FY 2006-2007 General Fund Operating Budget

July 21, 2006

Introduction

The budget that we present for FY2007 allows us to advance the academic excellence of the University through investment in core academic programs and new academic initiatives, and to honor our strong commitment to access through robust growth in spending on financial aid. We continue to expand our academic enterprise both in student numbers and in levels of research activity. We have been challenged by sharply rising energy costs, by an intensively competitive faculty recruitment and retention environment, and by a flattening of federal support for research. To deal with those challenges, we have maintained discipline on the expenditure side. Once again we are requiring that General Fund expenditures be reduced through increased efficiencies. In developing this year's budget, units are challenged to reduce General Fund expenditures by over $18M through a combination of increased efficiencies, elimination of lower priority activities and moving expenditures from the General Fund to other funds. In a later section we detail some of the steps being taken.

Student access remains a top priority for the University. As is customary, we will increase central financial aid at a higher rate than our proposed tuition increase. Our FY2007 budget calls for an increase of more than $5.7M in centrally awarded financial aid to a new total of $90.9M, which represents a 6.6% increase in financial aid. It is the longstanding policy of the University of Michigan to meet the demonstrated need of all of its Michigan resident undergraduate students. The M-Pact Program, launched last year, continues to provide additional need-based grants to Michigan residents. Over $2.9M was disbursed to 3,190 students through the M-Pact Program during FY2006. We are also investing significant resources, in partnership with the Jack Kent Cooke Foundation, to offer greater opportunities for high-achieving, low-income community college students to transfer to the University of Michigan.

Academic quality is an equally critical goal that drives our budget allocations. In recognition of the importance of our educational mission, we are giving highest priority to our academic units with a particular emphasis on those units that are experiencing enrollment growth (helping us achieve both quality and access). The excellence of our faculty is perhaps the single most important factor contributing to the quality of our academic enterprise. We compete for leading faculty with the very best universities, as can be seen by the institutions that have made offers to recruit away University of Michigan faculty over the last two years. This list includes Harvard, Yale, Stanford, Brown, Cornell, Dartmouth, Oxford, Cambridge, Duke, Berkeley, MIT, UCLA, and the University of Virginia, just to name a few. Many of these institutions have considerable resources that they can bring to bear in competing for faculty. This year, we are placing a particular emphasis on recruitment and retention of outstanding faculty through a faculty salary program that is more generous than in recent years and through a special faculty recruitment and retention fund to be allocated by the Provost. We are also allocating funds to the College of LS&A to meet the need for additional faculty in departments that are facing heavy enrollment demand, in part because of the unusually large freshmen entering classes in Fall 2004 and Fall 2005.

Successful universities must maintain a focus on the future. Correspondingly, this budget provides substantial support for new research and instructional programs and support for new facilities that will allow academic work at the University to remain at the forefront. For example, in response to student demand we are supporting a new undergraduate degree program in public policy [Gerald R. Ford School of Public Policy] and changes to the Bachelor in Business Administration degree program [Stephen M. Ross School of Business]. The changes include enhancements to advising and earlier entry into the degree program so as to allow greater flexibility to incorporate learning experiences such as study-abroad and to provide earlier career counseling.

The University is also investing substantial sums in forward-looking research initiatives. Two major efforts underway that will have university-wide impact include the Energy Research Initiative and the Graham Institute of Environmental Sustainability. These initiatives positively affect the local and state economies through workforce training and the generation of start-up companies. They are also heavily supported by funding sources from outside of U-M. The Energy Initiative will be housed in the Phoenix Memorial Lab facility whose renovation is being funded in partnership with the State. The Graham Institute is being supported by University resources combined with a gift from alumnus Donald Graham.

Cutting-edge academic initiatives involve novel modes of teaching or research taking place in new scholarly areas. In many cases facilities are key to the success of a particular initiative. Consequently, the University continues to invest heavily in the renovation and renewal of its physical plant. Whenever possible, we choose to renovate existing space, but on occasion expansion is necessary. In FY2007, the University will see the completion of major facilities to support the work of the School of Public Health and the Ford School of Public Policy.

We have some relief this year from the very challenging revenue situation that we faced over the last four years. For FY2007, we anticipate a 3% increase in state appropriation. Given the State's very constrained financial circumstances, this increase shows strong support for higher education, for which we are very grateful. More importantly, this increase is an important indicator that the State recognizes the crucial role that higher education in general, and the State's research universities in particular, can play in transforming the State's economy.

This year we are asking for moderate increases in tuition rates, reflecting the anticipated change in state appropriation and our success in constraining expenditure growth. We also expect an upturn in interest earnings as well as substantial growth in endowment returns and expendable gift funds due to a banner year in raising new gifts and growth in the corpus of our endowment through wise investment of assets.

The Scope of the Budget Challenge

Constraints on revenue growth over the past several years as well as significant increases in essential costs contribute to our budgetary challenge. Earlier we noted that we anticipate our state appropriation will increase by approximately 3%. This allocation will put our state appropriation at just under $326M, which is still $37M lower than the amount that was appropriated for FY2002. We very much appreciate efforts by the State to begin to return to increased support for higher education. But it remains the case that the considerable recent reductions in our state appropriation have caused the University to more aggressively tap other revenue streams, including tuition.

On the expenditure side, we continue to be subject to increases beyond the normal forces of inflation. The cost of doing business in a university tends to follow a higher trajectory than it does in the rest of the economy, because we face five sources of cost increase that tend to make our costs rise faster than those in the economy as a whole:

1. We are labor-intensive in comparison to the economy overall, and it is generally the case that the costs of labor rise faster than other prices.

2. Our substantial investments in technology and facilities, while putting us on the cutting edge, often do not reduce costs, increase revenues or create efficiencies.

3. The volume of activity (both research and instruction) will rise in FY2007 even as we continue to implement cost reduction strategies simultaneously.

4. It bears repeating to say that the sum of human knowledge and creative expression grows every year, and the University, unlike most private enterprises, has an obligation to preserve the past as well as to invest in the future. We are both museum and laboratory. The costs of museums grow in part because their collections grow, and the cost of staying on the cutting edge is always high.

5. We have major competitors who are often buffered from these market forces by much larger endowments.

Beyond these general factors that drive up the cost of university business, two additional factors have significant impact on the budget presented here. The first is a sharp increase in natural gas prices, which have risen over 67%in the past two years and will result in double-digit increases in utility costs for FY2007. The second factor is costs associated with recruitment of new faculty. The College of Literature, Science and the Arts, the Medical School and the College of Engineering are engaged in vigorous hiring programs in technical fields to meet enrollment demands and replace recent faculty losses. Leading faculty hired in the lab sciences and engineering often require advanced facilities in order to conduct their research. Expenditures for start-up costs in LS&A were more than $18M in FY2006 with a similar amount projected in FY2007. The College of Engineering has hired 20 faculty in FY2007 with resulting commitments in start-up costs of nearly $8 million. Start-up costs for new faculty typically entail lab renovations, major equipment purchases, graduate student support and a research fund to support research activity until external funds are secured. While these expenditures are necessary for us to maintain a world-class faculty with cutting-edge research and innovative instructional programs, they present a considerable challenge to the University.

In summary we face a total budget challenge for FY2007 of $80.5M in order to cover increased costs and fund new initiatives.

General Fund Reallocation

In putting together the FY2007 budget, we have succeeded in removing over $18M in General Fund expenditures through a combination of increased efficiencies, elimination of lower priority activities and moving expenses from the General Fund to other funds. Reallocation strategies have been implemented across the University including University-wide improvements in areas where operations are centralized and in the academic units. Some specific examples of University-wide efficiencies include:

- The North Campus Chiller Plant commissioned during FY2006 is expected to reduce the cost of providing air conditioning to North Campus buildings by $200K per year. In addition, the central air conditioning system will provide more reliable service than individual units housed in each building.

- The Central Power Plant installed two new steam turbines used for the cogeneration of electricity. The new turbines are expected to produce electricity more efficiently than the older models. The total costs savings is expected to be approximately $600K per year with the additional benefit of reducing carbon dioxide emissions by approximately 800 tons per year.

- Other actions taken to reduce utility costs include scheduling the on/off time for air handling units, continuation of the Energy Star programs including outreach efforts directly to the schools and colleges, and water conservation projects that have decreased the volume of water consumption from FY2002 to FY2005, avoiding approximately $450K annually in water and sewer costs.

- During FY2006, the University reached the decision to replace M-Stores with a more cost-effective direct delivery model. This eliminates the need to maintain inventory, eliminates distribution and warehouse operations, and saves on associated administration and overhead costs. A phased implementation plan is underway with anticipated savings of $500K per year for the first phase.

- The University realized considerable savings for FY2007 through debt refinancing ($100K), negotiation of more favorable vendor contracts ($3.1M), savings associated with prescription drug coverage ($2.6M), and insurance premium cost savings ($1.2M). An additional $4.1M will be saved on a one-time basis due to insurance cost premium credits.

Several units achieved savings through consolidation, reorganization and base reductions:

- The College of Engineering eliminated staff positions by 6 FTE through consolidation of administrative operations and reductions in administrative services. Base cuts to operating allocations coupled with staff reductions totaled over $800K in General Fund savings for FY2007.

- The College of Literature, Science, and the Arts is in the process of consolidating support facilities duplicated in several departments into a single college facility. This effort will result in a substantial reduction of the space needed for the facility, the release of space on central campus for other uses, a reduction in the number of technical staff needed to support the facility (estimated initial savings of $300K), and a superior level of technical support to a greater number of faculty researchers. Two initiatives currently underway are the consolidation of instrument/machine shops in the science departments into a single college facility, and the creation of a communal computer cluster to replace the numerous computer clusters operated independently by LSA researchers.

- Business and Finance units have identified $1.6M of cost savings for FY2007. The costs savings include the restructuring of open staff positions resulting in a reduction of 10 FTEs in building services, facilities, ground and waste management and property disposition. Operational improvements including successful vendor contract negotiations have reduced costs for data center support, building services and facilities maintenance. General Fund operating costs will be shifted to non-General Fund sources through continued expansion of revenue streams.

- The Law School just finalized a plan to reduce annual expenses of the Law Library by $1M over the next five years (equates to a 15% reduction in total expenses for the Law Library).

- The School of Information reduced costs by consolidating the services of its Practical Engagement Program with those of its Career Services and Placement Program.

- Information Technology Central Services achieved General Fund savings through reduction in low-demand services and through more efficient use of space. The University's dial-in service for the Ann Arbor campus has been greatly reduced and will be eliminated entirely by January 2007.

- The Medical School is in the process of combining administrative structures for the various graduate programs that will eliminate duplicative functions.

- The Rackham Graduate School is partnering with the Registrar's Office to reduce duplication by eliminating Rackham's redundant course approval process.

- Matthaei Botanical Garden and Nichols Arboretum continue to reallocate resources into mission-critical activities. In recent months, this has included eliminating a horticulturist position in favor of two dozen student summer interns and eliminating one manager-level position among the professional staff by combining visitor and administrative services into one unit.

Units across the university continue to reduce administrative costs through the use of technology-enabled solutions and business process improvement initiatives:

- The College of Literature, Science, and the Arts, the Stephen M. Ross School of Business and the School of Social Work have implemented processes to closely monitor class offerings in order to reduce the number of small section size elective classes while preserving new and innovative course introductions.

- Electronic newsletters and electronic communications with prospective, admitted and matriculated students have become standard practice for the academic units. The use of electronic communication tools has reduced printing, mailing and staff costs for admissions, development and alumni relation activities in the schools and colleges.

- The Office of Evaluations and Examinations is working with the Michigan Administrative Information Services to develop a Web-based system for collection of course evaluation data. Once the system is operational, the Office of E&E will reduce its course evaluation staff by one FTE and expects to achieve substantial savings on paper and printer supplies through the elimination of nearly 400,000 custom questionnaires for evaluation of teaching in 12,000 University classes.

The Office of Development has led the University to another banner year in fund-raising, securing over $255M in new gifts during FY2006. Many of these gifts support activities that allow the University to remain competitive and innovative while others provide funding for existing activities that permit us to reallocate General Fund resources to other needs. It is important to note, however, that gift funds must be spent for the purpose for which they are donated; they are not fungible, and few donors wish to support basic operating costs such as increasing energy prices. Gift and other non-General Fund sources play an important role in the University's ability to reallocate General Funds. A few examples are noted below:

- In the benefits area, we shifted $1M off the General Fund through the integration of Medicare Part D to reimbursement by the federal government.

- We have renegotiated the basis for charging utilities expenses in the U-M Hospital buildings, which has led to $2.9M in utilities costs being moved from the General Fund to auxiliary funds.

- We are launching a transformation of our School of Nursing to integrate their clinical activities with those of the U-M Hospital. This agreement adds $900K for School of Nursing activities and is funded by the U-M Health System.

- In the academic units, we are maximizing the use of endowed professorship support to shift faculty salaries off of the General Fund. For FY2007 the College of Engineering increased the portion of endowed chair salaries and benefits paid from endowment distributions, thereby releasing $245K in General Funds that can be reallocated for other needs. The Ross School of Business and the School of Natural Resources and Environment also employed strategies to maximize the use of their endowed professorship funding.

- A $3M gift to the Ford School of Public Policy will establish a dean's discretionary fund that will enable new initiatives in support of the School's highest priorities.

- The Bentley Library implemented a focused program to move responsibility for the conservation of its collections to private support.

While several examples of expenditure reductions, savings and reallocation have been cited in this document, there are many more success stories across the University. We continually seek ways to do our business at higher quality and lower cost.

The General Fund Budget Recommendation

The attached Table 1 summarizes the General Fund Budget Recommendation for FY2007. This reflects the assumption that the State appropriation will be $326M (a growth of 3% over FY2006). One important element of Table 1 is the difference between the academic units and the administrative units. On average, the academic units will experience a 6.3% increase in their General Fund budgets, which results from tuition rate increases, increased numbers of students and increased volume of indirect cost recovery from sponsored research. The administrative units will receive more modest budget increases in FY2007 as compared to FY2006, below the increase in CPI. One administrative area with more robust budget growth is the Executive Vice President and Chief Financial Officer (EVPCFO) area. However, it should be noted that a significant component of the increase in the EVPCFO budget comes from resources to operate newly constructed academic spaces. With increases to operate new space removed from its budget, the EVPCFO area receives only a 3.3% increase.

As usual, there is considerable variation in the rates of growth of the General Fund budgets of the academic units. In every case where an academic unit will experience a significant change in General Fund budget, that change reflects a change in instructional or research activity. Units with significant changes in instructional activity (numbers of students) include the School of Art and Design, the Ross School of Business, the Division of Kinesiology and the College of Pharmacy. Three schools – the Medical School, the School of Public Health and the Ford School of Public Policy – will receive rather modest increases in General Fund budgets as a result of incremental space costs for new buildings. General Fund budgets at the unit level are shown after a deduction to pay for space and utilities costs, so units that take on new space typically see constrained growth in their net funding as a result of these additional costs. The budget for the research units will grow significantly, corresponding to robust growth in sponsored research, particularly in the U-M Transportation Research Institute and the Life Sciences Institute. In large part, the increase in Academic Program Funds is due to a special fund for the recruitment and retention of leading faculty that is being budgeted in the Academic Program Funds line but which will be distributed to schools and colleges throughout the year.

There is significant growth in the University Items category. The drivers of this increase are utilities and financial aid. The double-digit increase in utilities costs is due to a very significant increase in natural gas prices and is an unavoidable increase of expenditures on the General Fund. While a nearly 15% increase in utilities is significant, the increase would be even higher if the University had not purchased natural gas futures at rates lower than originally expected.

Conclusion

The budget that we propose for your approval strongly supports the University's core values of academic excellence and access. It includes significant increases in financial aid, resources to launch innovative new academic programs and support for the recruitment and retention of leading faculty. This budget requires the University to maintain discipline in reducing General Fund expenditures by increasing the efficiency of our operations, moving costs from the General Fund to other funds and reallocating funding from lower priority to higher priority activities. Finally, this is a forward-looking budget proposal, providing support for important new initiatives that will shape the future of the University and for recruitment of high quality faculty who will lead these initiatives, while at the same time preparing for the budget challenges that lie ahead. We respectfully request that you approve the proposed budget.

Table 1

The University of Michigan - Ann Arbor
Proposed General Fund Budget ($000)
Fiscal Year 2006-07

	FY2006 Adjusted Budget*	Recommended Change	Proposed FY 2007 Budget	% change GF Budget
Revenues				
State appropriation	314,733	11,063	325,796	3.52%
Tuition and Fees	725,108	52,258	777,367	7.21%
Indirect Cost Recovery	165,384	5,176	170,560	3.13%
Other Revenue	15,260	6,065	21,325	39.74%
Total Revenues	1,220,485	74,563	1,295,048	6.11%
Expenditures				
A. Alfred Taubman College of Architecture & Urban Planning	10,150	754	10,903	7.42%
School of Art & Design	6,523	868	7,391	13.31%
Stephen M. Ross School of Business	56,224	7,264	63,488	12.92%
School of Dentistry	25,487	1,566	27,053	6.14%
School of Education	14,469	856	15,325	5.92%
College of Engineering	107,834	7,048	114,881	6.54%
School of Information	8,906	484	9,390	5.43%
Division of Kinesiology	7,405	1,105	8,511	14.92%
Law School	33,270	1,927	35,198	5.79%
College of Literature, Science and the Arts	245,700	13,231	258,931	5.38%
Medical School	81,424	(2,390)	79,034	-2.93%
School of Music, Theatre & Dance	23,024	1,910	24,933	8.29%
School of Natural Resources & Environment	5,555	686	6,241	12.36%
School of Nursing	11,448	871	12,319	7.61%
College of Pharmacy	8,441	1,088	9,529	12.89%
School of Public Health	28,097	(1,099)	26,997	-3.91%
Gerald R. Ford School of Public Policy	6,898	242	7,140	3.51%
School of Social Work	16,667	743	17,410	4.46%
Horace H. Rackham School of Graduate Studies	7,855	232	8,087	2.95%
University Academic Units	46,213	1,503	47,715	3.25%
Research Units	4,191	494	4,684	11.78%
Academic Program Support	34,955	10,004	44,959	28.62%
TOTAL ACADEMIC	790,735	49,386	840,121	6.25%
President	2,452	31	2,483	1.25%
Provost & Executive Vice President for Academic Affairs	42,385	1,624	44,009	3.83%
Executive Vice President & Chief Financial Officer	131,768	6,399	138,167	4.86%
Vice President for Communications	4,044	90	4,134	2.24%
Vice President for Development	8,121	205	8,326	2.52%
Vice President & General Counsel	2,722	168	2,890	6.17%
Vice President for Government Relations	1,646	56	1,702	3.43%
Vice President for Research- Support Units	15,509	1,041	16,550	6.71%
Vice President & Secretary of the University	578	79	657	13.73%
Vice President for Student Affairs	8,910	590	9,500	6.63%
TOTAL EXECUTIVE OFFICER AND SERVICE UNITS	218,134	10,284	228,417	4.71%
General University Support	45,920	(661)	45,259	-1.44%
Centrally Awarded Financial Aid	85,259	5,661	90,920	6.64%
Utilities	74,437	10,894	85,331	14.63%
Departmental Income	6,000	(1,000)	5,000	-16.67%
UNIVERSITY ITEMS	211,616	14,894	226,510	7.04%
Total Expenditures	1,220,485	74,563	1,295,048	6.11%

Detail may not sum to totals because of rounding

* Transfers between units are incorporated in the FY2006 Adjusted Budget