MEMORANDUM

TO: The Finance Committee:

Victoria D. Harker, Chair
Frank B. Atkinson
A. Macdonald Caputo
The Honorable Alan A. Diamonstein
Vincent J. Mastracco Jr.
Edward D. Miller, M.D.
John L. Nau III
Timothy B. Robertson
Helen E. Dragas, Ex Officio
Daniel M. Meyers, Consulting Member

and

The Remaining Members of the Board and Senior Advisors:

Hunter E. Craig George Keith Martin
Allison Cryor DiNardo Linwood H. Rose
Marvin W. Gilliam Jr. Hillary A. Hurd
Bobbie G. Kilberg William H. Goodwin Jr.

FROM: Susan G. Harris

SUBJECT: Minutes of the Finance Committee Meeting on November 8, 2012

The Finance Committee of the Board of Visitors of the University of Virginia met, in Open Session, at 1:20 p.m., Thursday, November 8, 2012, in the Auditorium of the Harrison Institute/Small Special Collections Library; Victoria D. Harker, Chair, presided.

Present were Frank B. Atkinson, the Honorable Alan A. Diamonstein, Vincent J. Mastracco Jr., Edward D. Miller, M.D., John L. Nau III, Timothy B. Robertson, and Ms. Helen E. Dragas, Rector.

Daniel Maxwell Meyers, the consulting member from the Council of Foundations, was also present.

Present as well were Ms. Teresa A. Sullivan, John D. Simon, Patrick D. Hogan, Ms. Susan G. Harris, Paul J. Forch, Ms. Susan A. Carkeek, Steven T. DeKosky, M.D., R. Edward Howell, Ms. Patricia M. Lampkin, Marcus L. Martin, M.D., Simeon E. Ewing, Ms. Nancy A. Rivers, Ms. Colette Sheehy, Robert D. Sweeney, John Sanders Huguenin, David J. Boling, McGregor McCance, Anthony P. de Bruyn, and Ms. Debra D. Rinker.

Ms. Victoria Harker welcomed Patrick Hogan, the newly appointed Executive Vice President and Chief Operating Officer, to his first full Board meeting in this role. She said he has already been hard at work with the finance team to develop greater analytics for our near and long term financial outlook. Many of the priorities for capital expenditures, including competitive compensation for faculty, will come with a large price tag and require close alignment with the strategic plan objectives. Funding prioritization and identification of sources will be particularly important for the success of these objectives, especially for the academic core given the limited number of funding alternatives. Ms. Harker also provided the Board with a brief overview of the agenda.

Report on FY12 Audited Financial Statements and Trends Over the Past Ten Years

The Chair asked Mr. Hogan to give a financial update. He started with a report on the fiscal year 2011-2012 audit, which is expected to receive a clean opinion from the Auditor of Public Accounts next week. He introduced Mr. David Boling, Deputy Comptroller, to go over the audit results and the trends for 2013. He said there were no material changes from the unaudited statements that were presented to the Board in September. For FY12, there was an increase in net assets of $248 million, a 4% increase over the previous year.

Mr. Boling then highlighted several key data trends over the last ten years, from FY03 through FY12. Net assets have increased for nine of the ten years, mostly because of strong investment returns, averaging 9.8% annually. The University’s diverse revenue base helps to offset the decline in state and federal support. He said total revenues, excluding investment income, have continually increased to almost $2.5 billion in 2012, or an increase of 67% over the ten year period. The Medical Center’s patient care revenue has accounted for 47% of that increase in revenue. University revenues from investment income have had a positive return for nine of the ten years, for a ten
year total of nearly $2.8 billion, or a 9.8% annualized rate of return.

Mr. Boling showed a graph that demonstrated the decline in state appropriations in the last few years, an increase in sponsored program revenues for all years except 2007 and 2012, and increases in the revenue from tuition and fees, gifts, and endowment distributions. University expenses have also increased by 67% over the ten year period. For the University as a whole, compensation and benefits account for about half of all expenses. The sponsored programs revenue figures included federal stimulus funds; otherwise these revenues would have declined for the last three years. He said total net assets have grown from $3.5 to $6.5 billion since 2003. Looking at each category of assets, capital or fixed assets have almost doubled, the nonexpendable endowment assets are just over $500 million, and the expendable portion of the endowment, which is divided into restricted and unrestricted net assets, has nearly doubled since 2003, and combined it is worth over $4 billion.

Report on the Current Fiscal Year

Mr. Hogan introduced Ms. Colette Sheehy, Vice President for Management and Budget, to report on the current fiscal year. She said that for the first quarter ending September 30\textsuperscript{th}, net sources exceeded uses by $172.2 million, or 5%. Tuition revenues for the first semester and state appropriations are realized in the first quarter, however, expenses are incurred more evenly throughout the year. Sources exceeded budget by 1% and uses are 0.7% below budget. The budget includes the 3% bonus for all employees. Looking ahead, they are monitoring the possibility of sequestration, which would particularly impact research programs.

Mr. Hogan reported on budget planning for 2013-2014. He said they are looking at funding strategies for the president’s multi-year faculty compensation plan and how that would impact fiscal year 2014. They are still developing revenue assumptions, looking for some cost savings and efficiencies, and looking beyond 2014.

Ms. Sheehy said they will look more deeply into how to fund the first year of the faculty salary compensation, which will add about $15 million in costs for the year. Some of the revenue assumptions for this fiscal year are based on Board guidance in September:

- Increase undergraduate tuition 2.5-3.5%. Enrollment growth will follow Board approved plan.
- Research Funding: 2.1% decrease projected
- Auxiliaries: fund themselves – unique to each unit based on volume, proposed student fees, other revenue sources
- Endowment: 4.95% of June 30, 2012 market value
- State Appropriations: no growth (conservative)
Philanthropy: based on school and University Development Office estimates

Budget planning expenditure assumptions for 2013-2014 include:

- Financial aid: hold AccessUVa costs flat; have tried to control the growth in the program.
- Compensation:
  - Teaching and Research Faculty - 1st year of 4-year plan to bring the average salary up to the 20th position of Association of American Universities (AAU)
  - Administrative & Professional Faculty/University Staff - merit based 2% increase if maintained in budget by General Assembly
  - Classified Staff - across the board 2% increase if maintained in budget by General Assembly
  - Fringe benefit rates are projected to decline slightly for faculty and increase slightly for staff

A question was asked about how the goal of average teaching salaries being brought up to the 20th position of the AAU was reached. President Sullivan responded that this is the top one third; the top one third of AAU is who we are competing with for our faculty.

Ms. Sheehy focused on budget cost drivers. Teaching and research faculty salaries are projected to grow by 2% per year, based on the president’s plan. The Virginia Retirement System also has some step increases based on those costs. Enrollment growth will also drive up costs for new faculty, start-up packages, utilities, and new facility maintenance.

Ms. Sheehy and Mr. Hogan said they will continue to refine the revenue projections, identify any additional critical spending needs, evolve the long-range plan given new financial model development, and identify funding challenges, revenue opportunities, and re-allocation strategies. Differential tuition is being considered by several schools.

Ms. Sheehy went deeper into the multi-year faculty salary plan’s scope and assumptions. It will encompass all of the undergraduate schools, which will benchmark against their peers. The School of Medicine will manage the plan in the context of clinical revenue. Assumptions include that the state will authorize a 2% increase each year, the AAU peer average increases 3% annually, and faculty must have rigorous peer review.

Funding strategies for the plan include a reallocation of savings from within the institution from operating efficiencies, increases authorized by the General Assembly, new philanthropy, and alignment of existing private resources with strategic priorities. She showed a chart that listed the many sources of funding for faculty salaries.
Ms. Sheehy itemized the sources of funding for fiscal year 2014, requiring $15 million: $3.3 million would come from savings, $1.2 million from the state, more than $1 million from tuition increases, $2 million from self-supporting tuition (Law and Darden), and $6.8 million from other sources to include gifts, grants, endowment distribution, and clinical revenue. Looking at the projected funding needs through 2017 requires an additional $64.8 million, which would require additional endowment of $1 billion to sustain it if it was to be fully funded by the endowment.

Ms. Sheehy also noted the salary plan risks:
- State fails to authorize a salary increase
- Peer institutions raise salaries by more than 3% annually
- Failure to raise adequate private funds
- Significant reduction in grants and contracts
- Decline in market value of endowment

**Internal Financial Model Report**

Ms. Sheehy gave an update on the new internal financial model. Identified objectives are to align resources with activity, promote prudent stewardship of University resources, and ensure transparent decision making. Currently, targeted budgets are provided by central administration to each school and service center. This model is historically based and does not reflect actual activity, or provide incentives to be innovative in revenue creation. It also does not consider all available funds, link sources and uses, or align authority, responsibility, or accountability. There is also a desire for more transparent decision-making. How revenue is generated and the basic cost structure will not change. The new model will change the distribution of revenue: it will go to the activity that generates it as an incentive to develop new programs and maximize opportunities. The allocation of costs for each activity will increase awareness of consumption, make institutional commitment transparent, and encourage efficient and competitive services. Priorities will be set closer to where the activity occurs and hiring will be aligned with priorities. Each unit will be more accountable for their own costs of space, utilities, and faculty, or in other words the control of the use of a space will go to who pays for the space.

Mr. Simon said it will also allow more cooperation between disciplines that could share the costs of a program or faculty member. Central administration will still have the approval process to control the quality of new programs, but the new model will incentivize schools to meet the educational needs of the workforce. If a high quality program has been created, the demand will be there and the revenue will return to the school that created it. He said there needs to be a balance of control between central administration and
the individual units. Interdisciplinary positions would need to be well documented with a memorandum of understanding for accountability in the future. The Provost Office should have a partnership with the units, especially when needing a catalyst for starting a new program or to act as a bridge between two units that need to cooperate.

Ms. Sheehy said the proposed new model will direct revenue to the school or unit responsible, then they will pay for services that they consume plus a "tax" for those services that need to be spread across the university. It is easier to implement this model in times of growing resources. She said it should encourage funding of strategic priorities and interdisciplinary activities; it does not incentivize unnecessary duplication of services; and it encourages collaboration, not competition. It will be important to regularly assess performance of revenue centers and cost centers.

The timeline for the new financial model:

**FY14 – Phase I**  Units receive the same amount of funds as the current model
- Attribute revenues based on agreed methods
- Allocate some costs based on agreed metrics
- Assess revenue centers for unallocated central costs
- Determine hold harmless/subvention provisions

**FY15 – Phase II**
- Attribute revenues as in Phase I
- Allocate additional costs based on agreed metrics
- Assess revenue centers for unallocated central costs
- Begin to phase out hold harmless provisions
- Make subventions transparent

**FY16 and beyond – continue to examine the model and make changes.**

**Action Item: Purchase of Land and Improvements in Louisa County**

Mr. Hogan said that the University would like to acquire a 48,072 gross square foot facility on 4.79 acres in Spring Creek Business Park in Louisa County from the University of Virginia Physicians Group (UPG). UPG completed construction of the shell and core building components in May 2012, with occupancy expected in early 2013. The facility will provide imaging services by University of Virginia Imaging, LLC, and outpatient clinics for several disciplines. The Medical Center will be responsible for facility operation and maintenance expenses. The cost to purchase the real property, land, and improvements from UPG will be no more than $18 million. The Medical Center will enter into a long term lease with the University of Virginia Imaging, LLC for the imaging space in the building. The following resolution was approved by the Medical Center Operating Board earlier today and fits in with the Medical Center’s strategic plan.
On motion, the committee approved the following resolution and recommended it for full Board approval:

APPROVAL TO PURCHASE 1015 SPRING CREEK PARKWAY, LOUISA, VIRGINIA

WHEREAS, the Medical Center Operating Board and the Finance Committee find it to be in the best interest of the University of Virginia to purchase from the University of Virginia Physicians Group land and improvements thereon located at 1015 Spring Creek Parkway, Louisa, Virginia (the “Property”) at a purchase price not to exceed $18,000,000;

RESOLVED, the Board of Visitors approves the acquisition of the Property; and

RESOLVED FURTHER, the President of the University, or her designee, is authorized, on behalf of the University, to approve and execute purchase agreements and related documents, to incur reasonable and customary expenses, and to take such other actions as deemed necessary and appropriate to consummate such property acquisition; and

RESOLVED FURTHER, all prior acts performed by the President of the University, or her designee, and other officers and agents of the University, in connection with such property acquisition, are in all respects approved, ratified, and confirmed.

Action Item: Authorization of and Intent to Issue Tax-Exempt Debt

Mr. Hogan asked for authority to issue tax-exempt debt to finance the project named above in Spring Creek Business Park. On motion, the committee approved the following resolution and recommended it for full Board approval:

AUTHORIZATION OF AND INTENT TO ISSUE TAX-EXEMPT DEBT

WHEREAS, the University intends to undertake certain capital projects identified below (the “Project”), and to finance the Project through the issuance of tax-exempt debt, in the maximum principal amount stated below for the Project:

MEDICAL CENTER

Spring Creek Acquisition - $17.3 million; and

WHEREAS, the University further intends to expend funds on the Project and to reimburse such expenditures from the proceeds of the tax-exempt debt; and
WHEREAS, to comply with the Internal Revenue Code of 1986, as amended, and Section 1.150-2 of the Income Tax Regulations (the "Regulations"), it is necessary, in order to reimburse such expenditures incurred prior to the issuance of the tax-exempt debt with the proceeds of such debt, that the University declare its official intent to make such a reimbursement of expenditures; and

WHEREAS, prior to the issuance of long-term debt, the Board of Visitors will be asked to consider a separate issuance resolution;

RESOLVED, short-term debt may be issued for the Project, but only if the following conditions are met:

1. A comprehensive and detailed financial plan for the Project is submitted to and approved by the Capital Outlay Executive Review Committee; and

2. A school or unit shall remain responsible for repaying any debt obligation incurred regardless of the status of such school’s or unit’s Project; and

RESOLVED FURTHER, the Board of Visitors of the University of Virginia declares its intent to expend funds on the Project and to reimburse such expenditures from the proceeds of tax-exempt debt, in accordance with the following:

1. This resolution is a declaration of official intent for purposes of Section 1.150-2 of the Regulations; and

2. The University reasonably expects to issue tax-exempt debt for the Project in the maximum principal amount stated in the recitals above.

Action Item: Amendments to the Optional Retirement Plan

Mr. Hogan said the University would like to make some changes to retirement plans offered to employees. He introduced Ms. Susan Carkeek, Vice President and Chief Human Resources Officer, to outline these changes.

Ms. Carkeek explained the University has nine optional retirement plans for employees. It is recommended that two of these plans be amended. The first amendment would remove the minimum dollar amount on the annual employer contribution for any individual participant’s account for the Defined Contribution Retirement Plan for Executive Employees of the University of Virginia. This amendment removes the current requirement of a $10,000 employer contribution and offers more flexibility in future benefit offerings.
The second amendment will add flexibility for participants in electing the form of distribution of accrued benefits upon retirement for the Qualified Governmental Excess Benefit Plan. The plan currently requires the individual to elect the form of distribution at the time of enrollment in the plan. This amendment would allow the participant to elect the form of distribution at the time of separation from employment.

On motion, the committee approved the following resolution and recommended it for full Board approval:

AMENDMENTS TO THE DEFINED CONTRIBUTION PLANS

RESOLVED, The Defined Contribution Retirement Plan for Executive Employees of the University of Virginia is amended to eliminate the required minimum annual employer contribution to a participant’s account; and

RESOLVED FURTHER, the Qualified Governmental Excess Benefit Arrangement for Employees of the University of Virginia is amended to allow a participant to elect the form of distribution of his or her Excess Benefit Account at the time of separation from service.

Remarks by the Executive Vice President and Chief Operating Officer

Mr. Hogan said he has completed almost two full weeks as Chief Operating Officer and wanted to summarize a few of the things he has been involved with. He said he will be spending more time on Access UVa. He attended his first Fall Convocation, visited The University of Virginia’s College at Wise, had meetings with the President and the Provost, attended a Faculty Senate meeting, and a meeting with the Deans. A meeting with Standard and Poor went well; the University was being assessed and rated. The search for a Vice President and Chief Financial Officer will be renewed, with James Hilton leading this search committee along with a consulting firm. They hope to have several good candidates by early 2013. Mr. Hogan thanked Colette Sheehy for the enormous task of filling in for the CFO and COO positions while they are vacant.

Mr. Hogan pointed out several written reports in the committee booklet, including the Report on the University Workforce. He noted there is a great deal of complexity in dealing with 10 different employee categories.

The Chair adjourned the Finance Committee meeting at 2:45 p.m.