

The University of Michigan
Regents Communication

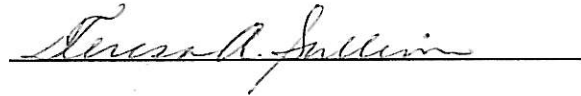
Approved by the Regents

December 13, 2007

Action Item

Attached is a copy of the annual operating request to the State for the University of Michigan-Ann Arbor campus for FY 2009 for your approval.

Respectfully submitted,

A handwritten signature in cursive script, reading "Teresa A. Sullivan", is written over a solid horizontal line.

Teresa A. Sullivan
Provost and Executive Vice President
for Academic Affairs

December 13, 2007
Attachment



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December 14, 2007

Mr. Robert L. Emerson
State Budget Director
State of Michigan
111 S. Capitol
Post Office Box 30026
Lansing, Michigan 48909

Dear Mr. Emerson:

I am responding to your invitation to provide information to the State in support of the fiscal year 2009 budget development process for the University of Michigan – Ann Arbor. We once again seek to build a budget that advances the excellence of the University while continuing to be prudent planners and careful stewards of public resources. In this letter you will find information about our general fund revenues and expenditures, our major initiatives and our continuing efforts to continue to contain costs at the Ann Arbor campus.

The challenges we face in constructing the fiscal year 2009 budget are similar to those we have faced in recent years. The reduction of over \$5.6 million to our base budget instituted in the middle of fiscal year 2007 and the delay of our August 2007 payment disrupted both our operations and our planning. We recognize that the State continues to face difficult and uncertain financial circumstances that require hard decisions and thoughtful prioritization of resources, and we anticipate that it will remain difficult for the State to make material increases in spending on higher education over the next few years. We respectfully request budget stability and ultimately progress toward the restoration of our fiscal year 2002 level of funding.

The University of Michigan continues to rank in the very top tier of the nation's research universities and is one of only a select few in that group that embraces a public mission. The most recent rankings show the University of Michigan with dozens of top ten schools, department and programs. Members of our faculty again received the most prestigious external awards for their exceptional teaching and research. This year, for example, a University of Michigan math and education professor received the National Medal of Science, the nations'

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highest science honor. We continue to attract extraordinary students – the median high school GPA of our entering class of first-year students this fall was 3.8, and the University of Michigan produced the highest number of 2007-08 Fulbright awards for American students, with 37 receiving grants. To maintain this level of excellence, the University must compete successfully with other top universities, both public and private, for both faculty and students. Excellence requires continuous investment in faculty recruitment and retention, programmatic initiatives, financial aid, student services and facilities.

We know that the state recognizes the crucial role that higher education in general, and the state's research universities in particular, can play in transforming Michigan's economy. We appreciate the Governor's efforts to recognize this role in the budget process, resulting in the provision in the fiscal year 2008 budget legislation that places the state's three research institutions in a separate category. This legislation represents an important first step, and we look forward to continued progress and investment in this area.

A recently released independent analysis showed that the state's three research universities helped create over 68,800 Michigan jobs and produced \$12.8 billion of net economic benefit in 2006. Last year's decision by Google and the recent decision by Spanish aerospace company, Aernnova, to open facilities in the Ann Arbor area (creating 1,000 and 400 new jobs, respectively) directly illustrate this role. Our research expenditures, from federal sources and all other sources, place us in the top two nationally among all universities, further demonstrating both our excellence and our importance to the future of the State of Michigan. In fact, Michigan's three research institutions account for 94 percent of federal academic research dollars brought into the state. In addition, the life sciences continue to be one of our highest priorities, and the University of Michigan's initiatives will continue to translate into positive effects on the state economy through new spin-off companies, innovations for established companies and a highly trained workforce to support the life science industry in the state.

As I discussed last year, technology transfer remains an integral part of our research mission. Our efforts continue to expand in this area, with University of Michigan researchers disclosing 329 new inventions in fiscal year 2007 – an all-time high and a 14 percent increase over the previous year. Fiscal year 2007 results also include 144 U.S. patent applications and 87 issued patents. Royalty revenues increased 19 percent to nearly \$13 million, providing a source for continued reinvestment that will strengthen future interactions with industry. The University also negotiated 91 technology transfer agreements, including seven with new business startups, bringing the total number of University of Michigan startups over the last seven years to 62, with more than 60 percent of the new businesses located in Michigan. In addition, the University is investing in the creation of a central, highly visible focal point for relationships between campus units and key industry and entrepreneurial partners. This Business Engagement Center will be a central hub to focus our activities with businesses, and to enhance industry relationships and economic development.

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Student access and affordability remain top priorities for the University. Regard for our public mission drives us to put in place financial aid policies that will allow every admitted Michigan resident to attend the University of Michigan, regardless of financial means. The President's Donor Challenge was established in October 2006 to increase support for need-based student financial aid and endowed professorships. To date, total impact of the need-based financial aid gifts is nearly \$43 million. The M-Pact Program, launched over three years ago, continues to provide additional need-based grants to Michigan residents. These and other programs enable the University to reaffirm its commitment to our long-standing policy of meeting the full demonstrated need of every Michigan resident undergraduate. As in the case of ensuring excellence, access and affordability require sustained investment of new resources.

In our budget request below, we will once again describe the numerous steps we have taken to contain costs and reduce expenditures. These efforts have proven more and more difficult, as continued growth in the general fund is essential if the University's quality, measured through excellence and access, is to be maintained and strengthened. As you know, the main sources for the University's general fund are the state appropriation and tuition, and the link between state support and tuition increases is unmistakable. If the state appropriation remains flat or declines further, substantial expenditure reductions along with considerable tuition growth will be necessary. The preservation and advancement of the University's excellence, and our ability to affect the stabilization and growth of the Michigan economy, become increasingly more difficult as the level of expenditure reduction increases.

Expected Expenditure Budget 2009

We are now beginning the process of planning for fiscal year 2009 and are several months away from building the budget. Nevertheless, we continue to be challenged by several factors including rising facilities and benefits costs, a highly competitive faculty recruitment and retention environment, and flattening federal support for research. The University is able to manage these pressures and invest in new academic initiatives only by focused attention on cost-cutting and business efficiencies. As detailed in the Appendix of this letter, we have continued to make reductions to general fund expenditures, with over \$21 million removed from this year's general fund budget through a combination of increased efficiencies, the elimination of lower-priority activities, and moving expenditures from the general fund to other sources of funds. In light of the uncertainty around our state appropriation and the increases in our fixed costs, this magnitude of expenditure reduction was necessary in order to keep our tuition increase moderate while enabling an increase of 4.1% in the general fund budget of the University.

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In FY 2002, the University of Michigan state appropriation was \$363M for the Ann Arbor campus. The FY 2008 appropriation is \$323M, a base reduction of \$40M or 11% over the six-year period 2002-2008. Using CPI inflated dollars, the magnitude of this difference grows to nearly \$100M. This reality as well as the financial challenges associated with maintaining and advancing the University's excellence and ensuring access for our students result in a precarious budget situation. During the same timeframe, the volume of our activity has been increasing. Total headcount enrollment has increased over 5% since the Fall of 2002, and the volume of research has increased over 25%. Meanwhile, the number of general fund FTEs has grown by less than 1%, providing evidence of our efforts to do more with less.

Our ability to be a leading research university rests squarely on our ability to have great scholars. Great faculty members translate into attracting great students, obtaining more grants and awards, and carrying out research, innovation and creativity that betters society. Recruitment and retention of outstanding faculty and students remains our number one priority, and the competition for great faculty is fierce. 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 continue to support our faculty with our actions, our facilities and our resources. Many of the institutions that we compete with for faculty have considerable resources that they can bring to bear, and we must invest responsibly but aggressively in our people in order to protect the quality of our academic enterprise. We recently announced that the University will invest \$30 million to encourage the hiring of 100 new tenure-track faculty members, especially in areas that advance the University's major teaching and research initiatives such as alternative energy and environmental sustainability.

We made critical investments in financial aid again in fiscal year 2008. Centrally awarded financial aid increased by more than \$8.1 million to a new total of just over \$99 million, representing an 8.95% increase in financial aid. Specifically for undergraduates, this equates to an increase of nearly \$6.4 million, an 11.5% increase. This aid is added to other University sources of financial aid, including scholarships supplied by the schools and colleges and those supported by private funding, and reflects the fact that no other Michigan public university comes close to providing the financial aid that we do for the most needy students. Moving forward, we will continue to support and expand financial aid, guided by our long-standing practice to provide the full demonstrated need of every Michigan resident.

The University Research Corridor's (URC) vision for stimulating technology transfer, business development and increased partnerships includes several new initiatives to help invigorate Michigan's economy. The University of Michigan – Ann Arbor, Michigan State University and Wayne State University are working to greatly expand research related to a highly promising industry: alternative energy. Last year I discussed the establishment of the Michigan Memorial

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Phoenix Energy Institute (MMPEI), which significantly expands our efforts in energy research by leveraging existing programs in nuclear engineering and automotive engineering, as well as our long-standing industry partnerships, to make a real difference in areas such as advanced nuclear power systems, solar power, hydrogen technology, fuel cells, battery research and low power electronics. With help from the State, we are in the process of renovating the Phoenix Memorial Laboratory to house a center for the MMPEI. Drug discovery and the study of orphan diseases are also areas of growing importance at the University. Last year, the University created a \$3 million fund that is being spent to attract and hire Pfizer scientists into U-M research track positions.

In addition, we are continuing to expand and improve our undergraduate educational programs. In response to student demand, this fall we launched a new undergraduate degree program in Public Policy through the Gerald R. Ford School of Public Policy. The BA in Public Policy is a liberal arts program that emphasizes multidisciplinary training in the social sciences organized around understanding the public policy process at both the domestic and international levels. The undergraduate program will build on two traditional strengths of the University of Michigan: our strong, interdisciplinary social sciences and our students' focus on issues involving politics and public affairs. In addition, this year we are developing a new, innovative interdisciplinary undergraduate concentration in Informatics that involves the College of Literature, Sciences & the Arts, the College of Engineering and the School of Information. This exciting program will study the intersection of people, technology and information systems.

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 that will result in a state-of-the-art facility for research and new micro-fabrication techniques. The MNF is accessed by both internal and external users 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. In addition to the University of Michigan faculty and staff, the facility is used by organizations ranging from small start-ups to multi-billion dollar companies. The number of external user lab hours has doubled over the past three years, and we expect this trend to continue as we invest in the facility and local industry. The University is also investing in forward-looking research and technology initiatives that will improve our instructional capabilities in areas that will directly contribute highly trained professionals to the Michigan workforces. The School of Dentistry is planning to move 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.

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In previous years I referenced our effort to transform the way we educate our students by better integrating what our students learn, and the ways that they learn, so that they can achieve greater success with the multifaceted problems and complex modes of interaction in the workplace. The third year of funding for the presidential initiative on Multidisciplinary Learning and Team Teaching will focus on how graduate and professional schools can enrich the undergraduate offerings on campus. We believe that international experience is critical to preparing tomorrow's students for a more culturally diverse and more cooperative world. Over the next five years, we seek to double the number of University of Michigan students who take advantage of study abroad programs. In addition, we are continuing to support the Ethics in Public Life initiative, which was launched over two years ago, reflecting the desire of the University to take a leadership role in teaching, research, and discourse about ethics in public life. The Center for Afroamerican and African Studies recently announced a set of initiatives in the area of African Studies. The initiative is intended to provide higher visibility for a variety of activities already undertaken and planned in African Studies at the Center. Specifically, the Rackham Graduate School will provide funds for grants and fellowships for current University of Michigan graduate students interested in African Studies. Each academic year, funds will be available to support graduate students who are studying or researching in the field of African Studies. Finally, a new University effort, the Engaged Academic Lives Initiative, aims to place value in the many ways senior faculty members in science and engineering contribute to communities on and off campus.

Funding Request

Constraints on revenue growth over the past several years as well as significant increases in essential costs contribute to our budgetary challenge. Apart from the aforementioned commitments to faculty excellence, student access and programmatic initiatives, we must respond to the demands of rising costs of all of our operations. On the expenditure side, we are subject to increases beyond the normal forces of inflation. For example, the cost of museums and libraries grow in part because their collections grow. 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. Additionally, investment in equipment, facilities and technology is a necessary component of our budget strategy if our teaching and research enterprise is to remain competitive and if we are to prepare students to help Michigan compete in today's knowledge economy.

To achieve our mission and advance the excellence of the institution, we must maintain a focus on the future. Despite funding challenges, we must continually innovate so that the topics we study and the methods we use to create knowledge remain at the cutting edge. Over the past several years, we have relied heavily on internal reallocation and cost containment to meet the demands of rising costs and simultaneous reductions in state support. We will continue these efforts, but they will be insufficient by themselves to allow us to meet the demands of rising costs and new investments.

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Again, we acknowledge the fiscal circumstances of the State. Nevertheless, the University of Michigan is an essential component in the stabilization and revitalization of the Michigan economy. And, we play a critical role in the development and education of our youth and cannot risk jeopardizing the quality of our instruction, research and service. Our current state appropriation is 11% less than the appropriation we received in fiscal year 2002. At the same time, our activity levels have grown, and the competition we face for the best students and faculty has increased. We are cautiously optimistic that the State will be able to modestly increase spending on higher education in fiscal year 2009.

We believe you would agree that maintaining our position as one of the most prestigious research institutions in the world is essential to both the University and the State of Michigan, particularly given the contribution that the University of Michigan is making to the economic recovery in the State. Excellence in teaching and research and enabling access to our students requires resources, and we respectfully ask that the State reinvest in higher education, particularly our research Universities, by progressing toward restoring our appropriation to fiscal year 2002 levels.

Sincerely,



Mary Sue Coleman
President

MSC/ALB/plk
Enclosure

The University's Cost Containment Measures

Once again, it is worth summarizing some of the reasons that the cost of doing business in a university tends to follow a higher trajectory than it does in the rest of the economy.

1. Universities are labor-intensive organizations compared to much of the overall economy, and the costs of labor generally rise faster than other prices.
2. The total volume of activity – in education, in research and in service – continues to rise, while we must simultaneously implement cost reduction strategies.
3. The sum of human knowledge and creative expression grows every year. Universities, unlike most private enterprises, have obligations to preserve the past as well as to invest in the future. We are both museums and laboratories.
4. Universities, particularly research universities, invest heavily in technology and facilities because it is important for the success of their scholarship and for the quality of the educational experience of their students. But unlike businesses, in which such investments are made to increase revenues or create efficiencies, universities typically achieve little savings from their technology investments.

Against that backdrop, I can report that the University of Michigan continued its diligent efforts to contain costs. In total, across the Ann Arbor campus, we removed over \$21 million in general fund expenditures in fiscal year 2008 through a combination of increased efficiencies, elimination of lower priority activities and moving expenses from the general fund to other funds. We note that this year's reductions are in addition to approximately \$37.5M in FY 2004, \$19.8M in FY 2005, \$20.1M in FY 2006, and \$18.3M in FY 2007. This equates to a total of approximately \$117 million over the five-year period from fiscal year 2004 through fiscal year 2008.

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.

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

- 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.

- 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 Literature, Science & the Arts 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 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 Michigan Administrative Information Systems (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.

Gift and other non-General Fund sources play an important role in the University's ability to reallocate General Funds. 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, Science and the Arts has shifted costs of a significant facilities project from the General Fund to endowment funds.