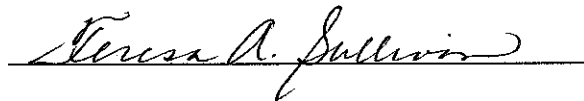


The University of Michigan
Regents Communication

Action Item

Attached is a copy of the annual operating request to the State for the University of Michigan-Ann Arbor campus for FY 2008 for your approval.

Respectfully submitted,

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

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

November 17, 2006
Attachment

MARY SUE COLEMAN
PRESIDENT



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

November 6, 2006

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

Dear Ms. Lannoye:

I am responding to your invitation to provide information to the State in support of the fiscal year 2008 budget development process. We continue to strive for a budget that strongly supports our commitment to both academic excellence and access. Supporting these goals is an over-arching principle of accountability as we make every effort to be careful stewards of public resources. 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 continue to contain costs at the Ann Arbor campus.

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. Members of our faculty again received the most prestigious external awards for their exceptional teaching and research, and we continue to attract extraordinary students. To maintain this level of excellence, the University of Michigan 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 innovation, financial aid and facilities.

The welcome increase in our state appropriation this year showed strong support for higher education, but more importantly, this increase was an indication 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. The recent decision by Google to locate a major new research and marketing facility in the Ann Arbor area, creating 1,000 new jobs in the region, directly illustrates this role. Our research expenditures, from federal sources and all other sources, place us in the top three nationally among all universities, further demonstrating both our excellence and our importance to the future of the State of Michigan. The life sciences continue to be one of our highest priorities, and the University of Michigan's success in this fast-moving area will continue to 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 science industry in the state.

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In addition, technology transfer is an integral part of our research mission and our efforts continued to expand during fiscal year 2006, leading to 288 new invention disclosures, nine business startups, and 97 license agreements - a 13 percent increase over the previous year. The nine new companies bring the total number of U-M startups launched over the last five years to 43, more than half of which are businesses headquartered in Michigan. Governor Granholm recently announced the first awards in the 21st Century Jobs program, of which twenty-eight of the sixty-one projects that received funding are in Washtenaw County. Approximately one-third of these are projects within the University, and many of the others have campus connections, directly contributing to the economic health of the state.

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. This year, in addition to the continuation of the M-PACT program, the University, in partnership with the Jack Kent Cooke Foundation, invested significant resources to offer greater opportunities for high-achieving, low-income community college students to transfer to U-M. 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. Like 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. The link between state support and tuition increases is unmistakable.

Expected Expenditure Budget 2008

We are now beginning the process of planning for fiscal year 2008 and are several months away from building the budget. As detailed in the Appendix of this letter, we have continued to make expenditure reductions, with \$18.3 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. This year's increase from the state was most welcome; however, we continue to be challenged by several factors including sharply rising utility costs, a competitive recruiting environment for faculty, and flattening federal support for research.

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The University is able to manage these pressures and invest in new academic initiatives only by focused attention on cost-cutting and business efficiencies. Even with the increase in our state appropriation this year, this magnitude of expenditure reduction was necessary in order to keep our tuition increase moderate while enabling a moderate increase of six percent in the general fund budget of the University. The three percent increase in state appropriation brought our appropriation at the Ann Arbor campus to nearly \$326 million for fiscal year 2007, but this amount is still more than \$37 million below the level of state funding to the University in fiscal year 2002.

Recruitment and retention of outstanding faculty and students remains our number one priority, and our faculty is essential to our academic quality. 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 offer competitive compensation packages. 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 made critical investments in financial aid again in fiscal year 2007, growing general fund support for undergraduate financial aid by 7.7 percent. In fiscal year 2007, the total general fund centrally managed financial aid that we are providing from University resources is \$91 million. 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.

Last year we discussed our intent 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. The establishment of the Michigan Memorial Phoenix Energy Institute (MMPEI) 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 now in the process of renovating the Phoenix Memorial Laboratory to house a center for the MMPEI.

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The Graham Environmental Sustainability Institute (GESI) encourages multidisciplinary research and education in environmental sustainability through a jointly funded effort with the Graham Foundation. Specifically, the mission of the institute is to “create opportunities and encourage collaboration among science, policy, engineering, and business faculty to extend the knowledge of, and offer solutions to, complex environmental sustainability issues - recognizing the need for balance between societal needs and social responsibilities.”

The University is dedicated to the preservation and advancement of scholarly communication. For example, a few years ago, the University of Michigan partnered with Google in an ambitious project to digitize the bound print volumes of our library collection. The digitization project will provide scholars and the general public with an unprecedented ability to search for and locate books from the University's vast collection, potentially revolutionizing the way the world's knowledge is transmitted and democratizing access to information. In addition, we recognize the need to be at the forefront of transforming our physical facilities in order to modernize their role in information exchange. The evolution and continued application of technology has and will continue to profoundly change the ways in which learning, teaching and communication take place, and electronic access to our library resources, coupled with an environment that encourages and supports student/scholar interaction, is necessary to support this transformation.

In addition, we are continuing to expand and improve our undergraduate educational programs. Next year, the Gerald R. Ford School of Public Policy will launch a Bachelor of Arts (BA) program in public policy. The BA in Public Policy, which was conceived in response to student demand, will be 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, we have restructured our Bachelor's in Business Administration (BBA) program, welcoming the first class of three-year BBA students this year to the Stephen M. Ross School of Business. The earlier entry into the degree program, and the associated enhancements to advising, will allow greater flexibility to incorporate learning experiences such as study-abroad and to provide earlier career counseling. Furthermore, in partnership with our health system, we are investing nearly \$2 million per year over the next several years to improve the quality of our nursing school and to expand its instructional activity, so as to contribute highly trained professionals to this important sector of Michigan's economy.

Last year I mentioned 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. We have launched initiatives to expand team teaching and multidisciplinary learning and to bring greater discussion of ethical issues to our classrooms.

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Specifically, our Ethics in Public Life Initiative is continuing its focus on increasing students' engagement with issues specific to public ethics through roundtable discussions, lectures and theatrical sketches. In addition, this winter we will launch a year of activities focused on global arts and culture. A celebration featuring performances, lectures, symposia and special events, this series will help illuminate the impact of the arts on the human condition across boundaries and within individuals. With our strengths in international studies, cognitive and social sciences, and the arts, the University of Michigan is an exceptional setting for exploring the world's diverse arts and cultures.

Funding Request

Our challenges continue to mount, testing both our creativity and resourcefulness. 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. We have seen dramatic increases in utilities costs, and despite sophisticated purchasing strategies and conservation efforts, we anticipate continued substantial increases in this area. Important policy changes in our health care benefits over the last few years have resulted in relatively modest cost increases; however, the effect of those cost containment policy changes are already starting to diminish. In fiscal year 2007, the University will experience health care cost increases that will be near the higher national trend rates. And, health care benefits costs remain an area of major concern as we move into future years. Additionally, investment in equipment, facilities and technology is a necessary ingredient 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.

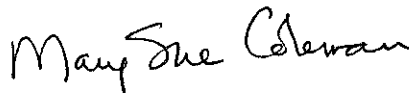
We must continually innovate so that the topics we study and the methods we use to create knowledge remain at the cutting edge. Over the past several years, we have relied heavily on internal reallocation and cost containment to meet the demands of rising costs and simultaneous reductions in state support. 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.

We appreciate the actions that were taken by the State to increase our appropriation by three percent in fiscal year 2007; it was a significant and meaningful indication of support for higher education. However, our current state appropriation remains 10.4% less than the appropriation we received in fiscal year 2002. At the same time, our activity levels have grown; in fact, our student enrollment is at an all time high. 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 2008, as it did in fiscal year 2007.

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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 continue to support higher education, particularly our research Universities, by progressing toward restoring our appropriation to fiscal year 2002 levels.

Sincerely,

A handwritten signature in cursive script that reads "Mary Sue Coleman".

Mary Sue Coleman
President

MSC/ALB/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 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 other prices.
2. The total volume of activity – in education, in research and in service – will continue to rise, even as we 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 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 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 have removed over \$18 million in General Fund expenditures in FY 2007 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 and \$20.1M in FY 2006.

Specific examples of efficiencies and cost reductions in the FY 2007 General Fund budget include:

- The North Campus Chiller Plant commissioned during FY 2006 is expected to reduce the costs of air conditioning by \$200,000 per year.
- The Central Power Plant installed two new steam turbines which will produce electricity more efficiently than the older models, saving approximately \$600,000 per year.
- Water conservation projects have decreased the volume of water consumption, avoiding approximately \$450,000 annually in water and sewer costs.
- M-Stores was closed and purchasing processes changed to reduce the need to maintain inventory, eliminate some distribution and warehouse operations, and save on administrative and overhead costs. Initial cost savings are estimated at \$500,000 per year.
- The University achieved additional savings through the negotiation of more favorable vendor contracts (\$3.1 million), reduced costs for FY 2007 prescription drug coverage (\$2.6 million), insurance premium cost savings (\$1.2 million) and debt refinancing (\$100,000 savings).
- Business and Finance units have identified \$1.6 million in cost savings for FY 2007. These include the restructuring of open staff positions, resulting in a reduction of 10 full-time positions in building services, facilities, ground and waste management and property disposition.

- The College of Engineering achieved more than \$800,000 in General Fund savings through reductions in operating allocations and consolidation and elimination of several staff positions.
- The College of Literature, Science, and the Arts will combine the instrument/machine shops in the science departments into a single college facility. This releases space on central campus for other uses, reduces the number of technical staff needed and provides a superior level of technical support to a greater number of faculty researchers. Initial savings will be about \$300,000 per year.
- The Law School will reduce annual expenses of the Law Library by \$1 million (or 15 percent of total expenses) over the next five years. The savings will be achieved through careful planning designed to minimize the impact on service and collections. Purchases of duplicate materials will be eliminated and some reduction in staffing will be made through reorganization as positions become vacant. The Law Library's comprehensive international collection (one of only five in the country) will be preserved.
- Information Technology Central Services achieved General Fund savings through reduction in services and through more efficient use of space. The University's dial-in service for the Ann Arbor campus has been greatly reduced and will be eliminated entirely by January 2007, resulting in an estimated annual savings of \$236,000.
- The Office of Evaluations and Examinations is working with the Michigan Administrative Information Services to develop a Web-based system for collection of course evaluation data. Once the system is operational, the Office of E&E will reduce its course evaluation staff by one full-time position and reduce its use of paper and printing supplies through the elimination of nearly 400,000 custom questionnaires for evaluation of teaching in 12,000 University classes, saving more than \$50,000 per year.
- The basis for charging utilities expenses in the U-M Hospital buildings has been renegotiated, which has led to \$2.9 million in utilities costs being moved from the General Fund to auxiliary funds.
- The academic units are maximizing the use of endowed professorship support to shift a portion of faculty salaries off of the General Fund.