

THE UNIVERSITY OF TENNESSEE  
BOARD OF TRUSTEES

MINUTES OF THE FINANCE AND ADMINISTRATION COMMITTEE

February 28, 2013  
Chattanooga, Tennessee

The Finance and Administration Committee of The University of Tennessee Board of Trustees met at 3:15 p.m. EST, Thursday, February 28, 2013 in the Tennessee Room of the University Center on the campus of The University of Tennessee at Chattanooga.

**I. CALL TO ORDER**

Charles C. Anderson, Chair, called the meeting to order.

**II. ROLL CALL**

Charles M. Peccolo, Treasurer and Chief Financial Officer, called the roll, and the following members of the Finance and Administration Committee were present:

Charles C. Anderson, Chair  
Joseph A. DiPietro  
J. Brian Ferguson  
John N. Foy  
Raja J. Jubran  
Don C. Stansberry, Jr.  
Betty Ann Tanner

Mr. Peccolo announced the presence of a quorum of the Committee. Other Trustees, administrative staff, members of the public, and representatives of the media were also present.

**III. MINUTES OF LAST MEETING**

Chair Anderson asked for any corrections to the minutes of the November 8, 2012 meeting of the Committee. Hearing none, the Chair called for a motion to approve. Trustee Tanner moved approval of the minutes as presented in the meeting materials. Trustee Foy seconded the motion, and it carried unanimously.

#### IV. TREASURER'S REPORT ON ENDOWMENT INVESTMENT PERFORMANCE

Rip Mecherle, Executive Director of Investments, explained that the report (Exhibit 1) included time periods December 31, 2012 (calendar year end) and June 30, 2012 (fiscal year end). He explained that blanks in the data table are a function of those being private investments and a lag in reporting.

For the one-year return, the Consolidated Investment Pool's return is 10.6%. This trailed the Broad Policy Benchmark but outperformed inflation plus spending. Approximately 80% of the Broad Policy Benchmark is allocated to the public equity market, and that is why the University trailed.

In the public equity space, the Pool's one year return is 17.2%, versus 16.4%. The outperformance by our public equity exposure is largely due to our emerging markets and international exposure.

Looking at the private equity composite, UT's is largely composed of venture and buyout. If you go back to the inception of this strategy for UT, the return is 10.6% relative to an 8.2% and 5.8% [returns for the benchmarks], going all the way back to 1993.

In the past one year, our hedged equity composite trailed its public equity counterpart, not surprisingly. When you're betting on prices to fall in a period flush with liquidity, it will be a challenging environment for those strategies. Over the longer term, performance has been more favorable.

High quality fixed income is basically investment grade, interest-rate-driven assets. It has done very well over every time period. Fixed income credit/distressed and private credit/distressed are two categories that are components of hedge funds and private capital in general. They have each done well on a short term basis and a long term basis relative to the indices; in particular the private credit/distressed, which goes back to 2001, has performed well versus some of the public comparables.

The Real Assets category (natural resources or real estate related assets) has been a very good performer over the long haul, as has Diversifying Strategies.

The public and private real estate divergence was covered in previous meetings. Public has done very well, and private has not, largely due to one asset—a Commonfund investment.

The Natural Resources composite and Private Natural Resources are hedge fund and private equity type vehicles, respectively. On the one year basis, they have suffered relative to the public comps largely due to recent commodity trends, but over the longer haul at 13.6% and 12.7%, have done well. The inception date goes back to 1998. The natural resources composite looks unfavorable at -2.6% with an inception date of 2007 - right at the start of the credit crisis. On a three-year basis (which is not shown on the charts) the numbers are 15.5% versus a 10.9% for the index.

Timber is a small part of the portfolio, about 2%. It has lagged a little, with negative long-term secular trends in that space, which is why we haven't allocated more to it.

Asset allocation has changed a little. Global equity, which is common public equity, is at 31.9% of the Pool. Roughly a year ago it was 34%. Fixed income, which is just the high quality interest rate driven assets, is at 6.8%--a year ago was 7.4%. Real assets 18.3%, a year ago was 18.7%. Private equity/venture is at 12.5% versus 12.8% before. Diversifying strategies have gone up 1% from a year ago.

Last year, based on the NACUBO study, we outperformed by 230 basis points over the broader averages, which is reflected in the three year numbers, but in the past twelve months, a lot of that was lost. Two broad categories are to blame for this: 1) lower level of high-quality fixed income assets that are in the Portfolio--were at 7% and the broader NACUBO averages were at 9 or 10, depending on which segment; 2) larger allocation to emerging market equity and international equity than the broader average. We still think this allocation makes sense.

Mr. Mecherle explained that every quarter the Investment Advisory Committee examines the Pool, specifically the asset allocation, and decides what action to take accordingly.

## V. ANNUAL REPORT OF THE TREASURER, 2012

Chair Anderson asked Mr. Peccolo to present the Annual Report of the Treasurer, 2012 (Exhibit 2). Mr. Peccolo explained that the audited financial statements were reviewed briefly at the November meeting. The component units, University of Chattanooga Foundation, University of Tennessee Foundation, Inc., and the University of Tennessee Research Foundation were not available at that time but are included in the Report in the meeting materials. The Auditor's Opinion Letter (unqualified opinion) is also included and the audit has been issued with two findings regarding the reporting of student enrollment data. There has been collaboration with campuses involved, and corrective actions have been made and filed with the Comptroller's report.

## VI. FY 2013 REVISED OPERATING BUDGET

Mr. Peccolo advised that the University of Tennessee budget requires revision each year to update revenue and expenditure projections. The FY 2013 revised budget takes into consideration final fall enrollments (estimated at the time the original budget is prepared), the effect of any prior year's activities carried forward into the current year, and adjustments in state appropriations occurring since the FY 2013 budget was prepared and approved in June 2012.

Mr. Peccolo explained that there were really no significant changes as far as the tuition and state appropriations in the revised budget (Exhibit 3). There is a \$5 million difference in a billion dollar budget. The largest factor in this budget was carryover funds from FY 2012 to FY 2013. Those were funds around \$34 million that were budgeted from FY 2012 that were not spent and were re-budgeted in FY 2013. The exercise of budgeting is done in May and June and the fiscal year is not over so the outcome is unrealized at this point. He then presented a slide that explained the \$34 million carry over. Total transfers are up \$6.9 million, carried forward \$33.8 million, \$5 million for improvements and are adding \$1.9 million to the fund balance at the end of the year over what was originally budgeted.

Mr. Peccolo then explained that the revenue overage (\$3.8 million) was due to a larger enrollment of students than expected. There was also a \$300,000 increase in appropriations for a claim adjustment and other revenues collectively totaling around \$900,000 revised upward.

Mr. Peccolo showed the trending of state appropriations from 2008-2013. He explained that the stimulus dollars were included in 2008-2011. The revised budget includes \$431.7 million in state appropriations. In perspective, the Governor's proposed budget for next year for Tennessee schools and institutions is \$467 million.

Budget expenses were increased by approximately \$37 million with the largest allocation to instruction and research at 42%. Trustee Schledwitz asked what the bulk of increase was for research. Mr. Peccolo replied that it most likely would be the academic departments doing research. Vice Chancellor Cimino explained that there were \$27 million in new research incentive funds and further explained that it relates to the F & A (facilities and administrative costs) received from grants and contracts. Mr. Peccolo then showed how the expenditure by function had remained fairly constant across the six-year period. The restricted E & G funds show a decline and the largest impact on that is the recognition of the solar award and grant through the State. That has been spent and will not be reflected going forward. The reduction was not reflected in the original budget but is in the revised budget. The bulk of the Auxiliary decline is

UT Knoxville athletics as far as revising their revenue estimates. The available funds are well within what the revised budget contemplated.

Mr. Peccolo then showed a trends graph and pointed out that the most revenue growth has been in grants/contracts for the University. He also noted that tuition and fees makes up a larger percentage now than state appropriations. He then showed a slide that reflected the restricted and unrestricted with the solar farm dollars removed.

He closed by saying that the revised FY 2013 budget for consideration is balanced and within resources. There is potential new funding for FY 2014 recommended by the Governor. One of the challenges is no improvement money for the non-formula units outside of the UT Health Science Center. President DiPietro has visited with the Governor and staff and they have acknowledged that it might have been oversight. They are going to look at the issue carefully and will hopefully issue a revised budget to include improvement dollars for those units.

There are multi-year plans to improve faculty and staff compensation to get to 80% of market. The administration is dedicated to this cause by it is a challenge when there are limited dollars to deploy to that effort.

Trustee Jubran moved that the Resolution on the Revised FY 2013 Operating Budget (Exhibit 4) be adopted. Trustee Tanner seconded the motion, and it carried unanimously.

## **VII. UTC DIFFERENTIAL TUITION PROPOSAL FOR BUSINESS, ENGINEERING, AND NURSING**

Dr. E. Grady Bogue, Interim Chancellor of UT Chattanooga, presented an overview of the proposal and goals. He stated that the differential tuition in Business, Engineering, and Nursing would benefit UTC as a whole. A lengthy discussion ensued regarding the previously allocated \$500,000 to fund all new faculty needs. Vice Chancellor Brown stated that it was one-time money. Dr. Bogue clarified that if the differential tuition is approved, then Business, Engineering, and Nursing faculty needs can be addressed separately, and the \$500,000 can be allocated to other programs. Dr. Brown confirmed that at no time would UTC use funds from the differential tuition to subsidize any other programs.

Additional discussion took place around program, quality, faculty needs, and enrollment growth. Chair Anderson stated that the Board's message was clear: differential tuition would only be approved if the monies stay within the three

programs being charged. Chancellor Bogue replied that careful monitoring would be placed on the differential tuition, and that stewardship would continually be evaluated.

Trustee Foy moved that: (1) The University of Tennessee at Chattanooga be authorized to implement a differential tuition model for Business, Engineering, and Nursing as described in the meeting materials (Exhibit 5), beginning with the 2013-14 academic year; and (2) The proposed FY 2014 operating budget for UTC be developed and presented to the Board of Trustees incorporating a \$50.00 per student credit hour differential tuition for courses in Business, Engineering, and Nursing; and 3. The differential tuition will increase in future years at the same rate as any future increases in tuition (in-state maintenance fees) at UTC. The motion was seconded and carried unanimously.

## VIII. REAL PROPERTY TRANSACTIONS

### A. KUB Substation Easements (UTK)

The Knoxville Utilities Board (KUB) is designing an electric power substation to be located on University property in order to provide effective electric service to nearby University facilities. The proposed new electric load associated with the Cherokee Farm development, as well as the load growth of the UT Medical Center, make it necessary for KUB to construct this substation and its connecting infrastructure. Construction of the substation will allow the University to successfully build out Cherokee Farm and will provide back-up power to UT Medical Center where the University's Graduate School of Medicine and various research programs operate.

The University and KUB propose the following easements:

Modify the purpose of an existing electric line easement of approximately 3.94 acres +/- to include access and/or utility uses; and

New easements including an access and utility easement of approximately 2.88 +/- acres total, utility easement of approximately 0.50 +/- acres total, slope and temporary construction easement of approximately 1.88 +/- acres total, and a substation easement of approximately 1.52 +/- acres total.

The easement area includes approximately 3.94 +/- acres under existing easement and approximately 6.78 +/- acres of new easement area for a total easement of approximately 10.72 +/- acres. The easements will authorize KUB to enter upon, construct, operate, repair

and maintain utilities located within the area defined by the easements. KUB agrees to pay the greater of \$233,600 or appraised value for the residence at the East Tennessee AgResearch and Education Center, which will be demolished to accommodate the new substation. KUB agrees to maintain the roads that lead into the new substation. The University reserves the right to relocate the easements at the expense of the University.

The proposed easements are for the benefit of the University's Cherokee Farm and programs operating on the campus of the UT Medical Center; no further consideration is requested by the University. Upon approval by the Board of Trustees, the University will seek all required state approvals.

Trustee Murphy questioned whether there would be two substation easements or if there would just be a new substation. If that is the case, what would be done with the old substation? Robbi Stivers, Executive Director, Capital Projects reported that it was his understanding that those two substations would interact with each other. The old substation will remain with the new proposed substation.

Vice Chair Stansberry moved that the permanent and temporary utility easements be granted to the Knoxville Utilities Board as described in the meeting materials (Exhibit 6). The motion was seconded, and carried unanimously.

#### **B. Cumberland Avenue Easements (UTK)**

The University of Tennessee, Knoxville and the City of Knoxville propose five (5) temporary construction easements, one (1) permanent utility easement and one (1) permanent drainage easement along Cumberland Avenue. The project is known as the Cumberland Avenue Streetscapes Project or the Cumberland Avenue Corridor Project. With the proposed easements, the City of Knoxville seeks authorization to enter upon, replace, install, and maintain utilities and sidewalks in the easement areas.

The proposed temporary construction easements are irregular in shape and contain approximately 914 +/- square feet. The permanent utility easement is irregular in shape and contains approximately 38 +/- square feet. The permanent drainage easement is irregular in shape and contains approximately 72 +/- square feet. The University reserves the right to relocate the easements at the expense of the University.

The proposed easements are mutually beneficial and have been assigned a total Nominal Parcel Payment (NPP) value of \$15,490 per a project field review and market analysis procured by the City of Knoxville. Upon approval by the Board of Trustees, the University will seek all required state approvals.

Vice Chair Stansberry moved that temporary and permanent easements be granted to the City of Knoxville as described in the meeting materials (Exhibit 7) for the monetary consideration of \$15,490. Trustee Ferguson seconded, and the motion carried unanimously.

#### **IX. REPORT ON STATUS OF SCIENCE AND ENGINEERING LABORATORIES**

Mr. Peccolo recalled that at the last meeting while considering the University's capital outlay/capital maintenance disclosed list for submission to the Tennessee Higher Education Commission, Trustee Wharton asked about the current condition of the University's Science and Engineering Labs across the System. Working with the campuses and institutes, a charted list (Exhibit 8) has been compiled for the Committee's information. He explained that the list includes a number of approved projects from last year and a number of projects in the Governor's recommended budget for this year that will address a part of the deficiency. The majority of the campuses and institutes are addressing the condition of their laboratories. Vice Chair Stansberry asked what the chart would look like if all of the buildings under construction were completed, how much has been solved or is being solved. Vice Chancellor Cimino stated that Strong Hall and Thirteenth and Cumberland Projects in planning right now take care of approximately ½ of UT Knoxville's research need in terms of class lab space. The Master Plan says there is a deficit of 870,000 square feet so those two projects will get us a good way toward that. New space is being added but there is a need to renovate the existing antiquated lab and classroom space as well.

President DiPietro asked if Chancellor Schwab would address the UT Health Science Center space. Chancellor Schwab stated that most of their space was in process or funded. Trustee Jubran asked how much the 33% poor conditioned labs would be reduced. Chancellor Schwab said that for the Health Science Center poor conditioned classroom space will almost completely go away and approximately 80% of the laboratory space in the poor conditioned category will also go away.

Chancellor Cheek explained that the mix of students is changing on campus, and that influences the space that is needed. Trustee Murphy asked if there were unmet needs not shown on the chart, and the answer was yes. He went on to note that Vice Chancellor Cimino had just indicated there is over 400,000 square feet of new lab



space and questioned whether the new need reduces the 300,000 square feet of poor space so that the percentage changes. Is progress being made or just treading water?

Chancellor Cheek stated they need to rethink what are we going to replace and what is to be added. The engineering growth plan calls for a look at what is to be done for the next building after Science Lab 1 building. Melrose is scheduled next but might not be the right thing to do. We may need to insert an engineering building there because faculty will have to be grown and there will be more undergraduate and graduate students. It is an area the State needs more people in and they make good money when they graduate, but also cost more money to educate. They must have laboratory activities as well as classroom activities. President DiPietro added that the replacement of Walter's is 200,000 square feet of poor space and we indicated on the list that there is 326,000 so it eats up 2/3 of that poor space unless there are others that slip into the poor category. Trustee Jubran asked how it affects the Top 25 if we continue on those percentages even with those that are not going to go down with the current construction. Chancellor Cheek reported that if UT Knoxville cannot grow in the College of Engineering the institution will not be able to grow in rankings. Dean Wayne Davis has put together data analysis that shows size makes a great deal of difference in ranking order. The growth will allow us to be more affective in receiving grants and contracts and keep research funding here with industry in our State.

Mr. Peccolo said that at the next meeting the list will be updated to show what it looks like after the space is built out.

**X. OTHER BUSINESS**

There was no other business to come before the Committee.

**XI. ADJOURNMENT**

There being no further business to come before the Committee, the meeting was adjourned.

Respectfully Submitted,



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Charles M. Peccolo  
Treasurer and Chief Financial Officer