

THE UNIVERSITY OF MICHIGAN - ANN ARBOR
Regents Communication

Approved by the Regents
December 17, 2009

SUBJECT: Fiscal Year 2010-2011 State Budget Request

ACTION REQUESTED: Approval of 2010-2011 State Budget Request

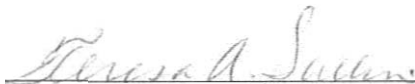
BACKGROUND:

Although the State has not asked the University to prepare a budget request this year due to the current economic environment and lack of available funding, the University has decided to go on record with information for the State in support of the fiscal year 2011 budget development process for the University of Michigan - Ann Arbor.

Attached is a copy of the annual operating request to the State for the University of Michigan - Ann Arbor campus for fiscal year 2011. The request highlights student access and affordability, our regional impact and initiatives, and our on-going aggressive efforts to contain costs at the Ann Arbor campus.

We recommend that the Board of Regents approve the proposed fiscal year 2010-2011 State Budget Request.

Respectfully submitted:



Teresa A. Sullivan
Provost and Executive Vice President for
Academic Affairs
University of Michigan - Ann Arbor

December 17, 2009
Attachment

UNIVERSITY OF MICHIGAN

2074 FLEMING ADMINISTRATION BUILDING
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ANN ARBOR, MI 48109-1340
734 764-6270 FAX: 734 936-3529

December 17, 2009

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

Dear Mr. Emerson:

Although a budget letter was not requested of universities this year, we wanted to provide you with information in support of the fiscal year 2011 budget development process for the University of Michigan - Ann Arbor. In this letter you will find information about student access and affordability, our regional economic impact and initiatives, and our on-going, aggressive efforts to contain costs at the Ann Arbor campus.

We will continue to strive for a budget that strongly supports our commitments to the academic excellence of the institution as well as access and affordability for our students. 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, yet we believe that strategic investment in higher education is essential to the future vitality of the State and its economy.

Student Access and Affordability

Student access and affordability stands as a top priority for the University. It remains the longstanding policy of the University of Michigan – Ann Arbor to meet the demonstrated financial need, as determined through the Free Application for Federal Student Aid, of all of our Michigan resident undergraduate students.

In addition to centrally awarded financial aid, our academic units also award need-based scholarships, which reduce dollar for dollar the loan and work-study amounts for our students.

Mr. Robert Emerson
Page Two
December 17, 2009

Furthermore, the University of Michigan's President's Donor Challenge and the accompanying matching program has raised over \$72 million in endowment for need-based undergraduate financial aid, which began adding resources to this priority in fiscal year 2009. At the same time, the M-Pact Program, launched over five years ago, continues to provide additional need-based grants to Michigan residents. These and other programs enable the University to reaffirm its commitment to ensuring that every admitted Michigan resident can attend the University of Michigan, regardless of financial means.

The recent elimination of the Michigan Promise Scholarship and the much-reduced Michigan Competitive Scholarship will challenge our budget situation. We will continue to meet the full demonstrated financial need of all undergraduate students from the state of Michigan this year and in the future, and thus will need to fill in the gap created by the elimination of these scholarship programs with institutional resources for students with financial need. We intend to use ARRA funds for the \$4.1 million gap that this loss of State support to our students has created during the current year, but will need to reallocate base resources to our financial aid budget for fiscal year 2011.

Regional Economic Impact

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 and diversifying Michigan's economy. The University of Michigan is committed to playing a leadership role in enhancing the economic vitality of the state and the nation, and we must protect our academic quality in order to continue to have this sort of impact. To help bring its resources to bear on the challenges of innovation and economic development, the University has developed a variety of programs and partnerships aimed specifically at building working relationships among academia, industry, and government and fostering an environment of creative innovation. Below are some highlights; for additional information, please see our website dedicated to this effort at <http://innovationeconomy.umich.edu/>.

Michigan's University Research Corridor's (URC) focus on innovation and research has led to substantial economic growth, growing in all competitive categories over the past two years and rising among the nation's top research and development clusters for producing patents, businesses and graduates with high-tech related degrees. The most recent annual economic impact study, "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 studies, which examine innovation clusters in other states, were conducted by Anderson Economic Group, and this year's reports a \$14.5 billion impact on

Mr. Robert Emerson
Page Three
December 17, 2009

Michigan's economy, up nearly 10 percent. This equates to a return of \$16 for every dollar the state invests. The report found that the URC universities accounted for 93 percent of federal academic research dollars brought into Michigan.

The University of Michigan's research and development expenditures, from federal sources and all other sources, ranks among the nation's top three research universities, further demonstrating both our excellence and our importance to the future of the State of Michigan. Research spending at the University of Michigan in 2008-09 exceeded \$1 billion for the first time - a milestone that highlights the university's role as an economic resource benefiting the entire state. In the midst of the most severe recession since the Great Depression, research spending at the university rose 9.4 percent over the previous fiscal year. The federal government provided 64.4 percent of the funds, and federal research spending at the U-M rose 7.1 percent over 2007-08. Our industry-related research also grew by a robust 6.1 percent, which is remarkable considering the severe economic pressures faced by the private sector.

Technology transfer, a key component of our overall economic development agenda, remains an integral part of our research mission. Despite the challenging economic climate, the University of Michigan's tech transfer metrics demonstrate continued progress. For fiscal year 2009, we received a record number of new inventions, 350 compared to 306 the prior year. We entered into 78 agreements, down from last year but with a higher ratio of high potential exclusive agreements. And, despite constraints on early-stage venture funding, we recorded 8 new start-ups in fiscal year 2009. Since 2001, our Office of Technology Transfer helped launch 83 new start-up ventures, over 70 percent within the state of Michigan, generating new jobs and opportunities for our communities. We also recorded a 20 percent increase in license royalties in fiscal year 2009 that, along with revenue from two equity events, produced \$18.3 million in total tech transfer revenue. These revenues allow the University to reinvest in further research and commercialization for the year ahead, and these results demonstrate our continued progress in leveraging the research and educational capabilities of our institution to benefit the region and the State of Michigan.

One 2008 University of Michigan startup is Sakti3, a company founded by Professor Ann Marie Sastry of the College of Engineering and funded by Kholsa Ventures, a leading venture capital firm. Sakti3 is designing next-generation lithium-ion batteries for the auto industry and an advanced, scalable manufacturing process to produce better, more efficient battery systems for electric vehicles. Sakti3 believes that this technology will allow cars to run for more than 100 miles per gallon, and with the Big Three looking to reinvigorate their troubled businesses, these batteries can help Detroit automakers be competitive as technology for electric and hybrid vehicles moves forward. Sakti3 has received a \$3 million Center of Energy Excellence award from the State of Michigan and is applying for a \$15 million Department of Energy grant, matching another \$15 million in state and private funds, to accelerate its plans to become a leading battery manufacturer here in Michigan.

Another example is the launch of Lycera Corporation in 2006, a University of Michigan startup focused on developing small-molecule drugs for treating autoimmune diseases such as lupus, inflammatory bowel disease, rheumatoid arthritis, psoriasis and transplant rejection. Founded by University of Michigan Chemistry Professor Gary Glick, Lycera's technology platforms hold great promise for the development of first-in-class topical and oral pharmaceuticals that are relatively inexpensive, highly effective and far less likely to impair immune function in patients. This past April, the company closed on \$36 million of venture capital financing, one of the largest rounds of Series A financing in the nation.

Two recent sales are prime examples of the downstream impact of these efforts. University of Michigan spin-out, HandyLab Inc., is an Ann Arbor-based developer and manufacturer of molecular diagnostic products. The company entered into an agreement earlier this fall to be acquired and the transaction recently closed, returning a record \$2 million to the University-based, student led Wolverine Venture Fund, part of the Samuel Zell & Robert H. Lurie Institute for Entrepreneurial Studies at the Ross School of Business. University of Michigan startup, HealthMedia, was acquired by Johnson & Johnson in 2008. The company was founded in 1998, and its products combine advanced technology and behavioral science to emulate a health coach via the web. These startups have shown it is possible to bring technology out of the University, infuse seed money from investors and create a new business.

General Motors (GM) and the University of Michigan recently announced the formation of a joint Institute of Automotive Research and Education, with a strategic focus on reinventing the automobile and developing the next generation of high-efficiency vehicles powered by diverse energy sources. The institute, which builds on more than 50 years of collaboration between the organizations, supplements GM's ongoing research and development in key areas: advanced batteries, engine systems, smart materials and vehicle manufacturing. The institute is envisioned to provide exceptional research opportunities for both faculty and students.

Last year, the University created the Business Engagement Center, developing new relationships with nearly 300 businesses across the state in fiscal year 2009, in addition to maintaining and expanding the University's existing industrial relationships. 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.

In the past year, the University has taken a lead role, through its Institute for Research on Labor, Employment and the Economy (IRLEE), in assisting Midwest communities experiencing major manufacturing plant shutdowns. With funding from the Economic Development Administration (EDA) of the U.S. Commerce Department, IRLEE has helped these hard-hit communities access resources at the federal and state levels to mitigate the negative consequences of plant closings.

Mr. Robert Emerson
Page Five
December 17, 2009

At present IRLEE is working with many communities in Michigan, Ohio, Indiana and Wisconsin that have announced auto plant closings to develop and implement strategic turnaround strategies.

In June, the University of Michigan completed the purchase of the former Pfizer pharmaceutical research facility adjacent to the University's current North Campus. This research campus will provide a springboard for new discoveries, job creation and educational opportunity. The purchase is anticipated to lead to the creation of up to 3,000 high-quality new jobs over the next decade, some 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. Occupancy is slated to begin this spring, and key areas of research interest include healthcare, biomedical engineering and energy technologies,

Given the increasingly international nature of the world, it is more important than ever for students and faculty to be actively engaged in global issues, and as reported in past years, energy research continues to be an area of investment and focus. The URC continues to work to expand research related to alternative energy. The Michigan Memorial Phoenix Energy Institute (MMPEI) significantly expands our efforts in renewable 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 solar power, fuel cells, energy storage, lighting, and low power electronics. These efforts are strengthened by close collaborations with our industrial partners, working to provide a more diverse industrial footing for the State of Michigan into the future.

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 percent of the budget) in each year's General Fund budget proposal.

Over the past six years, we have succeeded in removing nearly \$135 million in recurring General Fund expenditures through a combination of efforts. Additional cost reductions of over \$22 million are factored into our FY2010 budget. For detailed information on our cost containment efforts, I once again invite you to review our cost containment document at <http://www.provost.umich.edu/budgeting/Costf.ontainmentz009.pdf>.

Our cost containment and productivity improvement efforts to date have been paying off. Student credit hours delivered per General Fund faculty/staff full-time equivalent (FTE) grew

by 5.3 percent over the period fiscal year 2003 to fiscal year 2008. Our average annual increase in General Fund expenditures for health benefits has been 5.1 percent since 2002, while the national average has been double digits. We have experienced year-to-year declines in natural gas consumption over the last two years. And, since the launch of the space initiative, approvals for growth in General Fund square footage have dropped from an annual rate of 1.84 percent to .45 percent.

In fact, over the past five years, the University of Michigan's General Fund expenditure growth rate has been below the measure of inflation most appropriate for universities, the Higher Education Price Index (HEPI). The highest growth item during this time period among General Fund expenditures has been scholarships and fellowships, reflecting our ongoing commitment to affordability and accessibility. And, the University of Michigan's General Fund expenditures per student credit hour (net of the scholarships and fellowships the University provides) grew at an annual rate of 2.1 percent between fiscal year 2003 and fiscal year 2008, when the U.S. Consumer Price Index (CPI) grew at an annual rate of 3.1 percent.

Nevertheless, the severity of the current financial outlook has pushed us to move even more aggressively on efficiency efforts. Budget reductions of this magnitude must be well thought-out, planned and communicated. Aggressive policy and organizational changes will be required over the next three years. Current efforts include greater sharing of benefits costs with employees, the consolidation of information technology units, more efficient use of space through centralized scheduling of classrooms during peak hours, and travel and hosting policy reform.

In addition, to continue the momentum of U-M's cost containment efforts, five task forces of faculty and staff have been appointed to explore areas where we can further reduce costs or enhance revenue. The topics to be explored by the task forces emerged from the deliberations of the Prudence Panel, a cross-campus group convened last fall by the Provost's Office, and were further refined at a special deans' retreat in June.

Conclusion

Constraints on revenue growth over the past several years as well as significant increases in essential costs contribute to our budgetary challenge. We must respond to the demands of rising costs of all of our operations.

At the same time, 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

Mr. Robert Emerson
Page Seven
December 17, 2009

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 must continue these efforts even more aggressively

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. We also play a critical role in the development and education of our workforce and cannot risk jeopardizing the quality of our instruction, research and service. Our current state appropriation is \$47 million less, in nominal dollars, 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.

Maintaining our position as one of the most prestigious educational and research institutions in the world is one of our top goals, and it is critical to our ability to continue supporting the State's economic recovery. The impact of the State's historic contributions to the University of Michigan's success cannot be overstated, and we believe that the State's continued investment in our success is central to our collective future.

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/ALB/plk