was pleased to be able to present a positive report.

The mission of the Office of Risk Management is "to protect the resources of the University from the financial impact of accidental loss.
The total cost of risk managed through the Office of Risk Management totals approximately $10 million annually. The University employs a combination of self-insurance and commercial insurance to cover the myriad of risk areas within the institution."

The key accomplishments for 2005-06 (the period covered by this report) included: an 8.6% decrease in overall cost of risk, compared with the previous year;
the five-year annualized increase in the cost of risk is 2.7%; there has been a 4.5% decrease in the property premium despite several large losses (the University has paid $10.6 million in premiums over the past five years compared to $15.4 in losses); they have obtained $560,000 in dividends; there has been a 16% reduction in workers' compensation claim frequency; and they switched from commercial to self-insurance in three programs (Boynton professional liability, intercollegiate athletic accident insurance, and electronic data-processing coverage, with a total estimated annual savings of $311,000, recurring).
The University decided to participate in the Midwestern Higher Education Compact (MHEC) property program, which has prevented several major premium increases; the MHEC program is insurance within insurance, a consortium with other institutions to increase buying power.

Ms. Seck noted a graph illustrating the savings achieved as a result of self-insuring rather than going on the commercial market; the estimated savings for the last six years is $23.3 million, or about $3.9 million per year. Professor Martin asked where that money went; Ms. Seck responded that it was not spent on insurance.

Professor Roe asked, apropos the savings in workers' compensation claims, if the employees received the same or better

service than they would have if the University had had commercial coverage. Ms. Seck said she was not talking about service, only the funding mechanism to pay for the insurance; she said she was not aware of any complaints about the service.

Professor Roe also surmised that professional liability varies by field; is there an uneven distribution of outlays for professional activities? There is, Ms. Seck said; it is very volatile. Some can be very high while others are zero, Professor Martin observed. How does this play out in the internal budget model, Professor Roe asked? It is an insurance pool, Vice President Pfutzenreuter observed.

Professor Hendel said the MHEC program is a great idea and inquired if there have been discussions about other ways it could save the institutions money. Ms. Seck said they are being discussed but she did not know the state of the plans. Professor Martin pointed out that the CIC has purchasing programs to save the institutions money as well.

Mr. Fitzgerald said that student groups classified as part of campus life are covered by the University's policy while those that are not must find their own insurance.
Ms. Seck said the University purchases student organization general liability insurance and groups can participate through paying a fee. Mr. Fitzgerald said participation should be mandatory.

Professor Martin thanked Ms. Seck for the report.

3. Central Reserves Fund Report

Mr. Pfutzenreuter distributed copies of the Regents' policy on central reserves and the summary report on the reserves as of December 31, 2006.
The central reserves are resources not allocated to any specific unit but held centrally; the only sources of income for central reserves are investment earnings from the Temporary Investment Pool and legal settlements. The purpose of the reserves is to insulate the University from major financial risks (e.g., unanticipated or uninsured catastrophic events, temporary revenue declines, unforeseen legal obligations, failures in central infrastructure, or failure of major business systems).
A central reserves budget is prepared annually and submitted to the Regents as part of the annual operating budget.
The two-page Regents' policy can be found at
http://www1.umn.edu/regents/policies/financial/Central_Reserves_Fund.pdf .

Normally the central reserves should not fall below 4% of the state appropriation, or $25 million, whichever is greater. If there are earnings above that amount, the President can recommend to the Regents that the money be spent on University needs.

For 2006-07 the central reserves are projected to have a balance of slightly over $40 million (after a $10 million transfer to the University's operating budget); that is $15 million more than the minimum required, and that surplus has been allocated for capital projects (e.g., Northrop, Folwell). The balance at the end of the year will be between $25 and $30 million.

Mr. Andrist asked what kind of short-term investments the central reserves are placed in. Mr. Pfutzenreuter said they are put in very safe places, like government bonds; they will not take risks with such core funds. By Regents' policy, units are allowed to set aside funds (on an exception basis) in quasi-endowments in securities, which are more risky. The units can reap the rewards but they also take the risk. Those funds could be provided as incentives, Professor Roe said; Mr. Pfutzenreuter said that only about $20 million of department funds, out of about $600 million, have been moved into quasi-endowments, and that is mostly by the more sophisticated business units.

Mr. Pfutzenreuter touched on highlights for the Temporary Investment Pool for FY2006. It generated $26.8 million, $8.8 million more than the previous year; the yield was 4.7%; it maintained a high average portfolio credit rating; there was $55 million invested in the CEF pool to enhance return and diversity risk; and the balance on December 31, 2006 was $637 million, a decline of $20 million from last year.

4. Biennial Budget Update

Mr. Pfutzenreuter next reported on the status of the University's biennial request as of the end of March. In general, the House and Senate are proposing greater funding than the Governor recommended; the House proposal includes a considerable amount of money ear-marked for specific purposes. The House also funded (not by legislation but in work papers) various elements of the University's request; the Senate proposes a block grant.

One item in the House bill provides $7 million for a scholarship matching program; the University would be required to match it on a 2:1 basis. That would provide $21 million for scholarships, an enormous amount in a two-year period. The legislation does not stipulate if the scholarships are for undergraduate education, the Medical School, etc., or if they are to be need-based, and so on.
Mr. Pfutzenreuter said this will be debated in conference committee but that in general it is a good idea that the University could make work.

Mr. Andrist asked if the legislature was generating ideas or if the University was filling in the gaps; Mr. Pfutzenreuter said it was both.
The University has endorsed tuition banding for the coordinate campuses and buying down the tuition rates at those campuses so they are below the Twin Cities rates.
That would be good for those campuses and the University can support the proposal.

In the past, Professor Roe recalled, Mr. Pfutzenreuter has said the legislative appropriation for the University has not differed significantly from the Governor's recommendation. Is this a change? Mr. Pfutzenreuter said the House number is not reliant on increased taxes; the Senate number is. He cautioned that the University shouldn't spend the money yet; there is another month to go in the legislative process. He also noted that there are items in bills outside the higher education appropriation that are for the University.

Professor Martin thanked Mr. Pfutzenreuter for his report and adjourned the meeting at 4:25.

-- Gary Engstrand

University of Minnesota