FY 2008-2009 General Fund Operating Budget

June 19, 2008

Introduction

The General Fund budget we are presenting for FY2009 will allow the University of Michigan – Ann Arbor to advance the excellence of the institution through investments in core academic programs and initiatives, and to advance our unwavering commitment to access through robust growth in spending on financial aid. The proposed budget incorporates a significant level of cost reductions and reallocation to enable a prudent level of targeted investment while keeping tuition increases modest.

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 revenue growth in those units, such as the College of Engineering, the Gerald R. Ford School of Public Policy, and the School of Information, that are experiencing enrollment growth. The alignment of revenue with enrollment helps assure that units are able to maintain high quality in their educational programs.

To achieve our mission and advance the excellence of the institution, we must maintain a focus on the future. Despite volatile and uncertain financial circumstances, the University continues to advance in notable ways. This budget provides support for critical investments in the areas of faculty expansion, financial aid, graduate student stipends, academic program initiatives, research and technology initiatives, and facilities.

The excellence of our faculty is perhaps the single most important factor contributing to the quality of our academic enterprise. We continue to compete for top faculty against other top public and private universities, many of whom have greater resources that they can bring to bear. The list of institutions that have attempted to recruit away University of Michigan faculty over the past two years include Harvard, Yale, Stanford, Columbia, Princeton and Duke, to name a few. We are placing a particular emphasis on this priority in our budget recommendation by providing the resources necessary to support a competitive salary program and by continuing with our special faculty recruitment and retention program. In addition, this budget begins the establishment of base funding (which will be in place in two years) for our initiative to hire 100 new faculty members in what will be a deliberate attempt to reduce our student-faculty ratio over the next several years.

Student access stands as a top priority for the University. It remains the longstanding policy of the University of Michigan to meet the demonstrated financial need of all of its Michigan resident undergraduate students. The FY2009 General Fund budget recommendation continues our customary practice of increasing centrally awarded financial aid at a higher rate than the proposed tuition increase, and in fact, goes well beyond that objective. Our FY2009 budget calls for an increase of over $8.5 million in centrally awarded financial aid to a new total of nearly $107.6 million, which represents an 8.6% increase in financial aid. Specifically for undergraduates, this equates to an increase of nearly $6.7 million, a 10.8% increase.

In addition to centrally awarded financial aid, the academic units also award need-based scholarships, which reduce dollar for dollar the loan and work-study amounts for our students. Furthermore, the President's Donor Challenge and the accompanying matching program has raised over $60 million in endowment for need-based undergraduate financial aid, which will add resources to undergraduate need-based financial aid starting in FY2009. This program will ultimately provide approximately $3 million in new base funds for financial aid, a figure that will grow with the market value of the endowment.

As with faculty, we compete against other elite universities for top students. The academic units provide significant funding from multiple sources for merit-based undergraduate scholarships and graduate student support. This year, to help maintain competitive graduate student support packages, the University is investing nearly $1 million in additional base funding (above inflationary increases) to enhance these packages.

In FY2009, the University will continue to place a high priority on academic programs that promote globalization and international experiences for our students. In early 2008, President Coleman visited Ghana and South Africa to promote partnerships between African universities and the University of Michigan. At the same time, the University launched an African Studies Center as part of the International Institute to support research in that area on campus. The Joint Institute supported by the University of Michigan and Shanghai Jiao-Tong University in China is thriving and has admitted its second class of students. Growing numbers of University of Michigan students and faculty are spending time at the Joint Institute, and the University of Michigan anticipates a significant number of transfer students from the Joint Institute to the College of Engineering at UM starting this fall. And, the University continues to increase opportunities for our students to engage in study abroad programs as evidenced by our investment of incremental funds in the Global Intercultural Experience for Undergraduates (GIEU) Program as part of the FY2009 budget.

Globalization and internationalization will remain high priorities for University investment over the next several years. In 2010, the University of Michigan will undergo re-accreditation. The University has chosen 'Internationalization' as the theme of this re-accreditation to mark its importance to the University's academic mission going forward.

The Library is one of the University's most distinguished and valuable resources. The University Library has a nationally prominent collection that serves as an invaluable resource to University of Michigan faculty and students as well as to the public in the State of Michigan and to other universities. This year we are investing an incremental $1.2 million in the Library's collections budget to insure that the collection maintains its current value and distinction. The Library is also an area of the University where business operations are changing rapidly, as technology affords new and creative ways to deliver content and mine data. The University is a national leader in taking advantage of the opportunities that these new technologies permit. In this year's budget, we are providing additional support for the Google digitization project as well as investing in staff positions for the Library that are tied to new information technology opportunities.

The University intends to continue to invest in forward-looking research and technology initiatives. We recognize that high performance computing has become a fundamental component of modern science and engineering research. Our recent investment in the Michigan Academic Computing Center (MACC) facility created a state-of-the-art machine room shared by the campus that meets the special energy and cooling requirements imposed by high intensity research computing. Over the next several years, we anticipate a significant investment in the University's cyber-infrastructure – the computers, networks, software and personnel infrastructure needed to help our scientists and engineers make better use of the research opportunities afforded by today's high performance computers.

We are continuing to support the Ethics in Public Life initiative, which was launched three 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 remaining high priority is to significantly advance our activity and engagement with industry via partnerships. We have created a Business Engagement Center, whose focus will be to advance partnerships between the University and businesses as well as to provide gap funding and other support to help University of Michigan researchers take discoveries and inventions from initial creation to market. 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 and its graduates 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 expansion of the Lurie Nanofabrication Facility (LNF) clean room, which will result in a state-of-the-art facility for research and new micro-fabrication techniques. Faculty and students use the LNF 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 FY2009, the University will see the completion of the Kelsey Museum renovation and the addition of the William E. Upjohn Exhibit Wing, the Alumni Memorial Hall Museum of Art addition and renovation, and the Stephen M. Ross School of Business Facilities Enhancement Project.

Cost and Revenue Pressures

While we have been aided this year by relatively low fixed cost increases, we are faced with a significant drop in interest revenue and continue to deal 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 $19.5 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 will discuss our approach to becoming even more efficient.

Our revenue situation remains challenging. The State's uncertain financial circumstances, combined with constrained federal research funding and low interest rates, require a careful balance between fiscal discipline and the need to invest in our future. This year we are asking for modest increases in tuition rates, reflecting an assumption of moderate change in our state appropriation and our success in constraining expenditure growth. We also expect 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 prudent investment of assets.

We are always seeking diverse 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 revenue sources that can be flexibly allocated.

In our FY2009 budget proposal, we are anticipating a state appropriation at $330 million, assuming a 2% increase. Given the State's very constrained financial circumstances, this potential increase shows support for higher education, for which we are very grateful. More importantly, this possible increase in funding 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. Nevertheless, this assumed allocation will put our state appropriation at a level that is almost $34 million lower than the amount that was appropriated for FY2002, in nominal dollars, and nearly $100 million lower in inflation-adjusted dollars.

On the expenditure side, we are subject to increases beyond the normal forces of inflation. The cost of doing business at a university follows a higher trajectory than it does in the rest of the economy, and research universities are especially subject to cost increases beyond the normal forces of inflation. We can identify four factors contributing to cost increases that have significant impact at a top research institution like the University of Michigan.

1. Teaching and research are more labor-intensive than most activities in the economy, and it is generally the case that the costs of labor rise faster than other prices.

2. Universities make substantial investments in a broad range of new technology and facilities in order to conduct leading-edge research and prepare students adequately for careers in a full spectrum of fields. These are costly investments that typically do not reduce costs, increase revenues or create efficiencies. Companies, by contrast, make technology investments that support their business and create efficiencies or enhance revenue flow.

3. The volume of activity (both research and instruction) continues to rise, further driving up costs. Over the past six years the number of students at UM has grown by 5% and our research volume has grown by over 25%. This growth leads to commensurate expansion of work and infrastructure needs.

4. Beyond the growth in levels of activity, it is important to recognize that the sum of human knowledge and creative expression grows every year. The University, unlike most private enterprises, has an obligation to preserve the past as well as to invest in the future. We are museum, library, and laboratory as well as classroom. The costs of museums and other repositories of knowledge grow in part because their collections grow, and the cost of staying on the cutting edge is always high.

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. We have major competitors who are often buffered from these market forces by much larger endowments. 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 FY2009 of $69 million to cover increased costs and fund our highest priority new initiatives.

Cost Containment Efforts

A key to our success during this difficult financial period has been our ability to contain costs, reduce expenditures and reallocate within the General Fund budget. We incorporate an assumed level of reduction and reallocation (typically 1.5-2% of the budget) in each year's General Fund budget proposal.

As a result of this effort, in putting together our annual budgets over the past five years, we have succeeded in removing nearly $120 million in recurring General Fund expenditures through a combination of increased efficiencies, elimination of lower priority activities and moving expenses from the General Fund to other funds. We are planning for additional reductions/reallocation in the FY2009 budget, which will bring this total to over $135 million over a six-year period.

This practice of reducing General Fund expenditures by 1.5-2% 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 new investment could jeopardize the quality of the institution and requires careful monitoring. In seeking efficiencies from our units, we have adopted the following principles:

- Protect and invest in our core educational and research missions
- Remain competitive for faculty/staff/students
- Leverage our size and scale
- Maintain high quality essential services
- Eliminate duplicate and lower priority activities
- Shift costs from the General Fund to other funding sources, where appropriate
- Avoid short-term reductions with long-term cost and/or quality implications
- Introduce centralization and greater sharing of resources in cases where this will result in higher quality services and/or more effective use of high quality facilities
- Consider insourcing and outsourcing, when that leads to improvements in service at the same or lower costs
- Take advantage of advanced technologies to achieve efficiency of operations

These principles direct us to pursue a broad range of strategies to achieve cost reductions and long-term efficiencies in our operational areas. Within that general framework, we have focused our cost containment efforts on the seven areas listed below.

1. <u>Purchasing</u>

- Using the University's scale as a purchaser to negotiate strategic supplier contracts with favorable pricing
- Renegotiating existing contracts with better terms
- Choosing to self-insure in select areas so as to achieve the full financial benefit of risk-reduction programs and investment opportunities with insurance reserves

2. <u>Energy Efficiency</u>

- Putting in place efficient campus systems to produce steam, electricity and chilled water
- Constructing new buildings and retrofitting existing facilities so as to achieve a high level of energy efficiency
- Encouraging positive behavioral changes around energy consumption

3. Health Benefit Strategies

- Putting programs and incentives in place to improve the overall health of our community
- Aligning our benefit offerings with the market and ensuring the appropriate level of cost sharing with the employee
- Structuring our plans to result in proper utilization of health care

4. Leveraging Information Technology

- Using technology to create business process efficiencies

5. Other Revenue Sources

- Utilizing gift funds and investment proceeds to relieve the General Fund
- Increasing external research support through investments in strategic areas
- More effective partnerships with business and industry

6. Greater Productivity of Staff

- Constantly reprioritizing effort, reallocating resources and improving overall productivity levels – doing more with less

7. More Efficient Utilization of Space and Facilities

- Adding rationality and discipline to the prioritization of major capital projects
- More fully utilizing classrooms and other instructional spaces
- Campus-wide sharing of high technology facilities

The document, "The University of Michigan – Ann Arbor, Cost Containment Efforts", provides detail on our activities to date as well as a discussion of future efforts relative to each of the seven strategies.

The General Fund Budget Recommendation

The attached Table 1 summarizes the General Fund budget proposal for FY2009. As mentioned earlier, the proposed budget reflects the assumption that the state appropriation will be nearly $330 million (a growth of 2% over the FY2008 appropriation plus a $3 million adjustment for the difference between the FY2008 budgeted appropriation amount and the final FY2008 appropriation that was approved in October). 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 4.9% increase in their General Fund budgets, which results from tuition rate increases, increased numbers of students, investments in academic initiatives, and the volume of indirect cost recovery from sponsored research. These increases are offset by changes in interest revenue. The administrative units will receive more modest budget increases in FY2009.

As you can see on Table 1, the budget for the research units will decline. This is due to a decrease in indirect cost recovery for several units and a reduction in interest revenue for all research units. The increase in Academic Program Funds 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 primary driver of this increase is our additional investment in centrally awarded financial aid.

Conclusion

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. Accordingly, the recommended budget provides funding for critical investments in the areas of faculty growth, recruitment and retention, financial aid, graduate student support, and academic program initiatives. 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 approval of the proposed budget.

Table 1

The University of Michigan - Ann Arbor
Proposed General Fund Budget ($000)
Fiscal Year 2008-09

	FY 2008 Adjusted Budget	Recommended Change	Proposed FY 2009 Budget	% change GF Budget	Average Annualized 3 Year % Change in GF Budget
Revenue Budgets					
State appropriation	320,156,000	9,752,000	329,908,000	3.05%	1.58%
Tuition and Fees	840,565,529	53,920,976	894,486,505	6.41%	7.25%
Indirect Cost Recovery	164,709,739	6,859,396	171,569,135	4.16%	1.23%
Other Revenue	22,230,000	(9,400,000)	12,830,000	-42.29%	-5.62%
Total Revenues	1,347,661,268	61,132,372	1,408,793,640	4.54%	4.90%
Expenditure Budgets by Unit					
A. Alfred Taubman College of Architecture & Urban Planning	11,046,499	1,269,450	12,315,949	11.49%	6.66%
School of Art & Design	8,347,814	467,838	8,815,652	5.60%	5.96%
Stephen M. Ross School of Business	66,041,446	3,390,659	69,432,105	5.13%	7.29%
School of Dentistry	27,328,244	239,817	27,568,061	0.88%	2.56%
School of Education	15,559,343	206,550	15,765,893	1.33%	2.67%
College of Engineering	118,510,124	8,248,152	126,758,276	6.96%	5.43%
School of Information	10,344,261	874,200	11,218,461	8.45%	8.00%
Division of Kinesiology	8,804,973	826,417	9,631,390	9.39%	9.16%
Law School	37,966,210	2,653,707	40,619,917	6.99%	6.86%
College of Literature, Science and the Arts	279,471,671	8,945,166	288,416,837	3.20%	5.24%
Medical School	80,473,192	1,978,433	82,451,625	2.46%	0.38%
School of Music, Theatre & Dance	25,490,579	(185,158)	25,305,421	-0.73%	3.02%
School of Natural Resources & Environment	6,260,198	27,420	6,287,618	0.44%	4.22%
School of Nursing	12,862,955	585,410	13,448,365	4.55%	5.51%
College of Pharmacy	10,397,479	436,412	10,833,891	4.20%	8.68%
School of Public Health	27,751,286	(203,494)	27,547,792	-0.73%	-0.61%
Gerald R. Ford School of Public Policy	7,960,373	410,761	8,371,134	5.16%	5.76%
School of Social Work	16,705,436	386,438	17,091,874	2.31%	1.60%
Horace H. Rackham School of Graduate Studies	8,175,038	210,588	8,385,626	2.58%	2.61%
University Academic Units	49,475,226	2,916,850	52,392,076	5.90%	4.29%
Research Units	4,305,103	(304,958)	4,000,145	-7.08%	7.41%
Academic Program Support	49,232,881	9,889,816	59,122,697	20.09%	24.39%
TOTAL ACADEMIC	882,510,331	43,270,474	925,780,805	4.90%	5.57%
President	1,858,394	99,454	1,957,848	5.35%	2.89%
Provost & Executive Vice President for Academic Affairs	49,312,276	668,017	49,980,293	1.35%	2.61%
Executive Vice President & Chief Financial Officer	140,905,829	4,935,768	145,841,597	3.50%	3.46%
Vice President for Communications	4,912,848	465,743	5,378,591	9.48%	4.68%
Vice President for Development	881,466	50,792	932,258	5.76%	-51.40%
Vice President & General Counsel	2,716,771	124,971	2,841,742	4.60%	1.44%
Vice President for Government Relations	1,739,344	41,352	1,780,696	2.38%	2.67%
Vice President for Research- Support Units	18,008,234	495,495	18,503,729	2.75%	5.37%
Vice President & Secretary of the University	673,221	17,908	691,129	2.66%	6.15%
Vice President for Student Affairs	12,289,945	551,620	12,841,565	4.49%	11.35%
TOTAL EXECUTIVE OFFICER AND SERVICE UNITS	233,298,328	7,451,120	240,749,448	3.19%	2.62%
General University Support	35,435,266	813,966	36,249,232	2.30%	2.60%
Centrally Awarded Financial Aid	99,057,782	8,536,033	107,593,815	8.62%	8.28%
Utilities	81,806,791	1,276,310	83,083,101	1.56%	3.70%
Insurance	8,530,379	(1,228,198)	7,302,181	-14.40%	-10.64%
Legal and Professional Fees	569,031	0	569,031	0.00%	-5.25%
Ceremonial and Presidential Events	633,360	12,667	646,027	2.00%	0.66%
Departmental Income	5,000,000	1,000,000	6,000,000	20.00%	0.00%
Staff Benefits Pool	820,000	0	820,000	0.00%	0.00%
UNIVERSITY ITEMS	231,852,609	10,410,778	242,263,387	4.49%	4.68%
Total Expenditures	1,347,661,268	61,132,372	1,408,793,640	4.54%	4.90%

** Transfers between units are incorporated in the FY2008 Adjusted Budget