Minutes*

Senate Committee on Finance and Planning
Tuesday, May 5, 2009
2:00 – 3:45
238A Morrill Hall

Present: Judith Martin (chair), Jon Binks, Joao Boavida, David Chapman, Steen Erikson, Steve Fitzgerald, Kara Kersteter, Lyndel King, Thomas Klein, Joseph Konstan, Russell Luepker, Mikael Moseley, Kathleen O'Brien, Paul Olin, Richard Pfutzenreuter, Gwen Rudney, Michael Rollefson, Karen Seashore, Madelon Sprengnether, Warren Warwick, Aks Zaheer

Absent: Lincoln Kallsen, Terry Roe, Thomas Stinson, Michael Volna

Guests: Cynthia Kaiser (Minnesota Medical Foundation), Kathleen Pickard (University of Minnesota Foundation)

[In these minutes: (1) student involvement in budget discussions; (2) endowments "under water"; (3) annual capital improvement budget]

1. Student Involvement in Budget Discussions

Professor Martin convened the meeting at 2:00 and turned to Messrs. Boavida and Moseley to introduce a discussion about increased student involvement in budget discussions. They had provided by email a message to the Committee outlining their questions and issues.

Mr. Boavida began by saying that the issue is related to a point Mr. Moseley brought to the Committee earlier for advice, a proposal from the Minnesota Student Association to create a tuition-oversight committee. That committee was not established but it did lead to an MSA resolution supporting a tuition cap. He and Mr. Moseley talked to Vice President Pfutzenreuter, among others, about how people would react to student involvement in the early stages of the compact process. Tuition is a big issue, but the University needs a total amount of money to pay the bills, which are determined by institutional priorities. Who sets those priorities? They have the sense that faculty and students do not have much to say about the priorities. Part of the problem is that people don't know what is going on—they may criticize the number of vice presidents without knowing what those individuals do or they may say the administration is too big without any idea of what should be cut. Their idea is to demystify the budget process. (To which Professor Martin responded "good luck with that!").

Mr. Moseley tied the issue to the Student Senate, which he said is trying to be a more unified body across all campuses and various student-government bodies on the Twin Cities campus. They are trying to promote transparency, unity, and participation in the budget process. Some colleges have student participation, and they could pursue the matter in each college, or they could explore other routes. They ask the advice of the Committee.

They are looking for student involvement in budget development, which means asking for student participation as the compacts are developed, Professor Martin said. Developed, not making any decision,

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Mr. Boavida confirmed. It could be that the student members of this Committee report to the Student Senate, Mr. Moseley observed.

Professor Konstan said he thought the students were asking for four things. One, how to get a small group of students to understand the budget process and provide student views: this Committee and others are the right place; this Committee is consulted at various times during the process. The challenge will be to find students who can devote the sustained time to learn the vocabulary and concepts. Two, influence college priorities and the compact process: they must understand that colleges see the process as a zero-sum game. Other colleges get what they do not, and the question is who decides the priorities between nanotechnology and philosophy. Three, and this is the hardest one, get views into top-level decision-making: this is not just about tuition and where it is going at the University but also about how much the University wants to be a top-tier institution even at the sacrifice of affordability—or the reverse. It is difficult to say where those decisions are made. Four, tuition: this is the topic in which students are most interested and about which they are the most conflicted. It is difficult to retain a coherent position on tuition without the context of the other elements of the budget, and the decisions are made in a political venue. They could work on all four approaches at once, Professor Konstan said, but he suggested they work first on sustaining involvement on Senate committees and engaging with the deans to participate at the college level.

The big problem is first getting students involved, Professor Martin commented, and there is a steep learning curve. To have an impact, students must appoint people who can serve for two or three years. She suggested talking with students in the colleges to see what is already in place that allows a student voice in the development of college compacts. They may find that they cannot get students who are willing to participate. The other of Professor Konstan's elements are more difficult; budget decisions are basically made by four people (the president and three senior vice presidents), none of whom are in this room.

Mr. Boavida said some have expressed disappointment at the information that is available; is there a way to get it to students? Many are interested enough to do one click on the web, Mr. Klein commented, and after that they lose interest. It is in part an information-receiver problem, not only an information-transmitter problem. He said he has usually found people respond to questions about budgets if he asks and people see the connection to how it can affect their unit.

As representatives of the faculty, how do they determine how faculty feel, Mr. Boavida inquired? They email her, Professor Martin said; any committee chair is found by those who are interested. And views get expressed. Professor Konstan commented that it would be appropriate for the Student Senate Consultative Committee to decide, perhaps three times per year, what is important to students. It is good for students to be on the Committee, but that does not mean they want to know what students think every week. But a message once in awhile to students about issues would be helpful. Ms. Kersteter said she has learned that a large number of students do not know what is going on and students on this Committee could bring issues to their attention—but students don't have time to go find all the information if they are in school and also working.

Professor Martin suggested focusing on a couple of things, on what is do-able, on getting information at the collegiate level and learning whether students are involved in the process.

Messrs. Boavida and Moseley thanked Committee members for their counsel.

<u>2. Endowments "Under Water"</u>

Professor Martin turned next to Vice President Pfutzenreuter, who introduced Cynthia Kaiser, chief financial officer and vice president of operations of the Minnesota Medical Foundation (MMF), and Kathleen Pickard, vice president and chief financial officer of the University of Minnesota Foundation (UMF), to lead a discussion of endowments "under water," that is, the corpus is now worth less than the value of the original donation. He said the three endowments (UMF, MMF, and the Consolidated Endowment Fund (CEF) managed by Stuart Mason) have different issues and each has taken a slightly different approach to address the problem.

Ms. Kaiser began by providing a little background. In the past, Minnesota had a law, UMIFA, Uniform Management of Institutional Funds Act, governing endowments. Two things are pertinent: (1) if an endowment is under water, payouts were not allowed unless (2) there was an agreement with the donor that it was permissible to draw on the corpus. UMIFA has been replaced in August, 2008, by UPMIFA, Uniform Prudent Management of Institutional Funds Act. UPMIFA sets out seven "factors of prudence":

1. duration and preservation of principal
2. purposes of the institution (which are slightly different across the three endowments, so they will have different responses to funds that are underwater, which is appropriate)
3. general economic conditions
4. effect of inflation/deflation
5. expected total return (over what time period is not defined; most simulations use 30 years, an intergenerational standard)
6. other resources of the institution
7. investment policy.

The law governs permanent endowments; these are factors a board of directors is to focus on. UPMIFA is nearly uniform across the country, Mr. Pfutzenreuter told the Committee.

The major change from UMIFA to UPMIFA, Ms. Kaiser said, is that they need not track the historical value of the funds but must manage prudently. UPMIFA, Ms. Pickard added, provided endowments more flexibility.

Professor Martin asked if the change meant they need not track every dollar back to the donor. Ms. Pickard said they are obligated to maintain the purchasing power of the endowment in perpetuity. (UMF will continue to track gifts by donor for stewardship purposes, even though not required by UPMIFA.)

Professor Konstan observed there is nothing in the factors of prudence about the donor's charitable intent. He used the example of a donor who gave money for undergraduate scholarships; the prudent decision might be spend money faster when economic times are harder on undergraduates and spend less when more money is available. Ms. Kaiser suggested that donor intent was really addressed in the second standard of prudence—purposes of the institution—and boards do need to consider that factor when determining a course of action.

They are investing money designed for the long term and to provide a stable, predictable income to the designated programs, Ms. Pickard said, so they are not changing their policy and reducing the spending rate at this time; the University needs the money now. The best time to consider decreasing the spending percentage, Ms. Kaiser said, is during a market recovery, when they can lower the percentage paid out but keep the actual payments close to the same.

Professor Zaheer asked if they had any sense when the funds would be built back up. Ms. Pickard said that would depend on future investment performance and fund-by-fund spending decisions.

Ms. Pickard identified the guiding principles they (UMF) are following:

-- minimize University operational disruption
-- maximize student awards
-- effective donor stewardship
-- prudent endowment management. (UPMIFA compliance)
-- effective collaboration and communication with donors and the University community.

Their guidelines are to continue full payout until a fund is 20% or more underwater or the effective payout rate reaches 7% of the fund's current principal value. They are working with each college to develop an action plan for funds that run into those guidelines.

Professor Warwick noted that the state made it possible to use pension funds to create endowments without paying taxes on the money. He said he has done so and has been shocked to see that the principal value has dropped 29%--while the pensions continue to gain and what was not taken out for the endowment continued to grow. What is going on with the endowments? This is going on across the country. How will they get more people to donate when the donations lose a large percentage of their value? That is a challenge felt across the country, Ms. Pickard said. They (UMF) have less exposure to equity investments, (which are down 30-40% in the last six months), and are down about 20% in value, and they believe they have a good long-term portfolio. They also have a separate investment-management subsidiary dedicated to managing the assets to meet long-term-growth goals, University of Minnesota Investment Advisors.

Mr. Pfutzenreuter said that the allocation of pension funds differs from that of endowments. The University has a strategy of putting certain amounts into equity, certain amounts into fixed-income assets, and so on. Endowments across the country have lost about 30% of their value and it could take a decade to recover the value—but no one knows.

Has every endowment been hit by the decline, Professor Zaheer asked? Not all funds are under water, Mr. Pfutzenreuter said. In the case of the Consolidated Endowment Fund, if a fund is 25% or more under its book value, they suspend distributions. In the case of quasi-endowments, they inform the donor of the status of the fund, and can reinvest the funds or make distributions. The funds that are under water tend to be the new ones, and there are not a lot of them. Unlike the two foundations, Mr. Pfutzenreuter said, they suspend payments from the CEF. It is their judgment that if a fund declines in value by 25% or more, if they continue to make distributions it will take so long to climb out of the hole that they will not be able to preserve the principle. But there is a tension and a tradeoff and the boards must look at what the funds are supporting (e.g., critical research) in determining prudence.

Ms. Pickard said they use a 20% rule. Ms. Kaiser said the MMF will be taking up the question next week, but noted that they support medical research, which cannot be suspended and then picked up again a year later. They will probably divide funds into three groups: suspend payments from funds that are down 50% or more and talk with the donor; use current dollars as much as possible for funds that are down 25-50% in value and limit the effective spending rate to 4.75%; and, if prudent, continue spending with funds that are down no more than 25% in value.

Professor Zaheer asked about the size of each of the endowments. The MMF has a value of about $170 million, the University of Minnesota Foundation a value of about $1.1 billion, and the CEF about $900 million. Each of the three, Mr. Pfutzenreuter said, has slightly different asset-allocation policies.

Professor Luepker asked if they pay 4.5% on the true principle. They use a five-year trailing average, Ms. Pickard said. The MMF pays 4.75%, also using a five-year trailing average, Ms. Kaiser reported. So a donation made 50 years ago would take a long time to go under water, Professor Luepker concluded. The two guests agreed.

The key will be communication with donors and account managers, Ms. Kaiser said. They will need to talk about the impact of the market, and will do so case by case, because the situation could be different for each one.

Mr. Klein asked about the fund managers each organization uses to manage investments. Ms. Kaiser said the MMF uses Commonfund, a non-profit organization that manages money for 70 of the top 100 endowments in the country. They can pool money so that even small endowments can take advantage of better investment opportunities. Mr. Pfutzenreuter recalled that there was a lengthy discussion a couple of years ago when the President asked the MMF to consider partnering with the CEF or the UMF-IA; MMF decided to go with Commonfund. That was a good decision, he said, and Commonfund is a good organization. The MMF is too small to get into investments that would make more money, but Commonfund manages about $75 billion. Mr. Mason invests about $800 million, and the UMF is a separate entity. Ms. Pickard reported that the UMF has a separate body, UMF Investment Advisors.

Professor Konstan commented that UPMIFA sounds like a responsible set of rules, unlike those that govern some other non-profit organizations. He said that Professor Warwick made an important point: some donors will be hesitant to see their money subject to the vagaries of the market. Is there an option, for a financially-conservative donor, to put money in something safe so that he or she will know the money is safe forever, even if the payout is lower? There are different tools available to individuals, such as charitable trusts or gift annuities, Ms. Kaiser said, and the foundations would work with donors to find the best option for their circumstances; however, foundations are reluctant to set up individual portfolios. Donors always have the option to provide annual gifts for current spending. Mr. Pfutzenreuter said that with EFS, any one-time arrangement has to be handled manually, so they prefer that donations join the investment pool of the endowment.

They do have a separate option for large capital projects, Ms. Pickard said, where the money cannot be put at risk. She also commented that in the past they did have a more conservative option, but in good years donors were unhappy because the fund was not earning enough. The endowment pool is actively managed and offers the best long-term-growth option.

The good news in all of this is that none of the funds have had liquidity problems, Ms. Kaiser said, so that they did not have to sell assets (unlike the case at some institutions elsewhere in the country). Ms. Pickard reported that the UMF was down 19% as of December. Ms. Kaiser reported the MMF was down 29% as of December; Mr. Pfutzenreuter said the CEF was down 21%. He noted that the MMF is more exposed to equities because it is a smaller fund. He further commented that those portfolios that had significant exposure to alternatives such as CEF probably were not yet fully valued at market given the illiquidity in the market and difficulty properly valuing these assets.

Mr. Klein commented that it is important to keep in mind, as they hear the bad news, that the last bad news came when inflation was at 18% and eroded the real purchasing power of endowments. The idea then was to get out of bonds and into equities to protect the endowments against inflation. They need to look for advisors who manage a number of risks. That is a good point, Ms. Kaiser said, and noted both #1 and #4 of the principles speak to that issue. Mr. Klein said he assumed advisory groups also had deflation in view as a possibility for the next ten years. That is a potential factor, Ms. Pickard agreed.

Professor Martin thanked Ms. Kaiser and Ms. Pickard for joining the meeting.

3. Annual Capital Improvement Budget

Professor Martin turned now to Vice President Pfutzenreuter for a discussion of the capital improvement budget.

Mr. Pfutzenreuter distributed a handout with a pie chart and a bar graph indicating the funding sources for the capital improvement plan. The big assumption, he said, is that the University's request to the state is approved; it includes the Bell Museum and HEAPR funds, and the capital plan will be adjusted once the legislature completes its business. Of the $149.6 million planned, $88.3 million is University-supported and $61.3 million is state-supported. Of the University portion, $34.8 million is University debt, $41.9 million is University funds, and $11.8 million is from grants and gifts. Much of the $41.9 million is from auxiliary services or regular University repairs. The grants and gifts include, for example, fund-raising for the Weisman Art Museum. This is a relatively modest plan, he said, and the numbers could drop depending on what happens in St. Paul. The amount of the University's debt would be smaller if the state provides less money than requested.

The capital budget will go to the Regents for information in May and action in June—assuming there is a final appropriation by June. They also expect to bring a preliminary 2010 capital request to the Board in June.

Vice President O'Brien next reviewed the pages from the Regents' docket outlining the individual capital projects that make up the annual capital budget; these are projects that have funds in place and can proceed during the next year. The Regents see any project that costs more than $500,000.

Ms. O'Brien noted that there could be more than the usual number of capital budget amendments this year because there are a significant number of grant applications that include facilities costs in the range of $5 – 15 million, and the result of those applications will not be known until December.

Professor Luepker asked where the funding for the biomedical research facilities appears. Ms. O'Brien said that CMRR and the second building in the biomedical series were approved last year; the University will not start another one until after next year, so there are no biomedical facilities in this year's capital budget.

Professor Seashore asked if there has been any criticism that the University pays too much or spends too much on buildings. Vice President O'Brien said the people who participate in the capital bonding discussions at the legislature have studied the matter for decades and understand what the University is doing. When they discuss the 2010 capital request next month, one element of it will be a new physics building—a building that has a large price tag per square foot. They will do benchmarking with other institutions to illustrate the costs of these kinds of science facilities. The expected top priorities for 2010 will be interior restoration of Folwell Hall, HEAPR funds, and the new physics building ($80 million).

Professor Martin thanked Vice Presidents O'Brien and Pfutzenreuter for their reports and adjourned the meeting at 3:20.

-- Gary Engstrand

University of Minnesota