MINUTES OF THE FINANCE AND ADMINISTRATION COMMITTEE
THE UNIVERSITY OF TENNESSEE
BOARD OF TRUSTEES
OCTOBER 21, 2010

The meeting of the Finance and Administration Committee of the Board of Trustees was held at 10:30 a.m. EDT, Thursday, October 21, 2010 in Room 223/225 of the University Center on the Knoxville campus.

I. **Call to Order** - Mr. Robert Talbott, Chair, called the meeting to order, 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 Charles Peccolo, Treasurer, Chief Investment Officer and Interim Chief Financial Officer to call the roll. He did so and advised the Chair that a quorum was present.

<u>Present</u>

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

<u>Other Trustees Present</u>

Toby Boulet, Faculty Trustee
George Cates, Trustee
Spruell Driver, Trustee
Crawford Gallimore, Trustee
Monice Hagler, Trustee
Doug Horne, Trustee
Karen Johnson, Faculty Trustee
Karl Schledwitz, Trustee
Betty Ann Tanner, Trustee
Sumeet Sudhir Vaikunth, Student Trustee

Also present were Treasurer, Chief Investment Officer and Interim Chief Financial Officer, Charles Peccolo, other members of staff, and media representatives.

Chair Talbott informed the Committee that there were several items on the consent agenda and asked if there were any of those items that Committee members would like to move rather than on the consent agenda. Committee members did not want items moved.

III. **Approval of Minutes of Last Meeting—**Consent Item—Chair Talbott advised that there was a change made to page 13 of the June 23, 2010 minutes that was in the Board materials and explained that a new page had been passed out. He then asked Mr. Peccolo to explain the change. Mr. Peccolo explained that at the last meeting when there was discussion about discounted tuition at Chattanooga and Martin the minutes stated that UTC puts a 25% surcharge on in-state rate. Actually, UTC charges in-state fees plus 25% of regular out-of-state fees as the discounted rate. UTC charges 5% more than UT Martin does and Dr. Rakes actually said he could live with the increase. The page that was originally sent out read that he could live with the decrease and that was incorrect. He went on to thank Trustee Tanner for asking questions because it led to the finding of erroneous information on the minutes.

Chair Talbott asked committee members to replace the page in the Board materials and called for consideration of the last meeting's minutes. Trustee Wharton moved approval of the minutes of the last meeting; seconded by Trustee Anderson and the minutes were approved unanimously.

Chair Talbott then notified the Committee that Chancellor Steve Schwab had to leave the meeting early to catch a fight and therefore his presentation under item VII. would be presented at this point [see Item VII below].

IV. **Treasurer's Report on Endowment Investment Performance**—Information Item (Exhibit _)—Chair Talbott asked Mr. Peccolo to present the Endowment Investment Performance Report.

Mr. Peccolo began by saying that he would be covering the information in the green spiral bound book that was handed out earlier. It is a much easier task this year than last when it was about negative 20+% returns. This year there were positive returns but insufficient to make up the prior year's losses; it will be a few years before we recover from the devastation of the collapse in 2008 and 2009 as evidenced by the bar graph. In fact, there was a 13.3% gain this year but to give you a perspective of the degrees still to go – still 35% off of previous highs in our endowments.

What does that mean? He then pointed to the graph that is spoken of often and showed the total funds invested to benefit the University. The billion dollar mark was broken in 2007 and we celebrated that only to enter into two down years. We have recovered this year and have gained $61 million in that total fund which now stands at $768 million. To recap, the bottom two layers on the graph (purple and yellow) represent the endowment funds we manage which collectively are $541 million. The orange layer is the Life Income Trusts and totals $39.8 million. As you know we manage investments on those Trusts and when the Trusts mature they will revert back to the University for endowments. The light blue layer is the Chairs of Excellence managed by the State Treasurer and totals $99 million. The top red layer is the University of Chattanooga Foundation which totals $88.2 million. Collectively, $768 million is invested to benefit the University of Tennessee and is on its way back up.

The direct impact to the University for these total funds is $44.5 million last year to support Research, Public Service, Institutional Support and Scholarships initiatives. A total of 78% of the support goes for Scholarships, Instruction and Academic Support functions. University endowments distributions total $34.1 million for fiscal year 2010 and are reduced a bit from last year because of the down markets. Trustee Schledwitz asked how it is decided on how much to add back to principle or does it vary from year to year. Mr. Peccolo stated that was a good question and it results from a couple of scenarios. One, some of the endowments donors want a minimum endowment so they will give the University $25,000 but want a minimum of $50,000 before distributions begin. As they continue to add to it they ask that we reinvest the earnings. The other reason is if the specific purpose of the endowment that the donor has designated is not needed by the department they can request that we take part of the previous year and add that to the Corpus. Trustee Schledwitz asked if that was a typical number directionally speaking. Mr. Peccolo replied yes. Trustee Foy asked as a percentage how much of the total distributions was from Corpus and how much from current income. He then said that he was sure that Mr. Peccolo did not currently have that information but asked him to send it to him. Chair Talbott agreed with Trustee Foy and said that it was a great point. It needs to be added as the percent of the endowment payout. Trustee Foy said yes and how much you are invading the Corpus. Chair Talbott said if it was $30 million and on $500 million 6%. Mr. Peccolo assured them he would get the information to Trustee Foy.

Mr. Peccolo went on to discuss the Consolidated Investment Pool which represents the largest part of the University's endowments. This Pool comprises the majority of endowments and operates much like a mutual fund where additions and deductions buy in or sell at the current market/value share. The Pool over this ten-year period has grown by $107 million going from $424 million to $531 million. More importantly than that is a focus on the cumulative distribution of over $300 million during that ten-year period that was used to support the academic programs that are endowed.

He presented a chart that shows how the funds are invested. The Pool is a very diverse portfolio. We have an Investment Advisory Committee made up of many of the folks that are sitting around the table. The Committee meets quarterly and we have a plan consultant that helps us with asset allocation modeling and different tactical allocations throughout the year. These totals are just about on target. We have been shifting some out of the Global Fixed Income back to domestic international equities. It is not far off and the pie chart represents how it was aligned at June 30, 2010.

He then presented the ten-year return of the Pool. Our long-term goal for the Endowment Pool is around 9%, comprised of our average distribution of 5.5%, adding inflation, and trying to increase the real value minimally. We have managed to increase the real value over long periods of time. The past ten years has recently been referred to as the lost decade and as a result, we are well short of long-term goal. The thing to keep in mind is that endowed funds are permanent funds so they are invested in perpetuity. If you took a longer picture of the time and pick up the previous decade we are back around that 9% long-term goal. When we restructured the portfolio to incorporate a total return approach in the mid 80's, the average annual return for the portfolio since that time is over 10%. Accordingly, longer term we have been able to reach our long-term goals. The challenge will be how we perform coming out of this ten-year period.

Performance goals for the Pool are expressed in three different ways. The real portfolio returns compared to inflation as discussed earlier. Asset class returns compared to market indices and nominal total returns compared to similar endowments. He then presented the alignment of the long-term goal, the average distribution, Pool expenses and average inflation. Obviously, we are short of that goal for this period of time. By meeting that long-term goal, we would have been able to provide for intergenerational equity. In other words, the value of the endowment payout today would be the same in fifty years in real terms.

We continued to increase what we paid out. The solid bars at the bottom of the referenced chart are the annual distributions from the Pool. The way it is calculated is 5% of a three-year market value average. Using the three-year averages mitigates market volatility and similarly, means up and down markets while impacting distributions, do so less dramatically. Accordingly, distributions will be about 6% less next year as we work through that three-year average. The lines at the top of the referenced chart show that it will provide intergenerational equity. These last years have been difficult. Only last year we were above it and now we have fallen behind a little. Coming out of this will be a challenge until we work through those early years of the down markets.

He then showed the asset class earnings compared to applicable indices. If you look at the five-year comparative returns what we have benchmarked for the Pool is the CPI + 5.5% resulting in the preservation of the real value of the endowment. Obviously, the last five years we have been well short of that but if you look at the individual asset classes we are right on our benchmark for those asset classes.

Finally, the nominal total trends compared to the endowments – the University participates in an annual study by the National Association of Colleges and Business Officers. The deadline for filing the 2010 survey is not until the end of November 2010 and the results of that are not out until January. I will share the results with the Board at the February 2011 meeting.

The Pool performance as of September 30 is still "estimated " because we are awaiting some evaluations of private investments. The most current estimate for the three months is 6.8% with a rolling one-year total with a return of 8%. The CPI plus 5.5% for that one-year period you would get 6.6%. On a shorter term basis for the rolling one-year we would be able to meet that goal. This quarter, July was pretty good, August was challenging with September rebounding. The markets are still very volatile and are something we continue to struggle with. We have increased allocations to the large cap international equities and have also switched out some of the long-only equity exposure to long/short strategies which will hopefully mitigate some of that volatility.

Food for thought, the elections are coming up shortly. In the last fifty years the S & P has been up 21.3% per year under a Democratic President and Republicans controlled congress. Triple the 7% return under a Republican president and the congress controlled the Democrats. The Stock Exchange gained 7% when the White House and Congress were run by the same political party. The worst stock performance came under a split Congress and was up 6.2%. As you go to the polls, you may want to consider this information. This is the average over the last fifty years.

V. **Treasurer's Financial Report**—Information Item (Exhibit _)—Chair Talbott asked Mr. Peccolo to continue with the Treasurer's Financial Report. He advised the Committee that they had preliminary unaudited Financial Statements for the University. He pointed out that they are in a format consistent with what you've seen before. The first section is the unaudited Management's Discussion and Analysis; the Statements of Net Assets, Statements of Revenues, Expenses and Changes in Net Assets, Statements of Cash Flows and the related notes to financial statements. These are preliminary and we have been entertaining our auditors since late spring and hope they will wrap it up here in the next couple of months or so.

These statements include only the University of Tennessee. When the final statements are received they will include three component units. The UT Research Foundation is included for the first time because of the biofuels and solar initiatives, resulting in material financial activity levels for the UT Research Foundation and necessitating disclosure in the University's financial statements. The statements will also include the UT Foundation, Inc. financials and the University of Chattanooga Foundation.

We have been working closely with the auditors and of this date we have no indications of any serious findings from them. It is all going very well.

He then spoke about what these statements show and reflect on the past year. There was a $247 million increase in total assets and he then showed the composition of the assets. Cash was a big driver that increased by $65 million. Investments discussed early increased $52 million. Capital assets have increased by $116 million (construction, equipment, purchases and accounts receivables have increased).

The composition of the liabilities increased by $41 million and the most significant piece of that is bond sales. The Tennessee School Bond Authority issued debt at an incredible rate with an average interest rate of 3.63%. Chair Talbott asked if that was fixed for thirty years and Mr. Peccolo replied yes. Post Employment benefits also increased.

The University's revenue sources were up $302 million with the most significant component being investment income offsetting the decline in state and local appropriations.

The major expense categories increased $69 million with the biggest category being utilities, supplies and other services. As you can see they increased 16% or

$55 million. Vice Chair Murphy asked if the utilities, supplies and other services increased by 16% - is $55 million the amount of the increase and Mr. Peccolo said yes. Vice Chair Murphy then asked what the proportion of that component was on the total budget because $55 million adds to another number and I could probably figure it out if I had the other number. Mr. Peccolo asked if he wanted to know what of the $1.7 billion is the utilities, supplies and other services line and Vice Chair Murphy said yes. Mr. Peccolo stated that it was about $400 million. Vice Chair Murphy then stated obviously when you look at what makes up the University's budget the biggest component is personnel and asked if supplies, utilities and other services was then the next largest single component after that. Mr. Peccolo said yes. Vice Chair Murphy added and when it goes up that much to stay even we have to either make some cuts or raise some revenue. Mr. Peccolo added that all the campuses have green initiatives in order to conserve energy and reduce those utility costs. Trustee Foy asked how much of the $55 million increase was utilities. [Treasurer's Note: According to the Treasurer's Report, utilities and fuel actually decreased from FY 2009 of $53.5 million to $47.8 million in FY 2010 university-wide.] Controller Ron Maples stated that part of the increase in this category, "Utilities, Supplies and Other Services", is one-time money, the stimulus money that the campuses have spent and does not think there will be a large increase such as this next year. Trustee Schledwitz confirmed that part of that money is money that was spent to do the metering and other projects like that so utility costs could be tracked going forward. Mr. Maples replied yes and Trustee Foy questioned whether they were capital improvements. Were they expensed instead of capitalized and Mr. Maples said yes and no. Stimulus money is expensed.

Trustee Anderson asked if there was any movement on the idea of trying to get more competitive rates on utilities with the Tennessee Valley Authority. Trustee Horne said they wouldn't agree to reduce the rate. TVA is under extreme pressure as well. UTK is working with them to be more efficient and TVA may give them a loan to replace the steam boiler. That is the last information we had.

Trustee Hall then asked how much is being spent on energy retrofit and is that expense part of the utility number from the stimulus money? Controller Maples explained that he did not have that number but would get it. Chair Talbott said he utilities costs being so high the Trustee's questions reflect wanting to see if there are ways through capital expenditures or other ways that we can reduce utilities costs because it is such a large component of the budget. I know that the University as a whole is looking at this but we have to get a handle on it.

Mr. Peccolo then addressed Trustee Hall's question. Chair Talbott stated that knowing how Trustee Foy thinks we could borrow the money at 3.5% over thirty years and replace capital wise and reduce on the expenditure side. We ought to look at that because rates are so low.

Mr. Peccolo told the Committee that they would receive the audited financial statements at the February meeting.

VI. **Report on UTC Regional Tuition Discount for Graduate Programs—Information Item (Exhibit _)** Chair Talbott introduced the next agenda item and asked Chancellor Roger Brown to present. Chancellor Brown informed the group that Dr. Phil Oldham, Provost at UT Chattanooga would run through the report and he would be there to answer any further questions.

Provost Oldham began by saying on behalf of UT Chattanooga, we thank you for approving this pilot on regional tuition discount for graduate programs. This pilot program was approved by the Board a year ago and was started in the spring semester. There was very little lead time to advertise or promote the discounted program. This fall will be the first semester to show significant improvement. This is an important program and as you know, we have been running a similar program for undergraduate upper level students, juniors and seniors. The program is of significant benefit financially to the institution but also for regional development. Dr. Oldham then showed a chart that showed operation projections for the region around Chattanooga that included indications of the percentage of the population with an undergraduate degree. Away from the Chattanooga area the numbers drop off substantially. Those are also the areas where there will be substantial population growth. For regional development this is an essential outreach effort approved by the Board.

The graduate level was approved by the Board in October 2009. The eligible counties for this program are the same as for the undergraduate program. The participants pay full in-state rate plus the 25% of out-of-state tuition. He then showed a comparison of the full out-of-state rate and the regional tuition rate. Full out-of-state rate is $9,102 and the regional tuition rate is $4,485. Trustee Schledwitz asked how that compares to the in-state rate versus regional tuition rate. Provost Oldham replied that the regional tuition rate is the in-state rate plus ¼ of the out-of-state add-on. The difference would be around $4,000.

If the program had been initiated in the fall (it was not approved until October 2009) there would have been a baseline of 22.80 of graduate students from those counties. In the fall there were approximately 40 full time equivalency students. There was a doubling but not quite a 100% increase in the FTE enrollment over that time period. UT Chattanooga has broken through the breakeven point and the program is a financial plus for the institution.

Trustee Foy asked if there was room for the in-state students. Provost Oldham replied that there was approximately 4% in the total graduate enrollment at UTC. There were over 1,500 graduate students but there was still room. The bottom line is that the regional discount tuition rate program is not costing UT Chattanooga anything financially and is not causing any capacity issues for the acceptance of these students.

Provost Oldham went on to show the impact that graduate degree earners have compared to undergraduate degree earners. Career wise graduate degree earners earn an additional $3.1 million over undergraduate degree earners. Statistics are based upon data from “The Economic Impact and Return on Investment of UTC” by Chair of Free Enterprise. Increasing graduate enrollment could generate an additional $1.8 million by student expenditures, sales tax revenue, and additional income contribution. The estimate for state tax revenue is just short of $500,000 a year. We can show that the program has a positive impact on the state of Tennessee’s income.

UT Chattanooga has had strong signs of success and has almost doubled the FTEs from the counties in the program. There are still growth opportunities in business, engineering, education, criminal justice and English. This program was approved by the Board as a two-year pilot. There is still one more year to go and we will be happy to give the Board an update at that time.

Trustee Driver asked what the out-of-state counties were. Provost Oldham advised that the list includes the following:

Jackson County, Northeast Alabama
Catoosa County, Georgia
Dade County, Georgia
Fannin County, Georgia
Murray County, Georgia
Walker County, Georgia
Whitfield County, Georgia

VII. **Approval of UTHSC Pediatric Faculty Practice Plan, Memphis (Exhibit _)** Dr. Schwab addressed the Chairman and Committee and stated that on behalf of the UT Health Science Center he was pleased to talk about the new plan involving the faculty practice. At the last meeting of the Finance and Administration Committee the University outlined its plans for leverage to establish practice plans by a joint venture plan with our six partnering teaching hospitals. On average, our faculty practice plans generate well over $200 million in annual revenue. The discretionaries investable margin is derived from revenues generated by University Affiliated practice plans and hospitals. To be successful, we realized that growing our research mission was our key investment and we had to have discretionary investable funds to grow that research. The source of this revenue comes direct from academic payments. These academic payments are a direct result of joint venture practice plans with those teaching hospitals. These practice plans are possible only when we control a substantial market share of that particular business of that teaching hospital. In the last four years as part of our strategic plan we have worked aggressively and have grown our practice plans to gain market share and are now ready to begin the execution of these plans to generate the research revenue.

These joint ventures have two key focuses. The overwhelming key focus is they create for the first time direct academic payments from our teaching hospitals to the UT Health Science Center for academic purposes. In addition, this will allow us to directly control the teaching environment in our partnering hospitals. The handout in the Board book outlines the first practice plan. This is the practice plan that was brought to the Board today. This practice plan is a joint venture between the state's largest children's hospital, the LeBonheur Children's Hospital. It is part of the Methodist System and the UT Health Science Center.

We term this joint venture as UT LeBonheur Pediatric Specialists, Inc. and is abbreviated ULPS. The details of this joint venture are in the materials and I will not go through each individual detail. What I will assure you is that we offer a deliberate strategy to create this and subsequent faculty practice plans. In August of this year, a memorandum of understanding was signed between the Methodist System and the University of Tennessee Health Science Center after it was reviewed by the Board of Trustees Finance and Administration and Audit Committees, University Administration and the office of the State Comptroller.

Two major agreements will be required in order to execute this practice plan and stand it up as planned in January of this year. An affiliation agreement between the new practice plan and a modified affiliation agreement between our major partner, the Methodist Hospital System. This is possible because we currently comprise over 90% of the volume at the LeBonheur's Childrens Medical Center and makes UTHSC an attractive joint venture partner for that institution. In this joint venture, we share but maintain control of our faculty and faculty practice. The Executive Dean from the College of Medicine and the Chief Executive Officer from LeBonheur will chair this practice in a 501(c)3 corporation. Our children's practice loses approximately $2 million annum. At the same time the LeBonheur Children's Medical Center generates more than $65 million per year. This is not unusual when you look at children's practices. The physician's fee component is the smallest portion of the reimbursement and the vast portion of the reimbursement is the technical side. So this joint venture is good for both parties. As a result of this joint venture a $5 million academic payment will be made annually to the College of Medicine and the University of Tennessee Health Science Center. In addition as a result of this joint venture we have been able to renegotiate our graduate medical education agreement to a national standard with a net gain of $1 million per year. The net lift for the UT Health Science Center exceeds $6 million per annum and is repeatable every single year in perpetuity. We share equally in the losses and gains of this practice. The limits of our liability are fixed at the academic payment. We cannot lose money under any circumstance beyond the academic payment that is received annually. Our liabilities are limited to the academic payment. The proforma created by a consultant, ECG, who will assist this merger, shows how it is expected for this practice to perform over the next 3-4 years. It is our expectations that the practice will continue to lose money but we will share that loss with LeBonheur Children's Medical Center so that we have out of this a net gain of $2-3 million every year in the research enterprise of the UT Health Science Center. Also, there will be an additional $1 million in medical education payment. The University of Tennessee Medical Group (UTMG) will also benefit from this arrangement which was the cornerstone of this agreement. We could not disadvantage any of our existing practices by forming a new practice. By divesting the children's practice which loses $3 million per year from the adult practice – even after accounting for overheads there is a pick-up on the adult practice of about $1.8-$2 million per year in net revenue that we expect to see. This divestiture not only dramatically advantages our children's physicians but it also advantages the adult specialty practices.

The next steps outlined are after we seek approval from this Board is to form an affiliation agreement with the existing entity and modify the affiliation agreement with the Methodist Hospital System. We believe this is the first of several joint venture practices that will be brought before this Board. We anticipate at the next Board meeting to present the UT/Erlanger practice group which we believe will also have similar advantages that we will talk about. In addition, other actions that we have done since our last report is we told you that we would be standing up a joint venture with UT/Baptist and Methodist to form the UT Bone Marrow Transplant Institute. That has been done and the operation is successful. We hope to hire the institute directors soon. We are performing bone marrow transplants as part of a joint venture today.

We are actively engaged in negotiations to merge UTCI and UTMG as previously reported and will bring that to fruition in the future. We are aggressively continuing to negotiate with our other teaching hospitals to create joint venture practice plans.

Today, we are seeking this Committee's approval to proceed with the UT LeBonheur physician's practice.

Chair Talbott asked if there were any questions and there were none. He said it sounds like a very good plan.

Vice Chair Murphy moved that the creation of UT LeBonheur Pediatric Specialists, Inc. (ULPS) as the pediatric faculty practice plan for the UTHSC Memphis campus be ratified and that the administration be authorized to execute an Addendum to the Master Affiliation Agreement between the University and Methodist Healthcare and an Affiliation Agreement between the University and ULPS after review and approval by the Chief Financial Officer and the General Counsel and after all required or appropriate state government reviews and approvals; seconded by Trustee Carroll and was approved unanimously.

Chancellor Schwab acknowledged that Dr. Ken Brown and Mr. Tony Ferrara were key people in bringing ULPS to fruition.

VIII. **Approval of FY 2010 Annual Flight Operations Report—**Action Item **(Exhibit _)**—Chair Talbott advised that the next agenda item was the FY 2010 Annual Flight Operations Report and asked Mr. Peccolo to continue. Mr. Peccolo informed the Committee that there was a two-page narrative and a five-year recap of flight operations in the materials. The report is presented in accordance with University Fiscal Policy 735. During fiscal year 2010 the UT plane flew 309 flight hours during 346 separate flights or legs. A total of 73% of those were flown between Knoxville and Nashville where the plane spends most of its time.

There were no flight schedules cancelled due to maintenance deficiencies. In addition to the expenses shown here for UT Flight Operations the University did contract for charters flights valued at $542,978 during the year.

The primary user was the Athletic Department during recruiting period and is also a big user of charter flights.

This report is presented to the Committee for approval.

Trustee Wharton asked if there were still policies and procedures in place so that the Board can be assured that the plane is being properly used. Mr. Peccolo replied yes.

Trustee Carroll made the motion for approval of the FY 2010 Annual Flight Operations Report as presented in the meeting materials; seconded by Trustee Wharton and was unanimously approved.

IX. **FY 2010-11 Operating Budget Update**—Information Item (Exhibit _)—Chair Talbott asked Mr. Peccolo to update the Committee on the FY 2010-11 Operating Budget. Mr. Peccolo explained to the Committee that when the budget is presented in June, it is not final. The latest iteration from Nashville recaps for you after the final Appropriations Bill is approved and all the provisions are sorted through.

The original FY 2011 state appropriations budget presented was $532,826,381. The 401-K match was switched from recurring to non-recurring item. Initially there was talk of a 3% bonus for employees that came off the table. The original document had that in there so it is a reduction. Funds were given back for improvements paid by the Maintenance of Effort funds. The other big item is the deduction of the ARRA monies. All of the Federal stimulus funds were moved to K-12 and then; the state gave higher education money back as non-recurring one-time appropriations.

The other item of interest for Board approval is the two items estimated for FY 2010 stimulus money carry-over. Those previous appropriations are on a cost reimbursement basis so they pro-rate the money. The University does not draw from the State until the expenditures are made. Going in, they estimate how much we will spend during the year. These carry/overs were amounts that were not spent but were carried over to fiscal year 2011. The amount of $6.6 million was moved to Plant Funds to do capital maintenance items and the other is just a carry forward. A one-time appropriation will be drawn from the state once the money is spent.

This is just a reconciling of what the final appropriations will be. At the Winter Board meeting we will present to you the Revised Budget Document that will have this and any other changes the units will make during the year.

X. **Approval of FY 2011-12 Operating Budget Appropriations Request—**Consent Item (Exhibit _) Chair Talbott noted that the FY 2011-12 Operating Budget Appropriations Request would have to be approved and asked Mr. Peccolo to proceed. Mr. Peccolo began by saying that in the materials was a schedule of the improvements request to the Tennessee Higher Education Commission (THEC) that the University submitted. The request is filed with THEC and these are for the non-formula units. There is a brief listing of the improvement items for the non-formula items. The reality of being funded for these improvement items is not very good. There is also a brief narrative of those improvement items.

To meet THEC deadlines, submission of these items has already taken place with the understanding that if our Board has any issues or changes that we may do so and submit an amended request to them.

Trustee Wharton made the motion to move approval of the University's state appropriations budget request for support of operations for the new budget year as presented in the meeting materials; seconded by Trustee Vice Chair Murphy and was approved unanimously.

XI. **Approval of FY 2011-12 Capital Outlay and Capital Maintenance Projects—** Consent Item (Exhibit _) Chair Talbott confirmed with Mr. Peccolo that the next agenda item would be the FY 2011-12 Capital Outlay and Capital Maintenance Projects and asked him to proceed. Mr. Peccolo explained that there was a schedule showing the current year through FY 2015-16. It is in accordance with the Tennessee Higher Education Commission and the State Department of Finance and Administration guidelines.

The five-year Capital Outlay reflects $665,100,000 in recommended projects. The schedule for Capital Maintenance is $175,680,000 in recommended projects.

These schedules and priorities were shared with each of the campuses' and institutes' leadership and everyone confirmed that this list is what the University would submit and send forward to THEC.

Chair Talbott noted that the Capital Maintenance amount of $175,680,000 is a scary number over five years.

Vice Chair Murphy stated that the track record on getting Capital Maintenance funding has been inconsistent. Mr. Peccolo said that the Capital Outlay has been inconsistent but the Capital Maintenance has been a little more consistent. Vice Chair Murphy then asked what has the University been getting on average for the last three or four years. Director of Facilities Planning, George Criss answered that on average it has been around $7 million in Maintenance. Mr. Peccolo said that begs to Vice Chair Murphy's point that $7 million is nowhere close to $175 million. Vice Chair Murphy said that was the point he was trying to make. Director Criss followed up by saying that last year was a good year for Capital Maintenance at over $20 million.

Chair Talbott asked if it was a correct assumption that Capital Maintenance requirements every year are going up. Director Criss replied yes that he felt that was a reasonable assumption.

Trustee Horne noted that the Effectiveness and Efficiency for the Future Committee (EEF) that he chairs is working on facilities planning issues to tighten that area up as well. Mr. Peccolo answered yes. Trustee Horne went on to say there is no answer on the Capital Maintenance problem. Mr. Peccolo explained that Director Criss wanted to be at the last EEF meeting but was entertaining a group out of Nashville to survey facilities. Trustee Horne went on to say there were a lot of great ideas that came from the meeting like additional project managers.

Trustee Carroll made a motion to move approval of the Capital Outlay and Capital Maintenance Funding Requests for FY 2011-12 and subsequent years as presented in the meeting materials; seconded by Trustee Wharton and approved unanimously.

XII. **Approval of FY 2011-12 Revenue/Institutionally Funded Projects—**Consent Item (Exhibit _) Chair Talbott announced that the next item was FY 2011-12 Revenue/Institutionally Funded Projects. Mr. Peccolo began by saying there were schedules in the Board materials of the capital projects that the University will finance. Most of these items will be financed either through debt issues through the Tennessee State School Bond Authority or from various campuses and institutes reserves. It is a separate item because these projects are institutionally funded not relying on state appropriations.

Chair Talbott asked if institutionally funded meant that the University would be raising the revenue. Mr. Peccolo replied that the campuses and institutes will generate the revenue through user fees and charges for any debt issue or the accumulated reserves are usually from fees and charges. These are all internally funded capital projects. Chair Talbott then asked if it was a wish list or are we actually going to do all the projects. Mr. Peccolo answered that it is probably a little of both. Once the projects are on this list they get moved to a disclosed list with the State through THEC so the list does become part of the actual budget presented. He added that the projects have made it through the approval process but all may not be started next year.

Trustee Schledwitz asked what the diversity plan is for capital outlay and capital maintenance projects. Do we have the contractors set goals or is a part of the bid process? What are we doing to ensure there is diversity participation? Mr. Peccolo stated that the University has made requests of the prime contractors to include that as part of their part of the process when they are putting together their bids. He followed up by saying that he would let Director Criss speak on the matter but he did not think there was any back end enforcement of the issue. Director Criss reported that the when it is simply a design process the University's and State Building Commission's policies strongly encourages prospective bidders to utilize minority business participation. When we select a Request for Proposal, which is an evaluation process we do have more of an auxiliary criteria of minority participation. Trustee Scheledwitz asked what the follow-up to monitor compliance and the consequences for those that don't comply. Director Criss said if it is a design build project the contractors supply lists at completion of the project. The follow-up on a Request for Proposal process is that the contractor is actually doing what he said he would do and we monitor that.

Trustee Foy asked why paving was on the list and if the streets belonged to the City. He then referenced the paving of Todd Helton drive at $750,000 and then campus paving at another $500,000. Director Criss stated that most of the streets are still owned by the City but there are streets on the campus that the University owns. Trustee Foy said to give the streets to the City and Director Criss replied the City would rather give the rest of them to the University.

Trustee Anderson asked if it was possible to obtain a snapshot of the data of minority or disadvantaged businesses and track record that we can show on capital projects. Director Criss said yes. Chair Talbott stated that was a good request and if asked Director Criss to get the information together.

Trustee Anderson made a motion to move approval of the Revenue /Institutionally Funded Projects for FY 2011-2012 as presented in the meeting materials; seconded by Trustee Foy and was unanimously approved.

XIII. **Approval of UT Martin Master Plan—**Consent Item (Exhibit _) Chair Talbott informed the group that Marion Fowlkes from Centric Architecture would be presenting on the UT Martin Master Plan. Mr. Fowlkes recognized and thanked Chancellor Rakes and Vice Chancellor Hooten for assisting in the process as well as George Criss and Facilities Planning. He told the group that his presentation would reflect on the drawing that was in the board materials that also include a written narrative. Centric Architecture was asked to come in an update a 2003 planning document that in response to the growth at the University of Tennessee at Martin. We have taken growth trends of an increase of 5,300 FTE in 2003 to 6,720 FTE at the end of this year.

He then showed a map and pointed out Highway 22 or University Avenue and the stadium. He then pointed out where most of the agricultural activities take place. He then pointed out the area where most of the academic buildings are located. Student recreations are located at the Martin bypass. Most of the student housing is together but University Apartments are in another area.

On the map, the existing buildings are in blue and proposed new construction is in red. This is not a plan that will happen over a two, five or even a ten-year period. We are trying to locate buildings, parking arrangements and site acquisitions for a long-term plan. In the 2010 Master Plan Recommendations there are additions suggested for a number of buildings. Joseph E. Johnson Engineering-Physical Sciences building should expect to expand by approximately 30,000 square feet. He then showed the art wing that is being built now on the map. The Business Administration Building is planned to receive an addition of approximately 10,000 square feet to support the College of Business and Global Affairs programs. A New Classroom/Laboratory Building is expected to need an additional 120,000 square feet to meet THEC formula requirements. We have located a building to reinforce the historic quadrangle on campus. He then pointed out other future academic buildings in red and by placing them we had to define where they would go. There is parking in there right now and is all that is there.

Conceptually as you look at this plan you will see a grey area and that is where we are trying to push the parking outside the perimeter of the campus when the opportunity arises.

We are proposing a new Quadrangle which will not be similar to this Quadrangle but will be but one that is properly landscaped and can mix with student housing and will promote student activities. Mr. Fowlkes showed proposed housing that was in red. There are two that remain on campus that are outdated and need to be replaced and the area he showed is where they think the future housing should be located. The major housing will be in one area, University Courts and University Apartments will be in another and both of these locations will be utilized into the future but they are also locations for future housing.

Sororities and Fraternities are spread all over campus and will try to bring as much of that together to make a campus community.

There are improvements we are suggesting around University Avenue and most of those have to do with entrances. One would be at Lovelace and 22, Grove, the Martin Bypass and 22 and another one at Kennedy. All of these are major entrances into the campus or circulation entrances that we believe should be accented.

There are slight improvements recommended for University Avenue.

There are some paving and life safety improvements in terms of civilization maybe relocating circulation so that you cross in certain areas to define to a vehicle that you have arrived on the campus of the University of Tennessee at Martin – slow down this is part of our domain. It isn't a state road so it is nothing the State will have a voice in the final solution.

There are a number of areas that are included in land acquisition right now. Parking is where the four buildings are located on the map. Once, these buildings go on line the parking will have to be relocated. Mr. Fowlkes then showed the Committee where future parking would be and is a number of parcels that we suggest to acquire over time. There will be a need for additional parking and the 2010 Master Plan proposes an area over time to be acquired. There is a parcel at Martin Place Apartments that could be a future acquisition if it could be purchased at the right price. There are approximately 700 apartments there that UTM could take on as housing in the future and is something that just has to be monitored over time.

What was not shown on the earlier drawing was Cartwright Run? 74 acres on the other side is not being utilized by UTM. We are suggesting that UTM sell that piece of property and purchase a piece of property that is available as part of parcel 5 in order to support the agricultural program long-term.

The total of the capital outlay on the acquisitions as well as the improvements that have been presented to the Committee is $91,723,500, capital maintenance is $37,810,000 and total institutionally funded is $95,545,000.

Chair Talbott asked if this is being brought to the Committee with UT Martin agreeing that this is what they want to do. Chancellor Rakes said that UT Martin will be ready to move on this very quickly.

Vice Chancellor Murphy made sure with Chancellor Rakes as far as locationally where Centric Architecture is proposing to put the buildings and the other recommendations that it is what the campus wanted and not what the firm is presenting. Chancellor Rakes said this is fairly standard practice of adding to your quad, moving your parking out and consolidating resources on the other side for the farm. It is very planned and is all being placed where it makes sense such as extending your housing near the other housing and keeping it near the University Center. Also, putting your academic buildings where the others are located.

Trustee Hall asked what kind of enrollment would UT Martin be able to grow to when this plan is completed. Chancellor Rakes replied that it would allow another 2,000-3,000 students. Trustee Hall then asked how many students residentially would it allow. Chancellor Rakes stated that UT Martin's housing is currently topped out. The recommended plan would add at least another 1,200 students to be able to reside on campus which it increases by about a third with these additions. We just added 18 apartment-style residence halls and we are hanging on to the Y dorms that you referenced because it is a revenue stream. They are filled. At some point, we will have to get on this. We would like to start while the interest rates are down but it is also tough to get the money.

Trustee Hall asked if the recommended list would meet all the capital maintenance needs and in what period of time. Director Criss explained that the Master Plan time-frame was infinitive. The list of capital maintenance projects are the ones that have been identified by the campus administration. Trustee Hall commented that he was not a member of this Committee but suggested that it might be helpful when plans that are needed are brought to the Board that there is some sort of staging in terms of needs. I hope that as long as I am a Trustee on this Board that we don't see another campus get in the same condition as we saw when we toured the UT Health Science Center. The Board needs to have a rating or an understanding of the urgency and timeframe for various buildings so that we don't get in the situation where we lose value in a piece of property because it is not properly maintained. Director Criss replied that we can do that and that we are in the process of completing facilities evaluating surveys and it addresses those concerns. We are in the third phase of a three phase project and we can certainly share the results of that evaluation with the Board. It does describe in priority order the needs for improvement. Trustee Hall then said that he has contributed to rebuild his fraternity house three times. Chair Talbott said that was a good point but these guys are like emergency room doctors they treat whoever is dying first and then go on to the next guy if they can and have the money. He asked Director Criss if that was a fair statement and he said yes. Trustee Hall commented that it might be something that we want to consider bringing an outside consultant in. Chair Talbott said that was a good suggestion.

Trustee Anderson asked if each of the University's campus have a Master Plan. Mr. Peccolo said yes and they are in the process of updating them because many of them are outdated. He then asked Director Criss what the cycle was for updating the Master Plans. Director Criss said they are actually in the process of updating the Master Plans for the Knoxville and Agriculture campuses now. Both Chattanooga and Memphis have consultants employed to update their Master Plans. That process is in progress. Trustee Anderson added that he thinks it is important that each of the campuses do have a current Master Plan unfortunately by the time we get the funding they may need adjusted. Mr. Peccolo noted that was part of what came out when the study was started to look at the entire facilities enterprise. Director Criss gave an example of UT Martin. Their Master Plan was updated the last time in 2003, seven years ago. Seven years seems to be a reasonable timeframe to look at a campus' Master Plan. Chair Talbott asked what the number was they reported earlier of students that had been added since 2003. George Criss said it was an approximate 25% increase. Mr. Peccolo advised the Committee that any suggested acquisitonal or distributional property would come back before the Board.

Trustee Anderson made a motion to move approval to develop and update the Campus Master Plan for the University of Tennessee Martin as presented in the meeting materials; seconded by Trustee Foy and was approved unanimously.

XIV. **Approval of Real Property Transactions**—Consent Items—Chair Talbott informed the Committee that the next agenda item was the Real Property transactions and each one must be approved individually. Mr. Peccolo presented the following:

A. Property Acquisition at 208 S. Dudley Street (UTHSC) - The University seeks approval to acquire approximately 1.01 +/- acres located at 208 S. Dudley Street in Memphis, Tennessee. It is located on the southeastern outside edge of the UT Health Science Center Campus. It is improved with a one-story warehouse that contains approximately 15,000 +/- square feet of office/retail space and was constructed in 1951. The proposed property will replace warehouse/records storage space displaced by major renovations to the Mooney Library and the demolition of the Beale building.

The University requests approval to acquire the property at 208 S. Dudley Street in Memphis, Tennessee at a purchase price that is equal to or less than the appraised value. Revision of the University's land acquisition plan to include this property will be a part of the motion and we will seek all required State approvals. Trustee Wharton asked about the cost and where the money would come from. UTHSC's Vice Chancellor, Finance and Operations, Tony Ferrara replied that an appraisal has not been done yet but the appraisal from 2004 was around $1 million. It would be paid for out of the campus' reserve funds.

Trustee Foy made a motion to acquire the property located at 208 S. Dudley Street in Memphis, Tennessee at a price equal to or less than the appraised value and to revise the University's land acquisition plan to include this property; seconded by Trustee Carroll and was approved unanimously.

B. Grant of a Permanent Easements for Cherokee Farm – Knoxville Utilities Board (UT Knoxville)—Consent item (Exhibit)—Mr. Peccolo began by saying that there were several permanent utility easements across the Cherokee Farm site with Knoxville Utility Board and is approximately 18.59 +/- acres. We will seek all required State approvals. The easements are for utilities, water, sewer and gas. Trustee Wharton asked if the utilities would be underground. Mr. Peccolo confirmed that the utilities would be underground.

Chair Talbott voiced concern that 18.59+/- acres was a lot of land under easement and questioned whether the total was correct. Director Criss explained that essentially those easements follow the streets that will be formed. They have to conform with Knoxville Utility Board's requirements. Chair Talbott said that his concern was having an easement from building to building later. Director Criss said that is not the case and essentially the easements follow the streets. Vice Chair Murphy commented that he assumed that what Director Criss was saying that all the streets would be private. Director Criss said that is correct and that the University owns them. Trustee Horne confirmed with Director Criss that KUB would work with us if something needed changed and Director Criss assured him they would.

Trustee Carroll made a motion to approve the grant of Easements to Knoxville Utilities Board (KUB) for the Cherokee Farm site as presented in the meeting materials; seconded by Trustee Anderson and approved unanimously.

C. Collins Gift Property, 114 Old Fulton Road (UT Martin)—Consent item (Exhibit)—Mr. Peccolo presented the next item for authorization to accept as a gift from Walter and Susan Benson Collins at the Martin campus. It is off Old Fulton Road (114) and is on the east side of the agriculture land. The University plans to use it for a ropes course.

Trustee Foy made a motion to move approval to accept a gift of real property from Walter and Susan Benson Collins located at 114 Old Fulton Road and to revise the University land acquisition plan to include this property; seconded by Trustee Anderson and was approved unanimously.

D. Property Acquisition in Hornbeak, Tennessee from Tennessee Wildlife Resources Agency (UT Martin)—Mr. Peccolo stated that the final item was to acquire property in Hornbeak, Tennessee from the Tennessee Wildlife Resources Agency (TWRA). This is a facility that is adjacent to Reelfoot Lake. It consists of a building that was formerly used as a hunting lodge. It is 3,492 square feet and was constructed in 1958. The UT Martin campus plans to use it as a teaching center, research and student field trips. They will convey it to the University at no cost but there will be a right of reversion in the conveyance that the property be returned if the University abandons it.

Trustee Wharton asked if the building was in good shape or does it require maintenance expenditures. Mr. Peccolo made the comment that it was not resort quality and that answered Trustee Wharton's question. Chair Talbott commented that it was a good question.

Trustee Wharton made a motion to approve to acquire twenty (20) acres in Hornbeak, Tennessee, from Tennessee Wildlife Resources Agency at no cost but with a right of reversion to TWRA if the University abandons the property; seconded by Trustee Anderson and was approved unanimously.

XV. **Other Business**—Chair Talbott asked if anyone had any other business to discuss: none was noted.

XVI. **Adjournment**—The meeting was adjourned at approximately 12:05 p.m. EDT.

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Charles M. Peccolo
Treasurer and Chief Investment
Officer, Interim Chief Financial Officer