Minutes*

Senate Committee on Finance and Planning
Tuesday, September 6, 2011
2:00 – 4:00
238A Morrill Hall

Present: Russell Luepker (chair), Jon Binks, Sarah Chambers, Will Durfee, Lincoln Kallsen, Kara Kersteter, Cody Mikl, Fred Morrison, Kathleen O'Brien, Richard Pfutzenreuter, Gwen Rudney, Terry Roe, Ann Sather, Karen Seashore, Arturo Schultz, S. Charles Schulz

Absent: Judith Martin, Michael Rollefson, Thomas Stinson, Michael Volna, Aks Zaheer

Guests: Associate Vice President Michael Berthelsen, Sean Schuller (Facilities Management)

Other: Liz Eull, Jon Steadland (President's Office)

[In these minutes: (1) welcome and introductions; (2) budget update; (3) light-rail transit update; (4) Facilities Condition Assessment; (5) committee business]

1. Welcome and Introductions

Professor Luepker convened the meeting at 2:00 and called for a round of introductions.

2. Budget Update

Professor Luepker turned to Vice President Pfutzenreuter for a report on President Kaler's recommendations to the Board of Regents to amend the FY12 operating budget and matters related to the FY12 and FY13 budgets.

Mr. Pfutzenreuter began by reviewing the situation that led to the presentation of a provisional operating budget to the Board of Regents in June. The provisional budget assumed the funding level established by the legislative conference committee, reducing the University's state appropriation from (in round numbers) $591 million per year to $520 million per year. The provisional budget also identified a framework for the use of any additional funds that might be provided as a result of a special session of the legislature; President Bruininks had recommended that one-third be used to reduce tuition increases, one-third be used to address issues in FY12, and one-third be used in FY13. The July 19, 2011, special session increased the University's funding by $25 million per year. (The net result is that the state funding for the University dropped about 7.8% per year.) The increased $25 million will allow President Kaler opportunities to do things the University otherwise could not do and to deal with problems caused by some of the cuts.

The two-year financial framework adheres fairly closely to the original framework in the provisional budget adopted by the Regents in June, Mr. Pfutzenreuter reported. The administration wished to maintain maximum budget flexibility to meet recurring budget needs and make strategic investments in FY13—because there will be needs and because there remains uncertainty about the state's budget situation.

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So, the administration is proposing to the Regents to use one-third of the RECURRING funds in FY12 to meet critical academic needs and to use a portion of the FY12 funds on a NON-RECURRING basis to provide student tuition relief. In FY13, one-third of the recurring funds (about $8.3 million) would be used to lower the level of tuition increases for Minnesota resident undergraduates who quality for Promise Scholarships; the remainder of the one-third would be used for strategic investments in FY13 (one of the thirds would have been committed on a recurring basis in FY12, so unavailable in FY13).

The President's recommendations for FY12 RECURRING allocations are these (in millions of dollars), $8.15 million:

4.0 new faculty lines (primarily in STEM fields, but this is system-wide)
3.05 mitigate the impact of state cuts in Medical Education and Research Costs (MERC) to Dentistry and other units in the Academic Health Center
.8 to support the Veterinary Diagnostic Lab
.15 to support UROP (increase student numbers from 800 to 900)
.15 to adjust budget allocations in the College of Pharmacy

The President's recommendations for FY12 NON-RECURRING allocations are these (in millions of dollars), 10.75 million:

4.15 one-time scholarships for Minnesota resident undergraduates eligible for the Promise Scholarships, spring semester 2012 only ($310 per student, about 13,400 students)
6.0 support Doctoral Dissertation Fellowships, to be spent over three years
.35 assist Morris campus in network upgrade costs
.25 address several matters on the Crookston campus

This leaves $6.1 million to carry forward to FY13.

For FY13, the preliminary numbers, recurring funds, are these (in millions of dollars):

8.3 undergraduate tuition relief
8.55 strategic investments

Mr. Pfutzenreuter turned next to recurring cost increases and the budget framework. He noted that every year about this time the compact process starts, as does budget planning. There has to be a framework for the budget, some parts of which are driven by fixed costs and some by variable costs. The fixed costs include, for example, increases in utility bills, building leases, student financial aid, and so on. It can include increases in compensation if there is a plan to increase salaries. The conversation about those costs will start now with the "Budget 6" and they will formulate issues to be considered (e.g., what the cost of a 2.5% compensation increase would be, what other costs are coming, and so on). They need to make decisions on these issues soon so that administrative units can be given guidance on preparing their budgets.

The good news, Mr. Pfutzenreuter related, is that it appears that fringe benefit rates are coming down. He explained the complicated and convoluted way that the University (along with all institutions that received federal salary funds) must calculate fringe benefit costs, because of federal regulations. The gist of the matter is that there is a two-year lag in calculating them; the FY13 fringe benefit cost projections must be based on actual costs in FY11. The result is that the actual costs may not be the same as the projected costs; because of changes in fringe benefit employee contributions and because there are fewer employees, the actual costs will likely be lower than what was projected. The rates thus bounce around, Mr. Pfutzenreuter observed, and because they will probably come down next year, an increase in compensation (salaries) would not be as costly as usual because there will be a simultaneous decrease in fringe-benefit costs. In addition, new-building operating costs will not be going up very much in FY13, so the list of fixed cost increases for FY13 will not be as large as usual.

Assuming no further changes in state funding levels for the biennium, the University can manage its budget without additional deep reallocation, Mr. Pfutzenreuter concluded. But then in the next biennium (FY14 – FY15), the state budget will still be out of balance because the recent budget agreement did not remedy the underlying problems.

Professor Luepker recalled that sometimes the state has asked for givebacks in mid-year. Mr. Pfutzenreuter agreed, and said the state is out of ways to avoid dealing with the problems; if the revenue forecast is down, there could be trouble.

Professor Seashore said that the Committee has had questions about how to save money, such as closing over Christmas, demolishing buildings, etc. Those are incremental but they save money. Where are they looking for savings now? Mr. Pfutzenreuter said that President Kaler has convened a new central committee to identify where there can be savings across the University. When buildings are taken down, the savings come in the future (often the savings in the first few years are used to pay off the loan to pay the cost of demolition—some buildings cost a million dollars or more to demolish). The utility savings then flow into the cost pool, reducing the amount needed.

Professor Luepker said he had noticed that a number of the cost-pool charges had fallen, which is a way that more money comes to the units. The changes were in low single digits—but more were down than up.

There is news here, Professor Seashore said. The University made decisions several years ago that have led to savings coming into the budget now. So it is important to talk not only about tuition increases but also about how the institution is saving money.

Professor Morrison asked what the University's payroll is now and the percentage of employees on O&M funds (that is, state funds and tuition). Mr. Kallsen reported that the payroll totals $1.968 billion in FY11, and that includes both salaries and fringe benefits. About 53% of University employees are on O&M funds.

Professor Durfee recalled that President Bruininks had surmised that there could be savings of up to $25 million in operational changes. He asked if Mr. Pfutzenreuter had a sense whether that remains possible. Mr. Pfutzenreuter said he could not answer the question. The University is making changes in procurement, for example, and is has programs to save money in energy consumption, but the administration cannot force units to buy from a specific vendor. They can document that there will be savings but cannot force people to buy.

Professor Luepker noted that the tuition reduction for spring semester and next year would not be across-the-board but limited to those eligible for Promise Scholarships. What about graduate and professional tuition? The President's priority was undergraduate tuition for Minnesota residents, Mr. Pfutzenreuter said, and directed toward a need-based program. Mr. Kallsen noted that $6 million for the Doctoral Dissertation Fellowships was not a small amount. Professor Luepker agreed but pointed out that it will cover about 50 graduate students, out of a total of about 16,000.

Professor Luepker thanked Mr. Pfutzenreuter for his report.

2. Update on the Central Corridor Light-Rail Transit Project

Professor Luepker turned next to Vice President O'Brien for an update on the light-rail project.

Vice President O'Brien first introduced herself and University Services, for the benefit of new Committee members; she noted that University Services has a budget of about $400 million, employs about 3500 people (1800 of whom are students), and that it essentially runs "the city of the University."

About half of the funding for the light-rail project comes from the federal government; the other half comes from the state, split between the state and county sales tax. The project has been under development since 1972; construction started last year and is about 20% complete. The stations on the University campus will look a little different from those elsewhere on the line because they are designed to fit with the campus.

The University continues to be heavily involved in the project. There are four working groups in the University monitoring it: one for construction, one for access, one for communication, and one for research mitigation (the last for monitoring dust and vibration, for example). There have been incidents that had to be dealt with, such as severing a power line.

Construction is to be completed in October, 2012, then there will be a year for installing the power system, then a year of testing the trains and mitigation. It must be certified that the project meets the mitigation standards before the line can be put into operation.

Vice President O'Brien invited Committee members to let her know of any specific problems that they see.

Professor Luepker thanked Vice President O'Brien for the update.

3. Facilities Condition Assessment

Professor Luepker welcomed Associate Vice President Berthelsen and Mr. Schuller to the meeting to discuss the Facilities Condition Assessment (FCA) report that will be provided to the Board of Regents at its September 2011 meeting.

Mr. Berthelsen began by explaining that Facilities Management deals primarily with the Twin Cities campus, although it does do some work across the system, providing expertise when needed. Vice President O'Brien provides the FCA report annually to the Board of Regents, which draws on a large database they maintain that records the quality, status, and projected useful life of each building. He provided a handout and began by reporting on the vision of the Facilities Condition Assessment.

> The enterprise source of the most accurate and up-to-date information regarding existing buildings (component and system condition, fire safety, environmental safety, historical characteristics, past improvements, budgeted/planned capital projects, etc.) used to ensure effective operation of facilities and guide capital projects.
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> Operationally, this means:
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> -- An independent, inspection based review of building conditions

-- Report prioritized needs for facilities renewal over next ten years
-- Database provides a tool for accessing and utilizing information
-- Information used to measure long term facilities condition against established metrics and peers.

The University, system-wide, has about 29,000,000 gross square feet of space, which is an enormous built environment, Mr. Berthelsen said. It is one of the largest and most complex campuses in the country and encompasses facilities for research, teaching, athletics, entertainment, residence, and many other activities.

Mr. Schuller reviewed the FCA 2011 report which shows that the Twin Cities has 22.55 million gross square feet (not including parking ramp decks). The estimated replacement value of the facilities is nearly $6.2 billion, and the projected 10-year needs to maintain them is $2.4 billion. The Facilities Condition Needs Index (FCNI), which is an industry standard for evaluating the condition of facilities (dividing ten-year needs by replacement value), is 0.39. Lower is better. This number does not include the new TCF Bank Stadium, which would lower the FCNI to 0.37.

They continue to work to bring all information into the same database in order to create accurate reports on buildings and facilities, Mr. Berthelsen reported. They will soon be preparing for the preparation of the latest six-year capital plan, for which there are two major drivers: academic program needs and facilities condition (can they deliver what is needed by the program?).

Before turning to the remainder of the data, Mr. Berthelsen explained maps of the campuses, which color-coded all the buildings by their FCNI. The predominant color on Minneapolis, St. Paul, and Morris is pink, which indicates an FCNI of 0.41 – 1.00—or facilities that are in poor condition. The coordinate campuses have only three buildings that are colored red—in critical condition. The St. Paul campus has four red buildings (Seed Stocks, Veterinary Isolation Buildings, Crop Service Building, and Poultry Teaching and Research), and the Minneapolis campus (East Bank) has ten of them (including Morrill Hall, the Armory, Nolte Center and garage, Norris Gymnasium, Eddy Hall, Johnston Hall, and the VFW Cancer Research Center).

Mr. Berthelsen also provided a "bar graph" showing, by decade of construction, the color code for the FCNI range for all buildings on the Twin Cities campus. The buildings constructed most recently have the lowest FCNI but few of the buildings built before 1990 do—and those that do, such as Walter Library, Coffman, Jones, and Nicholson, have undergone extensive renovation.

Mr. Berthelsen noted a graph indicating the percentage of buildings in good condition at Minnesota compared to peers in the Big Ten and elsewhere. Minnesota is below the average of its peers. He also provided data on project spending at peer institutions; to fund facilities renewal/maintenance at the same level as its peers would mean spending an additional $26 million per year.

Capital needs exceed available funding, Mr. Berthelsen explained. The required capital to maintain the current FCNI of 0.39 is $160 million per year. The actual funding per year, over the last five years, has been $114 million. The total facilities investment (excluding new construction, but including renewal, value of razed facilities, HEAPR funding, utilities infrastructure, Repair and Replacement, and Auxiliary funds) FYs 2008-2012 has been $455 million. [HEAPR = Higher Education Asset Preservation and Replacement]

The Board of Regents sometimes asks how it is decided what to fund when there are so many problems, Mr. Berthelsen related. What criteria are used? They cannot fund everything, and the

University does not keep all its buildings, but they do keep some old ones and make them very good. But it all comes down to money, he said, as they have to decide what to fix. When one looks at what needs to be spent simply to maintain the current FCNI, "the buildings are getting older faster than we are reinvesting in them," Mr. Berthelsen commented.

Mr. Berthelsen reviewed the University's HEAPR appropriation history and pointed out that it has been the number one capital priority with a number of years. The University has substantially increased the amounts it has requested from the legislature, and the amounts appropriated, while not what was requested, increased substantially as well beginning in FY02.

In terms of capital investments in the last decade, new construction has accounted for 36% of the expenditures, asset reinvestment for 27%, and annual maintenance for 37%. The latter two are funding maintenance of existing facilities and reflect the fact that the University has made it a priority to take care of the facilities it has rather than build more new ones. This has meant following certain strategies: Utilize existing space, demolish or decommission targeted buildings, implement district utility strategies, maximize energy conservation, target individual system improvements, renovate existing spaces, and build new facilities. Given the $2 billion in needs, money they do not have, what are they to do? There is no one answer, Mr. Berthelsen said.

There are a set of criteria used to select projects to receive funding. They include: facilities condition, operational risk, program impact, historic status and the campus master plan, opportunity to leverage other investments, regulatory and legal statutes, operating cost including energy usage, and building decommissioning evaluation. In terms of operational risk, some needs are greater than others: A leaking roof is more important than aging windows. In terms of leveraging, they will ask whether academic investments are planned. In terms of energy usage, they will inquire if there is a way to address it and to lower costs. As for the building decommissioning evaluation, they will ask whether a building is worth investing in, and they have a number of criteria they use to make that judgment.

One draft approach for discussion is to use the FCA data to assemble them by building purpose. Their draft model suggests five categories. Buildings requiring:

-- Maximum Stewardship, reserved for select buildings that demand impeccable condition and unwavering service to serve occupying programs or represent the campus at its finest (e.g. flagship buildings) (e.g., Science Teaching and Student Services)

-- Enhanced Stewardship, for buildings that merit above-average investment to support excellent overall condition and reliable service to serve occupying programs (e.g., classrooms, health/chemical/biological labs, such as MCB, Biomedical Discovery District facilities, Kolthoff)

-- General Stewardship, which consists of buildings that merit routine investment to maintain respectable overall condition and reliable service to serve occupying programs (e.g., offices, student life, athletics/recreation, clinics, residential life, arts/natural science labs, such as Coffman, Wilson Library, Mayo)

-- Maintain for Safety, which means buildings in this class merit minimum investment to maintain basic health and safety. If/when FCNI of a building in this class exceeds 0.75, a review for divestment candidacy is appropriate (e.g., support facilities, such as Como Recycling, Farm and Ground Maintenance, Botany Field House)

-- Teardown / Decommission, for which buildings automatically qualify if or when the FCNI exceeds

0.75 AND the building lacks additional traits consistent with higher levels of stewardship (such as Fraser, Wesbrook, Williamson, Norris).

They can apply those categories to FCA data by building purpose, such as classrooms, health/chemical/biological labs, arts labs, office spaces, and so on, and assess the costs necessary to reach the proposed standard. To bring all buildings on the campus to the standard indicated (enhanced stewardship, general stewardship, maintain for safety) would cost about $927 million. Mr. Schuller provided some examples of how the data could be used to make decisions about classrooms and about energy usage.

Despite having funding levels below the capital need, the FCNI ratio has not increased over the last several years. How has the University maintained the current FCNI ratio in spite of a funding gap? By adding new buildings, which increases the average condition; by extending the useful life of buildings through good maintenance, which pushes the projected needs further into the future; and tearing down targeted buildings, which reduces the total project need. Over the last dozen years all of those approaches have been used, Mr. Berthelsen pointed out: a number of buildings have been remodeled and a number have been torn down.

Professor Seashore commented that she has been in a number of the "crummiest" buildings on the campus and said that there is a lot of variability in the usability of buildings, even those considered to be in "poor" condition. Morrill Hall is usable; Pattee Hall is not. The situation has improved a great deal in the last 20 years, but as they make decisions about priorities, there is something to be said for asking whether people can function reasonably well in the space. Mr. Berthelsen agreed that there is a functionality component in addition to cost; lights, carpeting, and paint can make a big difference without getting into serious renovation. But it is difficult for Facilities Management to evaluate functionality; their role is to determine whether the major components within a facility are working effectively. What will be important for them, he said, is that each college is asked to identify facility needs to deliver its programs, and the next six-year capital plan will help guide Facilities Management in making decisions. The decision can't be entirely based on historical value or whether a building is ugly, Professor Seashore said, and it can be difficult to know what to decide (e.g., Pattee versus Mayo). Mr. Berthelsen agreed and said there are so many needs that it would be hard for them to make a bad decision. He noted again that they look at operational risk, such as what would stop a program from operating, or if there will be an elevated risk if they do nothing—and said they wish they could operate at a higher standard. He also observed that not all the HEAPR money the University receives in a year could bring Mayo up to an appropriate standard. And sometimes they cannot save a facility.

Is the risk factor at the top of the list, Professor Seashore asked? It is, Mr. Kallsen said, but so also is academic opportunity cost—what is given up on the academic side of the house if they do one project rather than another? The academic side of the house has to make that judgment. Some buildings can be renovated to meet the needs of the program, such as Folwell; others cannot, such as Owre, which had to be demolished.

Professor Olin asked if they maintain buildings enough to keep facilities from needing more money. Mr. Berthelsen said that if the campus did not receive new buildings, the FCNI would be getting worse. There is a risk in not maintaining buildings, and the cost is compounding. There is a natural aging process to buildings, as with cars; there ARE pieces that wear out (such as the alternator or tires). They try to address the factors that have the biggest impact on building operation and longevity, but there comes a point at which time things wear out, such as the roof, plumbing, and wiring.

Professor Roe said he found this report very interesting, however, there was too much pink (poor condition) on the maps for decision-making purposes for allocating limited resources; there must be other sources of information used in the decision-making process. Mr. Berthelsen agreed. He said they do ask the deans for guidance on which are the most urgent problems, which would stop the college from delivering programs, and where they would get the most bang for the buck.

Professor Roe inquired what happened if there are emergency expenditures that drive Facilities Management over its budget. Is there a loan that they must pay back? They are always dealing with that possibility, Mr. Berthelsen said. They try not to allocate all of their funds; they will commit all the HEAPR funding so they can make progress and report to the state on the use of the funds. They are receiving diminishing amounts of Repair and Replacement funds from the cost pool and they manage the spending of R&R through the year and continue to monitor project spending and status, making changes to priorities as needed. If they get into major difficulties, they would have a conversation with Vice President Pfutzenreuter to discuss an internal loan or other balances that could be used.

Professor Luepker thanked Messrs. Berthelsen and Schuller for their report. He said he has heard this report for a number of years and that it seems like the campus is always hovering near disaster; he commended them for their work.

4. Committee Business

Professor Luepker reported that he had provided the report on reviews of vice-presidential units to Provost Sullivan the previous week. The report does not single out any group or unit for elimination, he noted, and those who were at the meetings will know that each vice-presidential area is very complex.

In terms of the work of the Committee, Professor Luepker said, it has prepared a number of reports and recommendations and its role is much larger than just hearing report. The Committee needs to listen, so it knows what is going on, but it must ask direct questions when it is concerned and must select topics to look into when it believes they are important. The Committee may need one or two retreats to deal with major items this year, such as continued review of vice-presidential units (the vice provosts for undergraduate education and for student affairs have been scheduled, and units in the Academic Health Center will be scheduled later).

Professor Seashore said that she thought about half the members of the Committee believe that if it wants to look at the growth in administration, it should look at the colleges. It cannot deal with all the colleges, but it could select a few and look at college offices. Professor Luepker agreed that was a good idea and observed that much responsibility has devolved to the colleges without any funding following.

Professor Roe said that some cost questions are profound but the Committee does not have the staff or analytical capacity to look at them and to help make decisions. What is important is that the Committee asks the right questions and decides which ones it wishes to recommend that the central administration pursue. Professor Luepker agreed that the Committee's task is to raise reasonable questions and to ask for information—and then to ask what happened. The latter is something the Committee has slipped on doing, and it needs to keep asking questions to find out what happened (e.g., with EFS, fees, etc.).

Professor Olin suggested, in response to Professor Seashore's suggestion, that the Committee look at administrative appointments and salaries by college, such as at the 93xx level, and look at growth over time. Looking at trends would allow the Committee to ask questions. One problem is with the way jobs are classified, Professor Luepker said, but agreed the Committee could look at the colleges; he observed that most administrators at the University are not in Morrill Hall. Professor Seashore suggested inviting the college human resources and finance people in to help the Committee.

As for other issues to take up, Professor Roe said it had been some time since the Committee had looked at auxiliary enterprises, such as the bookstores, cafeterias, parking, and so on. Professor Luepker agreed. Professor Seashore suggested the Committee also keep an eye on issues that are salient for President Kaler; Professor Luepker said he would invite the President to join the Committee.

Professor Luepker adjourned the meeting at 4:15.

-- Gary Engstrand

University of Minnesota