# FY 2007-2008 General Fund Operating Budget

*July 19, 2007*

## Introduction

The General Fund budget we are presenting for FY2008 has been developed with the best information available given the level of uncertainty around our state funding. In these difficult fiscal circumstances, we continue to be prudent in our planning while actively seeking to build a budget that advances the excellence of the University through investment in core academic programs and new academic and research initiatives. The proposed budget incorporates a significant level of cost reductions and reallocation to enable the necessary level of investment. In addition, we strive for a budget that strongly supports our commitment to access through robust growth in spending on financial aid.

The quality of our academic enterprise drives our budget strategy and associated allocations. In recognition of the importance of our educational mission, we are once again giving highest priority to our academic units by seeing that needed resources flow as much as possible to them to ensure the accomplishment of the University's essential missions. You will see a particular emphasis on those units that are experiencing enrollment growth (helping us to achieve both quality and access) such as the School of Information, College of Literature, Science & the Arts (LS&A), College of Engineering, College of Pharmacy and the Gerald R. Ford School of Public Policy.

The excellence of our faculty is perhaps the single most important factor contributing to the quality of our academic enterprise. To maintain our level of excellence, we must compete successfully with other top universities, both public and private, for faculty and students. To attract and retain faculty who bring knowledge and distinction to our campus and to recruit new scholars who will ensure our preeminence in the future, we must offer competitive compensation packages. Many of the institutions with which we compete for faculty have considerable resources that they can bring to bear, and we must continue to invest responsibly, but aggressively, in our faculty in order to protect the quality of our academic enterprise. For the second consecutive year, we are placing a particular emphasis on this priority in our budget recommendation through a special faculty recruitment and retention fund to be allocated by the Provost.

Difficult and uncertain financial circumstances require us to further sharpen our business-like approach in both our planning and our operations. To achieve our mission and advance the excellence of the institution, we must maintain a focus on the future. Despite funding challenges, the University is advancing in notable ways. This budget provides selective 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, this fall we are launching a new undergraduate degree program in Public Policy through the Gerald R. Ford School of Public Policy. In addition, this year we are developing a new, innovative interdisciplinary undergraduate concentration in Informatics that involves the College of LS&A, the College of Engineering and the School of Information. This exciting program will study the intersection of people, technology and information systems.We also are investing in the arts through support for individual academic units and programs.

The University intends to continue to invest in forward-looking research and technology initiatives. The School of Dentistry is moving to a chair-side electronic health record system that will incorporate digital imaging instead of the traditional film-based x-rays. Investment in this technology will support dental education, excellent patient service, and efficient business operations. The School of Information is piloting a project, called the Virtual Space Interaction Test Bed (VISIT), to improve interactions between and among faculty and students and to facilitate connections between North and Central Campus. Technology infrastructure priorities include IT security and wireless capabilities across the College of LS&A. We also plan to further enhance the capabilities of CTools, our web-based system for coursework and collaboration.

One of our highest priority research initiatives, the Michigan Memorial Phoenix Energy Institute (MMPEI), was founded in September 2006 to support and increase research that will lead to a future that can rely on clean, affordable energy. Drug discovery and the study of orphan diseases are also areas of growing importance at the University. This year, the University created a $3 million fund that will be spent over a three-year period to attract and hire Pfizer scientists into U-M research track positions. We are continuing to support the Ethics in Public Life initiative, which was launched two years ago, reflecting the desire of the University to address these issues and take a leadership role in teaching, research, and discourse about ethics in public life. In addition, a high priority in the coming year is to significantly advance our activity and engagement with industry via partnerships. One tactic to achieve this is through technology transfer, and our efforts in this area are expanding. Many of our research initiatives positively affect the local and state economies through training and the generation of start-up companies and are also heavily supported by external funding sources.

Improved and advanced facilities serve as a foundation for both the research and instruction that enable the University to stay at the forefront of excellence. In many cases, facilities are key to the success of a particular initiative by enabling us to perform cutting edge research and instruction. A good example of this is the planned expansion of the Michigan Nanofabrication Facility (MNF) clean room which will result in a state-of-the-art facility for research and new micro-fabrication techniques. Faculty and students use the MNF to conduct research on the theory, design, and fabrication of electronic, optoelectronic devices, circuits, and microsystems, as well as on organic devices, novel characterization and metrology techniques and nanofabrication technology. Advanced facilities are essential to remain competitive for the finest research faculty, students and staff. Without first class facilities, we cannot sustain the external research support and superb student quality that are essential to our mission. In FY2008, the University will see the completion of the Walgreen Drama Center construction and the Observatory Lodge renovation that will house the Division of Kinesiology.

Student access remains a top priority for the University. It remains the longstanding policy of the University of Michigan to meet the demonstrated need of all of its Michigan resident undergraduate students. This commitment and resulting need-based aid package makes it more affordable for Michigan residents to go to the University of Michigan than any other public university in the state or in the Big Ten. As is customary, we will increase central financial aid at a higher rate than our proposed tuition increase. Our FY2008 budget calls for an increase of more than $8.1 million in centrally awarded financial aid to a new total of just over $99 million, which represents an 8.95% increase in financial aid. Specifically for undergraduates, this equates to an increase of nearly $6.4 million, an 11.5% increase. The academic units also award both need and merit based scholarships, which reduce dollar for dollar the loan and work study amounts for our students.

The President’s Donor Challenge was established in October of 2006 to increase support for need-based student financial aid and endowed professorships. The President is providing a match for each gift of student aid. To date, total impact of the gifts is over $32 million. The M-Pact Program, launched three years ago, continues to provide additional need-based grants to Michigan residents. Over $4 million was disbursed to over 2480 students through the M-Pact Program during FY2007. We have been challenged this year, by the passage of Proposal 2, to re-evaluate some of our scholarship programs in order to abide by the law. Despite this challenge, our commitments to diversity and access remain top priorities, and this budget reflects an increased investment in our outreach efforts.

While we have been aided this year by relatively low fixed cost increases, primarily due to declining natural gas prices and utilities purchasing strategies, we are once again dealing with a highly competitive faculty recruitment and retention environment and a flattening of federal support for research. In addition, our projections anticipate significant increases in facilities and benefits costs over the next several years, so we will need to continue to be prudent in our financial planning. To manage these 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, we have required units to reduce General Fund expenditures by over $21 million through a combination of increased efficiencies, elimination of lower priority activities and moving expenditures from the General Fund to other funds. Later in this document, we detail specific measures focused on becoming even more efficient.

Our revenue situation remains challenging. The State’s uncertain financial circumstances, combined with constrained federal research funding, require a careful balance between fiscal discipline and the need to invest in our future. This year we are asking for moderate increases in tuition rates, reflecting an assumption of little change in state appropriation and our success in constraining expenditure growth. We also expect a modest upturn in interest earnings as well as growth in endowment returns and expendable gift funds due to another strong year in raising new gifts and growth in the corpus of our endowment through wise investment of assets.

We are always seeking alternative sources of funding to support our academic work. Support from our donors remains an essential component of our financial strategy that makes the difference between a good university and a great one. While there are instances in which gift funds support activities that allow us to reallocate General Fund dollars, the use of most endowment funds is restricted by donor intent. Gift funds and endowment create an important margin of excellence, but they do not replace state funding support and student tuition dollars.

**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. Revenue to the General Fund comes from three main sources: state appropriation, tuition and indirect cost recovery. Changes in indirect cost recovery pay for changes in the indirect costs of research, implying that this funding is not available for allocation on a discretionary basis. This leaves tuition dollars and the state appropriation as the primary General Fund sources that can be flexibly allocated.

In our FY2008 budget proposal, we are anticipating a state appropriation at the level of our current FY2007 base, just over $320 million. This allocation will put our state appropriation at a level that is over $40 million lower than the amount that was appropriated for FY2002, in nominal dollars. We understand that the State is attempting to return to increased support for higher education, but 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 are 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. We face five sources of cost increase that make our costs rise faster than those in the economy as a whole:

1. We are labor-intensive in comparison to much of the overall the economy, 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. Businesses, by contrast, make technology investments that create efficiencies or enhance revenue flow.

3. The volume of activity (both research and instruction) continues to rise, while we must simultaneously implement cost reduction strategies.

4. It is important to recognize 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 our costs, as previously mentioned, the costs associated with recruitment and retention of new faculty have a significant impact on the budget presented here. Our budget challenge is enhanced by our need to invest to react to targeted recruiting opportunities, succeed at the retention of our most talented faculty members and deploy resources to areas of particularly intense competition or vulnerability.

Overall, the University faces a total budget challenge for FY2008 of $56.8 million to cover increased costs and fund our highest priority new initiatives.

**Cost Containment Efforts**

Several University-wide initiatives are underway which are intended to result in better use of our resources over the long term. The University has launched an ambitious initiative to explore the utilization of space and facilities on the Ann Arbor campus to make the best use of the physical resources that support our core mission. The multi-year space initiative will involve the cooperation of administrative units, schools, and colleges to develop a long-term plan that will be guided by a commitment to academic and research excellence. In addition, a campus wide Energy & Environmental Initiative was launched this spring to address several areas, including energy conservation, construction and design standards, alternative transportation, and outreach efforts.

In putting together the FY2008 budget, we have succeeded in removing over $21 million 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.

This practice of reducing General Fund expenditures by 1-2% to enable innovation is one that we intend to continue in our future budgetary planning. However, consistently cutting and reallocating at a level higher than our rate of investment could jeopardize the quality of the institution and requires careful monitoring. In seeking efficiencies from our units, we have emphasized the need to avoid negative impacts on our educational and research missions, a necessity that has become increasingly difficult given that this is the fifth consecutive year of reductions and reallocations. As part of our monitoring effort, we have chosen to offer relief in some cases where, without it, the unit's ability to carry out or support the core missions of the University would be hampered.

Some specific examples of University-wide efficiencies and unit savings achieved through consolidation, reorganization and base reductions include:

- The College of Engineering has undertaken a review of several of its student support activities, leading to an effort to streamline activities and improve support. In addition, the College has consolidated activities of the associate dean for research and the associate dean for graduate affairs under a single deanship, resulting in cost savings.

- The College of LS&A is achieving savings by developing, implementing, monitoring and evaluating programs aimed at conserving energy throughout the College. They also have identified deferrable facilities projects (those that do not involve issues of safety and for which deferral does not create significant additional cost) of over $1 million.

- The College of LS&A is further prioritizing its activities and will reduce funding for unit initiatives and eliminate the remaining research cost-sharing budget.

- The Law School is implementing its plan to reduce annual expenses of the Law Library by $1 million over the next few years.

- The Medical School accomplished a virtual consolidation of the basic science departments' administrative functions, leading to the sharing of personnel and streamlining and standardizing business practices across the basic science units.

- The School of Natural Resources and the Environment worked closely with MAIS to more efficiently leverage technology, freeing up staff time.

- The Rackham Graduate School downsized selected offices within the school, enabling the reallocation of resources. They also reallocated funds from lower priority activities in order to provide more support to student research and professional travel.

- Insurance premiums were reduced by $460K. The savings were generated by lower claims experience as the result of loss prevention strategies and higher investment returns. An additional $2.8 million will be saved on a one-time basis due to insurance cost premium credits.

- Procurement Services continues to expand the Strategic Supplier program to obtain quality goods and services for the University at the lowest cost. Examples include:

- For custodial supplies, bulk-contract pricing will result in annual savings to the University of more than $120K.
- In the technology area, new contracts produced savings on computer peripherals of more than $240K. Discounts of more than $600K were distributed to the units making purchases of desktops and servers.
- Flooring contracts produce lower prices for carpets and flooring materials. In the first four months of these contracts, we have realized savings of almost $60K.

- Business and Finance units have identified $3.5 million of cost reductions for FY2008:

- $1.4 million through the consolidation/elimination of staff positions.
- $1.1 million in expenditure savings through the successful negotiation of vendor contract terms.

- $800K in non-salary cost reductions through technology enhancements, the extension of equipment replacement cycles and management of inventory.
- $200K in business process improvements; self-service employee/student options eliminated postage and direct time entry eliminates vendor processing of timesheets.

- Units across the University continue to reduce administrative costs and improve efficiencies through the use of technology-enabled solutions such as paperless student application processes, a paperless system for student academic advising and degree progress checking, a tool to match students with scholarships, and a new process for evaluating cross-campus transfers.

- Proactive benefits management focuses on ensuring that the University maintains a cost-effective set of benefits that enables us to compete effectively for the best staff and faculty. Examples of recent results which have significantly aided our budget situation include:

- Negotiated a new Pharmacy Benefit Manager contract (SXC) for prescription drug claims resulting in a $4.3 million pricing reduction based on a change in the overall discount from average wholesale price rate.
- Developed and implemented the Medicare Part D employer subsidy, returning $3.5 million in prescription drug expense annually.
- Achieved $2.5 million savings to the prescription drug plan costs through increased use of generic drugs, pill splitting and specialty injectable medications.
- Implemented a debit card process for the Health Care Flexible Spending Accounts, increasing faculty and staff participation by 18%. Expanded the contract with our Flexible Spending Accounts vendor, saving $130K in administrative overhead.
- Implemented a new life insurance vendor contract producing total premium savings of $100K.

Gift and other non-General Fund sources play an important role in the University's ability to reallocate General Funds. The Office of Development has had another banner year of fund-raising, securing nearly $300 million in new gifts during FY2007. To increase its effectiveness, we have made significant investments in our Development operation over the past few years and will do so again this coming year. Examples of investments in FY2008 include support for the alumni database, international fundraising, and a parents and families program. We also will continue our support for the establishment of a comprehensive young alumni solicitation and donor education program and the reestablishment of alumni reunions. In addition to providing resources for new and innovative things, many gifts provide funding for existing activities, allowing us to reallocate General Fund resources to other needs. Through proactive and focused fund-raising activities, this source is becoming increasingly available for professorships, financial aid, and facilities. A few examples of prudently replacing General Fund needs with other funding sources are noted below:

- In the academic units, we are maximizing the use of endowed professorships to supplement the General Fund in providing faculty salaries.

- The School of Education is reducing the number of graduate student research assistants who are supported by the General Fund through use of other sources of revenue.

- The College of Literature, Sciences and the Arts has shifted costs of a significant facilities project from the General Fund to endowment funds.

- The University is shifting a portion of the Office of Development's budget from the General Fund to the endowment to better align the unit's activities with its funding source.

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 Proposal for FY2008. As mentioned earlier, the proposed budget reflects the assumption that the state appropriation will be the same as the current FY2007 base appropriation of just over $320 million. 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 5.8% increase in their General Fund budgets, which results from tuition rate increases and increased numbers of students, offset by changes in volume of indirect cost recovery from sponsored research. The administrative units will receive more modest budget increases in FY2008. It should be noted that the negative percentage change in administrative unit budgets from FY2007 to FY2008 is due to the shift of some operating costs for the Office of Development and the Office of General Counsel to non-General Fund sources; excluding these two units results in a 2.9% increase for administrative units.

As usual, there is considerable variation in the rates of growth of the General Fund budgets of the academic units. In nearly 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. 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.

As you can see on Table 1, the budget for the research units will grow significantly, primarily due to growth in indirect cst recovery for several units, namely the U-M Transportation Research Institute, the Center for Human Growth and Development and the Life Sciences Institute. The increase in Academic Program Funds is partially due to the enhancement of the special fund for the recruitment and retention of leading faculty that is again being budgeted in the Academic Program Funds line but which will be distributed to schools and colleges throughout the year. The balance of the increase is due to a significant amount of our new initiative funding being held centrally until we have clarity on the level of our state appropriation.

Overall, there is positive growth in the University Items category. The drivers of this are offsetting changes in utilities and financial aid. The welcome decrease in utilities costs is due to the purchase of natural gas futures at a favorable rate coupled with the decline in prices after the ‘unnatural’ spike last year.

**Conclusion**

It is worth repeating that this budget is built on the assumption that our FY2008 state appropriation will be flat at the FY2007 base appropriation amount of approximately $320 million. We should note that the State has implemented mid-year cuts in each of the last several years, and the actual amount of our FY2008 state appropriation has not been finalized. If the enacted appropriation amount differs significantly from what we are assuming, we may seek a revision from the Board at the appropriate time.

The budget that we propose for your approval strongly supports the University’s core values of academic excellence and access to ensure that we remain a strong and vibrant institution despite a period of difficult budgetary challenges. The budget maintains focus on our core missions of teaching and research and our core values of excellence and access. Accordingly, it includes significant increases in financial aid, resources to launch innovative new academic programs and support for the recruitment and retention of leading faculty. The budget is attentive to the future by strategically allowing for the investment in new initiatives that will shape the future of the University as well as the infrastructure (faculty, staff, students, facilities and technology) that will enable these initiatives to be successful.

At the same time, this budget requires the University to be a responsible steward of our resources and 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. We respectfully request that you approve the proposed budget.

**Table 1**

**The University of Michigan - Ann Arbor**
**General Fund Budget ($000)**
**Fiscal Year 2007-08**

| | FY2007 Adjusted Budget* | Recommended Change | Proposed FY 2008 Budget | % change GF Budget |
|---|---|---|---|---|
| **Revenues** | | | | |
| State appropriation | 325,796 | (5,640) | 320,156 | -1.73% |
| Tuition and Fees | 777,367 | 63,199 | 840,566 | 8.13% |
| Indirect Cost Recovery | 170,560 | (5,851) | 164,710 | -3.43% |
| Other Revenue | 21,325 | 905 | 22,230 | 4.24% |
| **Total Revenues** | 1,295,048 | 52,613 | 1,347,661 | 4.06% |
| | | | | |
| **Expenditures** | | | | |
| A. Alfred Taubman College of Architecture & Urban Plann | 10,903 | 143 | 11,046 | 1.31% |
| School of Art & Design | 7,391 | (43) | 7,348 | -0.59% |
| Stephen M. Ross School of Business | 63,488 | 2,553 | 66,041 | 4.02% |
| School of Dentistry | 27,053 | 201 | 27,254 | 0.74% |
| School of Education | 15,349 | 130 | 15,479 | 0.85% |
| College of Engineering | 115,131 | 3,290 | 118,422 | 2.86% |
| School of Information | 9,390 | 955 | 10,344 | 10.17% |
| Division of Kinesiology | 8,511 | 294 | 8,805 | 3.46% |
| Law School | 35,198 | 2,746 | 37,943 | 7.80% |
| College of Literature, Science and the Arts | 260,611 | 18,724 | 279,335 | 7.18% |
| Medical School | 79,034 | 1,353 | 80,387 | 1.71% |
| School of Music, Theatre & Dance | 25,030 | 425 | 25,455 | 1.70% |
| School of Natural Resources & Environment | 6,241 | 19 | 6,260 | 0.30% |
| School of Nursing | 12,319 | 544 | 12,863 | 4.41% |
| College of Pharmacy | 9,529 | 869 | 10,397 | 9.12% |
| School of Public Health | 26,997 | 788 | 27,786 | 2.92% |
| Gerald R. Ford School of Public Policy | 7,325 | 635 | 7,960 | 8.67% |
| School of Social Work | 17,410 | (326) | 17,083 | -1.87% |
| Horace H. Rackham School of Graduate Studies | 8,087 | 187 | 8,274 | 2.31% |
| University Academic Units | 47,715 | 1,781 | 49,496 | 3.73% |
| Research Units | 3,608 | 697 | 4,305 | 19.31% |
| Academic Program Support | 41,987 | 12,662 | 54,649 | 30.16% |
| TOTAL ACADEMIC | 838,309 | 48,626 | 886,935 | 5.80% |
| | | | | |
| President | 2,483 | 52 | 2,535 | 2.11% |
| Provost & Executive Vice President for Academic Affairs | 44,061 | 1,174 | 45,236 | 2.66% |
| Executive Vice President & Chief Financial Officer | 138,147 | 2,822 | 140,969 | 2.04% |
| Vice President for Communications | 4,134 | 102 | 4,236 | 2.47% |
| Vice President for Development | 8,326 | (7,444) | 881 | -89.41% |
| Vice President & General Counsel | 2,890 | (173) | 2,717 | -6.00% |
| Vice President for Government Relations | 1,702 | 37 | 1,739 | 2.20% |
| Vice President for Research- Support Units | 16,550 | 1,110 | 17,660 | 6.71% |
| Vice President & Secretary of the University | 657 | 16 | 673 | 2.46% |
| Vice President for Student Affairs | 11,279 | 1,011 | 12,290 | 8.96% |
| TOTAL EXECUTIVE OFFICER AND SERVICE UNITS | 230,229 | (1,292) | 228,937 | -0.56% |
| | | | | |
| General University Support | 45,259 | 729 | 45,988 | 1.61% |
| Centrally Awarded Financial Aid | 90,920 | 8,138 | 99,058 | 8.95% |
| Utilities | 85,331 | (3,587) | 81,744 | -4.20% |
| Departmental Income | 5,000 | 0 | 5,000 | 0.00% |
| UNIVERSITY ITEMS | 226,510 | 5,280 | 231,790 | 2.33% |
| | | | | |
| **Total Expenditures** | 1,295,048 | 52,613 | 1,347,661 | 4.06% |

Detail may not sum to totals because of rounding

* Transfers between units are incorporated in the FY2007 Adjusted Budget