Highlights
Fiscal Year 2007
University Spending Plan

BUDGET PROCESS

For even-numbered fiscal years, the University prepares a single fiscal year spending plan; for odd-numbered years, the University also prepares a "current services" budget for the upcoming biennium for submission to the Office of Policy and Management (the Governor's budget agency), as well as to the State Department of Higher Education. ("Current services" refers to the cost of continuing current programs and services, updated for inflation. The "current services" budget forms the basis of the Governor's recommendations to the legislature.) The June 20th budget workshop will be dedicated to the spending plan for Fiscal Year 2007. The biennial "current services" request for Fiscal Years 2008 and 2009 will be presented to the Board at the August 1st meeting, as will the proposed tuition and fee charges for Fiscal Year 2008. We will also bring to the August meeting any FY '07 adjustments that may be necessitated by changes in the state fringe benefit rate or similar events.

BUDGET GOALS

Our budgets for the last few years have focused on achieving and maintaining financial equilibrium during a time of unprecedented growth. Fiscal Year 2006—the year we are about to close—saw our largest enrollment ever and also represented the final year of the full rollout of the undergraduate enrollment surge. Total graduate enrollment has remained fairly constant over the past few years, although there have been shifts in enrollment among programs. Going forward, the University will see only minimal growth in enrollment, but will continue to experience instructional demands. For Fiscal Year 2007, course coverage and student faculty ratio remain focal points in the proposed spending plan for the Storrs-based program. At the Health Center, programmatic focus on the Signature Program continues, but in an extremely constrained financial environment.

The key element in the coming year's spending plan, however, is the imperative to address pressing needs in operations. In fact, in dollar terms, the most significant new commitments arise from the action plan designed to strengthen our construction program. Certain aspects of these recommended budgetary allocations arise from the University's planning last year; others emanate from the work of the Governor's Commission on UConn Review and Accountability and subsequent legislative action. Much of the increased cost is in personnel: fire code and building inspectors, and construction oversight personnel. The other significant operational investment is in the enhancement of audit and compliance functions. Finally, we continue to face the immediate financial reality associated with the building code violations discovered last year, and those which may be uncovered in the course of the ongoing Department of Public Safety reviews. Although the University is pursuing cost-recovery, we must manage the initial cash outlay as we complete corrective activities this summer. This issue is addressed more fully below, in the explanation of our fund balance and plant funds.

THE STATE BUDGET

The state's significant revenue streams continue to grow at a fast clip. The state's financial health has been reflected in the most recent appropriation to the University. For both the Storrs-based program and the Health Center, the revised state budget for FY '07 brings us closer to our "current services" request than any budget in recent memory. The General Assembly approved an FY '07 appropriation of $217.7 million for Storrs (an increase of $11.9 million over the FY ’06 allotment) and $76.9 million for the Health Center (up $758,828 from FY ’06). The revised FY ’07 state budget also repeals a separate provision enacted last year that would have reduced funding to Storrs by $832,500 and to the Health Center by $312,500.

The appropriation also contains $2 million for a new program to support the hiring of eminent faculty and $2 million for a Center for Entrepreneurship utilizing the expertise of UConn’s Schools of Business and Law. The state budget uses FY ’06 surplus funds for a one-time $350,000 appropriation for the National Undersea Research Center at Avery Point (to help offset federal funding cuts), as well as a $3.3 million appropriation for the Higher Education Matching Grant program for all of the state’s public higher education constituent units. Finally, the budget transfers $200,000 from the Tobacco and Health Trust Fund to the Health Center in support of the Health Professions Partnership Program Initiative, which provides education and support services to encourage under-represented minority students to enter the health care field. The funding in intended to assist in addressing the hardship caused by reductions in federal funding.

Fringe benefit support from the state for Storrs is estimated at $82.8 million for FY ’07, as compared to $75.8 million for FY ’06. The state share of the Storrs-based operating budget, which stood at 50% in FY ’91 and 35.5% in FY ’06, is projected to be 35.4% for FY ’07.

The share of the Health Center’s budget supported by the state (at 23.3% in FY ’99 and 16.2% in FY ’06) is expected to be approximately 15.7% in FY ’07. The Health Center budget also includes $90.7 million in contracted revenues/expenditures for the Correctional Managed Health Care (CMHC) program. This amount (which is a line item in the state appropriation for the State Department of Correction) is projected to be sufficient to meet expected service needs in the coming year.

Even if state tax receipts continue to rebound, the state budget’s legal cap on expenditures remains an important context as we look to the future. As a result, the University’s non-state revenue streams continue to play critical role in our financial health. These sources include private support, research funding (with reductions resulting from shifts in the federal budget), tuition/room/board/fees at Storrs and the regional campuses and clinical revenue at the Health Center.

SPENDING REDUCTIONS AND CONTROLS

We continue to seek efficiencies where possible, both immediate and long-term. For FY ’07, following the trend of ’06, even mechanisms previously put into place to achieve present savings or future cost avoidance saw unexpected increases. At the Health Center and at all of our other campuses except Torrington, the cost of contracted maintenance services jumped significantly and unexpectedly as the result of state-imposed requirements.

At Storrs, the new cogeneration plant, key to the University’s efforts to maximize energy efficiency, is operational. The decision to pursue this cost-avoidance strategy has proven to be a sound and timely one given the current climate of spiraling energy costs. The originally estimated net present value of cost avoided by the construction of this plant is approximately $80 million ($187 million in undiscounted dollars), and savings will increase after lease payments expire in 20 years. The project will also increase the reliability of campus utilities, and lower emissions. However, skyrocketing energy costs have clearly eliminated any hopes of cost improvement in the immediate future; in fact, Storrs expenditures for FY ’06 are forecast to show a deficit in the energy account of $4.3 million. The difficulty of completing a cost/benefit analysis for FY ’06 for the cogeneration plant was compounded by the tremendous challenge of bringing the plant on-line, which required us to dedicate our staff resources to operations rather than financial analysis. We have had to adjust our goal of completing the evaluation of fiscal impact from FY ’06 to FY ’07, when we will also complete the development of a new utility fee schedule and the timetable to implement the new charge structure.

At the Health Center, approximately $65 million in operational efficiencies were achieved from FY ’00 through FY ’06.

BUDGET PLAN AND PRIORITIES

By way of background, although we have not yet completed year-end closeout, our very preliminary estimates indicate that the Health Center will end FY ’06 with a $1.3 million deficit. The Health Center faced a dual financial challenge in FY ‘06: a declining trend in clinical volume and decreases in research awards and revenue. Clinical volumes were affected by unusually high faculty turnover and a coincidental increase in medical leaves for physicians. However, with successful recruitment of new faculty, current clinical results are beginning to show a recovery in volume.

The Storrs-based program is projected to close FY ’06 with an $8 million loss, just as the approved FY ’06 budget assumed. (You will recall that an $8 million loss was a planned expenditure for equipment that was in fact covered by unexpended equipment funds carried forward from FY ’05.) However, the Storrs bottom line now also includes a transfer to plant funds (not previously budgeted) to help address the remaining residential facility code correction.

This proposed spending plan for FY ’07 projects a deficit of $1.4 million for the Storrs-based program. This deficit is due to a net loss in the auxiliary fund of $2.4 million driven by energy costs; room and board rates are already set for FY ’07 and we do not have the capacity to cover the shortfall with spending cuts. The Health Center plan projects a net gain of $94,000. FY ’06 and FY ’07 budget totals are displayed below. (Percentages represent increases over the prior year.)

	FY ‘06	FY ‘07
Storrs-based	$ 806.0 million (7.4%)	$858.1 million (6.5%)
Health Center	$ 625.2 million (2.9%)	$654.7 million (4.7%)
Total	$1,431.1 million (5.4%)	$1,512.8 million (5.7%)

(Please note: detailed charts for the current funds budgets, and their revenue/expenditure components, are found in Tab 5 and 6 of the budget materials.)

This budget reflects the following:

- The state appropriation and “best guess” estimates of state fringe benefit support
- Efficiencies, cost-reductions and reallocations rolled out permanently into the base budget
- Revenue enhancement/implementation of charges previously approved by the Board

- Expenditures for quality: targeted increases for high priority programs 1) to ensure course availability for undergraduates and 2) to further the Storrs-based Academic Plan and the Health Center's Signature Programs
- Expenditures for equity: increased financial aid
- Expanded audit and compliance capacity
- Operational enhancements, including code compliance inspection and construction planning, management and oversight capacity

STORRS AND THE REGIONAL CAMPUSES

Quality and access remain the University's greatest challenges. Starting last year, our focus began to shift from the need to allocate resources to support increasing enrollment, to the opportunity to target resources to support increasing quality. Our Academic Plan will drive a budget that invests in high quality programs with high potential to achieve three interrelated objectives: improving undergraduate instruction, growing research productivity and enhancing the University's reputation as a center for scholarly endeavor. Our faculty hiring proposal and the metrics effort will continue to be priorities. Although we have not yet succeeded in securing the state support necessary to implement fully the faculty hiring proposal, we remain committed to the initiative because of its importance to 1) research, 2) course coverage, 3) improving our student: faculty ratio, 4) the "Finish in Four" effort and 5) enhancing faculty diversity. In FY '06, we started the academic year with 51 net new faculty members. The FY '07 proposal adds 20 faculty to that number. This investment in hiring represents significant progress towards our goal of 175 additional new faculty.

Revenue

The proposed budget incorporates the implementation of increases approved in June 2004 for tuition, room, board and fees. Detailed breakouts are in Tab 6 of these materials. Please note that for an in-state student, tuition covers only about one-third of the cost of academic services; all charges combined (tuition, room, board and fees) cover only one-half of total costs.

For FY '07 the total in-state undergraduate charge will be $16,628, an annualized increase of 6.48% over FY '06. Out-of-state undergraduate charges would rise at approximately the same percentages, for a total charge of $29,828 in FY '07. As described below, additional financial aid is budgeted to offset the impact of increased charges on financially needy students and families. In a dynamic college marketplace, UConn remains a tremendous value in comparison to our competitors—but it is a value only if it ensures high quality.

Tuition revenue growth—the combined effect of enrollment and tuition charges—is projected at 7.5% for FY '06 over FY '07. (Please see Tab 6 Current Funds chart.) Changes in room and board (in Auxiliary Enterprises) and fees drive an increase of 10% for FY '07 over FY '06 revenue. Please note that, unlike the past several years, growth in these revenue streams will henceforth be a function only of rate changes, as enrollment is stabilizing. Other sources of revenue for FY '07 are the state appropriation of $217.7 million (a 5.8% increase over FY '06) and research grant awards, projected at $98.0 million (a 4.0% increase over FY '06).

One final note: last year, the Board was presented with a decrease in FY '06 board rates due to the restructuring of meal plan offerings. At that time, the board fee for FY '07 was based on meal plan options that assumed $100 in "points" for students to use at the Student Union food court venues. Negotiations with food court vendors resulted in plans that no longer require building these "points" into the meal plan. As a result, $100 of the board fee already approved by the

Board is no longer required for this purpose. The resulting $974,000 in revenue is, however, critically necessary to help offset increased energy costs. Any reduction in room or board rates for FY ’07 will only worsen the auxiliary deficit caused by the spiking price of energy.

Expenditure Highlights

- Undergraduate Course Offerings

  The enrollment surge is nowhere reflected as clearly as in the increase in undergraduate credit hours, which jumped from 427,129 hours in FY ’01 (Fall of 2000) to 544,952 in FY ’06 (Fall of 2005). This is a 28% increase over the five year period at all campuses. (At the Storrs campus alone, the five year increase is 26%.) We have tried to respond to demand with a flexible mix of instructional capacity, including full-time faculty, in-residence faculty (3 year appointments) and adjunct faculty. This flexibility has been an essential element in managing instructional demand because of shifts in student course-taking behavior by content area, as well as financial realities. For FY ’07, a commitment of $3.65 million will support the new faculty hires described above and includes $750,000 in additional course coverage/extra sections. From FY ’00 to FY ’06, the University has devoted $8.6 million in new dollars to meet course demands of increased enrollment, with much of the increase in CLAS. Our largest increases in enrollment are in nursing, pharmacy, biological sciences and engineering. Two related points: 1) these are disciplines that address critical workforce shortage areas and 2) all of these students take courses in CLAS.

- Financial Aid

  Financial aid represents an expenditure that, while to some extent discretionary, is inextricably intertwined with the mission of the University and is therefore treated as a “must do” in our budgets. When we develop our budget, each increase in student costs is matched by increased financial aid to ensure that no student’s UConn education is denied or hampered based on financial need. For FY ’07, the University will earmark $243.0 million for all forms of financial aid, and $79.5 million (including tuition waivers) of that amount will be funded with tuition revenue. In other words, a remarkable 17.8% of this University’s tuition revenue is dedicated to financial aid. In fact, 78% of UConn’s students received some form of assistance last year. This budget represents an increase of $12.7 million over FY ’06 total financial aid expenditures.

- Library Acquisitions

  As you know, UCONN 2000 includes a project line entitled “Equipment, Library Collections and Telecommunications,” and we have used this source to fund library needs to date. We have, however, discussed for the last few years the importance of gradually shifting this item onto operating dollars. A steady phase-in would free up UCONN 2000 dollars for reallocation to other capital expenses. This is of particular concern in the short-term (because we had to reallocate FY ‘05 Equipment funds to address capital needs), but it is also an issue in the mid-term (because construction material prices show no signs of improving) and in the long-term (because at the end of Phase III of UCONN 2000 we must ensure a stable funding stream for this activity). The FY ‘06 budget moved $1.7 million for library acquisitions to the operating budget, with the remaining $4.3 million of the total $6.0 million allocation still coming from capital funds. Given how tight the FY ’07 budget is, we can only afford to dedicate a small additional amount to this effort, but the phase-in continues with $2 million of the $6.3 million total coming from operating dollars. We hope to complete the phase-in by FY ’12.

- Fire Safety/Building Inspection/Construction Management, Oversight and Compliance

  The FY '07 spending plan's most significant new commitments relate to the University's construction program. In addition to an expected $1.5 million in audit-related costs in FY '07, this budget accommodates significant staffing increases. Last year, $837,000 was earmarked for the first full year of the new University Office of Fire Marshal and Building Inspector. For FY '07, five new staff members (two building and two fire code inspectors and one supervisor) will be hired, at a cost of $540,000, in furtherance of our understanding with the State Department of Public Safety. This expanded capacity will move us to a staffing level capable of providing quality plan and inspection reviews for the University's construction, renovation and building maintenance program at all of our campuses.

  Another critical aspect of this budget is to fund the department of Architectural and Engineering Services (AES). AES has the primary responsibility for planning, managing and completing all capital projects University-wide. Our recent experience, as well as benchmarking these functions against those at similar universities, indicates that we are seriously understaffed. The staffing shortfalls have traditionally been resolved by utilizing outside contracted resources.

  $865,000 in the FY '07 budget is slated to add 11.5 FTE positions to existing staff. By bringing the department more in line with appropriate staffing levels, we will be able to reduce the University's reliance on third party vendors who provide engineering services and fill in areas of project planning, management and oversight. Further, a funded plan to increase staffing is essential in order to respond to concerns raised by the Governor's Commission and the General Assembly.

  Finally, $500,000 of the FY '07 budget is dedicated to the establishment of the Office of Construction Assurance, which is part of the new oversight structure set forth in this year's amendments to the UCONN 2000 statutory framework.

- Operations

  A focused improvement program for our utility infrastructure has begun, with assessment and planning activities underway. While significant funding for this effort will come from the capital budget, the FY '07 operating budget includes $300,000 for backflow prevention monitoring and $250,000 for water management activities. Our security infrastructure will see an $80,000 increase for our Blue (emergency) Phones system.

  Maintenance (cleaning) activities that are addressed through vendor contracts (all of which are subject to the provisions of the Standard Wage Act) will require a $2.4 million addition in next year's budget.

CROSS-UNIVERSITY COLLABORATION

- Audit and Compliance: For the '06 year, the office's budget was $2.6 million. The FY '07 budget includes $170,000 for new positions and $100,000 for the Corporate Integrity Agreement at Storrs. The budget also includes $1.5 million for UCONN 2000 audit activity. At the Health Center, $372,000 will fund new positions in the compliance unit.

HEALTH CENTER

In last year's budget presentation, we said "Given the relentless pressures of the health care marketplace, and the challenges of managing those issues in a public sector environment, FY '06 promises to be another tough year for our academic medical center." It was. The goal of the proposed Fiscal Year 2007 budget is to strategically reduce expenses while continuing to hold true to the Strategic Plan, but achieving this goal is likely going to be a greater challenge than ever.

Revenue

The state appropriation for FY '07 for the Health Center is $76.9 million, approximately $225,000 below the "current services" request, and we expect state fringe benefit support of $25.2 million. Of the Health Center's $654.8 million in revenue for FY '07, sources other than the state appropriation account for an increase of $29.1 million. Clinical revenue is projected at $298.6 million, a 6.2% increase over FY '06. Clinical revenues include volume assumptions that continue historical growth trends. In addition, the volume projection reflects Signature Program business plans, new faculty recruitments, increased marketing efforts, the impact of UMG's clinical incentive plan, the Dental Implant Center, the Electrophysiology Lab, changes in Farmington Surgery Center operations, and other performance improvement initiatives. Clinical revenue price assumptions include a continued slight shift to managed care, non-governmental contractual increases of 3%, and the impact of the Medicare and Medicaid changes.

In FY '07, we expect to see research award activity remain essentially flat—a dramatic shift from the 17% annual average increase from FY '00 to FY '04—due to the federal budget's impact on NIH. Research revenue is $89.8 million, a 1% increase over the prior year (and research awards stand at $88 million, a 0% increase over FY '05). Income related to the placement of interns and residents is $29.6 million, a decrease of 1.2%. Tuition and fee revenue is $14.9 million, which reflects the 15% rate increase approved by the Board last year. $90.7 million (on both the revenue and the expense side) reflects the contract with the Department of Correction for inmate health services. All other sources of revenue (including auxiliary) come to $28.2 million.

Expenditures

The Health Center's "Signature Programs" in cancer, cardiology, musculoskeletal medicine and Connecticut Health are the nexus for the programmatic confluence of distinguished basic science research, clinical services growth and educational excellence. Through translational research, the Health Center's investment in the integration of research, clinical care and education via the Signature Programs is the linchpin to the Center's plan for long-term fiscal sustainability.

The Health Center's FY '07 budget includes new incremental investments of more than $3 million – bringing total investments in the Signature Programs to over $13.2 million since FY '01. The budget also includes investments in compliance and regulatory activities, private fundraising and information technology, as well as support for the Research Strategic Plan.

Given the challenges on the revenue side, however, these investments cannot be supported by new income alone. The FY '07 plan calls for significant cost reductions to enable reallocation of existing resources. Changes in the Clinical Incentive and Research Incentive Plans will reduce FY '07 costs. More significantly, and more unfortunately, $6 million in reallocation will have to be achieved through workforce reduction. Although the challenge of maintaining a balanced budget over the last several years has entailed layoffs from time to time, this is the most sizable cost-related workforce reduction we have had to undertake since FY '00.

Detail for the Health Center spending plan is in Tab 5, as are the background data and Health Center performance indicators.

FUND BALANCE

As was the case last year, at Storrs, our fund balance and use of plant funds is a more significant issue than usual, primarily because of the corrective action plan to address code violations at some of our student residential facilities. This summary is intended to provide the Board with general background information as well as specifics regarding the source and timing of funds to accommodate the approximately $10 million of work that is projected to be necessary in the coming year. Please keep in mind that while this cash outlay for construction is required immediately, we will continue our efforts to secure recovery from contractors.

For the Storrs-based program, the FY ’06 projected year-end Unrestricted Fund Balance of $40.5 million represents 6.0% of the FY ’06 unrestricted budget ($698.5 million) or, alternatively stated, 22 days’ worth of operations.

The $40.5 million fund balance represents the funds and inventory remaining in these accounts: the Research Fund (designated for research); the Auxiliary Fund (residential, dining, health, student activities and recreational services); Departmental Funds (self-supporting fee-based instructional programs such as Continuing Studies and MBA); and a <u>liability</u> for compensated absences (vacation/sick leave), which is an accounting requirement. Existing fund balances are not generated from state support or tuition revenues.

It is important to remember that the money in the fund balance, while not all technically encumbered, may be committed in a more generic sense. First of all, funds may be held in a departmental account in anticipation of an expenditure (such as start-up costs for a new researcher). Second, under the provisions of UCONN 2000, the University is required to maintain a Renewal and Replacement Fund to keep projects in sound operating condition; the fund balance serves this purpose under the Master Indenture. Third, these amounts include inventory.

The fund balance is our operating capital and reserve for programs and activities that generate revenue and are not supported by state appropriation or tuition funds. We borrow from the fund balance to pay our bills when necessary. For example, in FY ’04, the University didn’t receive $13.4 million in state fringe benefit support until June—the very end of the fiscal year. In FY ’05, the first quarter allotment of our entire appropriation did not arrive until September 28th—two days before the close of the fiscal quarter. Another example: the state generally informs us of changes in fringe benefit rates after the fiscal year has started, and frequently the increases have a significant fiscal impact. The fund balance allows us to manage these dislocations without disrupting the University’s operations.

At year end, when funds are available, we also set aside dollars in accounts for <u>planned</u> one-time expenditures, mostly capital. These accounts comprise our plant funds. A good example of this is the $10 million we set aside two year ago towards our technology infrastructure upgrade plan. Plant funds also include specific repair projects and furniture/equipment replacement for Residential Life/Dining Services.

For Storrs, then, our projected unrestricted net assets of $85.0 million are made up of the $40.5 million current fund balance, the estimated $12.5 million in unexpended plant funds (described in more detail below) and a third component: $32.0 million in funds that are internally restricted for the retirement of indebtedness. We have traditionally been very conservative with regard to savings for debt obligations, maintaining funds at a level of approximately 1.6 times our annual debt payments. We believe that this policy has served us well, and recent events have reinforced this view. Fortunately, the code issues we dealt with at the new residences were not health/safety issues that required the relocation of students. Had that been the case, however, the loss of the room revenue stream would have forced us to turn to our debt reserve funds.

We currently estimate that the cost of upcoming corrective action (and enhancements that go beyond code requirements) at the residential facilities will be approximately $10 million for FY ‘07, mostly at Hilltop Apartments with a small portion of the expense at Charter Oak. Again, we are pursuing financial recovery, but we must nevertheless upfront cash for work underway this summer. Our current funds balance cannot handle this impact. That leaves plant funds, the source we tapped last year for $15 million to cover the initial impact of the remedial program. The effect of the FY ’06 expenditures on plant funds was significant, and we plan to augment the remaining funds with a $4 million transfer from operating funds (reallocated within the budgeted bottom line for FY ’06) and a $5.6 million transfer from our debt reserve. We normally reserve at a level representing 1.6 times our annual debt cost, but we expect to close FY ’06 with the reserve at a 1.7 level (because of changes in actual ’06 requirements from the State Treasurer’s Office). We also believe that we can safely set our reserve level at 1.5 (still a conservative approach) for a single year. The combination of the unexpected overage in FY ’06 with the reduced set-aside will generate the $5.6 million debt reserve transfer. We will budget a return to the 1.6 level for FY ’08. The resulting $12.5 million plant fund balance will accommodate the estimated $10 million needed for this activity in FY ’07, as well as the cash resources for other capital projects dependent on this fund. We also plan to deposit the proceeds of financial recoveries in this fund. Please note that this year’s legislative changes to UCONN 2000 prohibit the use of UCONN 2000 deferred maintenance funds for this type of code correction activity, so we have no option but to use operating funds.

Finally, at the Health Center, the FY ‘06 projected year-end Unrestricted Fund Balance of $54.6 million represents 8.7% of the FY ‘06 unrestricted budget ($625 million) or, alternatively stated, 32 days' worth of operations. The $54.6 million balance includes capital budgets from other funds, other current liabilities, including malpractice claims.