

August 10, 2017

Dear Matt and Neena,

Thank you for the opportunity to respond to your questions and for your research and interviews to learn more about The University of Texas System's AUF expenditures. We have provided detailed responses on the following pages, which I hope will dispel some of the inaccurate assumptions conveyed in your questions. As we discussed on the phone earlier this week, your deadline for information from us is occurring right before a new budget and operational plans will be presented to the Board of Regents at its August 23-24 meeting. We would prefer to provide you with the most up-to-date information as any AUF numbers you publish will not be current within a few days of your story's publication.

I hope our responses make it clear that the UT System Administration exists to support the missions and strategic visions of 14 diverse health and academic institutions that enroll more than 228,000 students and employ 100,000 faculty, health care professionals, researchers and support staff. In addition, University of Texas System-owned and affiliated hospitals and clinics handle more than 6.7 million outpatient visits and account for more than 1.3 million hospital days annually.

Any time a decision to fund a new initiative at the System level must be weighed, the potential for positive impact on institutions, students, staff and patients is the absolute primary factor. The needs of the institutions are always the driving force in decision-making by System Administration and the Board of Regents. This is demonstrated by Board of Regents' actions to use the AUF to fund initiatives to benefit and support institutions including:

- The establishment of a clinical data network to leverage the size and expertise of UT institutions and drive more efficient and improved health care delivery. Having access to large amounts of aggregated clinical data from across UT health institutions will help UT health care providers make better decisions about patient care.
- Seed funding for UT researchers to jump-start multi-disciplinary and innovative research on the human brain.
- Critical funding to establish and operate the Dell Medical School at UT Austin.
- Funding for the STARS (Science and Technology Acquisition and Retention) program to recruit world-class faculty to UT institutions.
- The Regents' Outstanding Teaching Awards, which annually presents a \$25,000 cash award to innovative faculty members at all UT institutions.

The UT System, through leadership of the Board of Regents and Chancellor, always seeks new opportunities to increase resources and support for UT institutions. To that end, UT System leadership is looking across the landscape of the entire System Administration to make sure functions and services are completely aligned with the most important needs of institutions. It continues to reduce the size of its staff and restructure priorities to better serve all 14 UT institutions.

Last fall, the Board of Regents approved the 2017 UT System Administration operating budget with instructions to reduce the number of FTEs by at least 130 positions. To date, 186.5 positions have been eliminated. UT System leaders are also exploring options to further reduce the size of administration staff by transferring some services to the institutions or a third party, for example, if it indeed results in better or more cost-effective services to the System or the institutions.

We are committed to providing the absolute highest level of service to UT institutions, and we will continue to look for ways to enhance those services while remaining vigilant stewards of state funds.

Sincerely,

Karen Adler

Texas Tribune Questions for Chancellor McRaven

What do you see as the role of the UT System’s administrative offices? Some have argued that it should be little more than a “holding company” for the universities and medical schools. Based on some of the initiatives you have advocated for — including the nine Quantum Leaps — it appears that you have a more ambitious vision. Do you agree? If so, why do you feel this way?

The UT System Administration’s first and foremost responsibility is to the institutions – period! However, running a 21st century university system requires leveraging the size, scale and diversity of the 14 institutions to better serve the broader educational and health care needs of the people of Texas. Failing to take advantage of the individual strengths for the collective good will leave us far behind our competitors in other states.

There are certain functions required by the Texas Education Code, such as providing oversight and coordination of the activities of the System and each UT institution within the System; initiating, monitoring, and approving long-range System plans and short-term UT institution plans for operations and expenditures; assisting each institution with the achievement of its performance goals; carrying out responsibilities as directed by the Board; and more.

In addition, the System, as part of its responsibility to advance UT institutions, historically has explored appropriate and timely opportunities to engage in innovations and activities to do things such as enhance student success, drive more research, attract star faculty, and deliver more effective and efficient means of health care. Each chancellor, over many years, has presented a vision to the Board of Regents to do just that. Some chancellors have sought to pull multiple UT institutions together to bid on and manage national laboratories; others have worked to create more emerging UT research universities. The creation of UT Rio Grande Valley and UT Austin’s Dell Medical School, for example, were UT System Administration-led initiatives, in concert with the Board, legislators, presidents and many more individuals.

The Quantum Leaps are no different. Whether you call them Quantum Leaps or System initiatives, each one is designed to advance UT institutions. Providing STAR funding to recruit and retain the best faculty and researchers, allocating grant awards to UT institutions that develop innovative student success initiatives, and working to promote fairness and opportunity and close the gender gap in compensation on campuses seems like something that a System Administration should do.

Take the Health Care Enterprise Quantum Leap, for example. Very few university systems in the nation or world have the expertise, data, or volume of inpatients and outpatients that UT hospitals have. We have a rare opportunity to leverage our size and expertise and connect UT’s health capabilities to ensure it provides patients with the finest health care possible. This will require a high degree of collaboration among UT health institutions along all lines of major health care functions — shared clinical

information, shared service lines, clinical trials, and more. If we find ways to deliver health care more efficiently and effectively, we have an opportunity to lead in that area.

Additionally, almost all of the Quantum Leap funds go directly to campuses and do not remain at the System Administration. A recent allocation of \$10 million to UT Austin to lead the System-wide effort in national security is a recent success story, and it has already garnered several million additional dollars from philanthropists to UT Austin's Clements and Strauss Centers.

When you are considering a new system initiative, how do you evaluate whether it's worth the money, particularly considering that any AUF revenue that is unused at the system level could be passed on to UT-Austin?

For fiscal year 2017, the UT System's AUF allocation was \$603.46 million. Of that, 49.3 percent, or \$297.6 million, went to UT Austin; 24.5 percent, or \$148.1 million, paid PUF debt service on capital projects at all 14 UT institutions; 18.5 percent, or \$111.4 million, went to UT System Administration; and 7.7 percent, or \$46.3 million, was unappropriated to serve as a reserve in case market returns are lower than expected.

Of the \$111.4 million for System Administration, \$58.2 million funded core operations at System Administration, which includes \$32.2 million for salaries of System employees who provide a large array of critical and essential functions to all institutions, such as legal services for real estate and business transactions and litigation management; accounting and budgeting and preparation of annual financial reports; compliance with Texas open meetings and records laws; professional development and training; and many, many more. \$42.1 million of the System Administration allocation funded direct UT institution support, including property insurance premiums, system-wide software licenses and digital library services; and \$11.1 million funded other services, such as the external financial audit.

In July 2017, the Board of Regents voted to increase UT Austin's allocation of the AUF from 49 percent to 53 percent for fiscal year 2018 to accelerate the institution's goal of ranking among the top five public universities in the nation. The allocation will increase UT Austin's funding from \$297.6 million in 2017 to about \$338 million in 2018. This amount does not include UT Austin's share of funding from the PUF to pay debt service on its capital projects.

Any initiative that is proposed for AUF funding must go through a rigorous review with the chancellor, the appropriate executive vice chancellor (health or academic and business) and the presidents of the requesting or affected institutions. Only initiatives with the highest potential for positive impact on students, patients and/or institutions are selected for possible funding. The Board of Regents gives the final approval to all requests.

For example, as part of the UT System's Student Success initiative, almost \$10 million was awarded recently to six UT academic institutions to support initiatives to help

improve graduation rates. Awardees offered proposals on innovative, campus-based projects designed to enhance student success.

None of the Quantum Leaps you proposed in 2015 directly addressed college affordability. Why not? Do you believe keeping the cost of a college education down is a major goal of the UT System?

Not only is affordability a top priority at the UT System, it is prominently addressed by the Quantum Leap on Student Success, which is focused on ensuring that every UT student is prepared and positioned to graduate. In fact, making sure that no student drops out because of financial challenges is one of three central foundations, or “pillars,” of the Student Success Quantum Leap. The other two pillars are providing all students the advising needed to graduate on time and ensuring all students have a sense of belonging in college.

Some lawmakers and other critics of the system have highlighted the new system headquarters downtown, the tens of millions of dollars spent supporting the Institute for Transformational Learning and the purchase of land in Houston without a specific plan for what to do with that land as signs that the UT System has more money than it knows what to do with. We understand that ITL and the new building were initiated before you arrived, but as the current leader of the system, how would you respond to that?

New building: In February 2014, UT System Regents approved replacing five separate buildings in downtown Austin, ranging in age from 42 to 136 years, with an efficient new building as an economical way to decrease annual maintenance and operating costs by millions of dollars. The soon-to-be vacated UT System buildings have been sold or leased, and will provide savings and estimated future income totaling between \$188 million and \$213 million. After covering estimated construction and transition costs of \$143 million, the new building is expected to generate financial benefits of between \$40 and \$60 million. The block of UT System property where vacated buildings reside will also be an added benefit for Austin and Travis County. As the property is leased for commercial use, it will generate an estimated \$6 million per year in tax revenue for the City of Austin and other taxing entities in Travis County.

Institute for Transformational Learning: In 2011, the Board of Regents, understanding the need to drive enhanced student success and access through the innovative use of technology, appointed a Task Force on Blended and Online Learning. Members of the task force included regents, institution presidents and education experts.

On August 25, 2011, acting on a unanimous recommendation of the task force, the Board of Regents also unanimously voted to establish the Institute for Transformational Learning with three goals:

- Establish UT institutions as world leaders in the development and implementation of best-in-class online learning resources and establish the UT Online Brand as synonymous with excellence in technology-enhanced education;
- Expand access to educational programs that will improve learning outcomes and reduce costs for students and their families, universities and taxpayers; and
- Promote a culture of educational innovation throughout the UT System.

Houston: The goal of the Houston project was to build a collaborative effort in the areas of research and education. The Houston Task Force recommended the establishment of a Texas Institute for Data Science with three pillars in Education, Energy and Health Care. As I have said many times before, I was unable to build a shared vision for moving this project forward and consequently, recommended to the Board of Regents that we stop the project and divest ourselves of the land we acquired.

In an effort to save money, the UT System has at times tried to centralize some campus functions. But in at least some cases — notably the consolidation of auditing offices and the implementation of the PeopleSoft system — that centralization has frustrated people on the campuses. The auditors have now been moved back to the campus level. How would you evaluate the system’s track record of saving costs for individual campuses by centralizing services?

In 2014, in an effort to keep tuition rates flat, a decision was made to move audit personnel and functions and other services from academic institutions to System Administration so that campuses could redirect those savings toward instructional costs. Even though this move of personnel increased the FTE count at System Administration – which contributed to criticism of the number of employees at System Administration – it freed up funding at institutions and negated the need for tuition increases that year, the ultimate goal of the Board of Regents.

However, the consolidation of auditing services was re-evaluated, and earlier this year, the decision was made to return auditing positions and functions back to the institutions. To allow time for campuses to absorb the cost of the auditors, the UT System is providing each campus with funding equal to three years of salary, fringe benefits, travel and operating costs of current audit staff. This will allow campuses, in effect, three years to absorb the cost of the audit staff without any additional financial burden. An explanation of how it will be funded is offered below.

Because of legal restrictions on the use of funds, the UT System will provide campuses with funding in the form of Permanent University Fund debt. Each campus may determine if it wishes to receive the entire three-year allocation of PUF funding for specific capital projects or as an annual supplement to the Library, Equipment, Repair and Rehabilitation (LERR) budget distributed annually, also funded with PUF debt. The expectation is that the campuses use the PUF funding for eligible capital projects where

they currently had planned to use institution resources and in turn redirect funds to cover the cost of the auditors.

PeopleSoft was implemented in 2014 so that human resources and financial functions at seven academic campuses could function on one unified platform. The transition has taken longer than expected, but it has saved institutions tens of millions of dollars they would have spent individually developing and financing their own platforms.

Overall, the UT System has an excellent track record centralizing campus services and functions in order to save significant money for the institutions. There are numerous services and programs the UT System Administration has centralized that have proved successful and added value for the institutions. Examples include:

- Digital library services – The cost of these services was also shifted from the institutions to System Administration in 2014 as part of the plan to keep tuition flat. Money is saved by comparing the prices universities would each pay if they were to subscribe to the total digital subscriptions to which they have access, compared to one consolidated price the System actually pays. Collectively, this program has saved institutions more than \$700 million.
- Intermediate term fund – This was established by the Board of Regents in 2006 as a pooled fund for the collective investment of operating funds and other intermediate and long-term funds held by UT institutions and System Administration. Measurable revenue is added to the institutions, calculated by comparing the return the campuses would have earned based on how they had previously invested their reserves compared to actual earnings from the intermediate term fund. Since its inception, the ITF has generated \$1.3 billion of value-add for UT institutions.
- Supply Chain Alliance – This was implemented in 2007 to expand the use of joint purchasing and to explore opportunities to leverage the size of UT System institutions through cooperative purchasing. Examples include the centralized purchase of lab supplies and medical equipment and computers, printers and accessories. Since its inception, the Supply Chain Alliance has saved UT institutions roughly \$210 million.

The longstanding practice of the UT System — a practice that predates your time at the helm — has been to spend roughly half of UT’s share of the AUF at the system level and then pass on the rest of the money to UT-Austin. Have you ever felt the need to re-evaluate that breakdown? What is the rationale behind a roughly 50/50 split?

It’s not a 50/50 split. For fiscal year 2017, the allocation was \$603.46 million. Of that, 49.3 percent, or \$297.6 million, went to UT Austin; 24.5 percent, or \$148.1 million, paid PUF debt service on capital projects at all 14 UT institutions; 18.5 percent, or \$111.4

million, went to UT System Administration; and 7.7 percent, or \$46.3 million, was unappropriated to serve as a reserve in case market returns are lower than expected.

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Note that per the Texas Constitution, the UT System is first required to pay the PUF debt service for all 14 UT institutions before making allocations for support and maintenance at the UT System and UT Austin.

Regents and top system officials have long cited the constitutional restrictions governing how the AUF is spent in explaining why the system hasn't used more of the money to cut costs at the campus level and help students afford college. Given how often the Texas Constitution is amended, has the system ever considered requesting a change? Why or why not?

The framers of the Constitution showed extraordinary wisdom in providing support through the Permanent University Fund for the state's two flagships – UT Austin and Texas A&M College Station – and the voters of Texas have enhanced that wisdom with changes to the Constitution over time to support Prairie View A&M and capital construction at 14 UT and seven A&M institutions. The current design of the PUF and the Available University Fund serves these two systems and the State of Texas exceptionally well.

In FY 2014, the Board of Regents authorized \$2 million in AUF spending for something called the "UT System Engineering Institute." Was that money spent, and what has happened with the Institute?

The funding was used to establish the Texas Oil & Gas Institute (TOGI) in 2015 and was a direct response to recommendations from the Task Force on Engineering Education for Texas in the 21st Century, which was established in 2012. TOGI, which is housed at the University Lands office in Houston, is working to optimize production and

operations on University Lands in part by performing and applying industry-sponsored research. In addition, TOGI and University Lands offer high quality summer internships to undergraduate and graduate geoscience and engineering students from both UT and Texas A&M. Interns are tasked with finding ways to make wells on University Lands more productive, and some interns work in-house at offices of key oil and gas operators on University Lands. This effort gives students extraordinary real-world experiences that will help them get placed in excellent jobs upon graduation.

Can you describe what the UT System Initiative known as “Strength in Numbers” is, and also the System Initiative known as the “UT System Innovation Framework”? How much AUF money has been allocated to those initiatives and how much has been spent?

From 2008 through 2014, the Board of Regents awarded \$25 million directly to all 15 institutions to help them build philanthropic capacity by hiring new development professionals and building new operational programs to secure private support. This funding was applauded by UT presidents, as it helped them provide new funding to their development office – a revenue-producing office – without having to cut funding from other areas to adequately support fundraising efforts. During the period of the Strength in Numbers program, philanthropy grew by more than \$425 million across the System, due in large part to the universities’ ability to hire more than 100 development professionals and institute dozens of new fundraising programs and enhancements to operations. Philanthropy plays an ever-increasing role in all 14 UT institutions’ ability to carry out their respective education and research missions.

Why does the system keep a reserve of AUF that is more than \$150 million, when the Regents rule only requires a reserve that is a fraction of that amount?

The AUF balance serves as a financial cushion against capital market volatility, which can adversely impact future PUF distributions to the AUF. In the event of any negative variance between projected and actual distributions from the PUF or unexpected capital needs, the AUF balance would be used to support operating expenses at UT Austin or to pay PUF debt service. The UT System is obligated to pay PUF debt service on behalf of 14 institutions – which totals \$180.4 million for fiscal year 2018 – so it’s financially prudent to ensure that there is an adequate reserve.

The minimum AUF balance reflected in the Regents Rule was established in 1993 when the size of the PUF was approximately \$4 billion. The minimum AUF balance established at that time represented approximately one-half of annual debt service due on outstanding PUF bonds. The size of the PUF has grown over time, now exceeding \$19 billion, as have the obligations to growing UT institutions. The reserves are now at around \$100 million, though \$150 million would not be an unreasonable reserve, given that annual PUF debt service will soon exceed \$200 million once all PUF debt currently authorized by the Board of Regents is fully issued.

During the July 12 meeting, David Daniel mentioned that there was still no plan to spend \$40 million from the AUF (originally allocated to UT-Austin but then redirected to the UT System for brain health research) because the System had not yet found a proposal to their liking. Has that changed since the meeting and is there a plan for spending the funds? Why not send that money back to UT-Austin so they can use at their discretion, if the System hasn't found a use for it?

UT Austin received a \$60 million allocation earmarked for student success and had previously used \$20 million of it for retention efforts. The remaining \$40 million did, in fact, go to UT Austin. UT Austin requested that the \$40 million be used to accelerate the building and operation of a new neuroscience clinic as part of the Dell Medical School. This clinic also received generous gift funds from philanthropists Jim and Miriam Mulva, for whom the clinic will be named. The UT System did not sit on those funds awaiting a proposal of its liking.