THE UNIVERSITY OF TENNESSEE
BOARD OF TRUSTEES

MINUTES OF THE FINANCE AND ADMINISTRATION COMMITTEE

October 17, 2013
Knoxville, Tennessee

The Finance and Administration Committee of The University of Tennessee Board of Trustees met at 3:00 p.m. EDT on Thursday, October 17, 2013, in the 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, Chair
Joseph A. DiPietro
J. Brian Ferguson
John N. Foy
Raja J. Jubran
Sharon J. Miller Pryse
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. CONSENT AGENDA

A. Minutes of Last Meeting
B. Real Property Transactions
   1. UTK Norfolk Southern Right-of-Way Acquisition (Exhibit 1)
   2. UTK Lake Avenue KUB Access and Utility Easement (Exhibit 2)
A motion to approve the Consent Agenda was duly made and seconded. The motion carried unanimously.

IV. STRATEGIC PLAN DASHBOARD REVIEW-ENSURING EFFECTIVENESS AND EFFICIENCY

The Finance and Administration Committee reviewed metrics related to Goal 4 of the System Strategic Plan, Ensuring Effectiveness and Efficiency (Exhibit 3). Mr. Peccolo highlighted the following:

1. Total gifts, payments, and pledges to the University have increased from $144 million in 2010-11 to $149 million in 2012-13.
2. Total endowment dollars per student FTE has increased over $5,000 between FY 2009 and FY 2013.
3. Capital Assets increased 42 percent from FY 2008 to FY 2012; Non-Capital Assets increased in value by 15 percent.
4. Net Assets (Rainy Day Fund) as a percentage of Current Expenses has fluctuated between 4 and 5 percent, which is the recommended range.
5. For FY 2013, the University received its first major state funding for Capital Outlay (new construction and renovation) in five years; for FY 2014, the University received $89 million.
6. For FY 2013, the University received $31.5 million in Capital Maintenance and $26 million for FY 2014, both amounts within the average range for state funding of Capital Maintenance.
7. Gross square footage of Education and General facilities has declined by 2 percent, most likely because facilities undergoing renovation are removed from the space inventory while the renovation is in progress.

V. TREASURER’S REPORT ON ENDOWMENT INVESTMENT PERFORMANCE

Mr. Rip Mecherle, Executive Director of Investments presented the Endowment Investment Performance Report (Exhibit 4) touching mostly on the Consolidated Investment Pool’s performance and allocation.

Following the presentation, Mr. Peccolo asked Mr. Mecherle to update the Committee on efforts regarding the spending plan, which currently uses a three-year rolling average of 4 ½% of market value, but other models further dampen volatility. Over longer periods of time, these models end up with...
more money being distributed. Mr. Mecherle explained that there are
methods of using moving averages for longer periods of time, and some
institutions use caps and floors based on inflation and a set spending rate of
growth. The Treasurer’s Office is examining some of the other methodologies
that can help to minimize some of that year-to-year volatility of the actual
distribution rate. Any proposed change would be presented to the
Investment Advisory Committee and then the Board of Trustees. Trustee
Pryse asked for clarification of whether the spending rate is 4½ or 5½ percent,
and Mr. Peccolo explained that the spending is 4½ percent of the endowment
program and a 100 basis point administrative fee, resulting in a total
distribution of 5½ percent. Trustee Stansberry noted that the University
raises over $100 million a year and after spending there is a little to add to
principle, and yet there is less money than five years ago with stock markets
at a record high. Mr. Peccolo responded that some private gifts do not go into
the endowment. Trustee Stansberry went on to say he had concerns that the
University is spending more than what is being made. Trustee Jubran asked
if a chart could be generated for ten years showing income from endowment,
income from the market, and expenses. Mr. Mecherle responded that the
information could be prepared.

Responding to Trustee Stansberry’s concern, Chair Anderson noted the Pool
performed well with a 5½ percent payout over the last four years. Mr.
Mecherle added that inflation has to be factored in at approximately 2½
percent. He went on to say that he is not concerned about the 5½ percent
spending rate given where the Pool is positioned, but he believes it is prudent
to investigate a change to the methodology to take into account longer and
broader market performance.

Trustee Wharton asked how the portfolio would perform in the event of
raging inflation and how quickly would it take to return to a defensive
position. Mr. Mecherle replied that the University is fairly well positioned
relative to the broader markets. Real assets should perform well, and equity
market exposure is mostly in the public space, which can be moved quickly.
Most of the bond positions are short-term so there is limited duration impact
and many are credit related. In short, the endowment is positioned well for
acceptable inflation, but not crisis level.
VI. TREASURER’S FINANCIAL REPORT

Mr. Peccolo explained that the process of preparing the University’s financial statements is going on presently and a draft is available (Exhibit 5). The audited financial statements of the component units are due soon and will be combined with the University’s statements. The auditors will then give the University an audited financial statement, and then an audit report will be issued. To date, the only two findings cited are the financial aid issue regarding timely reporting of withdrawals and making sufficient academic progress toward a degree.

Mr. Peccolo reported that the University’s total assets are $3.879 billion, an increase of $134 million. He also noted that the category Net Assets has been changed to Net Position in accordance with GASB Standard 63. He reported that there was a Tennessee State School Bond Authority issue last year and another will be issued shortly. These bond issues will help fund the University’s self-funded projects and projects that remain in commercial papers. Finally, he noted that two-thirds of the University’s expenditures are related to salaries and benefits, and salary expenditures increased 5.0 percent or $60.5 million last year.

VII. CLOSURE OF GLOCKER RENOVATION QUASI-ENDOWMENT

Mr. Peccolo informed the Committee that when the Knoxville campus transformed the Glocker Building into the Haslam Business Building, private dollars were raised for equipment and technology and placed in a quasi-endowment. The campus requests authorization to close this quasi-endowment and use the funds to pay for technology.

Trustee Pryse moved that the administration be authorized to close the Glocker Renovation Quasi-Endowment and apply the balance toward the Glocker Equipment Account at UT Knoxville (Exhibit 6). Trustee Tanner seconded the motion, and it carried unanimously.

VIII. FY2014-15 OPERATING BUDGET APPROPRIATIONS REQUEST FOR NON-FORMULA UNITS

Mr. Peccolo explained that each year the non-formula units present new funding priorities in the event the state is able to add improvement dollars to the budgets. The total improvement amount that will be submitted to the Tennessee Higher Education Commission is $41,807,290. Approximately 25
percent of the listing is directly related to the University's attempt to address the compensation gap that was identified during the 2011 Sibson Marketing Study. Almost 33 percent is for equipment and space enhancements for existing programs. Roughly 35 percent is to enhance existing programs by adding staff and operating dollars. The balance is to support new services.

Trustee Pryse moved that the University's FY 2014-15 operating budget appropriations request for support of the non-formula units (Exhibit 7) be approved as presented in the meeting materials. Trustee Foy seconded the motion, and it carried unanimously.

IX. FY2014-15 CAPITAL OUTLAY AND CAPITAL MAINTENANCE PROJECTS

Mr. Peccolo presented the University's priority ranking for capital outlay and capital maintenance projects and explained that upon approval by the Board, the list will be sent to THEC, which will compile a recommendation for submission to Governor Haslam and the State Department of Finance and Administration for consideration in the state budget.

He then explained the process and the ranking of the projects. Beginning in January 2013, system administration staff met with all the campuses and institutes to discuss the capital outlay timeframe and the process for developing priorities. Subsequent visits were made to the each campus and institute to hear their proposed priorities and rankings. In August, an initial list was prepared and reviewed with the President, who then met with the Chancellors to discuss the priorities and purposes of the proposed projects. For the undergraduate campuses, a key factor was facilities that impact outcomes and can help with student progression. Capital matching was discussed in detail. Formula campuses must provide 25 percent of the cost of the building as a match. Non-formula units must provide 10 percent of the cost of the building as a match. Mr. Peccolo explained that it would not be prudent to assign a high priority to a project with no chance for a match. He also explained that funding history is checked to make sure the same campuses do not receive priorities every year. President DiPietro added that sciences, technology, engineering and mathematics (STEM) fields are viewed as priorities. Mr. Peccolo noted that the list includes the estimated project cost, the state funded amount, and the institutional match. If a building moves up in the rankings and likely will be funded in a year or so, it is put on the list for planning purposes because the institution funds the planning dollars.
Mr. Peccolo then described the top five priorities:

1. UTK Science Laboratory on Cumberland and 13th Street. Microbiology, zoology, psychology and nutrition will be housed in an updated facility with an accredited animal care facility. The building will have approximately 220,000 square feet with laboratory space and faculty offices. The benefit of the building is degree production in the specific fields and enhanced research opportunities.

2. UT Chattanooga Academic Classroom Building Renovation. This project involves renovation of Fine Arts facilities and the Lupton Library, which will result in a more efficient academic space configuration for the College of Arts and Sciences. The benefit is facilitation of student progress and degree production.

3. Institute of Agriculture’s Energy and Environmental Science Education Building. This is 120,000 square feet on the site of the existing Ellington Hall. It will host new classrooms, teaching centers, outreach laboratories, and faculty offices and includes space to lease to US Forestry Service operations. The new facility will enhance research capacity and opportunities as it improves efficiency and degree production and contributes to economic growth in workforce development.

4. The fourth priority is the UT Knoxville Engineering Services Facility. This project is for freshman engineering classrooms and teaching and research laboratories. It will replace the outdated Pasqua Nuclear Engineering Building, which is a repurposed steam plant from the 1960’s. The UTK Nuclear Engineering program is one of the top 10 programs in the nation. Half of the match has been secured from two private gift pledges.

5. The fifth priority is the UT Martin Classroom and Lab Renovation and Addition. The project will renovate and expand the Joe Johnson Engineering Physical Science Building and help address space shortages and outdated labs, while also housing a new manufacturing engineering concentration being developed by UT Martin to benefit the northwest Tennessee region. A growth of 25 percent in engineering students is anticipated, as well as growth of computer sciences enrollment.

Finance and Administration Committee
Board of Trustees
October 17, 2013
Turning to the Capital Maintenance priorities, Mr. Peccolo noted that the list includes a total of $45.7 million in projects for FY2015. He explained, however, that the amount the state likely could fund would be around $25-$30 million, which would go down to about the seventh priority item on the list. He said all campuses and institutes reached agreement on the list.

Vice Chair Ferguson thanked Mr. Peccolo for the thorough explanation of the process to ensure Trustees understand how capital decisions are made. He asked if there is an escalator of projects so that projects move up as others move off. Mr. Peccolo replied that projects do not get locked into position. Every project is re-evaluated, especially in view of the matching requirement.

Trustee Foy moved that the Capital Outlay and Capital Maintenance Funding Requests for FY 2014-15 and subsequent years (Exhibit 8) be approved, with authorization to enter into contracts for design and construction for these projects within available funds. Trustee Jubran seconded the motion, and it carried unanimously.

X. FY2014-15 REVENUE/INSTITUTIONALLY FUNDED PROJECTS

Mr. Peccolo presented the revenue/institutionally funded projects and noted they are not prioritized. The campuses and institutes develop their own list of needed facilities to be funded from available institutional funds or revenue generated by the facility. There will be an associated fee or reserve fund that will be used to either pay for or debt finance project costs through the Tennessee School Bond Authority. The list will be forwarded to the Tennessee Higher Education Commission for consideration.

Trustee Tanner moved that the Revenue/Institutionally Funded Projects for FY 2014-15 (Exhibit 9) be approved, with authorization to enter into contracts for design and construction of these projects, within available funds, and, with the approval of the President, for design and construction of other revenue/institutionally funded projects identified during the fiscal year within available funds. Trustee Pryse seconded the motion, and it carried unanimously.

XI. FY2013 ANNUAL FLIGHT OPERATIONS REPORT

Mr. Peccolo presented the results of Flight Operations for FY2013. He advised that there will be major maintenance scheduled over the next two years or so as hours are accumulated and the engines require overhaul.

Page 7
Finance and Administration Committee
Board of Trustees
October 17, 2013
Trustee Jubran moved that the FY2013 Annual Flight Operations Report (Exhibit 10) be approved as presented in the meeting materials. Trustee Pryse seconded the motion, and it carried unanimously.

XII. UT KNOXVILLE REPORT ON USE OF DIFFERENTIAL TUITION FUNDS

Chancellor Cheek presented a report on the use of funds from the differential tuition rates for the College of Business, College of Engineering, and College of Nursing at UT Knoxville (Exhibit 11). He introduced the three deans: Victoria Niederhauser, College of Nursing, Steve Mangum, College of Business and Wayne Davis, College of Engineering. Chair Anderson asked if more money is being spent on improving retention. Chancellor Cheek replied that adding faculty and advisors helps with retention, which is a key metric. Trustee Stansberry asked if any of the monies are being used to enhance faculty compensation. Chancellor Cheek responded that some of the funds are used for salary enhancement at the time of hiring new faculty.

XIII. CHANCELLORS’ REPORTS ON ANALYSIS OF FINANCIAL INCENTIVES TO INCREASE SUMMER TERM ENROLLMENT

Chancellors Angle, Cheek, and Rakes gave reports on summer term enrollment (Exhibit 12). The consensus was that making the Hope Scholarship available for entering freshmen in the summer term would help to improve summer term enrollment. It was also noted that students who are full-time in the fall and spring are not eligible for a Pell Grant in the summer. All campuses are working on incentive models, such as discounted packages and twelve-month housing leases, and marketing plans to go out before Thanksgiving.

XIV. FINAL REPORT OF THE COMMITTEE ON EFFECTIVENESS AND EFFICIENCY FOR THE FUTURE

Ron Loewen, System Administration Budget Director, gave a final report on the Effectiveness and Efficiency for the Future (Exhibit 13). State appropriations in 2008 were nearly $510 million. Over the next five years, the University’s base appropriation was reduced by over $120 million. The reduction of 25 percent over a span of five years and represented roughly 12 percent of total unrestricted funding. After 2008, the University was facing an unprecedented financial challenge. Beyond the appropriations reductions, there were also funding gaps in compensation and a need to reinvest funds
into infrastructure and support services to refocus activities on student progression to comply with the Complete College Tennessee Act (CCTA). Mr. Loewen highlighted the effectiveness and efficiency initiatives of UT Extension, which implemented a comprehensive restructuring process to reduce positions, and UT Martin, which has made great efforts in converting their paper-based processes to paper-less approaches (approximately 200 projects).

XV. OTHER BUSINESS

There was no other business to come before the Committee.

XVI. ADJOURNMENT

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

Respectfully Submitted,

[Signature]

Charles M. Peccolo
Treasurer and Chief Financial Officer

Page 9
Finance and Administration Committee
Board of Trustees
October 17, 2013