

**MINUTES OF THE FINANCE AND ADMINISTRATION COMMITTEE  
THE UNIVERSITY OF TENNESSEE  
BOARD OF TRUSTEES  
FEBRUARY 25, 2010**

The meeting of the Finance and Administration Committee of the Board of Trustees was held at 10:30 a.m. CST, Thursday, February 25, 2010 in Room 206A of the Boling University Center at the University of Tennessee in Martin, Tennessee.

- I. **Call to Order** - Mr. Robert Talbott, Chair, called the meeting to order, welcomed all to Martin and made the following introductory remarks:
  1. While the public is invited and welcome at all Board meetings, our meetings are “in the public” but not “public meetings.”
  2. The Chair will recognize to speak only members of the committee, other Trustees, and members of the senior staff.
  3. The Committee has a set agenda and prepared materials for that agenda. No “new business” has been brought to the Chair’s attention prior to the meeting.
  4. Lastly, the name of the Trustee making the motion and the second will be announced to help in the preparation of minutes.
  
- II. **Roll Call** – Chair Talbott asked Dr. Gary Rogers, Senior Vice President and Chief Financial Officer to call the roll. He did so and advised the Chair that a quorum was present.

**Present**

Robert Talbott, Chair  
Charles Anderson, Member  
Jim Murphy, Vice Chair of the Board  
Jan Simek, Member  
Charles Wharton, Member

**Absent**

Bill Carroll, Member  
John Foy, Member

**Other Trustees Present**

Tyler Forrest, Student Trustee  
Jim Hall, Member  
Doug Horne, Member  
Andrea Loughry, Member  
Verbie Prevost, Faculty Trustee

Karl Schledwitz, Member  
Don Stansberry, Member

Also present was Dr. Gary Rogers, other members of staff, and media representatives.

- III. **Approval of Minutes of Last Meeting**—Consent Item—Chair Talbott called for consideration of the last meeting's minutes. On a motion made by Vice Chair Murphy and seconded by Trustee Wharton, the minutes were unanimously approved.
- IV. **Treasurer's Report on Endowment Investment Performance**—Information Item—Chair Talbott asked Butch Peccolo, Treasurer and Chief Investment Officer to present the Endowment Investment Report. Mr. Peccolo noted that the Report that was sent earlier had preliminary figures and that an updated final Report was in the current Board materials. He began his presentation by saying what a difference six months makes and that 2009 was much improved in the capital markets. With the exclusion of private real estate, capital market returns were up with strong double digits for the equity markets and single digits for the fixed income markets; investors again embraced risk and markets responded. For the quarter ended December 31, 2009, domestic equity markets outperformed international equity markets as the dollar strengthened. For the year 2009, the international markets outperformed domestic markets particularly with emerging markets outdistancing by far any of the developing markets. To the University's detriment, growth stocks continue to outperform value stocks on an annual basis and the portfolio has a value tilt to it. The fixed income category was relatively flat for the year as the high grade corporate credit gains were offset by the treasury declines. Real assets were up and even outperformed domestic equities; however, private real estate continues to struggle as mentioned earlier. The Pool's quarterly return was 2.5% and the one-year return for 2009 was 21.0%. The return was good but still lags the Broad Policy Benchmarks due in part to two factors: the value orientation and the need to work through the large cap domestic equity return after two managers experienced difficulties last year. The portfolio continues to be monitored by the Investment Advisory Committee and some repositioning has taken place in the portfolio over the past quarter. Additionally, some of the core equity will be redeployed into more long/short strategies in the core domestic markets. The next Investment Advisory Committee meeting will be held in Knoxville the first week of March.
- V. **Report of the Treasurer 2009 (Audited Financial Statements)**—Information Item—Chair Talbott asked Mr. Peccolo to present the next item on the agenda. Mr. Peccolo explained that the printed 2009 Audited Financial Statements were included in the Board materials. As mentioned at the Fall Meeting, these final statements include two component units discreetly presented: the University of Chattanooga

Foundation and the University of Tennessee Foundation. The Statements are presented as an informational item since the contents were discussed in detail at the October Meeting. The final audit report has not been received and we will continue to work with the Comptroller's office on that report.

Vice Chair Murphy raised a question regarding the Condensed Statements of Net Assets showing the University of Chattanooga Foundation had reduced assets in 2009 versus 2008 in the other asset category. He asked Trustee Hall if there was an explanation of the reduced assets. Trustee Hall commented that he believed it was the cost of the settlement on UC Place. Dr. Rogers added that it was a \$3 million item. Trustee Stansberry asked if the property had been disposed and Dr. Rogers said no it is still owned by the University of Chattanooga Foundation. Trustee Hall explained that there was a lien by the contractor/developer on the property and the Foundation had to settle it.

Chair Talbott pointed out that the last page of the Audited Financial Statements is a five-year summary of the results. It is a great snapshot for Board members to see where the University has been from 2005 through 2009.

- VI. **Revised Operating Budget for FY 2009-10**—Consent Item—Chair Talbott asked Gary Rogers, Senior Vice President and Chief Financial Officer to present the next item. Dr. Rogers noted that the revised budget is presented at the middle of each year to bring everything up-to-date after the Legislature has approved final appropriations. The revised budget document reflects a change in revenue; \$2.2 million in tuition and fees and \$27.4 million in state appropriations. The bulk of \$27.4 million is stimulus money (ARRA and MOE funds). The other revenues increased \$700,000 primarily from the UT Health Science Center. He pointed out that the state appropriations change is the most important detail.

The document has a history and a projection of the base appropriations that the University receives; based on present information, the University is unlikely to receive additional funds in the next couple of years. Non-recurring funds are also shown; those are related to the FY 2009 \$17 million mid-year rescission and the two classes of stimulus money in fiscal years 2010 and 2011. The total recurring decreased from \$487 million in FY 2009 to \$423 million in 2010. The difference was replaced with the stimulus funds and the same thing will happen in FY 2011. There is not any one-time money in FY 2012. Based on the Governor's budget; another \$24 million plus reduction in base will occur in FY 2011; that will be replaced with stimulus money but will not be replaced in FY 2012. The total appropriations in the amount of \$424 million noted for FY 2011 will go down to slightly below \$400 million in recurring appropriations in FY 2012.

The changes in expenditures have been reconciled and are included. Two buckets of stimulus money that has to be accounted for: a \$23 million pot that was received on June 30, 2009 which was not spent in 2009 but was a carry forward to 2010 and another \$24 million unspent in 2010 that will be carried over into 2011. After the one-time stimulus monies are accounted for, the basic change is \$12.5 million.

How the stimulus monies are being spent is reflected in two charts and broken out by function and natural classification.

He then explained the graph that consists of tuition and fees (blue line) and state appropriations (green line) as a total of unrestricted E & G money. It compares the percentage of the budget that is funded by tuition and fees versus state appropriations funding; the lines are getting closer together. It has been gradually inching up and the uptick in state appropriations is because of stimulus funds.

The eleven-year history shows the effect of inflation on the appropriations that the University receives. Once again, the uptick includes stimulus funds. Basically, in real dollars it has been flat across the ten-year period.

Slides were presented that summarized the budget information. Tuition and fees increased over the original estimate by \$2.2 million. That increase is due primarily to the enrollment gains at UT Martin. The state gave the University \$3.4 million in additional money to cover mandated increases in employee benefits. Group insurance costs increased this year as well as costs for the 401K program. Additionally, the state gave a special appropriation of \$1.0 million for the dental school at the UT Health Science Center. That money has been applied to a Dunn Building renovation project to improve the dental school's facilities. The \$23 million is the money received on June 30, 2009. The additional \$700,000 is from services at the UT Health Science Center. The total of new revenue is \$30.3 million that has been applied to these functional categories of instruction, research and on down through operation and maintenance. Research is the largest increase and that is the normal kind of carryover with unfinished projects. With \$21 million of stimulus money in the \$33 million, the net change is \$12.2 million. A total of \$300,000 was put into debt service for the new Regional Biocontainment Lab in Memphis. Vice Chair Murphy asked Dr. Rogers to verify that the only reason that the \$21.4 million deduction is shown is to explain that of the \$33 million only \$12.2 is additional money. Dr. Rogers said yes it is to show application of these funds is mostly stimulus money.

Regarding the sources of the funds, some \$1.1 million of encumbrance items were committed in the prior year that will flow through the current year and \$30.3 million in appropriations from the state which was mostly stimulus money. The stimulus money that the University

receives in this fashion is on a reimbursement basis and not received up front. After the expenditures are incurred they are reported to the state monthly and are reimbursed. It operates more like a grant. Regular appropriations are drawn down on a monthly basis. Next listed is the reappropriations and the carryovers that are reserve funds. The \$24 million is basically the \$23 million that the University will not spend in FY 2010 because it will be carried forward to FY 2011. Another \$33 million will be applied to this year. Vice Chair Murphy asked if the reason the \$24 million is going to be carried over to FY 2011 is due to the timing of the payments. Dr. Rogers said yes it is timing and also the planning and execution. Trustee Anderson confirmed that the money can't be spent in this year and this is an estimate of what won't be spent this year either because a project won't be ready or the expense has been incurred but the money will not have been reimbursed. Dr. Rogers replied yes. The list consists of all of those commitments and the state mandated costs and how it is used. The stimulus money was backed out to show what would have happened without those monies so that it is not added in and confused. All of those monies have to be accounted for separately and that is what has been done with the revisions in the budget.

He then presented a graph that was discussed earlier in the budget document and explained that the lines are getting closer and closer-- they are going to converge. He then showed another estimated graph with the stimulus money out of the top line that is state appropriations with three data points that are fiscal years 2010, 2011 and 2012. State appropriations show 43% and tuition and fees is at 42% without any increase in tuition and fees. If the University has additional tuition and fees the lines will get closer.

He then discussed the historical appropriations, as well as the inflation rate. The chart reflects a flat line when considering inflation using the Consumer Price Index. If the Higher Education Price Index, which includes construction, were used it would push the line down even further. No capital costs are in the numbers so only the Consumer Price Index is used. The curve is dropping rapidly in the \$300 million range. Roughly \$400 million in appropriations will push the purchasing power into the \$300 million range. That is with an anticipated 6% reduction added that is in the Governor's budget. It is not an encouraging picture but it is a reasonable outlook of what to expect. All the campuses have planned and continue to execute their plans to get to where they need to be to handle this situation in FY 2012.

Trustee Stansberry asked Dr. Rogers to back up to a previous chart because he did not understand how the numbers added up to make 100%. Dr. Rogers responded by saying the numbers won't add up because of additional funding sources. Other revenue amounts have to be included to add up to 100%. This compares the percentage of the total 100% that are appropriations and the percentage that is tuition and fees. Vice Chair Murphy noted that in the revised budget

document there is a third piece including pie charts that reflect the other 15%.

Chair Talbott stated that there is a train coming at us but the good news is that we know it is coming and are planning for it.

On a motion made by Vice Chair Murphy, seconded by Trustee Wharton, the Revised Operating Budget for FY 2009-10 was approved.

- VII. **ARRA-Funded Capital Maintenance Projects**—Information Item—Chair Talbott asked Dr. Rogers to continue with the next item. Dr. Rogers informed the Committee that a plan was worked out with the state to use stimulus funds to pay for some capital maintenance projects totaling \$52.6 million. This information is being presented to the Committee as a report. At the October 2008 meeting, the Board approved a list of projects to be submitted to the state. As part of that approval, the Board gave the President the authority to add projects later on when and if money was available. When some of the stimulus money was received, the campuses were asked to identify capital maintenance projects and submit a list. That list is included in the Board materials. The list was submitted to the Tennessee Higher Education Commission (THEC) and to the State Building Commission (SBC) in January and has been approved. The fact that there was no real capital maintenance money from the state has been alleviated somewhat because of the ability to use some of the stimulus funds for some maintenance projects. The list consists of the campuses' most critical and needed projects that they submitted.

Trustee Wharton asked how much money was needed to bring the deferred maintenance current. Dr. Rogers replied that it would be in the \$500 million range to clean everything up. Trustee Wharton then asked how much of that is critical that cannot be put off much longer. Dr. Rogers answered that \$50 million will get the University in relatively better shape. That amount will fix projects that may create more problems if they are not fixed. Other projects are in the terms of renovations that are needed but are not going to cause more trouble. Trustee Wharton asked what about buildings such as Estabrook on the UT Knoxville campus. He added that he did not see it on the list but knows that it is a building that is in dire need of repair. Dr. Simek interjected that Estabrook is a capital and not a maintenance project. Trustee Wharton asked if Estabrook was going to be maintained or demolished. Dr. Simek said the building would not be torn down but the work at Estabrook far exceeds what is available.

Trustee Schledwitz questioned if the \$50 million was not higher than what the University had been getting for maintenance projects. Dr. Rogers said yes by a factor of 2 to 3 times since it is usually around \$20 million. Trustee Schledwitz commented that from a historical standpoint the University was able to catch up some. Dr. Rogers said

yes this amount would be about three years worth of funding in the normal process.

Chair Talbott stated that staff has got to keep the Board apprised of what is going on regarding capital maintenance. The Board is aware there are operational issues. The capital maintenance has not been quantified. Staff needs to keep in mind that the Board needs to be aware of what the capital issues are. Dr. Rogers replied that is part of the project that is being done in three phases. The state funded the first and second phases and a request is in for the third phase. This project makes an assessment of all the properties across the entire state and will supply that information.

Trustee Horne asked if there would be negotiations with the architect, engineering and construction firms because it is windfall money. Dr. Rogers explained that it all had to be approved by the State Building Commission (SBC) and comply with the State's bid rules. Trustee Stansberry asked if the \$52 million had been allocated across the entire University and how that process works. He then added that it would not be realistic that the campuses got everything they asked for. Dr. Rogers said it goes back to the original allocation of the stimulus dollars and follows the appropriation by entity. Trustee Stansberry confirmed that the campuses then went through their wish list and picked the most critical. Dr. Rogers replied yes. Dr. Simek added that the System did not receive any stimulus funds and that the funds went directly to the campuses.

- VIII. **Report of Capital Project Outside Budget Process**—Consent Item—Chair Talbott moved to the next agenda item and asked Dr. Rogers to continue. Dr. Rogers noted the item is a self funded project that the Board has not seen previously. At the October 2009 meeting, the Board reviewed and approved a list of projects that was forwarded to the state and is in the Governor's budget. Although the projects are not state funded, they still have to be processed through the budget. This project was not on the list presented in October 2009 and is being brought before the Board for approval. Upon approval, the state will be asked to include it as an amendment to the appropriations bill. This is a project at the University of Tennessee, Chattanooga that the contractor, Aramark, will fund. Even though it is self funded and there is no state money involved it still has to go through the process.

Trustee Wharton asked if it was like a performance contract where Aramark will recoup their investment by charging the University more for food. Dr. Rogers replied that Aramark will have to recoup their cost through the sales of the food. Trustee Wharton stated that the real question is would it be more economical to bond and fund this project over a longer period of time and would the University not make more money from that approach than perpetuity with Aramark. Dr. Rogers explained that they have a limited term contract that was bid. Trustee Stansberry asked if they had agreed to this before they got the bid. Dr.

Rogers said yes and Trustee Stansberry questioned whether their prices would change. Chair Talbott explained that they are increasing capacity, more food will be sold and additional revenue will be coming in.

On a motion made by Trustee Anderson, seconded by Vice Chair Murphy, the Report of Capital Project Outside Budget Process for UT Chattanooga was approved.

IX. **Real Property Transactions**—Consent Items—Chair Talbott asked Dr. Gary Rogers to present the Real Property Transactions. Dr. Rogers explained that each had to be handled as an individual item and approved.

A. **KUB Utility Easement (UTK)**—Consent item—Dr. Rogers explained that this item was a utility easement for the Knoxville Utilities Board (KUB) to install the necessary utilities at the Sorority Village that is under construction. It is a permanent easement so that KUB can supply sewer, water and gas.

On a motion made by Vice Chair Murphy and seconded by Trustee Anderson, the KUB Utility Easement located on the UT Knoxville campus was approved.

B. **Disposal of Future Interest in Property (UTHSC)**—Consent item—Dr. Rogers informed the Committee that this item was a disposal of future interest in property in Memphis. That is a fancy way of saying there is a part of an alley way that will belong to the University and we need to give it to the adjacent property. It contains approximately 3,439.76 +/- square feet. Vice Chair Murphy confirmed that it will be given to them at the appraised value and Dr. Rogers replied yes. The University will not use the property.

On a motion made by Vice Chair Murphy and seconded by Trustee Anderson, the Disposal of Future Interest in Property at the UT Health Science Center was approved.

C. **Sale of Gift Properties**—Consent item—Dr. Rogers stated that the University has four gift properties that require the Committee's approval to sell. The first property is a vacant lot and the appraised value is \$150,000. The second property is a single family residence in Tullahoma and the appraisal is \$210,000. The third is a commercial parcel that is around an acre and the appraisal is \$240,000. The fourth property is a single family residence in Shelby County on the east side of Memphis and the appraisal is \$280,000. Chair Talbott confirmed that these will be sold as long as the appraised value is received and Dr. Rogers said yes. If there is an offer that is



below appraised value, special permission by the State Building Commission would have to be given to sell it at the lower price.

On a motion made by Trustee Wharton and seconded by Vice Chair Murphy, the Sale of Gift Properties was approved.

- X. **Voluntary Retirement Incentive Proposal (UTIA)**—Consent item—  
Chair Talbott asked Dr. Joe DiPietro, Vice President, Agriculture to present the Voluntary Retirement Incentive Proposal. Dr. DiPietro began by saying this is the same proposal that was presented to the Board before from the standpoint of the voluntary retirement program that was put in place last year. Dr. DiPietro said that as the Institute of Agriculture is faced with a \$2.5 million budget reduction the main point is how to implement the reduced budget without stimulus funds. The Agricultural Experiment Station and the UT Extension Service are interested in offering this program again. Employees have to be retirement eligible; that includes all the retirement systems such as Tennessee Consolidated Retirement System (TCRS), Optional Retirement Program (ORP) and federal employees. The program includes a lump sum of four month's salary upon separation and the option of a temporary, one-year, part-time appointment after retirement at 35% salary. The only difference between the materials that were in the Board book and the revised ones are federal employees have been included in the package. The necessary approvals from the various state and/or federal agencies that are associated with this program will have to be secured. It was not problematic last year and no problems are foreseen this year. Last year's program yielded 70 employees that took part in the program. Approximately 400 employees in the two units of the Institute of Agriculture are eligible. Approximately 40-50 employees are expected to sign up for the program. Both of the organizations are going to be doing strategic planning to look at how to reorganize their operations given the downturn in the budgetary allocations of those units from the standpoint of staffing across the state. Extension is still holding very tightly to a county based model. A Performa is attached that shows the cost of the program. The first year's cost of the program is \$1,343,750 if 25 exempt and 15 non-exempt staff choose to enroll. The one difference in this program on the Performa is the TCRS one-time payment. Because an early retirement opportunity is offered for the employees in the TCRS program, it changes the actuarial picture and requires a one-time payment on those employees. Stimulus funds or other monies from these units will be used to cover the costs. Trustee Prevost asked if ARRA funds were allowed to be used on a one-time expense such as this. Dr. DiPietro explained that if not there were other available sources of funds. Trustee Wharton questioned Dr. DiPietro about coming back to the Board each time the program is offered so that they can look at the figures, etc. Dr. DiPietro said that there was no problem in doing that.

Vice Chair Murphy asked how close these savings from the program would bring UTIA towards their reductions. Dr. DiPietro responded that it would provide half. The two units in question are the Agricultural Experiment Station and UT Extension. The additional reduction that is anticipated is approximately \$1.7 million. The long-term savings are \$2.5 million and that produces a net gain. The units hope to redeploy some of these positions at lower levels to re-staff. The Experiment Station and Extension model in place across the state is key to the organization from the standpoint of outreach and activities.

Dr. DiPietro clarified Trustee Wharton's question regarding coming back to the Board with the language change is at the pleasure of the Committee and the Board.

Trustee Wharton said that he would make the motion subject to that revision and seconded by Vice Chair Murphy, the Voluntary Retirement Incentive Proposal with amendments for the UT Institute of Agriculture was approved.

- XI. **Differential Tuition Proposals for the Colleges of Business, Engineering, and Nursing at UTK Item**—Chair Talbott asked Dr. Cheek, Chancellor of the Knoxville campus to present the differential tuition proposals for UTK. Dr. Cheek noted that today, we are proposing differential tuition for three different colleges: Business, Engineering and Nursing.

In February of 2009 the proposal for the College of Nursing was to reduce the class of juniors coming into the College by 50% percent (96 students to less than 50). The students opposed to the cuts talked about the need for nursing, the reason they wanted to attend the University of Tennessee and questioned why UT would put together a plan that would reduce the nursing program by 50%. As an alternative, stimulus funds were used to keep the class at 96. Since that time, those students have had a fundraiser on the banks of the Tennessee River and raised \$50,000 of private money to help the College of Nursing.

The proposals today are not the exact same for each college but they respond to a need at the University of Tennessee to provide resources in the three colleges to allow continuance of the programs and in some cases expand programs. He then informed the Committee that he had Dean Jan Williams, Dean Wayne Davis and Dean Joan Creasia with him to briefly explain the plans for the Colleges of Business, Engineering and Nursing.

Chancellor Cheek then asked Dean Williams to present the plan for the College of Business. Dean Williams noted that he would go over five things about the business proposal.

First, the number of students majoring in the College of Business on the Knoxville campus increased from 2,516 to 5,135--more than doubling within a five-year period. Additionally, the faculty size has declined from 120 to 114. Those are fall semester numbers and the number of students to date is actually higher than that totaling around 5,500. The 114 faculty number is going to take a significant drop year after next when the stimulus money goes away.

The proposal is a \$50 per credit hour differential tuition for students taking business courses. This applies to 200, 300 and 400 level courses and does not apply to graduate work because a different fee schedule applies to those programs. It would add approximately \$3,100 for a student to get a business degree at UT Knoxville. Charges would not increase in the freshman year; increases would be around \$700 in the sophomore year, and approximately \$1,200 in the junior and senior years. He then mentioned a table in the materials that showed similar structures in place at many other schools. The different fees consist of a semester, course or a credit hour fee, which is what is proposed at UT Knoxville. The schools on that list include: Alabama, Auburn, Kentucky, Arkansas and South Carolina and they all have structures similar to this. In Tennessee, Memphis and Tennessee State have plans like this in place and have had them for a while. Even with this differential cost increase for a business degree in Knoxville it is still relatively low compared to other schools.

The alternative is one similar to a situation that the Chancellor explained in nursing to reduce the size of the class in the College of Business. The College had about the right size of student body versus faculty in 2006 and would have to make significant reduction in enrollment to get back to that level. In May, the College would have to accept about half as many students as we have been and do it for four years to right size the College of Business in Knoxville to the expected faculty size.

Students are extremely supportive of the increase particularly after they understand the situation and the alternatives.

Finally, the five-year graduation rate is 85%. Students are admitted into the College at the end of the sophomore year and 85% of them graduate three years later. The University is particularly interested in raising graduation rates. The College of Business has a graduation rate now that is helping the University. Reducing the size of the College would work against the graduation rate of the entire campus.

Dr. Cheek then asked Dean Davis to present the differential tuition for the College of Engineering. Dean Davis prefaced his remarks by stating appreciation of the Board for being allowed to present. Currently, there is a student course fee that was approved by the Board eight years ago that is \$25 per student credit hour. That has been in place for the last eight years and has not increased. From an

inflationary standpoint alone it would be necessary to have an increase in that fee. However, that fee is being rephrased to differential tuition. Basically the fee would be increased from \$25 to \$45 per student credit hour for courses taken in Engineering. That fee already supports the College's efforts in increasing specialized equipment that is used in Engineering and specialized software to train students to go out into the profession and already understand the types of equipment and software that are being used in industry and with corporations.

From a retention standpoint, the College has had an unprecedented increase in both the quality and the growth of students in the College of Engineering over the last six to seven years. The current entering freshman student's GPA is 3.98, current math ACT is 29.9 and it may be the highest within the UT Knoxville campus and System as a whole. This is due in part to the Hope Scholarship and the fact that the differential tuition concept was initiated eight years ago with the Board. It has made a phenomenal difference in the ability to respond to students. The current retention from freshman to sophomore is 80% and that is for the students as a whole. Fifteen years ago, it was probably around 50%. It is a tough curriculum and as a result of our efforts, a good portion supported by the fee, has made a phenomenal change in our ability to retain students. The retention rate for honor students is 90% from freshman to sophomore year.

Eight years ago we were not ranked as a College of Engineering. Six years ago we were 81<sup>st</sup> in the country. Our ranking (April 2009), has improved to 68<sup>th</sup> and the College is now 40<sup>th</sup> among public institutions of Colleges of Engineering across the country. Our undergraduate program is 32<sup>nd</sup> across the country and a lot of that is because of the investment made by faculty and the Board in terms of respect to those kinds of assistance.

The College of Engineering is not reporting that it will have to eliminate a portion of our students if the differential tuition is not increased; however, we will not be able to continue to provide the quality service to our students that we are now if the fee is not increased. The reason being the toll the budget reductions have taken.

Student leaders in our student societies and college ambassadors unanimously agreed that they preferred to see a differential tuition increase as opposed to dropping critical services that they are currently getting in the path that our college is growing today. If needed, letters of support are available.

Currently, there are 3,039 overall students and that is 11% of the student body of the UT Knoxville campus. The College has had an 18% increase in undergraduate students over the last five years and 38% increase in PhD students essentially with a constant number of faculty members. That reflects a tremendous increase in productivity of faculty and staff within our college over the last six years.

The materials have a summary of the areas where these funds are currently being expended and where they would continue to be spent. The freshman advising program is essentially funded by the student course fee and that is one reason why we are no longer at 50% but at an 80% retention rate. We have a well-tuned advising program. Other areas, as I indicated earlier, are equipment, software and supplies. A small increase in faculty members is needed because of the large increase in students that would be supported by the differential tuition.

In all of our proposals, approximately 10 % is built in for scholarships for students who cannot pay the fee. The students' main concern raised was that if we increase the differential tuition from what we have today to the future what about the students that have proved through financial aid that they are unable to pay the increased fee. The students were more than willing to pay the fee as long as those students could receive help to pay the increased fee. Trustee Wharton asked if 10% was enough to cover those students' needs. Dean Davis said yes that amount does adequately cover the charges for those students that officially cannot pay their tuition or the differential tuition increase.

Dean Creasia then presented the plan for the College of Nursing. She noted that the students made a huge impression on the community as a whole because of the way they went about trying to champion the cause of not cutting students as a result of the necessity of cutting budgets.

The rationale for differential tuition for the College of Nursing is the cost of clinical education. Students are with faculty members in very small numbers. The 1-8 ratio is used in the hospitals. Some of the hospitals are trying to convince us to decrease that number and at the moment we are putting our foot down because it would be even more expensive.

The 1-8 ratio is one that the hospitals have been comfortable with primarily because we have some excellent faculty members. They feel comfortable having students come in with our faculty members. Students each take two patients and faculty in essence are then responsible for sixteen; that is a tremendous load. That is why they are trying to change the ratio to 1-6. For the moment, we are keeping it at 1-8 faculty student ratio for clinical education and are looking at some other innovative teaching opportunities to make our dollars stretch a little bit further.

Our differential tuition is a \$90 per credit hour boost. The fee increase is only on the upper division of nursing courses taught. We have not assessed the fee when the students are taking general education courses during their first two years at UT Knoxville. As Dean Davis said, we are putting aside 10% for scholarships for students who really

can't afford the increase and are encouraging them to come to us if they need additional help. The College of Nursing does have scholarship money that can be used to help support students if this becomes a problem. Students that can't get into the College of Nursing because the demand is much higher than can be accepted have to go to the schools listed on the table in the materials. The tuition is more expensive than the University of Tennessee and the programs are not as high quality.

Our licensure pass rate last year was 99.6% for the first time takers. The students are sure to pass the licensure exam and they can get a job when they get out so they are willing to make the sacrifice on the front end so they can have a quality education and graduate from a high quality program. Tuition at the private schools is far more expensive, granted they do have some scholarship aid, but it is still higher than the University of Tennessee. The students really want to attend the University of Tennessee. That is why the College of Nursing is promoting the differential tuition to try to keep the enrollment of students at the same level and allow us to increase a slight amount. Right now, we have approximately 300 applications for the 104 (increased from 96) assuming the Board will approve the differential tuition increase. It would allow us to enroll a few more qualified students for the next year. The GPAs for these students are running around 3.7 and below that we have to cut. Obviously, we can't admit the 250 but if we could enroll a few more it would be good.

Chair Talbott stated that this is obviously an important Board matter and encouraged questions. Trustee Stansberry commended the Chancellor and the Deans for taking the initiative to bring this matter to the Board's attention and to, in effect, save these programs from what otherwise would be the case. He stated that he felt it was an easy decision and one that is easy to support. He encouraged all to consider this matter in what will soon be a common context and that is "is this program one that is worth paying for if the state is not going to pay for it". This decision is easy but we are going to see other situations that are not easy as revenue drops even lower. Do we abolish programs or do we step up and ask the students to pay for them. This will be a common theme here in the next several years. The model we are seeing today is one that we will end up following because if students want to buy it then it should be offered. Nurses, engineers and business people are not going to go unemployed. I want to be the first to support it and secondly encourage that all programs are given this same analysis. Is it a program that is worth paying for?

Trustee Anderson said that he thought this was overdue and it is good. He added that the Board should look at it every year and hoped other Board members felt the same way. He stated that he would like to see some form of peer comparison towards excellence. As Trustee Stansberry said this is going to happen more and more and upon

yearly review would create excellence for each of these Colleges. Chancellor Cheek said that they would be happy to report to the Board on an annual basis and added that the Governor has asked us to aspire to be a top 25 public institution. UT Knoxville has taken that challenge very seriously and a task force has been formed and is in the process of choosing a consultant to work with. In June, we will provide the Board a gap analysis of the University of Tennessee at Knoxville and the top 25 in the United States. In some areas, UTK will be very close to the top 25 and in some areas better than the top 25. The Colleges of Business, Engineering and Nursing at the University of Tennessee Knoxville are among the best in the country. He informed the Committee that he and Dean Davis have been working on development and are trying to raise \$24 million for faculty and UTK will match that \$24 million to fund 12 additional faculty members over time.

Trustee Wharton commented that Dr. Creasia said that they will add eight students in Nursing and asked how many students will be added in Engineering and Business with these proposed increases. Dean Williams of the College of Business said the business proposal was to maintain and not cut but the proposal does state that it is a possibility the number of students can be raised to 5,800 from the 5,200. Currently, the number of students is up to 5,500 in one semester. It does not accommodate a lot of growth from where we are right now.

Dr. Cheek stated that Engineering is on a projected growth and the differential tuition increase can maintain that growth but will get to a point where it can't. Additionally, there are two new buildings coming on line though which are critical to the University. One is the Tickle Building and the ground has been broken for that and the other is the Min Kao building and it is being constructed right now. Major Engineering infrastructure issues need to be solved.

Vice Chair Murphy stated that he looked at the charts that are attached to the end of the proposal which are peer comparisons. Even with the additions, UTK's programs are not the most expensive programs among peers. Nursing is the one that gets us closest to the top from that standpoint. It doesn't take into account the other chart that was shown that that showed private nursing competitors out there. UTK is not charging half of what students would have to pay if they went to a private institution. He stated that he thinks all are concerned about raising tuition and feels that the six years he has been on the Board that tuition has been consistently raised. The program presented today has been done in the right way. One of the key components of the program is talking to the students and asking for their preference of a size reduction or paying a little more. It makes a lot of sense from a student's standpoint on these particular programs as far as increases. We will have a harder time with other programs. This model needs to be used when other programs are brought before the Board for increases. He added that Board members are going to be looking at whether or not certain programs are right for the differential tuition or

not and if the students support it. If students are adamantly opposed to the increase other options will have to be looked at. We are going to see state appropriations drop considerably year after next and they are not likely to come back anytime soon. Some real hard choices have to be made. He then commended Dr. Cheek and the Deans for the process they used because it helped Board members to get a feel for where the constituencies are with students.

Trustee Schledwitz asked whether or not the differential tuition fees will be subject to the annual increases and if tuition is raised by a certain percentage does that apply to these as well. Dr. Cheek answered yes. That is why we are calling it differential tuition instead of a course fee and when we come to you as a Board we will explain that very clearly. Trustee Schledwitz said that he is very much in support of the increase but was having a hard time comprehending the statistic that five years ago in the College of Business the faculty to student ratio was 1 for every 210. Today, the faculty to student ratio is 1 for every 450 and has more than doubled. It just doesn't make sense that the faculty has not been increased and has even decreased when tuition has been received for 3,000 more students. Chancellor Cheek said it has to be on a performance based model and allocation of resources. He went on to say that he can't answer the question as to how it got that way but that is the way it is now.

Dean Williams commented that just because additional funds come into the University does not necessarily mean that it goes to the unit where the students go. Funds don't necessarily follow the students. During the period of time that is being looked at, the University had so much pressure for fixed cost increases, etc. The additional funds that came in because of the growth of students did not go to the College of Business but to the University to cover these other expenses.

Trustee Schledwitz asked if there was a chart that shows student to faculty ratio on the College of Business with our peers and how the University stacks up. Dean Williams said that he doesn't have the specifics with him but said that five or four years ago the College of Business was about where direct peers were but are now much higher regarding students per faculty. Direct peer institutions such as Georgia or Alabama have not had the growth that UTK has had over five years. Their faculties are remaining stable or may be declining slightly. Faculty decline is very simple to explain. Every time we replace a faculty member it costs us 130% of the budget. If we replace four faculty members - we get three. You can look at it almost systematically – one a year. The priority for the College of Business will be to put the funds back into 130 or where it needs to be. That is primarily how we would use the differential tuition to build our faculty back up. Again, I think we will be at about the right ratio with the other schools.



Trustee Horne voiced concern about the profit schools that are springing up and asked if it was possible to change our philosophy and have a high-track that allows a student to graduate in three years for a lot more money in order to compete with other schools such as Phoenix and South College. Dr. Cheek stated that the emphasis is quality and that is what differentiates the University of Tennessee Knoxville from other institutions. Trustee Horne said that is true but we need more students getting in and out. Chancellor Cheek said that is why we are working on throughput and long-term so we can grow. We can't grow if the state doesn't put in their resources we will have to increase tuition substantially. Trustee Horne said that he 100% supports this but one thing that bothers him is the faculty to student ratio in the College of Business. Running the school for profit is something to think about for the future.

Trustee Loughry applauded the amount of information that the Deans provided. One thing for another committee, not today, is a need for better advising in order to get more Tennesseans graduated. The College of Business adviser ratio compared to peers is almost a 1 to 10 ratio: a very high ratio of advising and yet a very high graduation rate. We need to take some best practice that is going on there and share with Dr. Bonnie Yegidis to spread it out among some other groups. These statistics are telling us something that we need to apply to some other areas also.

Trustee Hall stated that he has been asking for statistical information since he has been on the Board and is pleased to see the detail that has been presented. He then asked where the information on the College of Engineering ranked with PhDs came from. Any footnotes when ranking the schools would be helpful in the future. This is information that we ought to look at every year because the bottom line is how much it costs to get a degree at the University of Tennessee. I hope it is not a self fulfilling prophecy that state appropriations are going to continue to decrease. A concern to me is that the more detail that can be given to the legislators so we don't become a private school in terms of costs is better. While these are three outstanding colleges, I am concerned about the other Colleges and the plans for them. He then asked if it is something that we are going to see across the board and at other campuses across the state. Dr. Simek said yes but each case needs to be justified as it is here. In our view and the Chancellor's view these three were the most critical circumstances because they were actually going backwards. These are very high quality units that were suffering badly at the budget reductions they were facing. This began 1 ½ years ago, when we charged the Colleges to make a strong case for this that was statistically based on comparisons. We will not come to the Board unless those same cases are made for others. It is the Board's decision but I too would like to see this as a model for how this is done. The Board needs to see all of the elements and comparisons but the appropriate level for those comparisons from my point of view is not the campus as a whole but

the individual units within. The costs for those units are differential. The fact of the matter is it is very expensive to make nurses versus archaeologists. Those are the cases that need to be made and each need to be looked at critically. I think you will see more of this because of the level on which we need to consider the possibilities of how we fund the different units. Other campuses can make those cases as well. We must have substantial cases with detail and should not approve across the board.

Student Trustee Forrest thanked the Chancellor for bringing it before the Board. He stated that he hated that his fellow students will be paying significantly more and had a concern because he spoke with some of the College of Business students. His understanding was that the number of students that attended the information session was only 61 out of 5,100. He stated that he didn't doubt that some students will support it but wanted to know how it would be communicated that the change would occur. Chancellor Cheek said that he met with the student leaders on campus, both undergraduate and graduate, in the spring. News articles have appeared and he spoke with the Student and Faculty Senates. It has been something that has been talked about all over the campus. No one wants to pay more but once they understand the circumstances they choose the increase as the option.

Trustee Prevost commended the Chancellor for showing where the increased tuition would be used. It appears that the money will be going back to the program that generated it and wanted to ensure that it would continue in the future. Chancellor Cheek said yes that is the plan. Initially it was discussed whether some of the funds could be used for a central purpose to help others around the campus. These are not luxurious proposals and it could be argued that the increase should be more.

On a motion made by Trustee Anderson and seconded by Trustee Wharton, the Differential Tuition Proposals for the Colleges of Business, Engineering, and Nursing at UT were approved.

XII. **Update on UTHSC Faculty Practice Plans**—Information Item—Chair Talbott asked Dr. Schwab to give an update on the UTHSC Faculty Practice Plans.

As background, Dr. Schwab noted the University of Tennessee's Faculty Practice Plans currently account for roughly \$240 million in revenue per annum. These revenues not only pay operating expenses of the faculty practice plans but pay roughly 90% of the physicians' salaries. So the state's contribution of the physicians' salaries is only around 10-15%. Over the last two years, UTHSC has been moving to create joint ventures. The current practice plans can best be described as owned by the members or a third party with the University of Tennessee providing governance to the practice plans. The University

is not permitted to own practice plans but is allowed to govern them. That is the model we have and continue to use.

We are currently moving to a series of joint ventures to create new non-profit corporations with some of our partner teaching hospitals. This is a trend throughout the United States and we were one of the leaders but the market is rapidly catching up with us. The overwhelming advantages of these joint venture practice plans with our participating hospitals is to substantially improve contracting arrangements and substantially improve clinical effectiveness and efficiency leading to a larger profit margin than is achievable by the two entities operating independently. It also reflects a major change in our ability to share technical revenue with our joint venture partners. Currently, since the University of Tennessee doesn't own a hospital no mechanism exists by which the vast majority of the money generated in the healthcare system--which is technical revenue, operating room, CT Scan costs, etc.--can be shared with physicians. It is a regulatory prohibited procedure. If the University of Tennessee owned a hospital, obviously, it wouldn't be a problem for our constituents in the practice plans. By forming joint ventures we overcome the vast majority of these and in some cases are actually able to file an academic medical center exception where Stark doesn't apply at all.

The other huge advantage is that it gives us dramatically improved financing and reserves for our practice plans by tapping into the substantial reserves of our partner hospitals. It also allows us to create much larger practices with a much larger teaching base than we currently have.

For the first time, another advantage in creating these joint venture plans is receiving direct support payments from participating hospitals. Part of our agreement with our participating hospitals is not direct payment plans to the practice plan but direct payment plans to the Health Science Center as a result of this joint venture that has been created.

The disadvantage of this is we will now have to share our faculty. He reassured the Committee that this is just a shared faculty. We will show you as we go forward that each of these practice plans maintains substantial or near total control of governance. Why did the hospitals want to do that? Over the last three years we have dramatically increased our market share and are now a more attractive partner. In fact, you really want to freeze us in place so that we don't seek to go out and peddle our wares at other competing hospitals.

The practice plans that we will be bringing to you that we are in the near final stages with include the relationship with the practice plan called UT of Honor. This would involve us taking the University of Tennessee Medical Group, a large specialty practice, and several of

our smaller subspecialty practices and roll them into a joint venture. This practice plan will be called UT of Honor Physicians. The memorandum of understanding has been advanced to the University of Tennessee System and has been reviewed by financial and the President of the University and will go forward to the Attorney General and State Comptroller. UT of Honor is upfront as one of our first practice plans as a joint venture with the big Children's Hospital in Memphis. The other practice plan that we would like to bring to the Board at the June meeting is called UT Erlanger. The Erlanger campus has a hodgepodge of practices. Some are administered by the University and some by Erlanger. They constitute a substantial market share and they have not been managed to satisfaction. As a result, by merging into a UT Erlanger joint venture practice plan we are allowed to get substantial advantages through the College of Medicine and the faculty.

Our timeline for these proposals is to present them to the Board of Trustees for approval at the June meeting; they must go before the hospital Boards for approval as well. Methodist expects to vote on the UT of Honor Practice Plan in April and in some cases the practice plans boards themselves administered by the University of Tennessee will have to vote to merge in.

At the same time we have a series of things that don't require Board approval. We have approximately 15 acquisitions in progress and Executive Vice Chancellor Brown and I are carefully watching these acquisitions. We are looking to aggressively expand our practices and our ability to go forward with our joint venture partners. In many cases we will offset our overwhelming deficiency by not owning a University hospital by binding us to our six partner hospitals throughout the state. If these two joint ventures are successful, we believe that the additional ones will be rapidly brought forth in our best interest.

We bring this to the Finance and Administration Committee as an information item at Dr. Gary Rogers' recommendation. As I said, we have an extensive reporting relationship with the Audit Committee of the Board of Trustees. Executive Vice Chancellor Brown and I will answer any questions you may have but the market is driving us to these decisions in a rapid fashion.

Trustee Schledwitz asked Interim Chancellor Schwab to explain to the committee the rapid rise UTHSC has had in its practice planning growth over the last three years. Interim Chancellor Schwab said that in the last three years we have decided that our new players would have to have market share and the big money is in the hospitals and not in the practice plans. Once you have paid the physicians, the practice plans exist on a very small margin and it is very market and competitive sensitive. Margins, when they exist, are in hospitals so we have aggressively grown our practice plans so that we can build favorable relationships with our hospitals. It was a conscious decision.

In no small part, the audit that was done on our largest practice plan was driven because some of the things that were being done. Instead of it slowing us down it speeded us up. We actually went much faster and we are grateful that we did otherwise we would be far behind the curve. Currently, things are happening that I never anticipated would happen. Independent practice groups are in such freefall that they are seeking employment relationships directly with hospitals. We find that a little bit concerning especially as our overwhelming place in the market has been our ability to develop a remarkable integrated service. We are not particularly fond of a hospital physician appointment model. We would like to move our joint ventures forward before these get much more traction in the marketplace. We have aggressively sought to grow our practices' margins over 15% per year over the last three years.

Trustee Talbott asked Interim Chancellor Schwab to clarify that physicians are now coming to hospitals for direct employment. Interim Chancellor Schwab replied yes they are and it is frightening from our standpoint because we are building joint ventures. We are building them as we have market share because there are huge efficiencies and advantages for the both of us. If you look at the top ten in the United States they exist in that model. I grew up in a system where the University owned the hospital and had substantial influence over the practice plan. It was vertically integrated plan – we had a common boss and that drove us. Duke University and Johns Hopkins have a common boss. This is a step to get us there without us coming to the Board asking to buy a \$100 million hospital.

Trustee Schledwitz commented that the 15% growth over the last four years or so is attributed to Interim Chancellor Schwab's vision and his ability to go out and aggressively recruit and fill vacancies and attract top talent with a great deal of obstacles. I know that these statistics are coming at us fast but this is a great thing that we have been able to grow over the last four years with deteriorating facilities and a tough environment. Interim Chancellor Schwab interjected that the reason it is so important is because it is the only source of discretionary income that we have. As you know, we look at encumbered and unencumbered income so when we bring in grant or contract dollars they are encumbered dollars and cannot do much with them. If we make a clinical profit and the hospital gives us a support payment it is unencumbered dollars and we can deploy those dollars to whatever we need to do for our education or research mission. What we need is a steady reliable stream of unencumbered dollars. Our hope is by creating these joint ventures those direct lines will be created so the College of Medicine and the Health Science Center will receive a series of unencumbered dollars that will allow us to drive our mission forward while we have a stable position. Growth of 15% a year is what we have done and we believe that with joint ventures with the hospitals will put us in an even better position. This also increases the teaching portfolio of the University of Tennessee so we are probably the only

medical school that has clinical teaching capacity. UTHSC's College of Nursing has a ratio of 1 to 4 and it is about the same for the College of Medicine. If you want to learn how to practice plastic surgery the ratio may be 1 to 2 so we need this type of capacity to grow our post-graduate programs. I reported to the Board last year that residents and Fellows come close to doubling our state appropriations. So what the College of Medicine receives from the state will double in federal dollars by our residencies and fellowships.

Trustee Horne asked how much UTHSC receives from the joint venture plans. Interim Chancellor Schwab replied that he did not want to talk about the details of the individual deals. Everything will be spelled out in the MOUs. We believe that by sharing the risks with our partners they are willing to offer us a lot more money. Some of these are risk sharing agreements. We are not risking the University's assets but are risking our profits. For instance, they are willing to give a guarantee profit of \$3 million per year but then put \$10 million on the table as a joint venture which means if you manage that practice badly you might not bring anything home and if you manage it wisely you can bring \$8 million home. We are perfectly willing to joint venture, not the University's assets but the joint venture profit assets. Most of our plans that we are bringing forward in order to get us vested in the management practice tie us to a joint venture. The University is not at risk our profits are at risk. We can either make a lot of money or no money depending on how we run the practice plan.

Trustee Hall commented that the folks from Memphis have been so cooperative in terms of working with the Audit Committee. I commend this Board and Dr. Gary Rogers for being able to provide the funds to bring an outside consultant in that provided direction. We are in an unusual situation of not having a hospital. I am impressed with the new direction of the leadership and appreciate the transparency that has been provided to the Audit Committee and this Board in keeping us informed. The trip to Memphis at the request of Trustees Cates and Schledwitz opened our eyes to the needs of the entire medical establishment and is impacted in Chattanooga, Knoxville and the rest of the state.

- XIII. **Other Business**—Chair Talbott asked if anyone had any other business to discuss: none was noted.
- XIV. **Adjournment**—The meeting was adjourned at approximately 12:15 p.m. CST.



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Charles M. Peccolo  
Treasurer and Chief Investment Officer/  
Acting Chief Financial