MINUTES OF THE FINANCE AND ADMINISTRATION COMMITTEE

THE UNIVERSITY OF TENNESSEE
BOARD OF TRUSTEES

October 27, 2005
Knoxville, Tennessee

The meeting of the Finance and Administration Committee of the Board of Trustees was held at 1:00 p.m. EST, Thursday, October 27, 2005, in the University of Tennessee Plant Sciences Biotechnology Building, Room 156-157, in Knoxville Tennessee.

I. CALL TO ORDER
Mr. Bill Stokely, Chair, called the meeting to order.

II. ROLL CALL
Ms. Sylvia Davis, Vice President for Administration and Finance, recorded the following members as present:

Mr. Bill Stokely, Chair
Ms. Johnnie Amonette
Mr. Bill Carroll
Mr. Jim Haslam
Mr. Jerry Jackson
Dr. John Petersen
Mr. Don Stansberry
Mr. Bucky Wolford

Ms Davis announced there was a quorum present.

III. INTRODUCTIONS
Mr. Bill Stokely welcomed everyone and introduced new trustee Mr. Bill Carroll and the new Chief Financial Officer, Dr. Gary Rogers. Mr. Stokely charged the committee with gaining an understanding of the university's financial statements.

IV. APPROVAL OF MINUTES OF LAST MEETING
Mr. Jim Haslam moved approval of the minutes, and Mr. Stansberry seconded. The minutes were unanimously approved as distributed.

V. TREASURER'S REPORT ON INVESTMENT PERFORMANCE
Mr. Butch Peccolo presented the Treasurer's Report on Investment Performance to the committee. Investments are administered in accordance with investment policies approved by the Board in 2002. Mr. Peccolo noted these policies are under review and he expects to have recommended revisions to the policy statement at the next Board meeting.

Mr. Peccolo reviewed with committee members the total funds invested to benefit the University of Tennessee. Funds invested as of June 30, 2005 totaled \$767.0 million and are comprised of Chairs of Excellence, UC Foundation, Life Income Funds, and Endowments (separately invested endowments and the Consolidated Investment Pool).

Endowments at June 30, 2005 totaled \$499 million, an increase of \$48 million over last year. 75% of this amount funds scholarships, instruction and academic support and 17% supports research. The Consolidated Investment Pool (CIP) has grown over the past ten years from \$187 million to \$499 million. New gifts totaling \$209 million along with net capital appreciation of \$103 million account for this increase. Total distributions during the ten year period were \$181 million. The CIP goal for return is 9% and we are on track to obtain this goal. In response to how the university is keeping pace with inflation, Mr. Peccolo said our compounded growth was a little over 5% compared to an average annual inflation rate measured by the CPI of a little over 2.5% over the last ten years.

Mr. Karl Schledwitz asked how our return on investments compared to the two funds we do not manage. Mr. Peccolo said the return on the externally managed Chair of Excellence was 5.9% to UT's 11.2%. Mr. Haslam and Dr. Petersen pointed out the state is limited in how they invest their funds.

The number of underwater endowments dropped from 99 December 2004 to 33 as of September 30, 2005. The value of underwater endowments is \$190,000 and Mr. Peccolo foresees no problems in overcoming this position.

Mr. John Thornton asked how often we review allocations or when would we consider changing the allocations. Mr. Peccolo indicated allocations are reviewed annually. Mr. Stokely stated we have a separate investment committee comprised of some board members, along with outside non-board members. The Investment Committee participates in presentations with fund managers and reviews all performances against the benchmarks. The committee spends a large amount of time discussing the asset allocations and any new products or new areas such as real estate and natural resources.

Mr. Jackson asked about university's investment in natural resources. Mr. Peccolo indicated it was new and the target allocation was set at 8%. Mr. Thornton stated he was glad to see an alternative investment fund which was proposed several years earlier and these should provide great dividends.

Mr. Stokely stated these numbers show we are moving in the right direction.

VI. TREASURER'S FINANCIAL REPORT

Mr. Peccolo provided an overview of the draft, unaudited financial statements for the year ended June 30, 2005.

The Statement of Net Assets shows the University had $2.2 billion in assets, with liabilities of $573.0 million and a net asset position of $1.6 billion. The Statement of Revenues, Expenditures, and Changes in Net Assets includes a restatement of $82.1 million for pledge valuation and accumulated depreciation.

Mr. Schledwitz asked why the auditors restated the statements. Mr. Peccolo stated this was due to GASB changes for gift records and also further research by the auditors.

Mr. Wolford asked if the University was doing cost segregation studies on new buildings. Mr. Peccolo answered that we have hired a consultant to assist us and we are working with them on the accelerated depreciation.

Mr. Peccolo stated that as soon as audited financial statements were received, he would transmit them to the Board of Trustees.

VII. FILING OF FLIGHT OPERATIONS ANNUAL REPORT FOR FY 2005

Ms. Davis presented the annual report of the UT Flight Operations for FY 2005 as required by Fiscal Policy 735. The report covers both the UT owned airplane and charter flights.

In FY 2005 the UT plane flew 190 flights totaling 400 air miles. This compares to 192 flights and 429 air miles for FY 2004. 82.5% of the flights were within the state of Tennessee. Departments using the plane included the offices of the President, Athletics, Alumni Affairs, Administration and Finance, and the Executive Vice President. Operating costs for the airplane were a little higher this year due to a major engine overhaul costing approximately $600,000. The FAA requires the overhaul of engines every 3,000 miles, which occurs about every seven years for UT. The operating costs for FY 2005 were $652,000, a 3.1% increase over the previous year. Increased expenditures included fuel costs, 17% greater than the previous year, as well as ongoing maintenance repairs. A major purchase was a ground warning proximity system.

The university utilizes charter aircraft when the UT plane is not available. The university spent approximately $600,000 on charter flights in FY 2005.

Mr. Jackson asked if the age of the UT plane, 27 years, is a concern. Since the cost of maintenance is ever increasing with the age of the plane this is a concern. Dr. Petersen responded that Dr. Rogers is to look at a business plan on this situation as one of his first priorities.

Mr. Stansberry made a motion to approve the report and Mr. Jackson seconded the report. The motion was unanimously approved.

VIII. FY 2006-07 APPROPRIATIONS REQUEST

In accordance with the Operating Budget Guidelines approved by the Board of Trustees at its June 2005 meeting, Dr. Petersen presented the programmatic improvement requests submitted to the Tennessee Higher Education Commission for FY 2007. The university's improvement request ties to six strategic initiatives: student access, student success, research, economic development, community outreach, and globalization. The improvement request includes $190 million in system-wide initiatives and $19 million in unit specific requests. The funding priorities include increased matching funding for the recruitment of world class scientist and engineers, enhancements to science and engineering research programs, continuation of the Geier Consent Decree funding, and technology infrastructure improvements.

Dr. Richard Rhoda, Executive Director of the Tennessee Higher Education Commission stated their office found the requests as reasonable and focused.

Mr. Jackson asked if Veterinary Medicine's animal facilitated reading programs was an old or new program? Ms. Davis stated the HABIT program is an existing program the College wants to expand to include school settings for reading class. Mr. Buddy Mitchell expounded on the HABIT program and indicated that animals are used in various settings to facilitate learning and care of patients because the animal does not show rejection.

Mr. Jackson asked if the Leadership Development and Civic Engagement item requested by the Institute for Public Service (IPS) was an expansion of the WestStar concept. Dr. Mary Taylor, Assistant Vice President for IPS, responded this program is similar to, but not an expansion of, WestStar. IPS's proposal expands a successful program underway in Knox County that helps integrate Hispanic leaders into government operations across the state.

Ms. Amonette asked if we had any commitment on the research matching from the state for the $10 million committed from Oak Ridge. Dr. Petersen indicated UT received $2.5 million in FY 2006 and conceptually has the commitment of the Governor to continue this commitment to request additional matching funds to expand this program.

Mr. Haslam moved approval of the requests and Ms. Amonette seconded the motion. The requests were approved unanimously.

IX. APPROVAL OF FY 2005-06 MID-YEAR COMPENSATION PLANS

The FY 2006 Appropriations Bill requires any general mid-year salary adjustment beyond what the state's general salary plan be presented to the Board of Trustees for review and approval. Ms. Davis reviewed with committee members plans proposed by various campuses and institutes. The estimated plan cost without benefits is $1.5 million and includes approximately 400 employees.

Mr. Jackson moved for approval and Ms. Amonette seconded the motion. Mr. Stokely indicated his review found the Health Science Center's request, the most costly of those before the committee for approval, was needed to retain proper staff. The motion passed unanimously.

X. APPROVAL OF FALL 2006 FEES FOR MBA PROGRAM (UT KNOXVILLE)

Ms. Davis presented for consideration an increase in student fees for the UT Knoxville MBA program, effective Fall Term 2006. The proposed increase does not impact currently enrolled students. The purpose for asking for approval at this meeting is to enable the College to include the new fee rate in their marketing program.

The current student fee for this 17-month program is $9,000 plus a $1,000 seating fee and a $1,000 curriculum fee for a total program cost of $11,000. The recommendation is to increase the curriculum fee to $8,000, thereby increasing the total fee $11,000 to $18,000 for an in-state student. The cost for out-of-state student will increase from $27,605 to $34,605. Research shows student fees will remain competitive with peer programs even after this increase.

The college is also evaluating an increase in class size, which is possible through the expansion of Glocker. If the target enrollment of 135 is achieved, then additional faculties are needed to support the increased class size. The increases revenues would help fund this cost. In addition, revenues from the proposed fee increase would support additional quality initiatives with a focus on the student by enhancing job placement programs, providing internships, and offering some global studies not currently available. Lastly, the MBA program is dependent upon the College of Business Administration for funding to support the program and this would help move it to some self-sufficiency and would in turn free up funds for the College of Business to support other initiatives.

Mr. Stansberry asked if the assumption is that the fee increase does not result in an enrollment decrease. Ms. Davis said this was the assumption. The college conducted a survey of their 2003 graduates to determine if they would have still attended if the fees were higher. The students responded they would still participate if the fees had increased as much as 50%. The proposed increase is just under that amount. If the fees had doubled, the survey showed they would have considered other options.

Mr. Wolford asked where the program ranks currently. Dr. Crabtree answered the ranking depends on which program you are looking at as to the current standing. This program is ranked as one of the best values.

Mr. Stokely said this was a bold move but heading in the right direction.

Mr. Stansberry moved approval of these fees and Mr. Jackson seconded. The motion was approved unanimously.

XI. REVISION OF POST-RETIREMENT SERVICES PLAN FOR FACULTY

Ms. Davis presented a revision to the Post-Retirement Service Program maximum work period requirement for consideration by the committee. The maximum work period is tied to legislation that specifies the number of hour a retired employee may work and retain full retirement benefits.

This year, the General Assembly passed legislation to increase the work period from 100 days to 120 days. The equivalent faculty workload was increased from 15 semester hours to 18 semester hours. The University has changed all university policies impacting staff and faculty but needs the Board of Trustee's approval to amend the post-retirement program to extend the work period for faculty. Campuses have the flexibility to modify existing contract under this proposal, if desired, but there is no requirement for them to do so with this change.

Mr. Stansberry moved for approval and Ms. Amonette seconded the motion. The motion was approved unanimously.

XII. APPROVAL OF FY 2006-07 CAPITAL OUTLAY AND MAINTENANCE BUDGET

Mr. Alvin Payne, Assistant Vice President of Capital Projects, presented for consideration and approval the FY 2006-07 Capital Outlay and Maintenance Budget. The five-year schedule for Capital Outlay project totals $358,885,000, funding twenty-one projects. The university's number one priority is the Material Sciences Building on the Knoxville campus. The University has received a $20 million grant from the Federal Department of Transportation and is requesting $10 million in additional funding from the State of Tennessee to fund a total project cost of $30 million. The university's second priority is a Fine Arts Building at UT Martin, a project that has been on the list for a number of years. All remaining projects through the 17th priority have also appeared on previous approved list. Projects 18 through 21 are new projects and represent the next highest priorities as recommended by the campus Chancellors.

Mr. Jackson asked if the dormitories were funded with income from student room fees and if so why were Strong and Melrose Halls on the list. Mr. Payne indicated three years ago a decision was made to convert those two dormitories for administrative use. Dr. Petersen stated the ability to update the facilities for dormitories is more expensive than converting to administrative uses.

The five-year Capital Maintenance recommendation totals $162,455,000 with year one cost of $37 million. Capital maintenance projects include HVAC repairs, roof repairs, exterior repairs, and a wide variety of other building improvements.

Additionally, the University administration requests authorization to enter into contracts for design and construction of these projects within available funds.

Mr. Stokely said these items have worked their way through the system, from campuses to the President's Office. Mr. Payne responded all projects had followed the appropriate review process.

Mr. Stansberry made the motion for approval of these requests, and Mr. Jackson seconded the motion. The motion was approved unanimously.

XIII. APPROVAL OF FY 2006-07 REVENUE/INSTITUTIONALLY FUNDED PROJECTS

Mr. Payne presented the list of revenue-funded projects for FY 2006-07 for inclusion in the State of Tennessee budget document. Although no State funds are requested, legislative approval of the projects is required. Identified are seventeen projects totaling $81 million.

Mr. Murphy asked how we received revenue from libraries. Mr. Payne the UT Knoxville Library has a grant from the National Endowment for the Humanities that is paying for approximately fifty percent of that project. The remaining fifty percent is from savings the Library has generated in past years.

Mr. Haslam moved for approval and Mr. Stansberry seconded the motion. The motion passed unanimously.

XIV. APPROVAL OF CONSTRUCTION OF WEST TENNESSEE REGIONAL ANIMAL DIAGNOSTIC LAB (UT MARTIN)

Mr. Payne said the University of Tennessee at Martin has received a grant from the Tennessee Department of Agriculture to establish a diagnostic lab for West Tennessee. Currently, the Department of Agriculture provides animal diagnostic services centrally at the Ellington Agriculture Center in Nashville. The Department desires to establish two satellite locations – one in West Tennessee and one in East Tennessee. The university is proposing to use $750,000 from the Department of Agriculture to renovate existing facilities to serve as the diagnostic lab for West Tennessee. The Tennessee Department of Agriculture will also provide recurring funding for the operation of the facility.

Mr. Haslam moved for approval of the motion, Mr. Jackson seconded. The motion was approved unanimously.

XV. APPROVAL OF SALE OF KINGSTON APARTMENTS (UT KNOXVILLE)

Presented by Mr. Payne, the Knoxville campus seeks approval to sell the Kingston Apartments and its associated parking garage located at 2521 Kingston Pike. The building and parking garage contain approximately 280,000 gross square feet and are located on 2.75 acres. This sale of this property is part of the updated Housing Plan for the Knoxville campus.

The cost to renovate the apartments/garage is financially prohibitive. The remaining graduate and family housing is adequate to address the current and projected housing demand in this category. The property will be appraised according our policy and the property will be offered on the market, at or above the appraised value.

Mr. Stansberry moved for approval and Mr. Haslam seconded the motion. With no questions, the motion was approved unanimously.

XVI. ADJOURNMENT

With no further business to come before the Committee, the meeting adjourned.

Respectfully submitted,

Sylvia Shannon Davis

Sylvia Shannon Davis
Vice President for Administration and Finance