

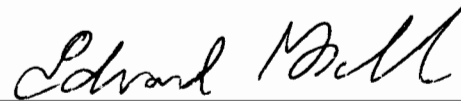
The University of Michigan
Regents Communication

EXH	MOTION: <i>White</i>
	BY: <i>Maynard</i>
	ACT: APPROVED BY THE REGENTS
NOTE:	NOV 17 2005

Action Item

Attached is a copy of the annual operating request to the State for the University of Michigan-Ann Arbor campus for FY 2007 for your approval.

Respectfully submitted,



Edward M. Gramlich
Interim Provost and Executive Vice
President for Academic Affairs

November 17, 2005
Attachment



MARY SUE COLEMAN
PRESIDENT

THE UNIVERSITY OF MICHIGAN

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November 7, 2005

Ms. Mary A. Lannoye
State Budget Director
State of Michigan
Post Office Box 30026
Lansing, Michigan 48909

Dear Mary,

I am responding to your invitation to provide information to the State in support of the fiscal year 2007 budget development process. In this letter you will find information about our general fund revenues and expenditures, major initiatives underway on our campus, and steps we have taken over the last year to contain costs at the Ann Arbor campus.

The challenges before us in constructing the fiscal year 2007 budget are similar to those we have faced over the past several years. We recognize that the State has faced difficult financial circumstances and that these circumstances have forced the State to make hard choices including significant cuts to higher education over the last three years. We anticipate that it will remain difficult for the State to make material increases in spending on higher education over the next few years.

By any measure, the University of Michigan ranks 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, departments and programs. Once again this year, a number of our individual faculty members received prestigious external awards including Fulbright and Guggenheim Fellowships and memberships in the National Academies of Sciences, Engineering and the Institute of Medicine. Our research expenditures, from federal sources and all sources, place us in the top three nationally amongst all universities. We continue to attract exceptional students – the median high school GPA of our entering class of first-year students was over 3.8. To maintain this level of excellence, the University of Michigan must compete successfully with other top universities, both public and private, for faculty and students. We must continually innovate so that the topics we study and the methods we use to create knowledge remain at the cutting edge, and must maintain state-of-the-art facilities to support our teaching and learning. Excellence is fragile and requires continuous investment in faculty recruitment and retention, programmatic innovation, financial aid and facilities.

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The priority we place on access and affordability equals the priority we place on excellence. 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 their family's financial means. The University reaffirms its commitment to our long-standing policy of meeting the full demonstrated need of every Michigan resident undergraduate. This year, we also launched the M-PACT program, which provides \$3 million per year in gift funds to supplement our general fund support for financial aid. The M-PACT program provides grants of up to \$1500 to reduce the loan burden on qualified Michigan residents whose family incomes are in the range of \$80 thousand and below. In this, its first year, the M-PACT program is distributing grants totaling \$3 million to over 2800 needy Michigan residents. Like excellence, access and affordability require sustained investment of new resources.

In the budget requests of the last several years, and again this year, we will describe the exceptional steps we have taken to contain costs and reduce expenditures. However, continued growth in the general fund is essential if the University's quality, measured through excellence and access, is to be maintained and strengthened. The main sources for the University's general fund are state appropriation and tuition. If state appropriation is flat or declines, considerable tuition growth coupled with corresponding growth in financial aid will be necessary, along with substantial expenditure reductions, in order for the University of Michigan to remain a singular asset for the State as one of the world's leading research universities.

Expected Expenditure Budget 2007

We are now beginning the process of planning for fiscal year 2007 and are several months away from building the budget. As detailed in the Appendix of this letter, we have made significant expenditure reductions (over \$20 million) again this year. In light of continued reductions in our state appropriation, this magnitude of expenditure reduction was necessary, together with a sizable tuition increase, to achieve a modest increase of 4.9 percent in the general fund budget of the University. In fiscal year 2002, the University of Michigan's state appropriation was \$363 million. The fiscal year 2006 appropriation is \$316 million, a base reduction of 13% over the four-year period 2002-2006. More importantly, if one simply grows the University of Michigan's fiscal year 2002 appropriation by the CPI, which is a conservative estimate for our growth in costs, one arrives at a fiscal year 2006 appropriation of \$396 million. Instead, the fiscal year 2006 state appropriation is \$316 million, a difference of \$80 million.

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Recruitment and retention of outstanding faculty and students remains our number one priority. We made consequential contributions to faculty salaries last year and must continue investing in salary and recruitment packages if we are to remain competitive. As noted above, we made critical investments in financial aid, growing general fund support for undergraduate financial aid by 11.1 percent in fiscal year 2006 and launching the M-PACT program, which represents a substantial additional outlay of gift funds. We will continue to support financial aid guided by our long-standing practice to provide the full demonstrated need of every Michigan resident. In fiscal year 2006, the total general fund centrally managed financial aid that we are providing from University resources is \$85 million. This reflects the fact that no other Michigan public university comes close to providing the financial aid that we do for the most needy students.

Programmatically, the life sciences continue to be one of our highest priorities. Leadership in the life sciences is critical because of the exciting research advances it will bring to our campus and the benefits it will bring to our students who have keen interest in research and learning in this area. The University of Michigan's success in this fast-moving area will translate into positive effects on the state economy through emergence of spin-off companies and through delivery of a highly trained workforce to support the life sciences industry in the state. The University's Life Sciences Institute was launched several years ago to recruit some of the world's leading scientists to the University. The Institute has enjoyed great success in faculty recruitment over the past several years and is building major centers of activity in chemical genomics, computational biology and stem cell research. Consistent with our programmatic emphasis on the life sciences, the University is just completing the Biomedical Sciences Research Building, a major facility to support biomedical research. Our companion submittal for capital outlay gives highest priority to a new Biology Building to support research and education in molecular, cellular and developmental biology.

We are poised to launch two major research initiatives - one in energy and one in environmental sustainability. Both of these areas play to the University of Michigan's strategic advantages by leveraging research strengths on campus, addressing issues of statewide importance and seeking advances on questions of relevance to regional industries. Beyond being important research directions for the University, it is difficult to imagine two areas of greater importance to our nation and world. With help from the State, we are renovating the Phoenix Memorial Lab to house a center for the emergent energy initiative. Our focus will be on alternative energy sources research, including hydrogen. The initiative in environmental sustainability is just being formed, supported in part through an important gift. The areas of focus for this initiative are likely to include environment and health, sustainable systems and Great Lakes research. In parallel, through our programmatic initiative in environmental sustainability, we are actively pursuing development of a Great Lakes Research Facility on land adjacent to the University of Michigan campus.

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This facility will house research centers affiliated with the University, and State and federal agencies that are engaged in research on the Great Lakes. The synergies created by the proximity of these different units has the potential to make this one of the leading centers in research on freshwater systems in general and the Great Lakes in particular. We are looking forward to partnering with the State in this effort.

We are engaged in a major effort to transform the way we educate our students. The goal is to better integrate what our students learn, and the ways that they learn, so that our graduates can achieve greater success with the multifaceted problems and complex modes of interaction that they will face in today's workplace. Concretely, this transformation will bring to our classrooms greater exposure to complex problems that require synthesis of multiple perspectives and disciplines, and classrooms that will allow easy transitions between instructional formats – lecture, small group discussion, and experimental lab work. In last year's letter, I noted the Residential Life Initiative, a multi-year initiative that will couple an overhaul in our resident halls with an ambitious program to integrate the academic and residential lives of our students. We are launching critical initiatives to expand team teaching and multidisciplinary learning and to bringing greater discussion of ethical issues to our classrooms. We are nearing completion of a new Undergraduate Science Building that features a number of unique teaching spaces, such as studio labs that co-locate instructional chemistry/biology space with technology enriched seminar space and lecture halls that seat students in small pods around computer simulation platforms. An unprecedented gift will allow us to rebuild the instructional spaces in our Ross School of Business to allow for greater interaction between students and instructor.

Funding Request

Our challenges are enormous. Apart from commitments to faculty excellence, student access and programmatic initiatives outlined above, we must respond to the demands of rising costs of all our operations. We have seen an almost 20 percent increase in utility costs over the past year and we anticipate continued substantial increases in this area. In fiscal year 2006, we are anticipating relatively modest increases in health care benefits costs, the result of important policy changes that have been implemented over the past several years. The cost containment benefits from these policy changes are likely to diminish in future years with resulting material increases in the cost of health care benefits starting again in fiscal year 2007. Investment in equipment and facilities is a necessary ingredient if our research enterprise is to remain competitive and if we are to prepare students to help Michigan compete in today's knowledge economy. 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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We have grave concerns about some of the proposals discussed this year for allocating the Higher Education budget according to formula. We support the goals of greater accountability in the budgeting process and creating a funding mechanism that is tied to levels of research and educational activity. However, the fifteen state universities have a wide variety of characteristics, missions and strengths. A single funding formula applied to all fifteen institutions will drive these Universities to be more and more similar rather than allowing the State to benefit from their richness and variety.

We recognize that the State is unlikely to be in a position to make substantial increases to spending on higher education in fiscal year 2007. We respectfully ask that the State make whatever progress it can toward restoring our appropriation to fiscal year 2002 levels.

Sincerely,

A handwritten signature in black ink that reads "Mary Sue Coleman". The signature is written in a cursive, flowing style.

Mary Sue Coleman
President

MSC/PJH/plk
Enclosure

The University's Cost Containment Measures

It is worth summarizing, as we have in prior years, some of the reasons that the cost of doing business in a university rises faster than those in the economy as a whole.

1. Universities are labor-intensive organizations compared to most businesses and the costs of labor generally rise faster than prices economy-wide.
2. The total volume of activity – in education, in research and in service – continues to rise. This is certainly true at the University of Michigan where both research activity and number of students will be at all-time highs in fiscal year 2006.
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 invent the future. We are both museums and laboratories.
4. Universities, particularly research universities, invest heavily in technology 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 technology investments are made to create efficiencies, universities 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 have reduced expenditures by \$20.1 million during fiscal year 2006. We note that this year's reductions are in addition to \$37.5 million in fiscal year 2004 and about \$19.8 million in fiscal year 2005.

During this three-year period, more than 400 staff positions have been eliminated from the General Fund, partly through attrition and partly through layoffs, and nearly 100 faculty positions have been eliminated through attrition. We have introduced steps to create on-going efficiencies in our business processes, such as,

- Construction project cost containment has saved a total of \$11.7 million to date in equipment and other building components.
- Strategic supplier contracts are saving University departments several million dollars per year in the cost of purchases, with an anticipated savings of \$10.6 million in fiscal year 2006. Through these contracts, the University has negotiated lower prices for items such as office supplies, lab supplies and equipment, furniture and computers.
- The University's commitment to energy-efficient measures through the Energy Star Program has reached an estimated \$8.7 million in reduced energy costs per year. Through this program, thermal energy costs have been reduced by about 15 percent and electricity usage has been reduced by 20 percent from what they would otherwise have been.

- We are investing in central chiller plants to deliver chilled water to multiple facilities, which allows us to achieve efficiencies over having individual chillers in each building. Our recently completed North Campus chiller plant will save us \$300 thousand in annual costs as well as over \$6 million in capital costs.
- The University introduced a new process for leasing off-campus space, a change that is expected to save at least \$1 million per year in rental costs.
- A revised structure for employee health insurance premiums has dramatically slowed the growth in University-paid employee health care costs, estimated to save at least \$6.5 million in the General Fund for fiscal year 2006.
- The University began contracting with a prescription drug benefit manager, which has slowed the growth in University-paid prescription drugs expense.
- The Ross School of Business is increasing its offering of custom programs in its Executive MBA program, the result of which will be to expand revenues. These new auxiliary revenues will allow us to shift costs off of the general fund.
- The College of Literature, Science and the Arts (LSA) has teamed with our administrative computing organization to put in place an electronic waitlist system with advanced features that will enable LSA to more effectively fill sections of its most heavily enrolled courses. This will allow us to meet enrollment demand by offering fewer sections thereby saving on instructional costs.
- The University is moving forward on plans to construct a large machine room facility to house advanced computing hardware, in particular computer clusters. These clusters are becoming an important research tool across the University, a number are in place already with many more likely to be purchased over the next several years. These clusters need to be housed in a machine room with advanced power and cooling. Currently such machine rooms are being constructed in buildings across campus, often with costly specialized construction to serve their power and cooling needs. A centralized machine room will provide efficient space that will reduce duplication and save several million dollars per year.
- The CFO organizations have achieved over \$4 million of reductions in general fund expenditures in fiscal year 2006 in addition to those outlined above, through a variety of steps that included more efficient processes leading to reductions in staff, moving selected work in-house thereby eliminating the costs of third party vendors, reductions in reserves for hardware replacement and software upgrades, renegotiating hardware and software maintenance contracts to give the University more favorable terms, extending repair, replacement and cleaning cycles on some equipment and facilities, use of advanced technology to reduce personnel costs related to building services, introduction of paperless business processes in some areas and negotiation of cooperative agreements with local businesses and industry that move work currently done at the University of Michigan to those businesses.