UNIVERSITY OF MINNESOTA

August 29, 2017

To: Lendley Black, Chancellor, University of MN Duluth
From: Eric Kaler, President

Re: FY18 Central Allocations

CC: Stephen Keto, Chief Financial Manager, UMD
Greg Sather, RRC Contact, UMD

The President's Operating Budget Plan for FY18, which included the allocations as communicated to you in May, was approved by the Board of Regents on June 20. The purpose of this memorandum is to remind you of the framework and context of the annual budget and to document the individual allocation decisions for your unit, including any further direction.

The FY18 budget framework, outlining the incremental changes in resources and expenditures in the Operations and Maintenance fund (including tuition) and the State Specials, was the basis for the final decisions included in the budget. The details of that framework are as follows:

Recurring Resources – Incremental Change from FY18	
State Appropriation	$22,300,000
Tuition (adjusted for final approved rate changes)	19,500,000
Planned Reallocation – System-wide Costs/Investments	17,100,000
Other Revenues/Resources	9,500,000
Total	$68,400,000
Recurring Expenditures – Incremental Change from FY17	
Compensation (O&M and State Specials)	$34,000,000
Student Aid	300,000
Core Operations & Services	15,900,000
Enhanced Student Services, Instructional & Financial Support	2,000,000
Program Enhancement & Compliance	8,500,000
Facilities & Technology Infrastructure	7,600,000
Total	$68,300,000
Balance	$100,000

Further details on the resources changes and investments are described in the President's FY18 Operating Budget available at http://finance.umn.edu/Budget_FY2018/FY18_OpsBudget_Approved.pdf.

Unit Level Budget Decisions:

As part of the annual budget development process, a number of factors specific to your unit were considered in arriving at the final allocations: revenues, expenditures and balances for the last several years and projected for next year; tuition proposals and estimates, your projected cost increases for O&M/State Specials funded compensation; the change in your cost pool charges for FY18; your submitted reallocation plans per the budget instructions, and your requests for new initiative funding. Following the compact/budget meetings, these factors were reviewed and discussed for each academic unit by the "budget committee", made up of Provost Hanson, Vice Presidents Levine, Jackson, and Burnett, and Associate Vice President Tonneson. Collectively they developed recommended budget plans for each unit, which included allocation totals, tuition plans, reallocation levels, fee approvals etc., and addressed the unit's priorities as well as my own, all under the constraint of arriving at a balanced budget for the University. In an iterative process, I reviewed the recommendations, and ultimately approved the decisions outlined below for inclusion in the FY18 Operating Budget presented to and approved by the Board of Regents.

To help explain the decisions that were made and any corresponding guidance or expectations related to those decisions, please review the following table and bullet points. The table contains the same information communicated to you in May. It identifies the total change in all recurring "framework" resources against the total change in all recognized costs that were considered during the decision making process. The bullets following the table provide further explanation of the numbers and, where appropriate, detail further direction or understandings related to those particular items. The revenue and cost allocation tables you received in May for budget entry purposes have not changed and are thus not repeated with this memo.

FY18 Incremental Budget Changes from FY17 – Summary of Changes in Structural Imbalance
University of MN Duluth

Projected Structural Imbalance Entering FY18	**$3,979,506**
Planned UMD Internal Reallocations/Other Revenue Increases	(2,300,000)
Subtotal – Structural Imbalance Entering Budget Process	**$1,679,506**
Plus Cost Increases - FY18 Budget:	
Compensation	$3,392,000
Cost Pools	385,014
Increase to R&R	26,000
Two Mental Health Counselors	135,000
Perkins Loan Administrative $ Replacement	100,000
Scholarship Match Program	110,682
Subtotal – Revised Structural Imbalance Before Other Resources	**$5,828,202**
Less Other Recurring Resource Solutions:	
Framework Tuition Revenue Increase	$1,196,325
FY17 Tuition Over Budget	457,707
O&M Allocation Increase	954,935
Subtotal–Structural Imbalance Estimated at Budget Approval	**$3,219,235**
Plus Late-in-Process Adjustments:	
Repurpose U Promise Allocation to Support Budget	($1,000,000)
SEM Initiative Costs Paid with Nonrecurring Funds	$ 1,039,000
Final Estimated Structural Imbalance Ending FY18	**$3,258,235**

- The structural imbalance estimated as of the end of FY17 - $3,979,506 at the top of the table above – was presented by your leadership team and confirmed by University Budget and Finance as the starting point for analysis related to the FY18 budget.

- As you are aware, each unit was given a proportionate share of the overall reallocation target to reduce costs by at least $12.5 million in FY18, primarily through reductions in administrative activities. Due to your significant projected budget challenge, you proposed and implemented a $2.3 million reduction in expenses for FY18, consistent with the plan approved and outlined in last year's allocation letter. As projected, these actions reduced the projected structural imbalance from $4.0 million to $1.7 million as we entered the rest of the FY18 budget process. This coming winter we will ask you to verify implementation of these plans and describe any other reallocations you may put into place during FY18.

- The cost of general compensation increases for FY18 was again identified through the budget development process as an institutional priority. Therefore, although you proposed a different plan which included a salary freeze for some employee groups to further address the structural imbalance, I felt it necessary to implement the same general 2% increase on your campus as experienced elsewhere in the system. Your incremental cost related to this decision for O&M and State Special funded salaries and fringe benefits (incremental $3,392,000) added to the imbalance as indicated in the table above.

- The total change in your cost pools from FY17 to FY18 is an increase of $385,015, which is the result of a $301,761 increase from a combination of investments and reallocations for the cost pool units and changes in your proportionate share of the statistics used to distribute the cost pool charges; and an increase of $83,253 from two budget neutral changes in the structure of the cost pools. This additional cost also added to the imbalance as identified in the table above.

- Then there are four cost items for FY18, three of which you requested as part of the budget process, that are approved and fully funded through the increase in the O&M allocation as outlined in a subsequent bullet. Factoring in each of these additions to the structural imbalance leaves the total at roughly $5.8 million before applying further resource solutions.

- The projected change in tuition for FY18 compared to the updated FY17 tuition revenue estimate is $1,196,325 as reflected in the table above. This estimate is based on the proposed tuition rates and your estimated total enrollment. In addition, your FY17 tuition revenue was estimated to come in over budget by over $450,000, so we factored that in as available to address the imbalance and incremental costs for FY18.

  You should be aware that we are asking tuition generating units to begin plans for a recurring tuition reserve to help address potential negative budgetary impacts of fluctuations in enrollment. In your case, we do not expect creation of such a reserve to be possible until the structural imbalance is completely eliminated.

- On a recurring basis, your O&M allocation is being increased $954,935. This is the net change from a series of separate decisions:
  - an increase of $26,000 to your repair and renovation (R&R) base funding (reduced from $88,000 communicated earlier in the process due to late changes in the budget by the Board of Regents);

   - an increase of $83,253, to offset an equivalent increase in your cost pool charges for FY18 related to two technical changes in the calculation of the pools (this is a budget neutral adjustment);
   - an increase of $135,000 for two mental health counselors as requested in your budget submission;
   - an increase of $100,000 to partially offset a loss of Perkins Loan administrative funds as requested in your budget submission;
   - an increase of $110,682 to cover the additional costs of your scholarship match program as requested in your budget submission; and
   - an increase of $500,000 specifically to address a portion of your structural imbalance and FY18 cost increases.

- Once again, given the size of your structural imbalance and the challenge of increased costs for FY18, your requests for central investment in any items beyond those identified above could not be accommodated within the FY18 overall budget framework. Each year we will work with you to address as many of your top priorities as possible within available resources.

- Up to $1,752,000 is approved as part of the financing plan for the UMD Sports and Health Center project. This is not included in the table above as it is a post-budget nonrecurring transfer. In total, the plan is as follows:
   - Total project cost estimated at approximately $6,500,000
   - $4,748,000 from UMD balances, HEAPR and R&R allocations
   - $1,752,000 from TC 2018 nonrecurring R&R funds (to be reimbursed by central balances)

  If the total project cost is less than projected, any savings will result in a reduction to the $1,752,000 contribution.

- In the approved budget for FY18, a recurring $300,000 was set aside for addressing sexual assault and Title IX needs on the system campuses. We are reviewing your request for a Title IX investigator position and a Women's Resource and Action Center Coordinator, along with proposals from the other system campuses, and will communicate a decision regarding the allocation of those funds as soon as we can.

- Finally, in addition to the course fee changes submitted and approved through the fee system, your proposals to increase the collegiate fees 1.08%-2.44% and to remove the intercollegiate athletics fee from the student services fee group and replace it with a new athletics/athletics facilities fee of $84/term are approved.

<u>Structural Imbalance in the Budget</u>

Over the last four years, we have worked during the annual budget development process to reduce a structural imbalance (recurring expenses exceeding recurring revenues) of over $9 million. According to our summary level tracking, which has been reconciled with your budget office, the decisions we have made and the actual tuition and spending activity has led to the following:

- A recurring structural imbalance at the end of FY14 of $9.4 million
- A recurring structural imbalance at the end of FY15 of $6.0 million

- A recurring structural imbalance at the end of FY16 of $5.0 million
- A recurring structural imbalance at the end of FY17 of $4.0 million
- A projected recurring structural imbalance at the end of FY18 of $3.3 million

Two notes related to FY18:

1) I have decided to approve the movement of $1.0 million of your current O&M allocation dedicated to Promise Scholarships to support your general operating budget on a recurring basis beginning in FY18. According to our analysis, the portion of your allocation dedicated to the Promise Scholarship Program (that you have been required to budget and hold for that purpose) is currently exceeding the needs of the program by approximately $1.5 million on a recurring basis. This approval allows you to "spend" $1.0 million of that surplus to address the increase in FY18 costs identified in the table on page 2 of this letter, and therefore results in a reduction in your projected structural imbalance. I was going to review the overall Promise program allocation across the institution as part of developing the FY19 budget, so this approval is an early decision in reallocating a portion of the overall surplus to a significant need on your campus, rather than make it available to the general budget balancing pool for the whole system.

2) The ending imbalance of $3.3 million is also $1.1 million higher than we had planned when we finalized the FY18 budget, due to late information you provided on recurring costs for implementing your Strategic Enrollment Management plan being covered by nonrecurring resources. As we have not had an opportunity to discuss this in detail, it is my expectation that these costs will be examined for potential savings as you evaluate the effectiveness of your SEM plan up to this point. If no savings can be derived, then it is appropriate to include these costs in the calculation of your structural imbalance going forward.

Looking ahead to the FY19 budget, it is important to emphasize that incremental/new resources to cover costs and investments will be in short supply. Given the significant structural imbalance remaining in your budget, no increase in the state appropriation for FY19, continued intention to curb the growth in resident tuition rates, the desire to move forward with strategic investments, and the fact that some of our basic costs will grow next year (fringe benefits, facilities, technology etc.), you must be prepared to combine any modest revenue growth with continued internal reallocation. Difficult decisions about ending activities will likely be necessary for every unit. Please keep this environment in mind as your plans move into the fall and we consult with you on development of the budget framework for next year. At this time I will not set a date-certain deadline for elimination of your imbalance, but as I'm sure you agree, moving forward to address opportunities for strategic investments in the quality of the campus is contingent on achieving that goal. We simply must put this challenge behind us. University Budget and Finance will check with you throughout the year to monitor your financial situation and provide help as you develop plans and proposals for the FY19 budget.

If you have questions about the content of this memorandum, please do not hesitate to contact me, or any member of the "budget committee". Your thoughtful responses throughout the budget development process are greatly appreciated.