

**Approved by the Regents
November 18, 2010**

THE UNIVERSITY OF MICHIGAN-ANN ARBOR
Regents Communication

SUBJECT: Fiscal Year 2011-2012 State Budget Request

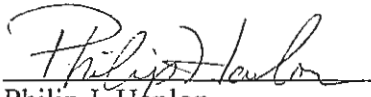
ACTION REQUESTED: Approval of 2011-2012 State Budget Request

BACKGROUND:

Attached is a copy of the annual operating request to the State for the University of Michigan – Ann Arbor campus for the fiscal year 2012.

We recommend that the Board of Regents approve the proposed fiscal year 2011-2012 State Budget Request.

Respectfully submitted:



Philip J. Hanlon
Provost and Executive Vice President for
Academic Affairs
University of Michigan – Ann Arbor

November 18, 2010
Attachment



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November 19, 2010

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 2012 budget development process for the University of Michigan – Ann Arbor. In this letter you will find information on our on-going, aggressive efforts to contain costs, on how these efforts have contributed to the success of the institution, and on our initiatives for regional economic impact.

We will continue to strive for a budget that strongly supports our commitments to the quality of the institution both inside and outside the classroom, and to its accessibility to qualified students regardless of their financial circumstances. And, as careful stewards of public resources, we will maintain our focus on prudent and responsible financial planning.

The University of Michigan – Ann Arbor operates in an extremely competitive environment for faculty, students, staff and research dollars while our revenue situation remains precarious. We recognize that the State continues to face difficult and uncertain financial circumstances that require hard decisions and thoughtful prioritization of resources. However, the time has come to reverse the decline in state support for the University; strategic investment in higher education is essential to the future vitality of the State and its economy. We encourage the leadership of the State to more directly partner with us as part of its economic development strategies and to increase state support for higher education. We request that the State increase the University of Michigan – Ann Arbor's fiscal year 2012 appropriation by 2.6 percent in order to partially cover inflationary cost increases and to replace scholarship funding for students with need.

Cost Containment Efforts

Despite the challenges of the current economy, the University of Michigan – Ann Arbor remains on a stable financial path largely because of our disciplined approach to financial management that emphasizes multi-year budget planning, on-going cost containment and continual reallocation of resources toward our highest priorities. For many years, we have incorporated an assumed level of reduction and reallocation (typically 1.5-2 percent of the budget) in each year's general fund budget proposal.

Our success at finding more efficient ways to operate has led to notable benefits. In fact, during the recent period when many of our competitors were experiencing dire fiscal constraints, we were able to make investments in faculty expansion, need-based financial aid and academic programs. And this year's resident undergraduate tuition increase of 1.5 percent was the lowest undergraduate tuition rate increase in over 25 years.

During recent times, this aggressive approach to containing costs and optimizing the use of limited revenue has been essential in order to innovate, invest in and advance the excellence of the institution. More specifically, our cost containment efforts have enabled us to:

- Keep a U-M education affordable by investing in student financial aid

The ability of admitted students to attend the University without regard to family financial circumstances remains a top objective. Recent actions by the State to eliminate the Michigan Promise Scholarship and significantly reduce funding for the Michigan Competitive Scholarship have challenged our financial aid budget situation. Nevertheless, the longstanding policy of the University of Michigan – Ann Arbor to meet the full demonstrated financial need of all of its Michigan resident undergraduate students will not be compromised even in these times of constrained resources. In fact, improvements in operating efficiency enabled the University to achieve double-digit percentage increases in the central undergraduate financial aid budget in five of the last six years. In addition, this fall the University launched an Economic Hardship Program for resident students from middle-income families, reinforcing our commitment to Michigan families during the current difficult economic times.

- Recruit and retain top faculty

The quality of our faculty is one of the most important factors underlying the success of our academic enterprise. Even though the institutions that we compete with for faculty are also experiencing financial difficulties, we continue to face significant recruitment and retention challenges. The institutions we compete with most often for faculty include Harvard, Stanford,

Yale, Berkeley, and Duke, to name a few. Resources for salaries and recruitment and retention remain a high priority in order to protect and advance the quality that is the hallmark of the institution.

Two years ago we began our initiative to hire 100 new faculty members in a deliberate attempt to reduce our student/faculty ratio over the next several years and to ensure our competitiveness by fostering key interdisciplinary areas of education. That investment was expanded this year to include an additional 50 faculty positions, a priority resulting from the unanticipated growth in undergraduate student enrollment. This will also enable the University to further enhance the students' academic experience through a reduced student/faculty ratio and smaller class sizes that are closer to those of other top universities.

- Enhance the student learning experience

Providing Michigan students with new venues, new perspectives and new opportunities to learn and engage is the essence of our work as a university. Recent investments include new degree programs in informatics and public policy as well as new and improved residence halls. We are also making greater opportunities available through the Undergraduate Research Opportunities Program (UROP), which pairs undergraduate students with faculty members who involve them directly in their research projects. Students who participate in this program are more engaged in their education, more proactive in networking and seeking opportunities here and off campus, and more likely to go on to graduate or professional school. Many participants cite UROP as the single most important activity they engaged in during their first two years on campus. In addition, the university recently dedicated funding to support student entrepreneurial projects.

When we point to our accomplishments, it is because we are resolute and strategic about protecting and strengthening the academic mission. This has only been possible because our cost containment efforts have continued unabated since fiscal year 2003. 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 the best 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 that will raise costs or undercut quality in the long-term
- 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

The chronology below summarizes the strides we have taken since fiscal year 2003 and the path we plan to travel through 2017.

Phase I: Fiscal Year 2003 through Fiscal Year 2009

We successfully reduced recurring general fund expenditures by about \$135 million, reallocating some savings to our highest priorities. Cost containment efforts during this period of time were focused on seven areas:

1. Purchasing
 - 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. Energy Efficiency
 - Putting in place efficient campus systems using regional planning 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 to reduce energy consumption through building by building energy audits
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 optimal utilization of health care, including the use of incentives
4. Leveraging Information Technology
 - Using technology to create business process efficiencies
 - Creating robust business intelligence tools to enhance data driven strategic decision-making

5. Other Revenue Sources
 - Utilizing gift funds and investment proceeds to relieve the General Fund
 - Increasing external research support through investments in strategic areas
 - Developing 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 stricter criteria and discipline to the prioritization of major capital projects
 - More fully utilizing classrooms and other instructional spaces
 - Campus-wide sharing of high technology facilities

Phase II: Fiscal Year 2010 through Fiscal Year 2012

Last year at this time, we announced a goal of achieving an additional \$100 million in general fund reductions and reallocations by the end of fiscal year 2012. As difficult as it is, we are on track for meeting that challenge. With a primary focus on lowering operational costs, changes have included adjustments to health care cost sharing (now 30 percent on average), making advanced purchases of energy at lower cost, consolidation of our central IT units and updating procurement processes.

Examples of specific actions taken or in process, along with *approximate* general fund savings, include:

- Reductions to units: \$40 million
- Procurement initiatives: \$17 million
- Consolidation of central IT units: \$7 million
- Health benefits restructuring and retirement savings restructuring: \$8 million
- Advanced energy purchase: \$6 million
- Facilities maintenance restructuring: \$3.5 million
- Travel and hosting reform: \$1.5 million
- Planet Blue / energy efficiency: \$TBD

Phase III: Fiscal Year 2013 through Fiscal Year 2017

We are in the process of planning longer-term efforts to enhance revenue and achieve operational efficiencies beyond fiscal year 2012. Suggestions from an internal panel, convened in March 2009 by the Provost's Office, resulted in five task forces on:

- Best Practices for Centers and Institutes
- Creative Staffing and Shared Services

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- Expansion of Spring/Summer Instruction
- Marketing U-M to Non-Resident Undergraduate Applicants
- Non-Traditional Educational Programs at U-M

The recommendations of these task forces will help shape specific cost reduction and revenue enhancement plans for the long term. Additionally, efforts at IT rationalization across the Ann Arbor campus that began early in 2010 will contribute to out-year efficiency savings, and a benchmarking study that was completed in late 2009 is helping us to begin to identify additional areas in our human resources, procurement, information technology and finance operations that have the potential for increased efficiency and cost savings.

A tentative list of out-year cost containment and revenue enhancement activities, along with *approximate* General Fund savings, include:

- Reductions to units: \$40 million - \$50 million
- Increased revenue opportunities: \$20 million - \$30 million
- IT rationalization: \$15 - \$20 million
- Strategic sourcing: \$5 - \$10 million
- Administrative transformation: \$6 - \$9 million
- Retiree health benefits: \$2 - \$3 million

Working to achieve this level of cost containment has been both difficult and disruptive, but necessary. We plan to continue to find ways to be more efficient in order to manage fixed cost increases and enable investments in financial aid, faculty recruitment and retention, and academic programs. But, consistently cutting and reallocating at a level higher than our rate of new investment will have a negative impact on the quality of the institution. With continued reduction in the level of state support, it will become extraordinarily difficult to continue to provide the same level of financial aid to our students, to keep world-class faculty on the Ann Arbor campus, and to provide the range of innovative educational programs we do today.

Although we are buoyed by our progress, we recognize that the fiscal environment remains volatile. While these disciplined and strategic efforts around cost containment and revenue enhancement have been key to our success during this difficult financial period and will help to position us to for a stable future, support from the State of Michigan has never been more important for a sustainable future.

Growth and Regional Economic Impact

Despite years of fiscal constraint, the University is growing and thriving and contributing to the vitality of the State. We need to partner to ensure that this contribution continues in a positive way. Enrollment on the Ann Arbor campus is at an all-time high in fall 2010 and is notable for excellence in all areas, including academic achievement. The average high school grade point average for entering students 3.8, while 13 percent achieved a perfect 4.0. Over thirty percent of the class had an ACT composite score between 31 and 36, compared to only 4 percent nationwide. Our outcomes further demonstrate the institution's excellence; for example, U-M Ann Arbor's six-year graduation rate is 89.5 percent for the latest cohort, and our freshmen retention rate is 96 percent.

Our research portfolio is growing as well. Research spending at the University of Michigan in 2009-10 grew 12 percent over the previous year to \$1.14 billion, the second straight year U-M has surpassed the billion-dollar milestone. Thanks in part to stimulus-funding research awards, federal research spending at U-M rose 14.7 percent over the previous fiscal year, accounting for 65.9 percent of total research expenditures, bringing considerable dollars from outside the state to Michigan.

The University of Michigan remains committed to playing a leading role in catalyzing the economic transformation of the state and the nation. The University has developed a rich variety of programs and partnerships aimed specifically at building working relationships among academia, industry, and government and fostering an environment of creative innovation. Through business engagement, technology transfer, industry partnerships, student internships, and entrepreneurship and community assistance, the University is bringing its resources to bear on addressing our region's economic challenges.

As the state and U.S. economies headed downward, Michigan's University Research Corridor (URC) contributed in areas critical to the state's resurgence: educating more students and boosting research and technology gains. Its 2010 annual report "Empowering Michigan" shows URC partners Michigan State University, the University of Michigan and Wayne State University have improved in several key benchmarks since the first study in 2007. The study, comparing Michigan's URC with leading innovation clusters around the world, was conducted by the Anderson Economic Group, building on data collected over the past three years. Michigan's research universities remain the number 1 cluster in the U.S. in terms of enrollment, and number 3 in terms of high-tech degrees, providing Michigan the talented workforce needed for the jobs of tomorrow. The report estimates that the URC universities provide a net benefit to the state that is 16 times the cost to taxpayers.

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Last year, the University completed the purchase of a major research facility -- now called the North Campus Research Complex (the NCRC) – that is intended to provide a springboard for new discoveries, job creation and educational opportunity. BoroPharm, Inc. has been selected as the first corporate tenant, and the University is fielding more inquiries from private sector companies. We expect their presence on campus to grow, bringing more R&D to the site. Over the next decade, the purchase is anticipated to lead to the creation of 2,000 to 3,000 high-quality new jobs as new scientists and their teams come to Michigan or join existing teams and others from the University’s increased engagement with the private sector.

To help spur technology transfer from work done at the NCRC, we have also located the Office of Technology Transfer, the Business Engagement Center and a new faculty start-up accelerator unit at the NCRC. To ensure that the facility supports undergraduate and graduate research experiences, we are dedicating space and staffing within the NCRC for a student center and research opportunities office.

The University’s Business Engagement Center is on pace to develop new relationships with over 200 businesses in fiscal year 2011. These new connections complement the ongoing efforts to expand and maintain existing relationships with more than 1,200 companies. The Center’s focus is to advance partnerships between the University and industry through connections for sponsored research, student hiring, technology licensing, usage of equipment or facilities, executive education, and engagement on University committees and boards.

U-M is also creating opportunities to assist existing businesses, launch new start-up, create high-growth jobs and improve the quality of life for the residents of Michigan through commercialization of University research. In fiscal year 2010 U-M Tech Transfer received 290 new inventions and created 97 new agreements with industry, including 10 new startup ventures. Total Tech Transfer revenues, which include royalties and equity returns, were a record \$39.8 million. Royalties increased 16 percent to \$17.5 million, while total revenues more than doubled from last year, mainly due to a one-time payment from the FluMist agreement.

U-M Tech Transfer launched the Venture Center in 2009 to serve as a one-stop hub for U-M start-up venture opportunities. Since 2001, 93 high growth start-ups have been launched— the majority in Michigan, a record among the best of all U.S. universities. Many have received venture funding at launch, and several U-M start-ups have been acquired in recent years, including HealthMedia (J&J), HandyLab (Becton-Dickinson) and Arbor Networks (Tektronix Communications). These acquisitions demonstrate the value created from U-M technology and result in increased investment and economic growth.

In addition, the University continues to provide numerous educational opportunities for student-entrepreneurs. In conjunction with a local venture capital firm RPM Ventures, the University launched TechArb, a student business accelerator in downtown Ann Arbor in 2009. Many of the

eight first generation ventures have enjoyed success. DoGood, an iPhone app developed by several students, was recently acquired by a national media company. Another company, Mobiata is expected to reach over \$2 million in revenues this year. The TechArb will have 12-20 companies for the winter/spring round with five companies returning from earlier terms.

Support for research that yields innovation leading to economic development is also prominent on campus. The U-M Medical Innovation Center (MIC) has created the Mark S. Kahn Family Medical Innovation Fund. The \$1.2 million fund will support leading edge biomedical research and entrepreneurship at the MIC; the MIC's mission is to foster innovation and enable new medical technologies by bringing clinicians, scientists, engineers, and business professionals together through education and research to, ultimately, improve health on a global scale. With funding from the Economic Development Administration (EDA) of the U.S. Commerce Department, the Institute for Research on Labor, Employment and the Economy (IRLEE) has helped hard-hit communities access resources at the federal and state levels to mitigate the negative consequences of globalization and transformations in the manufacturing base of the Great Lakes region.

In addition, the University of Michigan has played a pivotal role in business attraction by its participation in Ann Arbor SPARK. U-M's Vice President for Research serves as the Chairman of the Board of Directors.

Funding Request

Our impact as an institution arises from our relentless commitment to our academic mission, regardless of challenging economic times. For nearly a decade now, the State of Michigan has faced difficult fiscal circumstances, resulting in a decline in state support for the University of Michigan – Ann Arbor since fiscal year 2002 of over \$45 million in nominal dollars. This figure equates to approximately \$110 million in inflation-adjusted dollars, when adjusted for the Detroit Consumer Price Index (Detroit CPI). The current estimate for the fiscal year 2012 Detroit CPI is 1.6 percent. At the same time, our activity levels have grown, and the competition we face for the best students and faculty has increased, all strong indicators that we are an institution in high demand.

In addition, the elimination of the Michigan Promise Scholarship and the reduction in state funding for the Michigan Competitive Scholarship have added strain to our budget situation, as our students saw a reduction in scholarship support of approximately \$9 million. The University replaced over \$3.2 million of these state scholarship funds (the portion related to student need), which equates to approximately one percent of our state appropriation.

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Again, we acknowledge the fiscal circumstances of the State. Nevertheless, the University of Michigan plays a critical role in the stabilization and revitalization of the Michigan economy. And, we play a critical role in the development and education of our workforce and cannot risk jeopardizing the quality of our instruction, research and service. We respectfully ask that the State reinvest in higher education by increasing our appropriation by 2.6 percent in fiscal year 2012, in order to cover the projected 1.6 percent increase in the Detroit CPI and the one percent in lost state scholarship funding for students with need.

Conclusion

To achieve our mission and to 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 mitigate the effects of rising costs and simultaneous reductions in state support. We must continue these efforts even more aggressively -- but there are risks to the institution if even modest relief does not materialize. Our costs continue to rise, the faculty environment remains fiercely competitive, the needs of our student body continue to grow, and we must continue to ensure that qualified students of all economic backgrounds are able to attend the University.

For our State to be prosperous and successful, higher education must flourish. As one of the world's leading educational and research institutions, the University of Michigan is a key resource that can help stabilize and revitalize the Michigan economy. We are managing our resources strategically so that we can maintain the ability of the University to contribute to the vitality of our region, and the nation. The State's continued and expanded investment in our success is central to our collective future, and we respectfully ask the State to support our request for an increase of 2.6 percent for our fiscal year 2012 appropriation.

Sincerely,



Mary Sue Coleman
President

MSC/ALB/plk