Minutes*

Senate Committee on Finance and Planning
Tuesday, June 11, 2013
3:00 – 5:00
238A Morrill Hall

Present: Russell Luepker (chair pro tem), Gary Cohen, Catherine Fitch, Susan Hupp, Kara Kersteter, Talha Khan, Paul Olin, Richard Pfutzenreuter, Terry Roe, Michael Rollefson, Ann Sather, Arturo Schultz, S. Charles Schulz, Pamela Wheelock, Aks Zaheer

Absent: Will Durfee, Dan Feeney, Lincoln Kallsen, Jill Merriam, Fred Morrison, Gwen Rudney, Michael Volna

Guests: Kelly Farmer (Director, University Tax Management), Channing Riggs (Director, Federal Relations); Professor Jennifer Gunn (incoming 2013-14 committee member); Brian Swanson (University Services)

[In these minutes: (1) tax law changes and the University; (2) six-year capital plan and capital improvement budget; (3) new criteria for capital projects; (4) Regents' budget forum]

1. Tax Law Changes and the University

Professor Luepker convened the meeting at 3:00, explained that Professor Durfee was out of town, and welcomed Mr. Farmer and Ms. Riggs to discuss changes in federal tax laws.

Ms. Riggs provided an overview of actions in Washington on taxes that affect higher education. There is great interest in tax reform on both sides of the aisle; the Chairman of the House Ways and Means Committee and the Chairman of the Senate Finance Committee set up www.TaxReform/gov, which received more than 9,000 comments/suggestions in the first six weeks. The Chairman and Ranking Member of the House Way and Means Committee are also working together—they set up 11 Tax Reform Working Groups earlier this year, which have pulled together a 600+ page report of recommendations for tax reform. The higher-education community has spoken out on key tax issues: charitable deductions, tax-exempt bonds, and education and family benefits (incentives to save for college, and tax incentives to payback college loans).

The House Ways and Means Committee had a hearing on an IRS's College and University Compliance Projects, a three-year project that looked at unrelated business income (UBIT). The IRS looked closely at 34 institutions and found that 90% were not in compliance with the law; if they had been, there would have been millions of additional dollars in tax revenue. (The University of Minnesota was audited as part of the IRS compliance project but the Tax Management Office believes the University was not one of the 34 institutions included in the IRS Final Report). The IRS plans to continue the study and choose another group of colleges to study.

Professor Zaheer asked if the taxes would go up or down as a result of the Congressional interest. They are looking at various areas with a view to accomplishing what? There are many goals to tax reform and, naturally, many political viewpoints come into play, Ms. Riggs said. The easy answer is that

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Congress would like to simplify taxes. In addition, there is a belief that by simplifying taxes, eliminating loop holes and tax breaks, the government could generate more revenue from federal taxes. So, Professor Zaheer suggested, the GOP might want to make the taxes lower and the Democrats make them higher. This is where partisan politics comes into play and one's beliefs about who should pay more and who isn't paying their fair share, Ms. Riggs commented.

In response to a query from Professor Roe, Mr. Farmer reviewed tax issues the University has dealt with the last few years, including a complete UBI audit in 2011-12 and audits of stadium bonds, excise taxes, and a state sales tax audit. Why the stadium bonds, Professor Roe asked? Mr. Farmer explained that the IRS has audited a large number of "special purpose" bonds related to intercollegiate athletics facilities, such as bonds specifically designated for a stadium, even though a state appropriation pays for the bonds. Vice President Pfutzenreuter added that the IRS is also targeting the private use of athletic facilities, something they are watching carefully. The issue does affect the University's contract with the Vikings, which has been structured around an exception from private business use under federal law. Under this exception the Viking use of the University's stadium must be kept under 50 days for the length of the contract. This Vikings arrangement is an example of how the University strives to be in in compliance with all tax regulations and laws relating to private business use. The University's experience with the audits and compliance checks is that it is generally in compliance with the requisite tax laws relating to its operations, Mr. Farmer assured the Committee.

Mr. Pfutzenreuter said that as the University issues more and more of its own debt, if there is private use of the facilities (which could be intercollegiate athletics but also could be partnerships with industry on labs, for example), the University must structure the debt to comply with the law. Sometimes it may issue part of the debt as taxable.

Professor Roe asked if, when the University issues debt through bonds, the source of revenue to pay off the bonds is linked to the use of the money raised with the bond sale. It is, Mr. Pfutzenreuter said. What about general-use buildings, Professor Roe asked? With respect to Northrop, for example, Mr. Pfutzenreuter said, they had two choices in funding it as a common good: put the cost in the cost pools or take the money off the top of the state funding. If a facility is tied to a particular college, it will pay for it.

Professor Luepker noted a lengthy list of provisions of the tax code affecting colleges and universities that Ms. Riggs provided; the University would favor many of them and making the tax code simpler would deal with many of them. Does a simpler code mean lower rates? Mr. Farmer said they hear various rumors that the national organizations are working on (e.g., a cap on interest on bonds, mortgages, and charitable contributions), but they don't know anything for certain until it becomes public. Ms. Riggs observed that every tax provision has an interest group interested in retaining it; how would Congress ever get rid of the mortgage interest deduction? Professor Luepker agreed that the big items could be difficult to address but said there many smaller groups that seek to change provisions in the law. Making changes would take enormous political will, Ms. Riggs said, and politicians don't get much credit for doing the right thing. Universities are very resistant to changes in the charitable contributions provisions.

So is the likelihood that anything will happen low, Professor Zaheer asked? Ms. Riggs said she sometimes feels that was about everything that Congress is dealing with.

Mr. Farmer next reviewed three handouts. One dealt with a tax credit for businesses in greater Minnesota that hire interns; one dealt with changes in the sales tax on digital products (which will affect the University, but to what extent is not clear yet), and one dealt with Congressional action on sales taxes on internet sales passed by the U.S. Senate entitled the Marketplace Fairness Act. On the last, there is no exemption for higher education included and would require institutions to withhold sales taxes for all 50 states—which would be a major administrative burden for the University. The University has about $50 million per year in such sales across state lines; some of the items would be subject to taxes and some might not be. Mr. Farmer added that he hoped the law, if passed by the U.S. House and adopted, would not be interpreted to apply to tuition paid over the internet or to educational expenses. It is presumably aimed at product sales.

Professor Luepker thanked Ms. Riggs and Mr. Farmer for their report.

2. Six-Year Capital Plan and Capital Improvement Budget

Vice President Wheelock next distributed copies of handouts and turned to the six-year capital plan—which is composed of two parts, the Capital Improvement Budget (year 1, what will be done next year) and the Capital Plan (years 2-6). She reviewed the considerations and constraints that come into play in preparing both the capital budget and the capital plan; they include: academic and service unit directions, legal obligations, availability of local unit resources, health/safety/infrastructure, approved pre-design, project interdependencies, prior planning or partial funding, ability to leverage private funds, annual operating and debt costs, geographical balance, project readiness, potential for staging, the University's traditional share of the state bonding bill, the University's bond rating, and the one-third state matching requirement. There is value to having a six-year plan because it allows colleges to engage in planning with faculty members about academic programs, and there is flexibility in the plan.

Given what happened at the legislature (no capital bonding except for the State Capitol and few other items), they had to revise both the annual capital improvement budget and the six-year capital improvement plan, Ms. Wheelock reported. Their biggest concern is that each year the University asks for a large amount of HEAPR funding (for building renewal)—and this year received none. The lack of this funding is a challenge for a large institution with only limited internal renewal funding. The other changes that have been made to the six-year capital plan as a result of the lack of a capital appropriation during 2013 are these:

UMD academic priority	reassigned from 2016 to 2014
UMC Wellness Center	reassigned from 2013 to 2014
Research Lab Improvement Fund	reassigned from 2013 to 2014
Tate Lab of Physics	reassigned from 2013 to 2014 full project cost
St. Paul Labs Investment	reassigned from 2013 to 2014 full project cost
West Bank Rec facility	added to 2015

There are other projects under consideration, Vice President Wheelock related. They are at present insufficiently developed in terms of programmatic needs or funding to be included in the plan with a year and funding target, but warrant being identified based on college/academic priorities.

Eddy Hall	reassigned from 2013 to Under Consideration
Kirby Student Center UMD	Maintain on Under Consideration
AHC Interprofessional Educ Center	Added to Under Consideration
Bell Museum of Nat Hist	Added to Under Consideration
Athletic Facilities phase 1	Added to Under Consideration

It can be difficult to achieve funding for projects in a competitive capital request when one considers the number of legislators who must vote in favor of a capital bonding bill, Ms. Wheelock said, and it is a challenge for the University to renovate older buildings unless their program has a statewide interest. She explained also that the athletic facilities are expected to be support entirely by fund-raising, that the AHC interprofessional education facility had been proposed for 2018 but the University will be working to advance that sooner (and likely outside of a bonding bill), and that the Bell Museum remains a key priority of the House Capital Budget Committee. The University will have to think carefully about its priorities.

Professor Luepker noted that the Bell Museum has been off and on the University's request. It has, Ms. Wheelock agreed, and was twice vetoed by Governor Pawlenty, who was much more concerned about the size of the bonding bill. Professor Cohen asked if the conditions in the current building are so bad that the collections are in danger. There is water in the basement, and other improvements are needed, but staff is aware of the current limitations and has made operational adjustments necessary to minimize risk, Ms. Wheelock said.

The total six-year capital plan is $1.008 billion, of which $775 million would come from the state and $200 million from the University (and $33.5 million in self-funded projects). These plans are always dominated by the state capital request, Vice President Pfutzenreuter observed.

For 2014, the state-funded projects proposed for the University's capital request are these (in millions of dollars):

	Total	State	Univ
HEAPR	100	100	0
Tate Lab of Physics	85	56.7	28.3
St. Paul Lab Bldg Phase 1	45	30	15
UMC Wellness Ctr	15	10	5
Research Lab improvements	18	12	6
UMD academic priority	36	24	12
Total	299	232.7	66.3

This would be 23% of a $1-billion bonding bill, Mr. Pfutzenreuter observed, and the University's share of state bonding bills has never exceeded 18% (and in some cases has been as small as 12%). This is a large request, which is why projects on the six-year capital plan may take 8-20 years to get funded—but they do get funded.

Professor Luepker asked where the University would get the money ($66.3 million) if it were to receive the full request. Through the issuance of debt plus unit resources plus fund-raising, Vice President Pfutzenreuter said. Most projects are a mix of funding sources. The constraint is not only how much money will the state provide but also how much the University can afford, Professor Roe said. They do look at what the University can afford, Mr. Pfutzenreuter assured the Committee; this request would require $22 million per year if fully approved and all debt-financed (which will not be the case).

Professor Hupp said the University often puts projects off; are these numbers for when construction starts or only for this year? And units are only permitted to start fund-raising after a certain point in the approval cycle. The farther out one goes on the six-year list, the less reliable the numbers are, Mr. Pfutzenreuter said; they are the best possible guess by the facilities experts. As a project gets closer, the state provides inflation numbers and the University refines the design. For fund-raising, Ms. Wheelock said, the college would want to know it has been designated a priority for the University and have a working estimate of the project cost—but not start fund-raising too early because the scope could change. It is best to work with the University of Minnesota Foundation in asking donors for support.

Professor Luepker inquired how a project gets listed on the capital request. Ms. Wheelock said that last year there was more extensive engagement about it; this year it has essentially just been updated. The senior officers engage with the president and others, identify key opportunities, and the process is often more art than science. The six-year capital plan will be reviewed again next year. Mr. Swanson pointed out that the six-year plan has been adjusted on occasion, which means that some projects are moved earlier and some later (e.g., in a past plan, Kolthoff Hall had to be moved forward because of urgent issues with the building).

They are also looking to decommission buildings and downsize the campus footprint, Ms. Wheelock said. As they think about improving facilities, they also think about where they can move away from poor-quality space that should not receive any additional investment.

Mr. Pfutzenreuter observed, again, that the price tag for some of these buildings means that if the University doesn't receive the entire request, it may only be funded for perhaps two projects. That small a number then creates a greater backlog on the six-year plan. One major challenge in all this is heavy reliance on state funds for the institution's physical plant, Ms. Wheelock added. Mr. Pfutzenreuter agreed that there is no tradition of corporate giving for bricks and mortar in Minnesota, such as there is in Michigan (the University of Michigan is provided no state funds for capital projects). The corporations and the citizens of Minnesota view the state as the source of bonding for University buildings.

Professor Schulz inquired if the strategic planning process might include identification of ways to fund capital projects other than through state bonding. Vice President Pfutzenreuter agreed that is something the institution could think more about.

Professor Zaheer asked about the next biomedical building. It is infectious diseases and the project will start soon, Mr. Pfutzenreuter said. It is the last of the four biomedical science buildings. What comes next, Professor Zaheer asked? One priority is the health sciences interprofessional education center, Mr. Pfutzenreuter said.

Professor Luepker asked what will happen with Phillips-Wangensteen when the clinics vacate it. Funding for renovation is proposed for the 2016 capital request, Ms. Wheelock noted. Mr. Swanson said the leadership of the Academic Health Center and University Services are starting the process of reviewing options for the future uses of Phillips-Wangensteen.

Professor Luepker recalled that there have been discussions about the campus footprint, whether it is too big and should be shrunk, and whether the space now purposed is in keeping with reduction plans. Vice President Wheelock said that at 29 million square feet, one could argue that it is too large, but the University is also making approximately $20 million per year in lease payments, so presumably some of the off-campus offices could be brought back. The University does need to be realistic in what it can afford; it builds buildings with the expectation that they will still be here 50-100 years later. They are looking at the business model for facilities and at space that may be too inflexible or too old for renovation, and some space is being decommissioned.

Professor Cohen said there had been urgency about the need to replace parts of the steam plant. Is that a capital project? Mr. Pfutzenreuter said it had been approved and is underway; the cost of the new Combined Heat and Power plant is $93 million.

Dr. Fitch observed that the West Bank Plaza had problems and needs to get on the six-year plan; how is that handled when there is no "owner"? She also noted there is a shortage of space—but that no one is using the old bookstore. Ms. Wheelock said that there are R&R projects outside the capital request that are more focused on upkeep and maintenance, not new projects. Mr. Swanson said that Facilities Management keeps a Facilities Condition Assessment score and tracks problems, and manages the worst of them. If there is a major problem, they will use HEAPR funds, and R&R funds if it is less major (but there is only about $6 million available in R&R funds for the entire Twin Cities campus). It is because there are so few R&R funds that the University relies heavily on HEAPR funding to keep buildings functional—and Facilities Management needs a predictable flow of HEAPR money or it is always in a fire-fighting mode.

Professor Zaheer noted that the proposed 2016 capital plan includes $7.5 million in University funds (no state funds) for renovation of the golf course. Mr. Pfutzenreuter explained that that money would come from fund-raising; Ms. Wheelock said the plan is to make the course more functional, improve draining and irrigation, and renovate the clubhouse. President Kaler set a maximum of $7.5 million for the project, and 90% of it will go to improving the course.

3. New Criteria for Capital Projects

Vice President Wheelock said that they have tried to reflect the president's priorities in assessing capital projects. He and they have looked at projects and assess how they relate to the University's goals.

Mr. Swanson noted the long list of factors that come into play in assessing a proposed capital project (paragraph 1, item 2 of these minutes). There are always more projects than money available so the academic leadership must decide on the priorities.

4. Regents' Budget Forum

Professor Luepker reported that he had spoken on behalf of the Committee at the Board of Regents' budget forum the previous week. Many who commented at the forum were civil service and AFCSME staff who expressed worry about the effect of the "Cadillac tax" on the UPlan, especially on low-income employees, if costs are shifted to employees. This Committee will hear more on that topic and may wish to weigh in on it. He noted that while the law provides the tax goes into effect in 2018, the University is implementing the changes in 2014, something the Committee may also wish to address.

Vice President Wheelock observed that while the tax is being implemented in 2018, the obligations will be based on prior years' data. Professor Cohen said that the test of the value of the plans will occur in 2016.

Professor Luepker said that he commented on two matters at the Regents' forum. One was tuition and debt for students in graduate and professional schools. There has been a focus on undergraduates, but not graduate and professional students, and the poster child for the problem is the Medical School student, who graduates on average with a debt of $175,000, among the highest in the nation. This is an issue that deserves attention and the Committee will begin to discuss it in July when it meets with the deans of the professional schools.

Professor Schulz asked what role the deans play in tuition. Do the schools set tuition or is that determined from higher in the University? Mr. Rollefson said the Graduate School dean does not set graduate tuition because the Graduate School does not collect the tuition; the professional school deans set the tuition for their schools (subject to approval by the Board of Regents).

The second point he addressed, Professor Luepker said, was that when the Committee reviewed the vice-presidential units it discussed administrative costs and staffing. Then came the *Wall Street Journal* and *Star-Tribune* articles. Progress is being made in addressing administrative costs but there has been concern among the P&A and civil service staff that any cuts would be in their jobs, not to higher administration. This is an important issue the Committee may wish to consider.

Professor Luepker reported that he also met with Vice President Brian Herman and said it would be worth inviting him to talk with Committee about the crisis in research funding and where he sees things headed. That discussion might be held jointly with the Senate Research Committee.

Professor Schulz said that the AAMC (medical school association) newsletter reported that NIH will have 700 fewer grants next year. There have been comments that the sequester will have little effect on the University; the Committee should look at that proposition. There is much going on that will have a significant impact on medical schools. The Committee should also look at the decrease in the size of awards, Professor Hupp added; it is expected to be about 10%, which will affect funding for graduate students.

Professor Cohen said he believed Vice President Herman should speak with both committees, as Professor Luepker suggested. One corollary of increased funding for STEM fields is that there will be decreased funding for the social sciences. Professor Roe said that if the Committee could hear from a national expert on these subjects, that would be helpful.

Professor Luepker thanked Vice Presidents Pfutzenreuter and Wheelock for their report and adjourned the meeting at 5:00.

-- Gary Engstrand

University of Minnesota