

**MINUTES OF THE FINANCE AND ADMINISTRATION COMMITTEE
THE UNIVERSITY OF TENNESSEE
BOARD OF TRUSTEES
February 25, 2011**

The meeting of the Finance and Administration Committee of the Board of Trustees was held at 8:00 a.m. EST, Friday, February 25, 2011 in the Lookout Mountain Room of the University Center on the UT Chattanooga 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 Mr. Charles Peccolo, Treasurer and Chief Investment Officer/Acting Chief Financial Officer to call the roll. He did so and advised the Chair that a quorum was present.

Present

Robert Talbott, Chair
Charles Anderson, Member
Bill Carroll, Member
John Foy, Member
Jim Murphy, Vice Chair of the Board
Joseph DiPietro, Non-Voting Member
Charles Wharton, Member

Also present were other Trustees, Mr. Charles Peccolo, members of staff, and media representatives.

- III. **Approval of Minutes of Last Meeting**—Consent Item—Chair Talbott called for consideration of the last meeting's minutes. Trustee Foy moved approval of the minutes of last meeting; seconded by Vice Chair Murphy and approved unanimously.

Chair Talbott asked Mr. Peccolo to present the Endowment Investment Performance Report. Mr. Peccolo took a moment beforehand to follow-up on an e-mail from Trustee Lowry and e-mail correspondence

from Vice Chair Murphy dealing with proposed rules surrounding the Securities and Exchange Commission and new legislation in the Todd Frank Act. The crux of the matter is that the Association of Governing Boards (AGB) put out an alert regarding how to interpret the rules which could result in the Board being considered a municipal advisor and as such would have to register with the Securities Exchange Commission (SEC). It is a stretch to get there but it has to do with the way they interpret advice that is given. Because this is an appointed Board and not an elected Board – they feel that it is an instrumentality of the State and would satisfy the definition of municipal advisor. We are monitoring this and a number of the Boards have expressed opinions and written letters to the SEC as they finalize these rules. In the case of the University of Tennessee, we do not issue debt. The Tennessee State School Bond Authority (TSSBA) issues debt for the University and all higher education in the state of Tennessee. The Board approves for the University to construct a facility with funding from bond proceeds. It is a pretty big leap to say that the Board is advising on the issue of debt, but I wanted to inform you that this issue is out there. We will continue to monitor it and keep the Board apprised. Trustee Loughry added that we are seeing this as an indicator of a continuing application of Sarbanes-Oxley to the non-profit arena. It would be appreciated if Mr. Peccolo and the Business Officers would stay aware of interpretations both from our end and from the SEC. Chair Talbott questioned whether or not the SEC's intent was to cover people such as the UT Board of Trustees. Trustee Loughry said no, that it was more independent institutions. Vice Chair Murphy stated that the problem is that the language they drafted is very broad. It does create a question as to whether we are in it or out of it. It is a proposed rule and what their hope is that by commenting about these issues they might make it clear that these types of agencies are not the ones they are trying to get.

- IV. **Treasurer's Report on Endowment Investment Performance—**Information Item (Exhibit 1)—Mr. Peccolo updated the Committee on the Investment Performance of the University's Endowments. He told the Committee that they would be looking at the current allocation and how these assets are deployed. Global Equities are 60% of the Pool, Fixed Income and Global Fixed Income comprise about 15%, about 16% in real assets and just under 9% in Diversifying Strategies. With that line-up in mind, the performance chart for the Endowment Pool ended December 31, 2010 is included in the Board Materials. We had a very good quarter of +5.2% and a one-year figure of just under 11.5%. These figures go with our long-term goal which is to earn 5.5% plus inflation so we can maintain the real value of the Corpus of the Endowment. When you break that down you can see the three-month and one-year are very good return figures. The five-year continues to trail this long-term goal. As we reported before, the capital market collapse between 2007-2008 continues to impact longer term returns. Mr. Peccolo pointed out that the story behind the story on the Real Estate composite figure relates to the public real estate component that

reported strong double digit returns. The private real estate has suffered significantly. The good news is we have about 3.5 or 4.0% in public real estate and private real estate is under 1.0%. For the one-year, private real estate is down about 78% and the public real estate is up roughly 1.7%.

An information item to be reported to the Board is how our funds compare to other similar endowed pools. For that purpose, we use the annual NACUBO Endowment Study. Last year there were 850 Endowments across the country that participated and the results are usually not reported until January. If you look at the past ten years (the orange line is UT's Pool and the blue line is the average of the 850 institutions that participated), when the Market is doing well the University compares favorably. We have now started to pick back up with a ways to go on the long-term average. It has been a difficult two years, but the one-year average return for the 850 institutions participating was 11.9%. The average of all endowments that are the same size as UT's had a return of 11.9% also, so UT's 13.3% compared favorably. The five-year and ten-year returns continue to lag as a result of the difficult two years mentioned earlier. Trustee Cates stated that the Endowment Pool has a relative better performance going forward now than in the past decade or more. Some of the problem is Private Equity and Private Real Estate performance has been serious underperformers as a percentage of the portfolio. Those are much more than they were ten years ago. We are better positioned going forward and may outperform the institutions in the NACUBO survey. Mr. Peccolo stated that is a good point and added that we do have that anchor on us. The one-year numbers that Trustee Cates pointed out is indicative of the position that the portfolio is in going forward.

Trustee Foy asked if the University has changed strategies, managers and advisers during those years – say five and ten. Mr. Peccolo replied yes and what has been done currently is to move more into long/short strategies to dampen the volatility. Besides that we did change our allocation, over that period, from 30% allocation to 18% allocation to Fixed Income. Yes, we have made some modifications. The Investment Advisory Committee will be meeting next week and we will be looking at those allocations to determine if we need to make any other kind of changes to the portfolio. Chair Talbott added that the Investment Advisory Committee has some very knowledgeable people with different feels. George Cates is the real estate guy, Fred Decosimo and a lot of others that have experience in different areas and the Committee is very active in being sure that it is being done the right way. Trustee Foy gave kudos because the Market changes have helped but you have also changed strategies. Chair Talbott interjected that the University is still going to have Diversifying Strategies as part of the portfolio. The question is how you allocate those assets. I would say it is that assets were allocated differently instead of changing strategies. Trustee Cates said it is fair to say that we are

more concentrated in value than anywhere else. I for one am very glad about that but it is less than a majority. There really is not a big concentration in any area - it is pretty well diversified.

- V. **Report of the Treasurer 2010**—Information Item (Exhibit 2)—Chair Talbott asked Mr. Peccolo to continue with the next item. Mr. Peccolo began by saying he went over some of the detail at the last Board meeting regarding the Report. At that time, we had not received the Auditor's Opinion letter and the final statements. The Report is now complete and located in your Board materials. The difference between this set of statements and the ones you saw in October is it has all three of the Foundations; University of Chattanooga Foundation, Inc., University of Tennessee Foundation, Inc. and for the first time the University of Tennessee Research Foundation, Inc. are included. These statements were audited and for the first time in my memory (which is 34 years) we had no audit findings at all. There are a number of folks sitting around this room today that are responsible for that. He then asked all of the financial staff to stand up. In the past there have been two or three findings but not to have any at all is a big deal.
- VI. **Revised Operating Budget for FY 2010-11**—Action Item (Exhibit 3)—Chair Talbott asked Mr. Peccolo to present the FY 2010-11 Revised Operating Budget. Mr. Peccolo explained to the Committee that the materials are in a blue binder located in their Board materials. He asked Committee members to turn to page five. The titles for the legends of the pie charts got shifted over one space. Please note that the blue box is Tuition and Fees, the green box is State Appropriations and the Yellow Box is Other.

The original budget had significant changes that were affected in three areas. The Board's initiative was to increase the actual tuition from 8.5% to 9% and that is now part of the July budget document. The second item is at one point the Governor had a one-time 3% bonus for employees included in the budget. When the final appropriations bill was approved the bonus was not in there. We have now adjusted and taken that out of the preliminary budget that was presented to the Board earlier. The third is the maintenance of effort money from the State Appropriations FY 2010 as well as the amount of stimulus funds, totaling \$39.5 million, are above original budget. Basically, the carry-overs from the maintenance of effort monies resulted from campuses not spending the money as they thought they would in the beginning. Those monies were carried forward to this year and there is a program to spend those funds. Mr. Peccolo made the point that is what the campuses should have been doing. We asked them to manage and cut expenditures so when they did they really didn't need the funds in a particular fiscal year. That will be playing through here and additional ARRA money. There are also accounting changes that do not affect the bottom line. They are mainly a shift in restricted and unrestricted funds - the way we treated the interns and residents at Erlanger Hospital. Those are the significant adjustments to this budget.

In summary, the total revenues for the University were up 1.3%, \$12.3M in unrestricted, auxiliaries were about flat and restricted was up \$13.9 million due in part to significant grants and contracts increases for the year. The unrestricted revenue increase is broken down as follows:

Tuition and Fees	\$3.1M Change (.5% increase that the Board initiated)
State Appropriations	\$14.5M Change (will discuss)
Other Revenues	\$-5.3M Change (the difference between restricted and unrestricted – interns at Erlanger Hospital)
Total Revenues	\$12.3M Change

The beginning balance is the amount of carry-over from the Maintenance of Effort monies. The State Appropriations change is how the ARRA budgets are reported. The ARRA funding is cost reimbursement. We have to incur the costs and seek reimbursement from the State. In this case, that doesn't flow through the budget until we actually budget the expenditure. This year the State Appropriations figure goes up by that amount because that is what we are anticipating spending on ARRA funds.

The changes in funding go back to the 3% one-time bonus in the original budget that was not approved. When they did that it was \$20+ million for all of UT. They said here is your Maintenance of Effort money – use that towards the 3% bonus but it wasn't quite enough. They gave us about \$1 million more to make that 3% bonus but when that went away they said o.k. we are going to take that off the table. Here is MOE money back and by the way we want our \$1 million back too.

Vice Chair commented that because we didn't do the staff 3% bonuses that money they gave us went away. Then the other thing that went away are these timing issues with the stimulus (ARRA) funds. It is not new money it is just money that was in one year's budget and is now in another because of timing and when we get our money from the State after we spend it.

Trustee Foy questioned if you took the accounting changes with the other revenues were they basically flat or were they in-line with budget. Mr. Peccolo replied it would be up a little with the accounting changes solely affecting the restricted funds. He then presented the total budget, \$1.94 billion expenditures for the University which is up 3.0% from what was presented to the Board initially. The unrestricted

expenses are \$1.19 billion which has the accounting changes for the stimulus funds to be discussed in more detail shortly.

If we don't spend the stimulus funds as we receive them they are appropriated or are budgeted in the following year. He then presented a state appropriations bar chart that showed in blue where the University is trending now. It is suspected at the end of fiscal year 2011 a good bit of the non-recurring will move down into base recurring as it is programmed. We have charged our campuses to manage through this period by making the needed budgets reductions and that is what has happened. We record the ARRA money as it is appropriated. We actually had \$30 million in 2009, \$60 million in 2010 and \$60 million in 2011 appropriated and continue to draw reimbursements that match our expenditures.

With that explanation, the FY 2011 revised budget is balanced and within available resources. There are some remaining challenges and priorities such as; loss of ARRA stimulus funding, possible appropriation reductions 1-3%, and the Complete College Tennessee Act – new funding formula. The President and Chancellors have communicated to the Governor that the priority need is for faculty and staff compensation. This is an action item and requires Committee approval.

Chair Talbott questioned the prior slide that Mr. Peccolo had presented. He wanted clarification that the University had been cut \$100 million from fiscal year 2008 but the stimulus funds actually more than made up for it in fiscal year 2011. The figure that we use is \$112 million and there have been some adjustments in that total.

Vice Chair Murphy noted that he still had questions. He asked if it was correct that in fiscal year 2010 that the University spent and was reimbursed \$70.3 million of the non-recurring (ARRA & MOE) and might have actually had more of that money in fiscal year 2010 if we had spent it and been reimbursed. Because we didn't spend it – it moved to an allotment. Mr. Peccolo replied considering the appropriation - up to \$60 million could have been reimbursed in that year if it had been spent. In fiscal year 2012, is there still going to be some non-recurring funds that will not be reimbursed until next fiscal year. Mr. Peccolo stated that we did get the one-time, non-recurring appropriations that the State appropriated which in fiscal year 2011 was substituted for ARRA funding. The state appropriation that is carried forward is primarily ARRA funding that we have to incur expenses for and then be reimbursed. Vice Chair Murphy continued by saying with ARRA money all of the expenditures have to be made by the end of fiscal year, calendar year or federal budget year because all three of those are different. Mr. Peccolo went on to say that the University has until September 2011 to spend money. There is rumor out there that this date will be extended to December 2011. If we do not spend the funds by December 2011 we lose them. Vice Chair

Murphy reiterated that by spending it that means we have incurred the expenditure but that does not mean we have gotten the money from the State. Mr. Peccolo said the terminology is that we have to actually be obligated for it. Mr. Maples said there are some questions but that is correct. Trustee Anderson commented that when we see these figures of non-recurring at \$70.3 and \$146.7 million – did we take advantage of all available stimulus funds or were we only able to take advantage of a percentage. Mr. Peccolo explained that so far, the University has taken advantage of all opportunities afforded higher education. What we will lose out on is what is not spent or contractually obligated by December 2011. Vice Chair Murphy asked if we are anticipating being able to spend or be contractually obligated for all of the money by the September/December's deadline so we don't lose any money. That is the Board's main concern. Mr. Peccolo said I think that is Trustee Anderson's concern as well. He said I think it is possible that we spend/obligate the money to the extent that we can. Last year we shifted \$14-\$15 million to plant funds to do capital improvements and have now gone back and shifted those funds back because we don't think they will be done in time. We are actively managing and are programming as we spend the funds. Trustee Carroll asked what projects the money will be spent on. We have been using the monies for campus facilities efficiencies updates, energy efficiencies applications, adjunct faculty in bottleneck courses. Vice Chancellor Cimino commented that UT Knoxville has a number of projects that are using stimulus money this year. The reason the money was not spent in the first year was because time was needed to put the contracts in place. There are a number of projects such as replacing old windows in some of the older facilities, 3 or 4 roofing projects and other initiatives that will continue throughout this calendar year. We will have either obligated our funding or spent the funds by the Federal fiscal year end. Vice Chancellor Brown noted that UT Chattanooga was in the same position as UTK. UTC used some of the funds for projects related to energy, roof replacements and most are under contracts now. Some of the funds were used for technological upgrades across campus and backfilled some faculty positions as we balanced the budget. President DiPietro added we do not want to return any money and will do our very best to spend it. Vice Chancellor Hooten from UT Martin reported that they had used the stimulus funds by strategically updating our instructional equipment. It was very needed especially in the Science area where the equipment was 40 years old. Some funds were used for roof replacements and adjunct faculty positions.

Trustee Hall stated that as we are trying to spend the funds be careful to follow the guidelines on what expenditures are allowed. Mr. Peccolo agreed and said that yes the guidelines are very descriptive. Mr. Hall then asked when all is said and done how much ARRA money would we receive and the answer was around \$93 million. Chair Talbott stated that he thought there was a question about whether or not we had to actually spend the money or be contractually obligated and I

would urge you to get that cleared up if you can. That is a big difference. Controller Maples commented that they have asked the State specifically that question and from the period of September 30, 2011 to December 31, 2011 we know that if we are contractually obligated that we are good. We don't know after December if we are good if we are just contractually obligated. Vice Chair Murphy reiterated that you think you have until the end of December to actually spend money but you are not sure after that. Controller Maples said that is correct – the folks from the State have said from the very beginning that as long as it was under contract we could go on. So we felt good about our instruction at that time. Then they came back and said everything has to be spent by December. Trustee Wharton noted that if that is the case we ought to pay everything that is on the table. Controller Maples said that the Chancellors and Vice Chancellors have their contingency plans and they can spend the money – that will not be a problem. Vice Chair Murphy confirmed that if we have to we can allocate the money on approved expenses for programs and then fund the construction type projects that is harder to spend it all by the time period is what you are looking at. Controller Maples went on to say that Mr. Criss, Facilities Planning Director, the President and Mr. Peccolo have been to the State Building Commission a few times to change funding sources back and forth because we thought we were going to be able to spend ARRA money but now it is going to be non-recurring money. Chair Talbott stated that the sense of the Board is to make sure the money is spent. Chancellor Rakes commented that in dealing with my colleagues in the south and northeast, the State of Tennessee was treated higher education better with stimulus funding than other states. We are very fortunate to have gotten this money and we are in much better shape than Illinois and others. The State let the money come to higher education when they could have stopped it.

Vice Chair Murphy moved the approval of the Resolution on the Revised FY 2011 Operating Budget as presented in the meeting materials; seconded by Trustee Anderson and approved unanimously.

- VII. **Allocation of Academic Reinvestment at UT Knoxville from FY 2010-11 Tuition and Fee Increases**—Information Item (Exhibit 4)—Chair Talbott called on Dr. Cheek to report to the Board. Dr. Cheek stated that due to the fee increase at last year's June Board meeting, UTK received additional tuition revenue and at that June meeting it was requested that a report be provided back on the use of the additional revenues. Dr. Cheek reported that the fee increase generated about \$1.7 million and they have been allocated to improve retention and graduation rates. He stated that \$1,159,800 was allocated to hire additional faculty, lecturers and graduate teaching assistants (GTAs) to help ease the "bottlenecks," which make it difficult for students to get the courses needed to progress at a steady pace toward graduation. He noted that approximately \$300,000 has gone toward new tenure-track faculty lines, approximately \$675,000 to hire additional lecturers in colleges that deliver a great deal of

undergraduate instruction and the final \$184,800 has been used to add six GTA lines to help meet the increasing demand for biology classes.

He stated that Provost Susan Martin allocated the money and there was some concern from Deans about the way it was allocated because it went to performance based funding for higher demand programs. He stated that they will monitor the money and how it's used over time against the objectives we set. If it is not used correctly, it will be reallocated.

Dr. Cheek stated that another roughly \$400,000 was allocated to hire additional advisers in the colleges of Agricultural Sciences & Natural Resources, Architecture & Design, Arts & Sciences, Communication & Information and Education, Health & Human Sciences. He stated that one of the issues at UTK is that we do not advise students as well as we need to. He stated that by many measures, our advising resources are "thin," and an external consulting group recently recommended the need for investment in both people and systems to improve advising. We have already purchased software to track advising interactions.

Dr. Cheek stated that the final \$175,200 was used to hire a UTrack coordinator and tutoring coordinator and to pay for related resources. He stated that UTrack, which should be in place by fall 2012, is an initiative to assist with student advising and course offerings, with a goal of keeping students on track to a timely graduation. The UTrack coordinator will implement and manage all of the "pieces" involved in tracking student demand and access to courses. At anytime a student can look at how they are progressing toward their degree. He noted that we also have added a tutoring coordinator position in the Student Success Center to direct tutoring for the most at-risk students as well as lead a new tutoring initiative that would coordinate tutors and supplemental instruction in the Library Commons. In addition, he stated that we have hired more student tutors for the library and increased the tutoring support currently offered through the Office of Minority Affairs. Dr. Cheek concluded his report and called for questions or comments.

Chair Talbott asked Dr. Cheek if the additional fee increase in June worked out the way he expected. Dr. Cheek responded that it did, and given the loss in state funding and increase in students, UTK is really pressured to provide enough capacity to graduate students in a timely manner. He stated that one of his first objectives, was to graduate students in four years, in order to do that courses need to be available, and we have not had a history of doing that as well as we need to do.

Trustee Loughry asked about the Utrack system that will be implemented Fall 2012, once you worked out the kinks in that program, would that be system that could be beneficial to our other campuses. Chancellor replied yes and we are transporting it to other campuses now. The first thing we have to do is get Banner in place. As soon as

that happens, we can build the Utrack system. It is transferrable but takes a great deal of time to do so. Trustee Stansberry stated that his recollection of the spending of this money was that it would be spent in ways that would give the students value for their money. Are there any plans to communicate how that money was spent and then send out a survey to the student population. Chancellor Cheek responded that the information has been communicated to some groups across campus and we are having a student forum coming up in the next 3-6 weeks and will brief the students on this. A portion of the students don't read their e-mails but we do try to communicate where we can. The Student Government is fully engaged and fully understands the issues that the University faces and is willing to say we will do something about it. We will talk about that as we go over tuition increases. We have communicated the need very well and have indicated what others feel that needs to be done. For example, when you look at the three new tenure-track faculty lines; one was in communication studies, political science and psychology. They are popular majors and have grown and during this budget cuts there have been a tremendous amount of faculty positions that have not been filled.

Trustee Blackburn asked if the summer school was the last piece to the puzzle in order to graduate students in four years and is there another element that is being worked on in order to do that. Chancellor Cheek said that there is the Strategic Plan on undergraduate programs. In other words, one of our objectives is the Top 25. One, we want to maintain the quality of our freshman students. Today, if you look at the quality they are in the mid-part of the Top 25. Secondly, we need to increase retention and we have pages of in-depth plans. There is war on graduate education, research, etc. and we have strategic plans to attack the problems. Provost Martin has a list of at least 50 things that are being done. We are working on graduating students in a timely manner. Our graduation rate has been about 60% for approximately six years. Next year, it will move up. We are tracking students at six, five and four years. In the fifth year of graduation at UTK is almost at 60%. That means that next year that bar will move to about 62-64%. Our four year graduation rate is higher than the fifth grade graduation rate. We are moving in the right direction and are monitoring it constantly. We have to keep pressure on our system to make sure that we have all of those things in place. We changed the entire orientation program to say to the students that we want you to graduate in 2014. Summer school is important and we need to allow the Lottery Scholarship to fund for summer school. In five years from now hopefully there will be provisions. We are trying to target this year an additional 20% for summer students and that is a major goal. That would bring us to 7,200 students in summer and it is essential that we do that. The Provost has in-depth plans such as what courses need to be taught in the summer. If you do not offer the classes students need they will not come to school in the summer. UTK must utilize their facilities on a

yearlong basis. We have this huge infrastructure, large fall class, good spring class and we drop off in the summer.

Trustee Wharton asked with regard to this year's freshman class have you seen an improvement in retention from fall semester to winter semester last year and the year before that. Chancellor Cheek did not have the answer but said he would get and communicate it. He believed the answer was yes but had not personally looked at that data. When the students come back in the fall we determine what our retention rate is and year before last it was 84% and this past year was 86%. We anticipate this year going up some more. The assumption is there will be more in the spring than there was in the fall. Trustee Wharton questioned whether or not freshman year was the most critical and Chancellor Cheek replied yes. A trend line on freshman has been reducing the dropout rate substantially over time. The dropout rate has lowered substantially over the past five years. Trustee Wharton said he would like to know how UTK did this fall and Chancellor Cheek said he would get that information.

Trustee Hall asked the percent of instructors or tenured faculty and how it compares to the Top 25. President DiPietro replied that in the Treasurer's Report the percentage of system wide tenured faculty is 53%.

Trustee Stansberry asked if we had considered a tuition fee that includes summer. Chancellor Cheek said no we have not but can certainly look into it.

Trustee Tanner began by saying the orientation model she remembered seeing was that there was a high percentage of students that attend orientation actually continue to school and Chancellor Cheek said that is still the case. Trustee Tanner then asked for the percentage that comes out of orientation. Chancellor Cheek said that he guessed the number to be 95%.

Vice Chair Murphy said in looking at the idea that you are going to use this money strategically to figure out which courses are needed. If annually we look each year at the things the students really need it sounds like a good plan. If in fact we are using funding to hire tenured track faculty and for some reason and the second year you realize that they didn't do what they are suppose to – how will you deal with that situation. When you have hired someone as a tenured track faculty member it is not easy to come back and say we don't need you anymore. Is that going to happen? Chancellor Cheek replied that there is always attrition in a department. Vice Chair Murphy stressed for the administration to monitor it. Chancellor Cheek does not feel that discussion will be needed. Vice Chair Murphy asked if he was comfortable with the courses that are being focused on are in fact the bottlenecks and Chancellor Cheek replied absolutely. The unfortunate thing is that we have a large number of bottleneck courses. Vice Chair

Murphy noted that not all have been fixed and Chancellor Cheek said that is correct. We have gotten the most critical ones but there are a host of other courses that are in the same situation. Provost Martin has gone through all the classrooms we have, how they are assigned, how classes are taught and how we could have more capacity. There has been a look at the whole courses inventory and laboratory space we have. We are making sure that we have all resources used to the maximum as possible. Per the Tennessee Higher Education Commission's Formula we are under the formula as far as laboratory and classroom. We will have as much capacity as we need and it is something that we will have to address over time. We are not saying that is a roadblock that we cannot deal with. We will deal with and teach the students as best as we can. Vice Chair Murphy then asked if it is being looked at as to when we offer courses as far as days and times and making sure that we don't have a classroom sitting empty early in the mornings and late in the afternoons because students do not prefer those courses. Chancellor Cheek replied yes – we begin early on Monday and conclude late on Friday.

Trustee Driver asked about the \$7.0 million and Chancellor Cheek explained that UTK had proposed .5% for academic reinvestment. I was asked if UTK had another .5% what would we do with it. I think we proposed that number at \$800,000 and I said if we had it we would do this. A Trustee said if we do that would you come back and tell us what you did with it and I said yes. Trustee Driver stated that he would be remiss if he did not take a moment to acknowledge Trustee Wharton. He was courageous in stepping up and asking the question about the .5% and Trustee Stansberry said it was a good investment. I think in hindsight in the spirit of this discussion we owe recognition for their support at that time. Chair Talbott said that is a good point and agreed with it. He then wanted to reiterate that our incoming freshman class ranges in the middle of academic achievement in the Top 25. Chancellor Cheek said yes and Chair Talbott commented it was amazing. Chancellor Cheek noted that when UTK presents their implementation plan in June there will be a chart of the Top 25 Institutions and UTK is right there in the middle. The point being, our students are already at that level. What we have to do then for the undergraduate student is increase their retention and graduation rates. We are moving on all of those. As we do that, it is one part of the Top 25 that has been achieved. The top issue with the Top 25 is the graduation rate. UTK needs to be at 75% and that is a minimal that we have set for the University but it takes a long time to get there. We will not know the six-year statistical information on the class we just admitted in the fall - the Class of 2014, until 2016. We will know the indicators along the line as Trustee Wharton discussed on a yearly basis versus semester basis but we will know if we are making progress. Each year as we are measuring the second, third, fourth and fifth year cohorts, we are going up and getting closer to that goal. Next year we will be at 62-64% based on projections. Trustee Wharton asked if he looked at resources when eliminating those

bottleneck courses. I would encourage you to take a hard look at the needs of the 'STEM' courses because those majors and graduates are the most valuable in terms of employer needs in the State of Tennessee. Chancellor Cheek said yes we are and have already been thinking about what we would like to show you in June. I have not run this by any of the administrative staff but I would like to show you some of the "STEM" laboratories because they are not what they are suppose to be. In the last five years, we have increased the number of "STEM" students and the number of "STEM" graduates by 22%. That is saying that the engineering classes in this last year had 20% more freshman than it did before. The number of Ph.D. students has increased by 25%. We have a broad based curriculum and are moving our students like the State of Tennessee wants us to. If you look at us as a University, we have more "STEM" disciplines today than there was five years ago with an increase of 22%. Research education will bring in additional "STEM" students. "STEM" is very important to us but our infrastructure is not where we need to be for stem.

President DiPietro stated that on the student parameters and the issue of the Top 25 - we are very much on track. What worries more is the operations side on all the campuses including Knoxville. One of the big gaps is the research funding gap. It is big and a lot of it is on the back of the faculty and we don't have adequate facilities for the kind of laboratory work that brings in big dollars. That is another big part of this Top 25 initiative. Chancellor Cheek added that the UTK Master Plan will be presented at the June Board Meeting.

- VIII. **College of Veterinary Medicine Incentive Compensation Plan—**Information Item (Exhibit 5) — Mr. Peccolo stated that the Committee is being asked to review an incentive compensation plan to financially reward clinical faculty and staff for increasing teaching hospital revenue, to share some of the increased revenue with college-wide faculty and staff exhibiting teaching and service excellence, and to push the hospital forward to become less dependent on state revenue. He stated that Dr. Thompson, Dean of the College of Veterinary Medicine will discuss the proposal as an information item at this meeting, gather feedback from the Committee, and seek a vote at the the next meeting in June as part of the overall discussion of compensation for employees.

Dr. Thompson referred the Committee to his memorandum included in the meeting materials. He stated that the College of Veterinary Medicine is a unique educational environment as an education program with an associated business. He stated that it is roughly an \$18.2 million dollar enterprise, and approximately \$10 million is revenue generation from the public and \$8 million of state support. The intention of the incentive plan is to push it to grow client based revenue and become less reliant on state support for teaching, and to expand opportunities to invest new revenue in our people and programs.

Dr. Thompson discussed the formula used to calculate available revenue for bonus distribution. He explained that available revenue for bonus distribution will be determined based-on each individual hospital service's earned gross revenue and subtracting expenses associated with salaries, benefits, longevity payments, and operating costs (i.e., gross revenue – (salaries + benefits + longevity + operating expense) = year-end profit or loss). Whether an individual service (eg. Cardiology, Neurology, Internal Medicine, Oncology, Surgery, Equine Medicine, etc...) earns bonus funds is determined on the success of that service to exceed an established profit target or to incur less revenue loss than an established loss target. He stated that it is important to understand that only those net monies which exceed the profit target or are less than an anticipated revenue loss are eligible for bonus distribution. He also explained that part of the money available for bonus distribution, approximately 20% will be split out and placed in a central college pool for distribution to college-wide faculty and staff based on teaching and/or service excellence. He stated that he wanted to steer away from a trap of cutting cases and teaching to retain funds. He stated that this compensation incentive plan pushes the hospital in the right direction and eventually can allow the hospital to market itself at a higher level and be visible across the state of Tennessee. He added that he is cognizant of being too marketable and too visible, because he does not want to take away cases from local practitioners. At the same time, he noted that the College of Veterinary Medicine needs to stand up and be just little bit stronger to increase revenues and change the culture.

Dr. Thompson stated that should the Board approve this proposal at its June meeting, what he is asking for is the Board's support to take this step, to agree that this is a good idea, and not necessarily require precisely how it will work, but to report back with how this plan is functioning towards achieving its goal. Chair Talbott stated that his concern would be the unintended consequences of doing something like this, for instance, would the quality of care suffer, because you are more profit motivated. Dr. DiPietro stated that his concern would be the cost side of the hospital, often times when the staff purchases items, due to the nature of their work, they don't always pay close attention to cost, but if they know it impacts their personal profitability, they may pay closer attention. Trustee Wharton commented that the quality of care may actually increase because of the renovations in progress and the ability to compete head on with high quality clinics. Trustee Wharton also stated that at the upcoming June meeting, he recommends that the Committee receive a preliminary report from the Compensation Advisory Board, including the non-formula units, and if possible, with a preliminary action plan. He discussed the departure of a key researcher at the College of Veterinary Medicine and the low, uncompetitive salary of some extension agents. He added that with no raises over four years, this flexibility is critical for Dr. Thompson. Trustee Foy added that he also agrees with Dr. Thompson's proposal and noted that one of the first rules of management is to reward the

behavior you want repeated. Mr. Peccolo stated that the CAB chair, Richard Brown, is present at this meeting and will undertake Trustee Wharton's request.

Trustee Cates requested that the preliminary report from the CAB include regional cost adjustments for peer comparison purposes. Chair Talbott agreed with the need to include cost of living adjustment data. He called for any further questions or discussion and thanked Dr. Thompson for his report. Chair Talbott agreed with the cost of living report. President DiPietro stated that the CAB will present where they are in June but it takes a significant amount of time.

- IX. **Revised Policy Statement on Discretionary Expenditure Reporting for the President and Chancellors**—Consent Item (Exhibit 6)—Mr. Peccolo stated that the Higher Education Accountability Act of 2004 (HEAA) required the Board to adopt a policy requiring quarterly reporting to the Board of discretionary expenditures by the President and Chancellors. He stated that the HEAA was amended in May 2010 to require only an annual reporting. This change, and other housekeeping changes, are presented in the Committee meeting materials, in the black-lined "Board Policy Statement on Discretionary Expenditure Reporting for the President and Chancellors," originally adopted by the Board on June 24, 2004. The Audit Committee reviewed the proposed revisions at its meeting on December 10, 2010 and recommended their approval to this Committee.

Trustee Foy moved approval of the revised Board Policy Statement on Discretionary Expenditure Reporting for the President and Chancellors as presented in the meeting materials; seconded by Trustee Carroll and approved unanimously.

- X. **Report of Capital Projects Outside the Budget Process**—Consent Item (Exhibit 7) — The University administration has identified additional revenue/institutionally funded projects for FY 2011 - 2012. The projects, both of which are at the Memphis campus of UTHSC, are as follows:

1. Dunn Building – This project will renovate space on the third (3rd) and fifth (5th) floors of the building. The space will be utilized by Orthodontics, Endodontics, and Advanced Education in General Dentistry. The total estimated cost of the project is \$1,350,000 which will be funded by gifts.
2. 920 Madison Avenue Building – This project will renovate space on the ninth (9th) and tenth (10th) floors of the building. The space will be utilized for the College of Nursing. The total estimated cost of the project is \$600,000 which will be funded through institutional funds.

These projects are in addition to the list of FY 2011 – 2012 revenue/institutionally funded projects approved at the Fall Meeting in October 2010. With the Committee's recommendation and the Board's approval, the University will submit these projects to the Tennessee Higher Education Commission (THEC) and the Department of Finance and Administration. The intent is to seek approval of these projects by the General Assembly this session. Chair Talbott clarified that institutional funds, means self-funded.

Trustee Wharton moved approval of the two revenue/institutionally funded projects described in the meeting materials; seconded by Trustee Foy and approved unanimously.

- XI. **Real Property Transactions**—Consent Items—Chair Talbott informed the Committee that the next item was the Real Property transactions and each one has to be approved individually. He stated that the Committee has had time to review the memorandums included in the meeting materials regarding these transactions. He noted that essentially property is sold at appraisal or better and purchased at appraisal or less, and easements are done if they benefit the University and if the easement does benefit the University it is done for no charge. Chair Talbott called for any questions or comments on the real property transactions presented at this meeting. There were none. Mr. Peccolo presented the following:

- A. Easement – Fulton Bottoms Rugby Fields (UTK/Knox County)—Consent Item (Exhibit 8)

Trustee Carroll moved approval of granting the Permanent Utility Easement and Temporary Construction Easement to Knoxville Utilities Board as described in the meeting materials; seconded by Trustee Anderson and approved unanimously.

- B. Easement – Metron Building (UTK/Knox County)—Consent Item (Exhibit 9)

Trustee Wharton moved approval of the Permanent Utility Easement and Temporary Construction Easement to Knoxville Utilities Board as described in the meeting materials; seconded by Trustee Carroll and approved unanimously.

- C. Easement – Student Health Clinic (UTK/City of Knoxville)—Consent Item (Exhibit 10)

Trustee Anderson moved approval of granting the Permanent Water Quality Facility Easement and Traversable Access Easement, as described in the meeting materials, to the City of Knoxville; seconded by Trustee Foy and approved unanimously.

- D. Easement – Sutherland Avenue (UTK/Knox County)—Consent Item (Exhibit 11)

Trustee Carroll moved approval of granting the Permanent Easement to Knoxville Utilities Board as described in the meeting materials; seconded by Trustee Anderson and approved unanimously.

- E. Closure of Lebanon and Mann Streets (UTK/Knox County)—Consent Item

Trustee Wharton moved approval of the right-of-way closures of Lebanon and Mann Streets in Knox County; seconded by Trustee Anderson and approved unanimously.

- F. Easement – West Tennessee Research and Education Center (UTIA/Madison County)—Consent Item

Trustee Carroll moved approval of granting a Permanent Utility Easement to Jackson Energy Authority, as described in the meeting materials, for consideration at or above its appraised value; seconded by Trustee Foy and approved unanimously.

- G. Easement – West Tennessee Research and Education Center (UTIA/Madison County)—Consent Item

Trustee Carroll moved approval of granting a Permanent Utility Easement to Jackson Energy Authority, as described in the meeting materials, for consideration at or above its appraised value; seconded by Trustee Anderson and approved unanimously.

- H. Disposal in Fee – TDOT Highway Expansion Project (UTIA/Morgan County)—Consent Item

Trustee Foy moved approval to dispose of approximately 34.50 +/- acres in Morgan County, Tennessee, as described in the meeting materials, to the Tennessee Department of Transportation for consideration at or above the appraised value; seconded by Trustee Wharton and approved unanimously.

- I. Acquisition in Fee – Closure of Allbright Road (Solar Farm-Haywood County)—Consent Item

Trustee Wharton moved approval of the acquisition of approximately 4.844 +/- acres in Haywood County, Tennessee, as described in the meeting materials; seconded by Trustee Carroll and approved unanimously.

- J. Acquisition in Fee – 720 McCallie Avenue – Thornton Building (UTC/Hamilton County)—Consent item (Exhibit 12)

Trustee Anderson moved approval to acquire the property located at 720 McCallie Avenue in Chattanooga, Tennessee, at a purchase price equal to or less than the appraised value; and Further moved approval to revise the University's land acquisition plan to include the property at 720 McCallie Avenue in Chattanooga, Tennessee; seconded by Trustee Wharton and approved unanimously.

- K. Acquisition in Fee – 801 McCallie Avenue – Red Cross Building (UTC/Hamilton County)—Consent item (Exhibit 13)

Trustee Wharton moved approval to acquire the property located at 801 McCallie Avenue in Chattanooga, Tennessee, at a purchase price equal to or less than the appraised value; and Further moved approval to revise the University's land acquisition plan to include the property at 801 McCallie Avenue in Chattanooga, Tennessee; seconded by Trustee Anderson and approved unanimously.

- L. Acquisition in Fee – 825 McCallie Avenue – Art Accent Building (UTC/Hamilton County)—Consent item (Exhibit 14)

Trustee Carroll moved approval to acquire the property located at 825 McCallie Avenue in Chattanooga, Tennessee, at a purchase price equal to or less than the appraised value; and Further moved approval to revise the University's land acquisition plan to include the property at 825 McCallie Avenue in Chattanooga, Tennessee; seconded by Trustee Wharton and approved unanimously.

- M. Easement – Library – Lot 6 Oak Street (UTC/Hamilton County)—Consent item (Exhibit 15)

Trustee Anderson moved approval of granting the Permanent Utility (Electric) Easement to the Electric Power Board of Chattanooga as described in the meeting materials; seconded by Trustee Foy and approved unanimously.

- XII. **Health Affairs Matters**—Information Item (Exhibit 16)— Dr. Ken Brown, Dr. David Seaberg, Chancellor Schwab and Tony Ferrara addressed the Committee. Dr. Brown stated that at the last Health Affairs Committee meeting, there were a few follow-up matters Trustee Hall requested and they will be addressed at the next meeting of that committee due to time constraints today (patient satisfaction data on UTMG and Methodist Hospital and the Financial Data on UTMG).

A. UT Medical Group Performance

Dr. Schwab discussed UTMG performance, GOP and earnings. He reported that the \$2 million dollar Deans tax, paid by UTMG in quarterly installments is up to date. Mr. Ferrara noted that there will be a decrease in the tax with the transfer of the pediatric practice. Dr. Brown reminded the Committee that this was the payment that we ultimately had to go to the state to receive a waiver on.

B. UT LeBonheur Pediatric Specialists, Inc. (ULPS)

Dr. Brown provided a brief update on the new physician partnership between LeBonheur Children's Hospital and UTHSC, UT LeBonheur Pediatric Specialists, Inc. Mr. Ferrara stated that the closing documents were completed and the practice was put into place January 1st. Organizational progress is continuing on time.

C. UT College of Medicine-Erlanger

Dr. Seaberg discussed the UT College of Medicine-Erlanger. He stated that the practice plan is a structured plan that provides greater stability for faculty, to not only retain, but grow faculty at UTC. The practice plan provides a greater voice for our faculty and better control in clinical operations that will not only improve patient care but revenue generation. It will provide for mission support dollars to achieve UTC's Strategic Plan. He stated that we have many initiatives in education and research, not only with our sister campuses in Memphis and Knoxville, but also with our graduate and undergraduate programs at UTC. He stated that this is the last step in his goal to make UT Erlanger campus and academic medical center.

D. Comparison of Practice Plan Designs

Dr. Brown presented a high level comparison of practice design plans (Exhibit). He presented a diagram illustrating the practice plan design of UTMG. He stated that it functions as a stand-alone entity that essentially sits outside of the University and is not encumbered by UT's state regulations. He discussed its income sources and affiliations agreements. He then discussed the design of the practice plan for ULPS highlighting the shared financial risks and financial incentive to co-manage an efficient practice. He reminded the committee that pediatrics was losing approximately \$3 million per year as part of UTMG. As a result of the joint venture, the hospital now pays a mission support payment back to UTHSC. Dr. Schwab stated that support payment is approximately \$5 million, however since UTHSC jointly manages the practice that payment could be at risk if the practice loses money. He estimated that UTHSC should receive \$2-4 million of that payment year to year after the initial investment to get the practice up and running. Dr. Brown explained that the risks to UTHSC are capped. He stated that he is reviewing the design plan for

UTMG to perhaps get a different mission support structure for UTMG similar to the structure in place for ULPS. He discussed an illustration of the design plan for the UT-Erlanger Medical Group. He reported that UEMG will be a non-profit practice plan in a subsidiary-like structure within Erlanger. Over 90% of the physicians joining UEMG are currently employed by Erlanger (part time UTCOM faculty). Through this structure, Erlanger ultimately assumes full financial risk of the practice. UTCOMC will have representation on UEMG board and actively help govern/manage the practice. He stated that UT and Erlanger are the process of restructuring its affiliation agreement which will yield a more contemporary arrangement that will strengthen the partnership. To date, the vast majority of UTCOMC's budget is supported by Erlanger funding. He stated that UEMG will be comprised mostly of UT faculty and be a bona fide faculty group practice plan of UTCOMC.

Trustee Stansberry asked what the impact of the joint venture arrangement of ULPS is on the profitability of the pediatric practice. Dr. Brown explained that the physicians now benefit from the hospital receiving ancillary revenues, from x-rays, etc. that take place in a hospital.

E. Nursing Statewide (DNP)

Dr. Brown stated that he will discuss this topic at the next meeting of the Health Affairs Committee.

Chair Talbott thanked Dr. Brown, Chancellor Schwab, Dr. Seaberg, and Mr. Ferrara for their report. He stated that the Committee really appreciates the progress being made.

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

XIV. **Adjournment**—The meeting was adjourned.



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