

THE UNIVERSITY OF TENNESSEE
BOARD OF TRUSTEES

MINUTES OF THE FINANCE AND ADMINISTRATION COMMITTEE

November 8, 2012
Knoxville, Tennessee

The Finance and Administration Committee of The University of Tennessee Board of Trustees met at 3:15 p.m. EST, Thursday, November 8, 2012 in Hollingsworth Auditorium on the campus of The University of Tennessee Institute of Agriculture in Knoxville, Tennessee.

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

The Chief Financial Officer 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 June 20, 2012 meeting of the Committee. Hearing none, the Chair called for a motion to approve. Trustee Foy moved approval of the minutes as presented in the meeting materials. Vice Chair Stansberry seconded the motion, and it carried unanimously.

IV. COMMITTEE CHAIR REMARKS

Chair Anderson noted that all action items, except item XVI, will move to the full Board of Trustees consent agenda. A call was made for any removal of agenda items from the consent agenda, and there was none.

Chair Anderson then welcomed new Finance and Administration Committee member, Trustee Raja Jubran.

V. TREASURER'S REPORT ON ENDOWMENT INVESTMENT PERFORMANCE

Mr. Peccolo, Treasurer and Chief Financial Officer, introduced Rip Mecherle, Executive Director of Investments, to present the report on endowment investment performance (Exhibit 1).

Executive Director Mecherle called the Committee's attention to handouts consisting of sections taken from the annual investment report. The report is no longer available in print, but is available in electronic format. The annual investment report is presented as an information item in accordance with the Investment Policies adopted by the Board of Trustees in June 2011. This report includes investment returns for the fiscal year ended June 30, 2012 and for longer periods measured against long term investment goals.

Mr. Mecherle explained how diversification works for the benefit of the endowment. In 2007 (prior to the national credit crisis) the Pool return was in the middle at 20.4%; S & P returned 18.3%; and the Global Equity Index returned 21.5%. The next year, as the market began to feel the effects of the credit crisis, the Pool was down 6.6%; the S & P was down almost 15%; and the Global Equity Index was down 12.5%. The crisis affected every asset class in the Pool, but the diversified strategies eased the brunt of it. The 2009 returns were the worst at -24.1%; S & P was down 28%; and the Global Equity Index was down 31%. In 2012 the Pool was down -2.2%; the S & P was up 5.4%; and the Global Equity Index was down -4.3%. The diversification works, and hopefully the volatility will remain muted over time and should serve also to smooth out the distribution calculations.

He also commented regarding the CIP Annual Unit Distributions vs. Inflation-Adjusted Unit Distributions, since 1994. In 1994 the University

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changed the pay-out formula from a current income driven to the rolling average of the previous three calendar year-end market values in the pool. 1994 was a natural starting point from which to take a fresh look at how the Pool had done with inflation over that timeframe and the University has done well. With the credit crisis and the low rate environment, there has been deterioration over the last few years. This is expected given, the rolling nature of the calculations.

The committee engaged in discussion regarding private equity. Mr. Peccolo expressed his appreciation to the Trustees who serve on the Investment Advisory Committee.

VI. TREASURER'S FINANCIAL REPORT

Chair Anderson asked Treasurer and CFO Peccolo to present the Treasurer's Financial Report (Exhibit 2). The draft June 30, 2012 financial statements were included in the meeting materials for the Committee's information. They consist of three basic financial statements along with a narrative section, "Management's Discussion and Analysis," that provides comparative financial performance information for the recently completed fiscal year. The financial information for the component units (UT Foundation, UC Foundation, and UT Research Foundation) has not been incorporated into the draft financial statements because the University is awaiting final audited statements from those entities. These statements are "draft" as the University is working with the state comptroller's office to finalize the audit. To date, management is unaware of any significant issues related to the audit.

VII. REPORT ON USE OF UHS PROCEEDS

Mr. Peccolo presented the report on use of UHS proceeds. The report was presented as an information item resulting from discussions during the June 2012 Finance and Administration Committee meeting. The schedule (Exhibit 3) provides an analysis of the sources and uses of the funds received from the lease and transfer of the UT Medical Center in Knoxville to University Health System, Inc. (UHS).

The University has received \$53.3 million from UHS to date and has expended \$48 million. The annual payment (due until 2020) is equal to the lesser of twenty percent (20%) net annual operating profit or \$3.0 million. Outstanding commitments as of June 30, 2012 on this balance and revenue

stream consist of: \$1.0 million for Audiology/Speech Pathology operating support (final payment); annual net proceeds for Health Science Center Chancellor initiatives through fiscal 2015; \$3.0 million Audiology/Speech Pathology capital (renovation/relocation costs); and annual tuition waiver for leased employees (to be considered next on the agenda). All uses of the UHS proceeds are presented to and approved by the Board of Trustees.

VIII. USE OF UHS PROCEEDS TO FUND FEE WAIVERS FOR LEASED EMPLOYEES AND THEIR SPOUSES AND DEPENDENTS

Mr. Peccolo presented the proposal to use UHS proceeds to fund fee waivers for leased employees and their spouses and dependents. He explained that in the 1999 Lease and Transfer Agreement under which management and operation of the UT Medical Center (UTMC) in Knoxville was transferred to University Health System, Inc. (UHS), the University agreed to continue to provide fee waivers for UTMC employees who were leased to UHS, their spouses, and their dependents. The University planned to pay for this obligation by using refunds from reserves established under the State of Tennessee Claims Award Fund for claims arising out of UTMC prior to the lease and transfer. As those claims were paid or otherwise resolved by UHS, refunds were paid to the University from the reserves. The refund of reserves ended during FY 2007, upon resolution of all pre-transfer claims; but the accumulated funds, amounting to \$2,713,826.65, plus interest, covered the fee waiver obligation until FY 2010. The leased employee fee waivers continue at an approximate rate of \$300,000 per year, but will decrease over time as the number of leased employees decreases by attrition.

Vice Chair Stansberry moved that the use of \$557,367.67 from UHS Proceeds be approved to fund the deficit in the UTMC leased employee fee waiver account as of June 30, 2012; and that the Treasurer be authorized to fund fee waivers for employees leased to UHS, and their spouses and dependents, from UHS Proceeds on an ongoing basis. Trustee Ferguson seconded, and the motion carried unanimously.

IX. FY 2013-14 OPERATING BUDGET APPROPRIATIONS REQUEST

Mr. Peccolo presented the FY 2013-14 Operating Budget Appropriations Request and explained that each year the University has the opportunity to present a state appropriations budget request for support of operations for the new budget year. The formula funding model is used to generate funding

recommendations for the Chattanooga, Knoxville and Martin campuses. As part of the request process, the University is also able to submit additional programmatic improvement requests for the non-formula units—the Health Science Center, Institute of Agriculture, Institute for Public Service, and University wide Administration (system administration).

A summary of the FY 2014 non-formula operating programmatic improvement requests submitted to the Tennessee Higher Education Commission (THEC) for consideration is attached for review and approval. This request was filed with THEC in accordance with its budget submittal instructions. Each programmatic request supports one or more of the University's Strategic Plan initiatives and is identified in the summary schedule.

The Operating Budget Submittal Guidelines approved by the Board of Trustees in June 2005 state that the Finance and Administration Committee shall review, approve, and recommend to the Board of Trustees the programmatic improvement requests submitted by the administration to THEC for consideration. To meet THEC's deadlines, the University's request must be submitted to THEC between the Annual Meeting and the Fall Meeting of the Board of Trustees. However, if the Board acts to change the University's request at the Fall Meeting, the administration will be permitted to submit an amended request to THEC for consideration.

Trustee Foy moved that the University's state appropriations budget request for support of operations of the non-formula units for the new budget year be approved as presented in the meeting materials (Exhibit 4). Trustee Tanner seconded, and the motion carried unanimously.

X. FY 2013-14 CAPITAL OUTLAY AND CAPITAL MAINTENANCE PROJECTS

Mr. Peccolo reported that in accordance with the Tennessee Higher Education Commission and State Department of Finance and Administration guidelines, the University administration has developed the Capital Outlay and Capital Maintenance Funding Requests for FY 2013-14 and subsequent years.

The five-year schedule for Capital Outlay reflects \$624,307,000 in recommended state funded Capital Outlay Projects, which is net of the requisite institutional funding match (25% for UTK, UTC, UTM and 10% for

all others). The five-year schedule for Capital Maintenance reflects \$350,085,000 in recommended Capital Maintenance Projects.

Trustee Wharton inquired on the status of science and engineering laboratories, and Mr. Peccolo offered to provide a report at the February meeting. A discussion ensued regarding capital needs.

Trustee Tanner moved that the Capital Outlay and Capital Maintenance Funding Requests for FY 2013-14 and subsequent years be approved, with authorization to enter into contracts for design and construction for these projects within available funds (Exhibit 5). Trustee Foy seconded, and the motion carried unanimously.

XI. FY 2013-14 REVENUE / INSTITUTIONALLY FUNDED PROJECTS

The administration has developed the revenue-funded projects for inclusion in the FY 2013-14 State of Tennessee Budget Document. Identified projects total \$173,200,000. Although no state funds are requested, legislative approval of the projects is required. The administration seeks approval of these projects prior to submitting them to the Tennessee Higher Education Commission to begin the legislative approval process, as well as authorization to enter into contracts for design and construction for these projects within available funds.

The administration also seeks authorization to enter into contracts for design and construction associated with revenue/institutionally funded projects subsequently identified during the fiscal year. Any subsequently identified projects will be approved by the President and reported to the Board of Trustees at its next regularly scheduled meeting.

A discussion ensued regarding borrowing funds to finance deferred maintenance. Dr. DiPietro stated that while the State is not interested in incurring debt, he is willing to discuss the issue further. Trustee Jubran asked whether we set aside deferred maintenance funds when we build. Mr. Peccolo stated that a reserve is not an authorized expenditure. The University must spend all capital money received from the state on the building.

Trustee Foy moved that the Revenue/Institutionally Funded Projects for FY 2013-14 be approved as presented in the meeting materials with authorization

to enter into contracts for design and construction of these projects, within available funds, and, with the approval of the President, for other revenue/institutionally funded projects identified during the fiscal year (Exhibit 6). Vice Chair Stansberry seconded, and the motion carried unanimously.

XII. REAL PROPERTY TRANSACTIONS

A. Grant of Permanent Utility Easements to Tuckaleechee Utility District for the Benefit of the University's Dairy Farm

Mr. Peccolo presented the proposal by The University of Tennessee Institute of Agriculture and Tuckaleechee Utility District for two (2) permanent utility easements necessary for construction of two (2) new water lines to serve the Dairy Farm in Walland, Tennessee. The easements will authorize Tuckaleechee Utility District to enter upon, operate, repair and maintain utilities located within the area defined by the easement. The University reserves the right to relocate the easements at the expense of the University.

Trustee Foy moved that the permanent utility easements described in the meeting materials be granted to the Tuckaleechee Utility District (Exhibit 7). Vice Chair Stansberry seconded, and the motion carried unanimously.

B. Quitclaim of Haywood County Property to the Tennessee Department of Transportation

Mr. Peccolo presented the proposal to quitclaim certain property in Haywood County to the Tennessee Department of Transportation. He explained that in October 2009, the Board of Trustees authorized the University to play a key role in the Volunteer State Solar Initiative funded through a U.S. Department of Energy award to the State of Tennessee, which in turn was granted to the University. The Board authorized the University to use these funds to purchase approximately 200 acres of land in Haywood County as the site of the West Tennessee Solar Farm. At the same time, the Board authorized the University at a future date to convey up to 20 acres of the Haywood County property to the Tennessee Department of Transportation (TDOT) "for the purpose of locating a Welcome and Education Center and other transportation infrastructure and interchanges as may be required." In 2009, when the Board authorized this subsequent conveyance, 20 acres was thought to be sufficient for this purpose. Due, however, to the final design of the solar

array and various subsequently determined infrastructure needs, TDOT has requested conveyance of a larger tract and several easements.

The proposed quitclaim consists of three parcels containing approximately 43.4 acres, three permanent drainage easements containing, and one (1) permanent access and utility easement.

Vice Chair Stansberry asked why the needed conveyance had increased from 20 acres to 43.4 acres. Robbi Stivers, Executive Director of Capital Projects, explained that no design work had been done for the Solar Farm or the Welcome Center at the time of the initial authorization for conveyance of 20 acres. Once TDOT developed their design, the ingress and egress routes and the new bridge across Interstate 40, more acreage was needed. The Welcome Center's footprint has not expanded, but how to traverse through the area and park tractor trailers and cars will require more acreage.

Vice Chair Stansberry moved that the quitclaim of property in Haywood County to the Tennessee Department of Transportation be approved as described in the meeting materials (Exhibit 8) and that this action shall supersede the Board's action in October 2009 limiting the conveyance for this purpose to 20 acres. Dr. DiPietro seconded, and the motion carried unanimously.

XIII. DISSOLUTION OF JOHN C. HODGES TRUSTS AND TRANSFER OF FUNDS TO AN ENDOWMENT

Mr. Peccolo presented the proposal for dissolution of the John C. Hodges Trusts and transfer of the funds to an endowment. He explained that Dr. John C. Hodges named The University of Tennessee, Knoxville as sole remainder beneficiary to two trusts and directed that the trusts be used to fund the Better English Fund to benefit the Department of English. The trusts have a combined total of approximately \$2.7 million in assets. The University serves as trustee.

The trusts are net income trusts and limit distributions to coupon payments from bonds and cash dividends from stocks. No distributions of capital gains or principal are allowed. The trusts limit permitted investments to New York Stock Exchange traded stocks and United States Government or other high quality bonds and cash. The terms of the trusts make them cumbersome to administer and yield low distributions to the Better English Fund each year.

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Since establishment of the trusts, investment practices and the laws governing the management of endowments have changed. If the funds were transferred to an endowment and managed in the University's Consolidated Investment Pool ("CIP"), the funds could yield significantly higher distributions for the Better English Fund and enhance the accomplishment of Dr. Hodge's intent to promote better English in the State of Tennessee without significantly increasing the risk for the funds. The inclusion of the funds in the CIP would permit the funds to benefit from higher yields and diversification of investment.

To accomplish dissolution of the trusts and transfer of the funds to an endowment to be known as the Better English Fund, the University proposes to enter a nonjudicial settlement with the Attorney General of the State of Tennessee under Tennessee Code Annotated § 35-15-110(d). The General Counsel's office has discussed this matter with staff of the Attorney General's office, and they have indicated support for a nonjudicial settlement regarding the Hodges Trusts. The use of the funds to benefit the Better English Fund would remain as specified by Dr. Hodges and in accordance with the Administrative Provisions.

Trustee Tanner moved that the Board of Trustees approve the dissolution of the John C. Hodges Trusts and transfer of the funds to an endowment to be known as the Better English Fund and authorize the University to enter a nonjudicial settlement agreement with the Attorney General of the State of Tennessee to accomplish this transfer (Exhibit 9). Trustee Ferguson seconded, and the motion carried unanimously.

XIV. MODIFICATION OF ADMINISTRATIVE PROVISIONS FOR THE CAESAR AND EDITH STAIR MUSIC EDUCATION FUND

Mr. Peccolo presented the UT Knoxville proposal for modification of the Administrative Provisions of the Caesar and Edith Stair Music Education Endowment (the "Stair Endowment"), which currently funds scholarships to juniors and seniors in the School of Music, with limited allowance for a scholarship for one freshman. The modified Administrative Provisions would expand eligibility for scholarships to all undergraduate and graduate students enrolled in the School of Music. The Stair family supports this change, as does the School of Music, and President DiPietro has given his approval.

The provisions of the Stair Endowment give the Board of Trustees the right to change the administrative provisions to select an appropriate use that comes as nearly as possible to fulfilling the donors' wishes if a need does not exist for the scholarships or if the terms conflict with law. These provisions indicate that the donors contemplated adapting the gift to accomplish their intent. Further, Tennessee Code Annotated § 35-10206(d) provides that if an institution determines that a restriction contained in a gift instrument on the purpose of an institutional fund is "unlawful, impracticable, impossible to achieve or wasteful," sixty days after notification to the Attorney General of the State of Tennessee, the institution may release or modify the restriction if the following criteria are satisfied: (1) the fund has been in existence more than twenty years; (2) the fund has a total value of less than \$150,000; and (3) use of the fund after modifying the restriction will be consistent with the charitable purposes expressed in the gift instrument. The proposed modification of the Stair Endowment meets all of these criteria, and the use under the current provisions is impracticable.

Trustee Foy moved that the modified Administrative Provisions for the Caesar and Edith Stair Music Education Endowment be approved (Exhibit 10). Trustee Tanner seconded, and the motion carried unanimously.

XV. FY 2012 ANNUAL FLIGHT OPERATIONS REPORT

In accordance with the Board-approved policy on University Aircraft, Mr. Peccolo presented the Annual Flight Operations Report for the Board's review and approval.

Trustee Wharton asked why it costs \$1,650 per hour to operate the UT Plane, but the departments are only charged \$950. Mr. Peccolo explained that the system administration pays the pilots' salaries and most of the operating costs and passes those savings on to departments as a subsidy.

President DiPietro commented that he could not do the presidency justice if he did not routinely see the regional campuses face-to-face. He explained that the plane is rarely used to go to the Chattanooga campus but is a necessity for UT Martin and the UT Health Science Center. He added that there is an initiative to maximize passengers on the flight to make it efficient.

Trustee Ferguson moved that the FY 2012 Annual Flight Operations Report be approved as presented in the materials (Exhibit 11). Vice Chair Stansberry seconded, and the motion carried unanimously.

XVI. REVISED TUAPA RULE ON LIBRARY FINES AT UTC

Mr. Peccolo presented the UTC proposal to revise its rules on library fines. Interim Chancellor Bogue explained that the revised rules allow an increased fine for lost books.

Trustee Ferguson moved that the revised TUAPA rule on library fines at UTC be approved as presented in the meeting materials (Exhibit 12). The motion was seconded and carried unanimously.

XVII. REPORT OF THE COMMITTEE ON EFFECTIVENESS AND EFFICIENCY FOR THE FUTURE

No report was made at this meeting.

XVIII. OTHER BUSINESS

There was no other business to come before the Committee.

XIX. ADJOURNMENT

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

Respectfully Submitted,



Charles M. Peccolo
Treasurer and Chief Financial Officer