

Preliminary Report on the Proposed “New Partnership”

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Senate Budget Committee

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At the request of the President of the University Senate, the Senate Budget Committee (SBC) has analyzed the white paper “Preserving Our Public Mission Through a New Partnership with the State”, which was released by the Office of the President in August 2010. For this report, we were asked specifically to look at the financial implications of the proposal, and its effect upon governance, operations, students and staff.

At this point, the New Partnership proposal is obviously still rather schematic; it will presumably become more detailed and definitive through discussions with all interested parties, especially state legislators. Therefore, the analysis in this report cannot be considered definitive either. (Hence the “preliminary” in the title.) We have raised the questions which occurred to us, and have attempted to answer as many of them as we could with the information available. Our emphasis has been upon the marginal changes due to the New Partnership; that is, if the New Partnership were to be implemented, how would the future of the University be different than if we stayed on our current trajectory.

Summary of the New Partnership

The New Partnership is a proposal to restructure the relationship between the University of Oregon and the State of Oregon, both financially and in governance. It is not a plan to privatize the University, but rather a way of “Preserving Our Public Mission”, as stated in the full title. It is mainly a response to the changing financial condition of the University over the past twenty years, where the percentage of operations funded by state support has sharply declined, and the percentage funded by tuition has sharply increased. Not only has state support declined, but it is unpredictable, and the University has often had to return funding to the State during a biennium, funding that had already been allocated and incorporated into budgets. Looking at these trends, and the projected state budget deficits for the next decade, it has become clear to many people that the traditional financial model for a state university has *de facto* already been changed, that the current course is not sustainable, and that a new model must be considered before the current system implodes.

The financial strategy proposed is for the State to “capitalize its investment in the University of Oregon.” Under the proposal, the level of the current annual State general fund support for the University, approximately \$62 million, would be locked in for the next 30 years. (This is a nominal dollar amount, and would presumably decline in real (inflation-adjusted) value, and as a percentage of the State budget, over that 30 years.) The State would issue bonds for an amount that could be supported by an annual payment of \$62 million, approximately \$800 million. Before the State committed any bond funding, the University would raise a matching amount from donors, and this combined \$1.6 billion would constitute a greatly expanded endowment for the University. The income from this endowment would support University operations, in lieu of the annual support from the State general fund. The State would make payments on the bonds for 30 years, and would not be responsible for any other support of the University of Oregon.

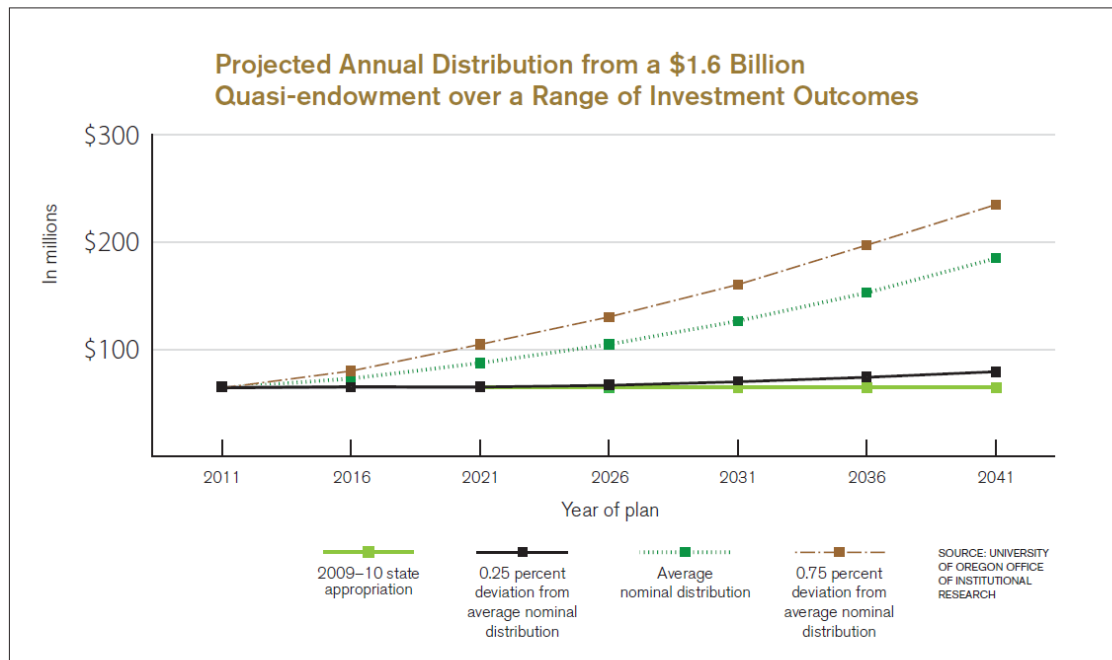
The New Partnership also proposes revising the governance structure for the University. The University is governed internally by the statutory faculty (the president and the professors), according to the new University of Oregon Constitution. The University is under the supervision of the State Board of Higher Education (OSBHE), which fulfills this role for all the OUS institutions. The New Partnership proposes that the OSBHE become a coordinating board for the OUS institutions, and that the University should be directly supervised by a University of Oregon Board, one that could be more aware of and attuned to the particular circumstances of this institution.

Finally, the New Partnership proposes that there should be accountability measures for the University, to ensure that the University continues to meet goals set by the State.

Financial Analysis

1) **Endowment growth.** Figure 13 from the White Paper presents a way to frame the riskiness of the new endowment model relative to fixed (or declining) State support. The lowest line represents the distributions if the returns on the endowment are in 25th percentile of outcomes where we expect to earn 9% and have a standard deviation of returns of 15%. Note that the 25th percentile remains approximately level with current levels of state support, while the average outcome illustrates the large potential upside to the endowment model with much higher funding levels accruing to the UO.

Figure 13



With data from the UO Foundation we analyzed a case we felt represented a legitimate concern for the endowment model. That is, suppose that the market were to have a dramatic downturn. We stress tested the model over the period from 2000-2010, which covers the dotcom bust and the Great Recession - the greatest period of economic decline since the Great Depression. The table below illustrates the stability that the payouts from the endowment are likely to provide to the university. Beginning with a hypothetical \$1.6 billion in the 1999-2000 school year and assuming we could have earned the foundation’s returns over the ensuing ten years, distributing 1% to the UO Foundation and 4% to the University Budget the endowment would have grown slightly, but importantly the distributions to the university would have been remarkably stable and would have grown from \$64 million in 2000-01 to \$75 million in 2010-11. While the illustrated growth is modest, it is important to keep it in context. First, the growth is greater than the growth in State funding, second, this period incorporates returns from

two serious financial crises, and third, the stability of distributions makes it possible to have a rational budgeting process.

10-year Endowment Distribution Simulation

FY	Annual Endowment Return	Endowment Value (\$)	Annual Distribution (\$)
1999-00	-	1,600.00	-
2000-01	10%	1,709.45	64.00
2001-02	-7%	1,516.70	66.03
2002-03	-5%	1,368.88	66.54
2003-04	22%	1,573.35	65.63
2004-05	11%	1,657.51	64.34
2005-06	10%	1,733.95	64.29
2006-07	16%	1,915.19	66.21
2007-08	13%	2,068.68	69.22
2008-09	-18%	1,626.30	73.27
2009-10	10%	1,688.94	75.20
2010-11*	4%	1,661.05	75.19

Assumes a 1% annual Endowment management fee and a roughly 4% distribution based off of the Foundation spending policy that is intended to smooth volatility of payouts.

Currently interest rates are at extremely low levels thus making the planned state contribution go a long ways. If interest rates were to rise prior to the debt being issued, the amount of debt supported would fall. In our opinion, the principle of matching state support for private giving would not likely change and that is the critical factor. As a practical matter, the new partnership is likely to be phased in over some horizon that is likely to extend 5 years. We don't see this as a material concern at this point.

2) **Effect upon other bonding capacity.** It is our understanding that the new partnership would allow us to use the current bonding system for capital improvements. This is an important feature of the plan and allows the State to contribute to capital projects that benefit the State in a manner that is parallel to how the State would be supporting the University's operations. That is, current bonding to which the state contributes funds requires a private match in order to use the bonds for capital improvements.

There are four primary financial benefits to the New Partnership (assuming that the proposed plan is adopted and funds are secured at the projected levels:

1) **More effective planning.** Our current system routinely leaves us with considerable uncertainty regarding levels of state support, even up to the time the academic year begins. Sensible management of a \$1.6 billion endowment can smooth out market fluctuations and provide a stream of returns that is much more stable and predictable than the stream of support currently provided by the state. This is significant as unpredictability is more than a mere inconvenience and can in fact lead to inefficient use of financial resources.

2) **More effective tuition management.** Full control of UO tuition policy will enable us to stabilize tuition growth patterns in ways that serve to enhance student demand and retention without diminishing aggregate tuition revenue. This is of benefit to the University, and should be of benefit to the students also. While it is impossible for the University to make any up-front guarantees on limits on tuition increases, given the uncertainty of all future economic and financial conditions, the increased stability of University funding should help to flatten out the abrupt spikes in tuition that have occurred in the past as tuition increases have been needed to backfill unanticipated cuts in state support.

3) **Small downside risk relative to potential upside gains.** In most plausible scenarios, the New Partnership yields more revenue than would the current financial/governance arrangement – often a lot more as the New Partnership materials document. While there is certainly some downside risk – if the endowment doesn't perform as well as anticipated (see below), there is probably no opportunity cost. That is, we don't think it very likely that the University of Oregon will miss out on what would have been its share of greatly increased State general fund appropriations in the future.

4) **Coordination of public and private sector support.** The New Partnership effectively serves as a coordination device that increases the incentives for both sides to contribute support and increases the likelihood that the stated objectives will be realized. If the objectives are not realized, presumably the plan can be aborted.

Although the benefits noted above are substantial, there are some qualifying concerns. Two of the most notable are the following.

1) **Extended periods of weak market performance.** Fluctuations in the market can be expected and a well-managed endowment will generally be able to weather downturns while still paying out a relatively stable stream of revenues to the University. However, if we have the misfortune of experiencing an unusually long market downturn before the endowment has time to substantially grow, it may be that revenues would be substantially lower than under the base case model in the partnership. Nonetheless, the relevant comparison is relative to our

current system and an extended market downturn is likely to be correlated with low state revenues so that state contribution that we would have received in our current organizational structure would also be expected to be severely diminished. Moreover, other state governments will also likely be suffering, suggesting that demand from out-of-state students would continue to be strong.

2) **Displaced private contributions.** Although the New Partnership can be expected to encourage increased donations from the private sector, it also encourage donors who may otherwise have contributed targeted gifts to specific programs/projects to pledge their gifts to the general fund. Consequently, we would expect a decrease in the volume of targeted gifts. The impact and importance of this effect is hard to quantify.

Governance Analysis

1) **University of Oregon Board of Directors.** The primary change in governance is that the University would be overseen by a new University of Oregon Board, rather than the current State Board of Higher Education. The benefits of this seem clear. The current State Board must try to understand and respond to quite different conditions on all OUS campuses, and must formulate policies which apply to all. The new UO Board could presumably develop a more in-depth understanding of the issues facing the UO, and would be able to develop policies which were optimal for the UO, and not compromises applicable to all other institutions.

However, this closer relationship might increase the possibility of the board being “captured” by an administration, as is not uncommon in corporations, where some boards rubber stamp the proposals of management. This possibility might be lessened through the composition and selection of the Board. Under the current proposal, the Board would comprise 15 members:

- Seven members appointed by the Governor

- One member of the OSBHE

- The UO President (nonvoting)

- Six members appointed by the UO Board itself, including:

 - One member of the UO Foundation Board

 - One student (nonvoting)

 - One faculty member (nonvoting)

Members of the SBC hold a range of opinions on this board structure. Some think that the students and faculty members should have voting rights, and that there should be more of them. Others think that voting rights are not that critical, since the board members who are part of the University could not form a significant voting bloc anyway. The method of selecting these internal board members was less controversial to us: we believe that the faculty and students should be able to select their own representation on the board, rather than having the board select these members.

2) **Academic freedom.** A related concern is the potential influence of important donors on the Board and through the Foundation. Just as we have defended academic freedom from political influence, we must be sure that policies are put in place which ensure that academic decisions (such as course content and tenure decisions) are not subject to the influence of private individuals, such as donors. It is somewhat beyond the purview of this committee, but we think the faculty must be fully satisfied that this issue has been appropriately codified.

3) **State rules and regulations.** An important result of this proposal for university governance would be the freeing of many university operations from state administrative rules and procedures. Just as it seems obvious that different universities might have different procedures that better fit their circumstances, it is even more obvious that different procedures might apply to the University and the Department of Corrections. Many faculty and staff chafe under administrative rules that create much paperwork for no apparent benefit, and relief from these rules will likely streamline our operations and allow us to focus on our core tasks.

4) **Operational autonomy.** Greater control over our own activities will have other benefits. We think (and hope) it unlikely that the University would be subject to state-wide pay freezes and furloughs under this proposal. The State would not be able to collect the interest on our tuition and spend it on other state agencies. University revenues, such as tuition, sitting in our accounts, could not be taken by the state and used for other purposes than educating our students. The UO currently receives the least state general fund support per student of any OUS institution; essentially, UO students are subsidizing students at other schools. Under this proposal. This problem at least couldn't get any worse.

5) **Personnel policies.** The continuity of current contracts and benefits is of great concern to many on campus. "Appendix B: Legislative Outline of Public University Concept:" goes into reasonable detail on this issue. PEBB and collective bargaining agreements would stay the same, "unless and until" the represented employees chose to renegotiate. Personnel policies would stay the same. The University could "offer" its employees alternative retirement programs in addition to PERS; the effect of this upon currently-offered alternative retirement programs should be spelled out.

Accountability Analysis

The New Partnership White paper asks for the creation of a new board of trustees for the UO, as well as a state-level coordinating board (replacing the current OSBHE) responsible for oversight of Oregon's four-year public colleges and universities. In exchange for increased autonomy, the state board should set standards, and "hold the institution accountable for meeting those standards, such as accessibility, affordability, diversity, economic development, and service impact" (p.16).

However, the white paper does not attempt to define these goals.

Page 17 offers an outline of the performance standards adopted in 2005 by the Virginia General Assembly for the University of Virginia. These 12 goals lack specific numbers and dates, and hence appear to be aspirational in nature.

Moreover, some of them may be relevant for Virginia but not for Oregon.

Section 57 of the Legislative Concept suggests a stronger form of accountability:

"this section also authorizes the State Board to adopt benchmarks to ensure that the UO delivers an education program that will meet the state's higher education needs and goals...the benchmarks are to be outcome-based, with the means and methods of meeting those benchmarks left up to the UO, and provides that the State Board may also adopt incentives for achieving the benchmarks and penalties for failure to meet them." (p33)

In the past year the Provost and President have spoken of involving faculty in the process of drafting these accountability goals. We see this report as part of this process, which still has a long way to go. The Senate Budget Committee has identified several issues here which ought to be addressed in the accountability standards:

1) **Growth vs. selectivity.** The introduction to the white paper emphasizes how many more students need to earn degrees in Oregon if the state is to be able to compete in the global economy. Yet details need to be set: how fast we should grow, how many more degrees should we have to produce to live up to our new partnership? Can this growth be consistent with the UO's desire to enhance its stature as an AAU research university which emphasizes graduate studies and seeks to attract world-class research faculty? We have already grown substantially in less than a decade from about 20,000 students to about 23,000, and our faculty and facilities are bursting at the seams. Further growth will require capital investments that will be very expensive, and may not be compatible with an agenda that emphasizes excellence, selectivity, and enhanced prestige.

2) **Accessibility and Affordability for Oregon students.** There is no discussion of limits on tuition increases as part of this proposal. Yet this issue is certain to be the prime concern of students, and as such, will probably come up in any negotiations with the State. The UO must have a clear understanding of

the parameters around this issue, if we are come to any agreement with the State.

The UO Freshman class of 2010 includes 49% out of state students. Many other states, including California, have imposed a ceiling, lower than 50%, on the proportion of out of state students at their flagship state universities. The UO has not yet made any such pledge, and neither has the UO raised the minimum GPA required for admission of Oregon high school graduates. If such thresholds are to be part of an accountability plan, they must be entered into only after a thorough discussion of the consequences upon tuition revenue and academic excellence, and upon the questions of growth and selectivity outlined above.

3) Transparency and accountability. If the UO achieves a new degree of autonomy from the OUS and the Oregon Legislature, we are concerned that the UO be held to high standards of administrative transparency. Section 9 of the Legislative Concept states that

“The UO would continue to be subject to[...]the public governance provisions of state law: The Public Records and Meetings Law, Government Ethics, Investment of Public Funds, the Public Employees Collective Bargaining Act, Public Retirement, and the Oregon Tort Claims Act. But the UO would be exempted from many of the business regulations applicable to state agencies, such as the Administrative Procedures Act.” (p30)

The New Partnership financial plan would create a large endowment to be managed by the UO Foundation. It would thus shift oversight and accountability from the Oregon Legislature and the OUS to the Foundation. This shift should not occur without increased transparency from the Foundation. Donors, faculty and students, and Oregon citizens should all demand greater scrutiny of the Foundation’s investments and its administrative expenditures.

4) Instructional Expenditures and Educational Quality. We believe that a core measure of accountability for educational quality is that funds be spent on classroom instruction, for this is what will have to produce the large increases in degrees called for in the plan’s “2025 Educational Attainment Goals” (p.7). Data from the Education Trust from 2008 shows the UO trailing its eight peer institutions in the key measurement of student-related expenditures per faculty FTE. We need to improve this key metric.

5) Accountability and faculty governance. The State board (whether OSBHE or a new ‘State-level board’ as envisioned in the New Partnership proposal), a new UO Board, and the UO faculty all have a role in setting accountability standards and monitoring UO performance toward those goals. It is in this light that we call for faculty and student representatives on any new UO board of trustees. We also believe that any New Partnership proposal that emerges from the Legislature or the OUS should require ratification by the University Senate.

Conclusions

The New Partnership proposal is still in a schematic stage. As it moves forward, many elements will undoubtedly change. But the Senate Budget Committee strongly endorses the underlying concepts, and hopes that a modified proposal which carries these concepts forward will be implemented.

This is the most momentous change which has ever been considered at the University of Oregon. It is in response to circumstances which have been steadily worsening for the past 20 years. It is clear that business as usual can't continue without seriously compromising the quality of the university. While there may be other ways out of our quandary, we haven't heard of any.

As we have discussed above, this approach is not without risk. However, we believe that it has strong potential on the upside, whereas the current approach has no upside at all that we can see. Our analysis shows that even a fairly bad scenario from the New Partnership is better than the way things are going now.

Moving forward on this proposal will require trust all around. All members of the UO community and citizens and officials of the State of Oregon must consider what will best serve the needs of our students and how the University can best accomplish this mission. However, the details of this must be closely watched and carefully considered. The faculty as a whole should follow the ensuing process and see whether the principles which we endorse are being carried forward into legislation. If this is the case, we believe that this initiative will place the University on the firm ground that is necessary for its future advancement.