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UNIVERSITY OF TORONTO

THE GOVERNING COUNCIL

REPORT NUMBER 140 OF THE BUSINESS BOARD

April 4, 2005

To the Governing Council,
University of Toronto.

Your Board reports that it met on Monday, April 4, 2005 at 5:00 p.m. in the Council Chamber, Simcoe Hall, with the following members present:

Mr. Richard Nunn (In the Chair)
The Honourable Frank Iacobucci, Interim President
Ms Catherine J. Riggall, Vice-President, Business Affairs
Professor Angela Hildyard, Vice-President, Human Resources and Equity
Ms Dominique Barker
Mr. Brian Davis
Dr. Alice Dong
Ms Mary Anne Elliott
Dr. Gerald Halbert
Ms Susan Eng
Ms Françoise Dolcinea E. Ko
Mr. Roger P. Parkinson
Mr. Andrew Pinto
Mr. Timothy Reid
Ms Marvi H. Ricker
Professor Arthur S. Ripstein
Mr. Robert S. Weiss

Professor Vivek Goel, Vice-President and Provost
Mr. John Bisanti, Chief Capital Projects Officer
Ms Sheila Brown, Chief Financial Officer
Ms Christina Sass-Kortsak, Assistant Vice-President, Human Resources
Professor Ronald D. Venter, Vice-Provost, Space and Facilities Planning
Professor Safwat Zaky, Vice-Provost, Planning and Budget

Secretariat:

Mr. Neil Dobbs
Mr. Andrew Drummond

Regrets:

Mr. Donald A. Burwash
Dr. Claude S. Davis
Dr. Paul V. Godfrey
Mr. Gerald A. Lokash
Ms Kim McLean
Mr. George E. Myhal
Dr. John P. Nestor
Ms Jacqueline C. Orange
The Honourable David R. Peterson

In Attendance:

Ms Grace Angelotti, Business Analyst, Real Estate Operations
Mr. Don Beaton, Director, Real Estate

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In Attendance (Cont'd)

Ms Sheree Drummond, Assistant Provost
Dr. Beata FitzPatrick, Director of the Office of the President and Assistant Vice-President
Mr. Ira Gluskin, Chair of the Board, University of Toronto Asset Management Corporation
Professor George Luste, President, University of Toronto Faculty Association
Ms Rosie Parnass, Quality of Work Life Advisor and Special Assistant to the Vice-President, Human Resources and Equity
Ms Mary Ann Ross, Director of Labour Relations
Mr. Allan Shapira, Hewitt Associates
Mr. Howard Tam, Vice-President, University Affairs, Students' Administrative Council

ITEM 2 REPORTS A CONCURRENCE OF THE BUSINESS BOARD WITH A PROSPECTIVE RECOMMENDATION OF THE ACADEMIC BOARD TO THE GOVERNING COUNCIL FOR APPROVAL.

ALL OTHER ITEMS ARE REPORTED TO THE GOVERNING COUNCIL FOR INFORMATION.

1. Report of the Previous Meeting

Report Number 139 (February 28, 2005) was amended at item 3, Report of the Vice-President, Government and Institutional Relations, on page 10, discussion item (d), "System funding." The report recorded the Vice-President and Provost's advice that the University's annual funding would have to be "approximately $3-billion to bring the University to the median of its peers in the Association of American Universities." The report was amended to insert the following sentence: "The member inferred that the amount needed to enable the University to compete with the top A.A.U. public universities like Berkeley or Michigan would then be in the area of $4-billion."

2. Budget Report, 2005 – 06

Professor Goel said that 2005-06 would be the second year of the six-year budget framework. The proposed budget was a "steady as it goes" budget, with no significant changes from the assumptions or plan established one year ago. The proposed budget was prepared in the absence of knowledge of the content of the forthcoming Ontario budget, in particular any measures it might contain to implement the recommendations of the Rae review. The highlights of Professor Goel's presentation, with contributions from Ms Brown, were as follows:

- **Multi-year budgeting**. The system of multi-year budgeting had proven to be highly beneficial. It allowed for planning and making changes in a way that was both manageable and fiscally responsible. It provided a way of forecasting the gap between revenue and aspirations and moving to close that gap. This second year of the six-year budget cycle was a year of considerable uncertainty, but uncertainty was frequent in the

2. **Budget Report, 2005 – 06** (Cont'd)

University's budgeting in the past and would likely remain so in the future because many revenue sources were not within the University's control. Multi-year budgeting, however, provided the best possible means of dealing with that uncertainty.

- **Policy guidelines**. The University's policy required that the annual budget variance be not more than 1.5% of operating revenue. The maximum variance applied both to surpluses and deficits. That maximum variance amounted to about $15-million, and it was difficult to achieve a budget that close to balance. The amount of $15-million represented little more than rounding error for many of the assumptions required in budget planning. Under long-range budget guidelines, the Governing Council allowed larger annual variances subject to two conditions. The University had to leave each budget-planning cycle: (a) with its annual budget in balance, and (b) with an accumulated deficit of no more than 1.5% of operating revenue. The long-range planning approach had served the University well, allowing it to deal with both unexpected new revenue (such as that from the Canada Research Chairs program) and unexpected, drastic revenue reductions (such as that associated with the Harris government's "Common Sense Revolution"). The multi-year policy allowed the University to adjust without requiring either the sudden imposition of spending reductions or sudden, unplanned and less-than-optimal spending.

- **The operating fund and other University funds**. Ms Brown explained that the operating budget did not represent all of the University's revenue and expense. The operating budget dealt with about two thirds of revenue and expense. In addition to the Operating Fund, the University managed its money in three other funds. For the year ended April 30, 2004, the Ancillary Operations Fund had revenues of about $104-million. The ancillary operations included the service ancillaries: residences, food services, beverage services, conference services, and parking operations on all three campuses, and Hart House. The operating plans and budgets of those operations were reviewed and approved by the University Affairs Board. There was an unincorporated business ancillary – the Real Estate operation. Its operating plan and budget appeared later on the agenda of this Business Board meeting. There were also incorporated ancillary operations: the University of Toronto Press, the Innovations Foundation and the University of Toronto Asset Management Corporation. Their budgets were reviewed and approved by their own boards, which were appointed by the Executive Committee of the Governing Council, and their financial statements were presented to the Business Board annually through the Audit Committee. The third fund was the capital fund, and expenditures for all major capital projects (costing over $2-million) were reviewed and approved by the Business Board. Finally, the restricted funds had revenue of $369-million in 2003-04, deriving from endowment earnings and external grants. The spending of that revenue was carried out in accordance with the terms and conditions of each restricted fund (research grant or donation).

2. **Budget Report, 2005 – 06** (Cont'd)

- **The operating budget and the financial statements**. Ms Brown explained that the operating budget report before the Board today was strictly cash based, projecting cash revenue and allocating that cash among various purposes. The financial statements, on the other hand, provided full cost accounting, including various non-cash accounting entries. For example, for pensions and other employee benefits, the operating budget allocated the cash necessary to make pension contributions and pay the employer share of premiums during the forthcoming year. The financial statements, on the other hand, included an accounting estimate of the full cost of the current and post-retirement benefits earned by employees during the year.

  The financial statements were prepared on a consolidated, single-column basis, but a supplementary schedule provided separate reporting of expenses and revenue for each fund. The financial statement for the operating fund differed from the operating budget. For example, the operating budget included the receipts and expenses of the Canada Research Chairs program. The financial statement for the operating fund did not include revenues and expenses from such restricted programs, which were reported in the restricted funds group. A second key difference concerned capital expenditures funded by operating monies. Those expenditures were budgeted as cash outlays in the operating budget. In the supplementary schedules by fund, the capital expenditures were transferred to the Capital Fund and depreciation expense was reported.

- **Operating fund support for capital projects**. In response to members' questions about the matter, Professor Goel commented on the use of operating funds to support certain capital projects. He stated that the administration would provide a more complete analysis later in the spring. In private corporations, a portion of sales revenue would be set aside for capital purposes. In the case of the University, apart from grants targeted for specific projects, the University received funding only for operating purposes. The bulk of operating revenue was transferred to the academic divisions. The divisions themselves set their priorities for the use of their budgets. It was very important that they do so. They gave careful consideration to their needs and aspirations and, in some cases, recommended allocation of a part of their budgets to capital investments needed to achieve their objectives and not funded from capital grants or donations.

  The primary source of operating money for such capital spending was each division's carry-forward account. In some cases, divisions completed their fiscal year with unspent funds. Those unspent funds were not clawed back but were retained by divisions in carry-forward accounts. The carry-forward policy had proven to be a very good one, preventing the unplanned year-end spending on lower priorities seen in other institutions and in governments without such a policy. It also provided a means for divisions to save for major projects and purposes, including capital purposes. In some cases, divisions would leave positions vacant for a period of time or defer spending in other ways to accumulate funds in carry-forward accounts needed for major purchases or to complete

2. Budget Report, 2005 – 06 (Cont'd)

capital projects. Each division was required to submit a plan for its use of its carry-forward account, and those plans sometimes included capital projects.

Divisions could accumulate operating monies for capital projects in a second way. An example was the method used by the Faculty of Arts and Science to accumulate carry-forward monies to fund the renovation of one of the floors of the Bahen Centre for Information Technology for the Department of Mathematics. When the University had decided to expand its enrolment, it had decided also to do so primarily at the Mississauga and Scarborough campuses. Those campuses were not, however, able to expand their facilities quickly enough to accommodate a substantial part of the enrolment growth associated with the arrival and flow-through of the double cohort of students graduating from the new four-year and old five-year secondary school programs in the same year. The Faculty of Arts and Science therefore agreed to expand its undergraduate enrolment on a temporary basis to accommodate those students, planning to reduce enrolment as facilities at Mississauga and Scarborough became available. In those circumstances, with additional revenue from the Enrolment Growth Fund being available only for a few years, it would not have been appropriate for the Faculty of Arts and Science to commit to the on-going, base-budget expenditures needed to expand its permanent faculty. It therefore did two things. First, it did engage new permanent faculty, but it did so only through appointments to replace faculty who would be retiring in a few year's time. Those "bridging" appointments provided the extra teaching staff needed to accommodate the temporary enrolment increase, but did so in a way that would not require a permanent addition to the base budget. Second, it used a part of the Enrolment Growth Fund money to fund relatively small-scale capital projects, in the amount of $3-million to $5-million, such as the renovation to accommodate the Department of Mathematics.

Professor Goel said that the later analysis would show the proportion of operating funding that had been, and was being, devoted to capital projects. That proportion was not unreasonable, given the size of the University's budget.

- **Summary of the budget strategy for 2005-06**. The proposed operating budget maintained the overall structure of the current six-year budget plan with only minor changes from the previous year's revenue and expense projections. It included no changes in the schedule for base budget reductions of 2% in 2005-06, 5% in 2006-07, 2% in 2007-8, 2% in 2008-09, and 3% in 2009-10. Planned one-time-only reductions had, however, been reduced. Investment income had been better than projected in the original plan, as reflected in the annual report of the University of Toronto Asset Management Corporation. Enrolment, and income related to enrolment, would be higher in some areas.

- **Budget assumptions: the Rae review**. The budget plan included no assumption of additional revenues arising from the Rae review, apart from those revenues that had

2. Budget Report, 2005 – 06 (Cont'd)

previously been assumed in the long-range budget framework. They included: payment to compensate for the cost of the second year of the tuition-fee freeze; the continuation of new revenue from the Province's Quality Assurance Fund in the amount that had already been announced for 2005-06 and 2006-07; and continued flow-through of funding for enrolment growth taken on to accommodate the double cohort. The continuation of this funding had been recommended by the Rae review. Because those funding sources, amounting to $60-million, had already been assumed in the budget plan, its availability would not spare the University from any planned budget reductions.

- **Key assumptions: revenue**. In terms of the revenue associated with enrolment, the budget contained no significant change from existing plans. There would be some reduction in undergraduate intake arising from the end of the double-cohort effect. There was no change planned in graduate enrolment. With respect to Government operating funding, it was assumed that the accessibility program would continue, with added students fully funded. It was assumed that there would be an increase of 2% per year in operating grant funding after 2006-07, matching the assumed rate of inflation. It was assumed that there would be no increase in the number of funded graduate students. With respect to revenue from tuition fees, it was assumed that the tuition-fee freeze for domestic students would be maintained for a second year in 2005-06, with the revenue loss being replaced by a Government grant. It was assumed that tuition fees would increase at the projected 2% rate of inflation thereafter. The revenue from tuition fees from international students would reflect the recently approved fee increases. Finally, it was assumed that the Canada Research Chairs program would be renewed by the Government of Canada, which would also continue its funding for the indirect costs of the research.

- **Key assumptions: expense**. It was assumed, for purposes of the budget model only and not as a negotiating position, that the cost of salaries and benefits would increase by 2% per year. It was assumed, based on the previous year's experience, that the amount budgeted for the amortization of previous investment losses could be reduced for the two remaining years. There would be no change in the amount budgeted for amortization of the pension deficit. Finally, there would be no further increase in debt funded by central operating funds.

- **Outcome**. Operating revenues were projected to grow significantly over the planning period, especially revenues that reflected the flow-through of the double cohort. However, expenditures were projected to increase even more quickly, leaving a gap of some $120-million in the absence of corrective action. A member had asked what amount of additional funding would be required to meet the University's needs. The answer was that the University would have to receive an additional $120-million from the Province beyond that already built into the budget model. That new funding would also have to be untied to new spending commitments, such as accepting additional students

2. Budget Report, 2005 – 06 (Cont'd)

into graduate and professional programs – an unlikely situation. Professor Goel thought that the University or Toronto's share of any new funding that might arise in the immediate future would do no more than cover one half of the projected shortfall. Therefore, the planned base-budget reductions of 2%, 5%, 2%, 2% and 3% for the next fiscal years were likely to be necessary.

- **Sources of operating budget revenue**. Provincial operating grants supplied 45% of the University's operating budget revenue, and tuition fees provided a further 33%. Other sources were as follows: 11% from divisional income, 3% from the Canada Research Chairs program, 3% from payments to cover the indirect cost of research grants and contacts, 3% from endowment income in support of chairs and student aid, 1% from investment income from the Expendable Funds Investment Pool, and 1% from other income such as application fees and overhead fees.

- **Breakdown of operating expenditures**. 65% of expenditures were made by the academic divisions; 9% was spent on student assistance; 8% was spent on plant maintenance, services and utilities; 6% was spent on central administration; 4% on academic computing and library services; 4% on such general university expenses as insurance and legal fees; 2% on campus and student services; and 2% on library acquisitions.

Professor Goel concluded that the crux of the University's budget problem was inadequate public funding. He displayed histograms showing that provincial funding per student had actually declined between 1994-95 and 2001-02. With inflation taken into account, the funding per student had declined even further. Using bar charts, Professor Goel demonstrated that government per-student funding for 2003-04 was second poorest among peer public institutions in the Association of American Universities, and total operating revenue was by a large measure the very worst. If peer private institutions were taken into account, the comparison would be even more unfavourable.

The President remarked that Ontario's funding of universities ranked tenth out of the ten provinces of Canada. The University of Toronto had increased its enrolment to meet the higher demand for places arising not only from the double cohort but also from the higher rate of participation in university education. The increased enrolment had come from all economic groups. 40% of the students admitted to the University for the current year had been born outside of Canada. All of that represented an excellent outcome and an exemplary level of service to Canada and Ontario. Operating funding had not, however, kept pace.

The President said that the proposed budget was consistent with the long-range budget framework. It was a prudent and conservative budget. It contained no assumption of new Provincial funding in advance of the Province's budget, expected either at the end of April or in

2. Budget Report, 2005 – 06 (Cont'd)

May. It maintained the expense reductions required to conform to the Governing Council policy requiring that the operating fund deficit be no greater than 1.5% of operating revenue at the end of the budget-framework period on April 30, 2010. The budget avoided major disruptions by providing for planned reductions over the full framework period. The base-budget reduction for 2005-06 would be 2%. For 2006-07, it would be 5% - a very severe reduction that was difficult even to contemplate. The reductions in the following years would be 2%, 2% and then 3%. The planned reductions represented sound planning. There was, unfortunately, no choice but to proceed with them. The President hoped that the Premier, having inaugurated the Rae review, would accept its recommendation to increase funding for universities and colleges. However, even if the Province provided the full increase proposed by the Rae review, that review had also proposed that the funding increase be accompanied by increased costs and obligations. Moreover, the full $1.3-billion increase recommend by the Rae review would be a great help but would not be a panacea. The University continued its strong advocacy of the Rae "stretch goal." An effective re-investment in post-secondary education would require the implementation of the stretch goal, not the bare-bones minimum increase.

The Chair said that the Budget Report was considered by both the Academic Board and the Business Board before it was forwarded to the Governing Council for approval. The Governing Council system sought to provide for both (a) academic self-governance within the University and (b) accountability to stakeholders, including the taxpayers and benefactors. The Academic Board was the source of academic self-governance. It was responsible for the selection of priorities and the allocation of resources contained in the budget documents. Its Planning and Budget Committee had reviewed the budget in detail, and it had recommended the Budget Report to the Academic Board, which in turn would be asked to recommend approval to the Governing Council. The Business Board was the source of accountability and advice about financial matters. It was asked to concur with the recommendation of the Academic Board that the Budget Report be approved. The Business Board's duty was to satisfy itself that the budget was achievable and financially prudent – that the University could accept the budgeted cumulative deficit and, by the end of the planning period on April 30, 2010, (i) reduce the cumulative deficit to the policy limit of 1.5% of operating revenue, and (ii) bring the annual budget back into balance. The Board should also satisfy itself that the budget assumptions were realistic, and that the level of risk in the budget was acceptable.

Among the matters that arose in discussion were the following.

(a) Base-budget reductions. A member asked whether, given the possibility of improved funding arising from the Rae review, it might be possible to defer the planned base-budget reductions, particularly the severe 5% reduction projected for 2006-07, until the Government of Ontario had made announcements concerning its implementation of the Rae recommendations. Professor Goel replied that the budget plan already included a deferral of base-budget reductions to allow divisions time to develop their plans and to allow the University time for advocacy activities. The relief that had arisen from improved investment income and increased enrolment

2. Budget Report, 2005 – 06 (Cont'd)

had already been taken into account by the reduction of the planned one-time-only reductions in 2007-08. A further delay in implementing base-budget reductions, particularly the 5% reduction in 2006-07, would bring the cumulative deficit to more than 10% of revenue, and it would be too large to reduce that deficit to 1.5% of operating revenue, as required by Governing Council policy, by the end of the budget planning period on April 30, 2010. When the Province's implementation of the Rae recommendations is announced, the University would review the budget plan. It was important to bear in mind, however, that approximately $60-million of the funding increments recommended by the Rae review had already been built into the budget plan. Moreover, a further significant portion would likely be required to meet the conditions likely to be attached to the added funding, for example the additional funding required for adding spaces in graduate and professional programs.

(b) Adequacy of funding for utilities and facilities maintenance and renewal. In response to a member's question, Ms Riggall said that the University's strategy with respect to utility bills was, wherever possible, to buy gas and electricity six months to a year in advance to ensure price stability. She was, therefore, confident that the amount budgeted for utilities would be reasonably accurate. With respect to deferred maintenance, the situation was better than it had been one year ago. The Government of Ontario continued to provide about $4.5-million for this purpose through its Facilities Renewal Program. In addition, the University was now budgeting close to $8-million per year for facilities maintenance. The outcome should be the avoidance of further deterioration.

(c) Income assumptions: long-term enrolment. A member asked whether the University could be confident about its long-term enrolment projections in the light of such factors as plans to increase tuition fees and attractive employment opportunities in certain sectors of the economy for individuals without university training. Would the University have the financial flexibility to reduce variable costs if enrolment did not, in the long term, match projections? Professor Goel replied that a substantial portion of the University's operating costs were fixed because of commitments to faculty and staff. The Ministry of Training, Colleges and Universities and the Council of Ontario Universities had both developed enrolment models, which projected increasing demand for university places for at least a generation. The "echo boom," the children of members of the post-war baby boom, would be in their post-secondary education years until the end of the decade. Moreover, it was likely that the participation rate in university education would continue to increase. There was increasing demand for university-trained people in the workplace, and there was also growing demand for continuing post-graduate education. The quality of applicants to the University of Toronto had remained very good and generally superior to that of other universities. Professor Goel therefore had no concern about long-term enrolment.

(d) Student assistance. A member was pleased to observe the $9.7-million increase in the budget for student assistance (excluding divisional support), an increase that exceeded the rate of inflation. Another member also commended the increase, although he was surprised at the size of the increase at a time when tuition fees had been frozen. Professor Goel observed that funding

2. Budget Report, 2005 – 06 (Cont'd)

the increase in student assistance had been more difficult than it might have been. While the Province had provided funding to compensate the universities for the tuition-fee freeze, that compensatory grant had not included the 30% of the planned additional revenue that would have been set aside for student assistance. Although tuition fees remained frozen, other student costs such as living costs had continued to increase. In addition, the extension of the graduate funding guarantee had continued. It was therefore necessary and appropriate to increase funding for student assistance.

Another member was pleased that the University was maintaining the guarantee in its Policy on Student Financial Support. Was that support vulnerable to any reduction of the investment returns on the University's endowment funds? Professor Goel replied that about one third of the funding for student assistance came from endowment income, with other funding from graduate fellowships, the Connaught fund and other sources. Beyond those sources, funding was supplied by the operating budget. The University regarded its commitment to the student financial support guarantee as a first charge on the operating budget; therefore it would be continued notwithstanding any difficulty with respect to endowment income in a given year(s).

(e) St. George campus and student services. A member expressed concern that there had been no increase in the $12.2-million budgeted for campus and student services on the St. George Campus. Another member expressed surprise that, in view of the recent focus on the improvement of the student experience, that budget had not increased substantially. Professor Goel replied that only a part of the funding for campus and student services was recorded in the section of the budget cited by the members. There was also funding for student services in the budget of the Vice-Provost, Students, and that funding had increased somewhat. He noted that funding for campus and student services had been protected at a time when funding reductions were the norm.

(f) Administration expense. A member expressed concern that central administration expense would increase by $3.1-million. He noted that, on the other hand, the General University Expense budgets, administered by the central administrative offices, were budgeted to decline by $3.5-million. Was it reasonable to assume that those changes balanced each other out? Professor Goel replied that the increase in spending on administration had taken place at a lower rate that the increase in the overall expenditure. The proportion of funds spent on administration had declined as enrolment, revenue and overall expense had increased.

(g) Risks: Risk concerning Government funding and the flexibility to reduce expenses. A member observed that the key risk in the budget appeared to be Government funding. The budget had assumed that $60-million of special funding would be received from the Government of Ontario. While there was good reason for confidence that it would be forthcoming, there appeared to be little opportunity to reduce costs if the funding was not provided. Would the consequences of that unlikely scenario be dealt with over the long term? Professor Goel clarified that the $60-million amount cited was total funding at the end of five years. Professor Zaky said

2. Budget Report, 2005 – 06 (Cont'd)

that the amount at risk for 2005-06 was the $15-million Quality Assurance Fund. Professor Goel noted that in previous years, budgets contained much more significant assumptions about uncertain revenue. The assumption of the $60-million of funding over five years was based on commitments that had been made in previous Provincial budgets. In addition, all were supported by recommendations of the Rae review. It was true that the University's flexibility to contain costs was limited. It had implemented budget reductions over the past twelve or thirteen consecutive years, and any "fat" in the budget had been trimmed long since. It would be very difficult to make further reductions in administrative costs because an already reduced administrative complement was serving a substantially expanded faculty and student body. Nonetheless, Deans and heads of other budget units had been asked to make contingency plans which would, if necessary, be implemented. Professor Goel noted that if the remaining cuts in the budget model were implemented, the University could not meet its aspirations.

(h) Risks: investment returns. In response to a member's question, Professor Goel said that investment income was an area of risk, but steps had been taken to contain the level of that risk, for example the reduced return target for the Expendable Funds Investment Pool, which permitted UTAM to make less risky investments for that Pool. Ms Brown recalled that the Expendable Pool contained three parts: one needed for near-term expenditure held in very short-term accounts, one not likely to be needed in the near term, providing internal loans to capital projects, and the final portion invested by UTAM. For that final portion, the reduced return expectation and risk tolerance meant that no part of the Expendable Pool was to be invested in the equity markets. The level of budget risk with respect to endowment income had also been reduced by the adoption of a new payout formula, prescribing a lower payout, enabling investments that would, overall, be less volatile, and reducing the risk that the endowment funds would not provide the budgeted revenue for the operating funds and reducing the possibility that the planned payout would put at risk the inflation-adjusted value of the endowment capital. Nonetheless, investment returns would remain uncertain, and the level of those returns would likely be a key factor in determining whether the University's financial year was a good one or a bad one.

(i) Operating fund support for capital projects. A member recognized that in a period of major capital expansion, there would be need for some operating fund support for capital projects, and therefore there would be need to balance capital needs with support for teaching and research. She asked for information on the proportion of capital support from the operating fund. Professor Goel replied that he would bring forward a report on the proportion of operating revenue devoted to capital projects. It had happened in recent years to be close to the amount of the accounting entry for depreciation. He would not, unfortunately, be able to provide systematic comparative figures because several other provinces provided capital-fund grants to their universities.

(j) Cumulative deficit. A member asked how the University funded its cumulative deficit. Ms Brown replied that the University's cash flows provided a sufficient float to enable the University to avoid borrowing to fund the deficit. If the University ran into a situation of reduced cash flows, it might then have to borrow to fund the deficit. As it was, the cost of the deficit was

2. Budget Report, 2005 – 06 (Cont'd)

an opportunity cost: in the absence of a deficit, the University would be able to invest more in the Expendable Funds Investment Pool and generate more investment income. The member urged the University to aim to reduce the cumulative deficit to zero at the end of the budget-framework period on April 30, 2010 rather than 1.5% of operating revenue.

(k) Contingency funds and budget reductions. In response to a member's question, Professor Goel said that the University had no monies set aside in a central contingency fund to deal with such risks as lower-than-projected revenue. Each division was asked to plan for contingencies. The member urged prudence in budget planning; the longer budget reductions were deferred, the larger the ones that would ultimately be needed.

On the recommendation of the President and the Vice-President and Provost,

YOUR BOARD CONCURRED

With the prospective recommendation of the Academic Board

THAT the Budget Report for 2005-06, dated March 8, 2005, be approved.

3. Business Arising from the Report of the Previous Meeting

(a) Item 5 – Health and Safety Annual Report

At the previous meeting, a member had suggested that, in connection with the annual report on health and safety, the Vice-President, Human Resources and Equity provide written certification that, to the best of her knowledge, the University was in full compliance with all legal requirements in the area of health and safety. Professor Hildyard reported that she had sought advice on the matter and that she would table the requested assurance at the next meeting.

(b) Capital Projects

The Chair recalled that there was, at the February meeting, substantial discussion about the use of operating monies for capital projects. The Provost would provide an initial response during his presentation of the Budget Report (see above).

4. Investments: Investment Performance Benchmarks

Ms Brown recalled that at the January 17, 2005 meeting, the Board had approved a revised University Funds Investment Policy. The major revision was in the return target and risk tolerance for the Expendable Funds Investment Pool, the Pool used for the investment of all of the University's money that was not invested in long-term funds (i.e. all of its money apart from

4. Investments: Investment Performance Benchmarks (Cont'd)

its endowment funds and the fund being set aside to match the University's liability under the Supplemental Retirement Arrangement). The Expendable Funds Investment Pool (or EFIP) included operating, capital, and expendable trust funds, and the working capital of the ancillary operations. The new performance target for that portion of the expendable Pool managed by UTAM was the rate of return on one-year Canadian treasury bills plus 50 basis points (or one half of 1%). The sole change proposed in the performance benchmarks reflected that policy change. The proposed benchmark for the portion of the Expendable Pool managed by the University of Toronto Asset Management Corporation (UTAM) was the Scotia Capital 365 day (Canadian) Treasury Bill Index + 50 basis points. Ms Brown stressed that the Expendable Pool consisted of three parts: (a) short-term funds need for expenditure in the very near future, which were managed by the University's Financial Services Department; (b) a core amount of the expendable funds that was committed for expenditure but which represented a constant cash float unlikely to be required for expenditure, which amount was loaned for capital projects; and (c) an amount that could be placed in relatively short-term investments by UTAM. The proposed benchmark was for that final portion of the Expendable Pool.

Discussion focused on the **process of determining the proposed benchmarks**. Members observed that the benchmarks were very important factors in driving the investment choices and performance of UTAM. Were the benchmarks set to provide easy, median or difficult comparisons? How were the recommended benchmarks determined? What was the role of UTAM management, its Compensation Committee and its Board? It was important that UTAM management not be seen as itself determining the targets that would be the basis for the team's incentive compensation.

Ms Brown replied that the Business Board, on the recommendation of the University's administration, approved the performance objectives within the risk parameters. In the case of all three funds, the determination of the targets had followed careful studies by the administration, completed with the aid of consultants. Those studies had considered the historical return and risk characteristics of various asset classes and possible deviations from historical patterns, and they had then considered various combinations of asset classes to determine their return and risk trade-offs. The key in determining the targets was the amount of risk that the University could afford. The objective of obtaining the best possible return had to be tempered by the amount of volatility in returns that could be tolerated by the University's budget. Setting higher targets meant having to incur higher risk, and that had caused problems in the past. After the University had set its targets, which were approved by the Business Board, UTAM had to determine the asset mix to achieve the targets within the specified risk tolerance. It might select the model asset mix that had emerged from the University's study or might deviate from it. The benchmarks were then selected to provide a mix of assets that would achieve the target return within the risk tolerance, and they were used as a basis for measurement of UTAM's success in achieving the targets set for it.

Mr. Gluskin said that the benchmarks for the individual asset classes were standard ones used in the industry that were selected by a logical process to represent UTAM's investment objectives.

4. Investments: Investment Performance Benchmarks (Cont'd)

Ms Riggall noted that the benchmark market indices formed only a part of the basis for decisions about the compensation of UTAM's senior staff. The UTAM Compensation Committee also took into account a comparison of UTAM's performance relative to the universe of peer funds and its own judgements about performance.

In response to a member's questions, Ms Riggall and Ms Brown said that the group of benchmarks used was more complex than that used by other Canadian universities. UTAM managed the largest pool of capital and was the only separate university asset-management company in Canada. As a result, its portfolios were more complex than those at most other universities, and the benchmarks reflected that fact. The peer universes were industry standards. Where there were choices, they were made to select the universes that most closely reflected the mix of return objectives and risk tolerance chosen by the University. Again, the University of Toronto's choices were often different from those of other investors, with the result that the asset mixes in the available peer universes often differed significantly from those in the university and pension funds.

A member expressed satisfaction with the answers to his and other questions. He was comforted to know that the process of setting targets was initiated internally by the University and that UTAM decisions on benchmarks were approved not only by the Business Board but by UTAM's highly expert board. It was entirely appropriate that the Business Board ask questions about the decisions of the UTAM Board, but it should do so without in any way usurping the role of the UTAM Board.

The President said that he had watched the UTAM Board in operation, and he was very impressed with its operations at all levels: oversight of investments and also assurance of management accountability and determination of compensation. The Board consisted primarily of very accomplished investment experts, and it was important to let those experts do their job.

Mr. Gluskin added that the Board included the President, Ms Riggall, and Governing Council member David Wilson, as well as former Governing Council members Tom Simpson and Joseph Rotman, who ensured that the University's needs were reflected in all decisions.

On the recommendation of the Vice-President, Business Affairs,

YOUR BOARD APPROVED

The proposed revised Schedule "C" to the Amended and Restated Service and UTAM Personnel Agreement, made as of the 14th day of May, 2003, containing the performance benchmarks against market indices and peer universes, a copy of which is attached to Ms Brown's memorandum of March 15, 2005 as Attachment 1.

5. Investments: Pension Fund Master Trust Investment Policy

Ms Riggall said that the pension funds formed a part of the assets under UTAM's management. The Pension Benefits Act required an annual filing including the pension funds' investment policies. Because of the University's relationship with UTAM, the filing required three documents. First, the Business Board was called upon to review and approve the University policy, setting out the return expectation and risk tolerance for the pension-fund investments. Second, the filing included the UTAM Service Agreement, which delegated to UTAM its operating authority and which set out the targets and benchmarks, in the revised Schedule "C", just approved. The filing included, third, the more detailed investment policy that has been approved by the UTAM Board, which set out the investment strategy and UTAM's undertaking to adhere to the stated investment targets and risk tolerances.

Among the matters that arose in discussion were the following.

(a) Conflict-of-interest guidelines. A member expressed his pleasure to see the inclusion of detailed conflict-of-interest guidelines in the proposed policy (section 3.1).

(b) Social and political issues with respect to University investments and corporate social responsibility. A member noted that article 6 of the Service Agreement stated that UTAM would act in accordance with various University policies including the 1978 Statement on Social and Political Issues with respect to University Investment. That Statement, however, only set out a procedure that members of the University could use to raise concerns. The member urged that the University act to consider the establishment of substantive ethical-investment guidelines.

Another member referred to a recent magazine article dealing with corporate social responsibility. There was clearly a growing interest in institutional-investor action to promote such responsibility, with a likelihood that institutional investors would soon be rated on their actions in this area. She suggested that the University take action ahead of any such action and undertake a policy review with respect to its role in promoting corporate social responsibility. She urged that Ms Riggall report back to the Board on how the University could act in this respect.

Ms Riggall replied that Statement on Social and Political Issues with respect to University Investment set out a criterion for possible action to restrict University investments – the then-established Yale criterion of causing no social harm. There was currently no review underway of University action to promote corporate social responsibility. Ms Riggall did undertake to look into the matter. Such a review would, however, have to be conducted as a lower priority than other pressing matters, and Ms Riggall could not undertake to report back quickly.

(c) Hedge-fund investments. A member was pleased to note the limit on the new provision allowing derivatives to be used as a substitute for more traditional investments. Where derivatives were not backed by cash collateral, the approval of the UTAM Board would be required. He assumed that derivatives would instead be backed by investments in hedge funds, and he asked whether there was a limit to the total percent of the pension fund master trust to be

5. Investments: Pension Fund Master Trust Investment Policy (Cont'd)

invested in hedge funds. Ms Riggall replied that there was no such limit. The asset mix for the fund specified that 10% of the fund would be invested in absolute-return hedge funds. Any additional use would be subject to the decisions of the UTAM Board. Mr. Gluskin reported that the issue was a matter of regular discussion by the UTAM Board, and it received attention disproportionate to the weight of the absolute-return hedge funds in the portfolios. He noted that Mr. Chee had proposed, and the Board had agreed, that hedge-fund investments would be made through funds of funds. Using such investments, because of the additional costs, restricted potential gains, but, because of greater diversification, it also introduced an element of added conservatism.

(d) Foreign-content restrictions. A member referred to the provision, contained in the recent federal budget, to remove the foreign-content limits on pension funds. Would that decision lead to a revision of the pension fund investment policy? Ms Brown replied that the University was reviewing a number of relevant matters, including asset-liability matching and the removal of the foreign-content limit. Depending on the timing of the completion of those reviews, the administration might forward a special proposal for a revision of the policy or it might simply include any needed changes in the next annual review of the policy at this time in 2006.

(e) Accountability for investment matters. In the course of discussion, Ms Brown stressed that the University's role was to set the return targets and the risk tolerance for the pension fund and the other funds. UTAM was then responsible for determining the asset mix to achieve the target return within the stated risk tolerance, and UTAM would be held accountable for the outcome. The restrictions that did appear in the University's policy were those required by the Financial Services Commission of Ontario. After those restrictions and other legislated requirements, the expert UTAM Board would make decisions and be accountable for the outcome.

On the recommendation of the Vice-President, Business Affairs,

YOUR BOARD APPROVED

(i) The proposed University of Toronto Pension Fund Master Trust Investment Policy, a copy of which is attached to Ms Riggall's memorandum of March 15, 2005 as Attachment 1, replacing the Policy approved by the Business Board on March 1, 2004; and

(ii) Taken together, (1) the proposed University of Toronto Pension Fund Master Trust Investment Policy, (2) the University of Toronto Asset Management Corporation Pension Fund Master Trust Investment Policy, a copy of which is attached to Ms Riggall's memorandum of March 15, 2005 as attachment 3, and (3) the Amended and Restated Service and UTAM Personnel Agreement made as of the 14th Day of May, 2003,

5. Investments: Pension Fund Master Trust Investment Policy (Cont'd)

including the amended Schedule "C", as the University of Toronto's Pension Fund Master Trust Statement of Investment Policies and Procedures, replacing the Policies and Procedures approved by the Business Board on March 1, 2004.

6. Investments: University of Toronto Asset Management Corporation: Annual Report, 2004

Ms Riggall stressed that the assets being managed by UTAM, and the gains and losses from the investment of those assets, were reported in the University's or the pension funds' financial statements. They did not appear on UTAM's own financial statements, which dealt only with its internal financial position and operations. The financial statements of the pension funds, the University and UTAM were all audited by Ernst & Young. The annual report provided information on the investment performance of the funds and on how they compared to their benchmarks and to the universe of other funds.

Mr. Gluskin said that UTAM was a separate corporation. Its Board was appointed by the University and contained University representatives, but the majority of directors were independent, expert individuals who oversaw the management of the investments as they would those of any client with similar objectives and risk tolerances. Most of the directors were individuals with exceptional experience and expertise in investment matters.

The Chair noted that the University's Audit Committee would review UTAM's financial statements at its next meeting, which was scheduled for May 17, 2005. The Audit Committee had not met since UTAM's December 31 year-end, and it therefore had no recommendation at this time. Consequently, the resolution on the agenda was to accept the UTAM annual report and financial statements subject to the Audit Committee's satisfaction with the financial statements. In response to a member's question, Ms Brown said that that the procedure was consistent with that used in recent previous years.

The Chair invited Professor Luste to speak. He noted that because the University's Audit Committee had not yet reviewed the UTAM financial statements, they had not yet been released publicly and he had not had access to them. The UTAM costs, which were paid by the University, were an important part of the University's budget, and any growth in those costs would have a negative impact on the University's budget. Professor Luste found the report to be light - lacking in detail compared to other reports of its kind. It reported a return of 11.5% for the pension fund for the 2004 calendar year, compared to a benchmark return of 10.9%. Professor Luste had, however, looked up the returns of a number of other comparable funds for the same time period – the year ended December 31, 2004. While the pension fund had outperformed that at York University and had turned in the same performance as that at Queen's University, it had under-performed that at McGill and both the Ontario Municipal Employees' Retirement System (OMERS) and the Ontario Teachers' Pension Plan, the latter enjoying a return of 14.7% for the year. Professor Luste did not, therefore, regard the return on the University's pension fund as

6. Investments: University of Toronto Asset Management Corporation: Annual Report, 2004 (Cont'd)

outstanding. All five other funds had different benchmarks. Professor Luste had found it difficult to come to grips with the benchmark issue on the basis of the information in the UTAM annual report. On page 13 of the Report, it was stated that the pension fund had ranked in the 18th percentile of the peer universe. That, however, appeared to be the outcome of only two factors: (a) the very high, second percentile ranking in fixed-income investments, which appeared to be the outcome of the investment in real-return bonds, and (b) the benefit of hedging foreign currency exposure, which presumably drew up the otherwise below-median performance in U.S. equities. It was highly unlikely that many other funds in the peer universe hedged their foreign currency exposure. It would be very useful for factors such as those to be discussed in the annual report.

Professor Luste commented on the costs of fund management. He recalled that in the mid-1990s, the cost of managing the then $1-billion pension fund had been about $2-million per annum. As he understood it, the current cost for investment management of a $2-billion pension fund was in the neighbourhood of $14-million. While it was true that UTAM managed both pension funds and endowment funds, given economies of scale and given that a significant proportions of the funds were being managed passively, there did not appear to be any reason for so high a cost. He was concerned that there was a layering of costs: UTAM's own costs, the cost of fund-of-fund managers in at least one asset class, and the fund managers themselves. The more costs required for investment management, the less investment earnings were left for the pension fund and the University. The Chair assured Professor Luste that his comments would be recorded in the Board's report.

Discussion focused on the following matters:

(a) Investment management costs. A member requested that the administration provide a written report on the costs for the investment management of the pension fund and other University funds. Ms Brown replied that the annual financial report on the pension plan, presented to the Board on November 8, 2004, had provided a detailed rendering of costs, including investment-management costs, for the year ended June 30, 2004. The member was pleased that the number was readily at hand; he asked that a comparable number be reported for the University funds and that the matter be scheduled for Board discussion at the next meeting. The Chair observed that the appropriate question was whether the University was obtaining value for the money spent. He asked that Ms Riggall and Ms Brown provide advice the Board about the administration's comfort with the level of costs for investment management and about value for the money spent on those costs.

(b) Value for money spent on investment management. A member agreed that it was appropriate to determine whether costs had escalated to the extent suggested by Professor Luste. However, he concurred with the Chair that the key question was value for money. With the pension fund ranking in the 18th percentile among peers and the Long-Term Capital Appreciation Pool ranking in the 17th percentile, a substantial additional cost would be well worth it. If the

6. Investments: University of Toronto Asset Management Corporation: Annual Report, 2004 (Cont'd)

benchmarks were the correct ones, the amount of value added relative to benchmark performance would likely far exceed the cost. While that did not mean that it would not be desirable to contain costs, the additional spending appeared to have been productive.

On the recommendation of the Vice-President, Business Affairs,

> Subject to the recommendation of the Audit Committee that the University of Toronto Asset Management Corporation's audited financial statements for 2004 be accepted,
>
> YOUR BOARD ACCEPTED
>
> The University of Toronto Asset Management Corporation annual report and financial statements for 2004.

7. Capital Projects Report

The Board received the regular report on capital projects as at February 28, 2005. Professor Venter drew members' attention to the changes made since the previous report, which had shown the status of capital projects as at January 31, 2005. That previous report, and the current report, showed the effect of the closing of the Bahen Centre for Information Technology project, subject of the project closure report that appeared next on the agenda, and also of the approval of the of the University of Toronto at Scarborough Food Services Revitalization project, approved in January, 2005. The current report also showed the changes arising from the approval of four projects in February, 2005: the Centre for Health Improvement and System Performance / 155 College Street; the Department of Mathematics, Phase I; the Centre for Biological Timing and Cognition; and the University of Toronto at Scarborough Electrical and Mechanical Infrastructure Upgrades, Phase 3 – Cooling Towers. The cash contribution to the increased cost of the Bahen Centre for Biological Timing and Cognition had reduced the overall borrowing requirement slightly. That had partly offset the borrowing required for the 155 College Street and the Scarborough Infrastructure projects, with the total borrowing requirement increased to $681.427-million. Of the most recent $150-million tranche of borrowing approved by the Governing Council in June 2004, $89.074-million remained available. Professor Venter referred members to the second page of his report, which listed projects that were essentially completed. A project conclusion report would be brought to the Board on each, leading to the removal of the project from the regular report.

8. Capital Project: Bahen Centre for Information Technology: Update and Project Conclusion Report

The Chair said that a proposal to approve the additional cost of the Bahen Centre for Information Technology had been recommended by the Academic Board to the Governing

8. Capital Project: Bahen Centre for Information Technology: Update and Project Conclusion Report (Cont'd)

Council. The report to the Business Board was intended to bring the Board up to date on the project. It was the first in a series of project-completion reports that would be brought to the Board for information, leading to the removal of the projects from the regular capital-project reports.

Professor Venter recalled that the scope of the Bahen Centre project had been modified over the years, and the most recent Governing Council approval had been at $108.8-million. The Vice-President, Business Affairs and the Vice-President and Provost had also exercised their authority, within established policy, to approve a $2-million increase in the cost of the project. The final accounting for the project had now been completed at a final cost of $112,189,000. Professor Venter noted that it was often difficult to define precisely the completion date of a project, with deficiencies sometimes appearing after the opening of the building. He proposed to conclude projects formally about six months after the opening of the facilities. If there were still outstanding issues, as in the case of the Bahen Centre, the Accommodation and Facilities Directorate (A.F.D.) would undertake to establish a new, small project to remedy the outstanding issues. In the case of the Bahen Centre, not only the costs but also the revenues had increased somewhat. A small surplus of about $42,000 would be transferred to the A.F.D. to cover a part of the anticipated $125,000 project cost of dealing with the final deficiencies in the building.

9. Ancillary Operations: Real Estate – 2004-05 Operating Results and 2005-06 Budget

The Chair noted that this was a consent-agenda item. Ms Riggall had responded to a question prior to the meeting, and no member had notified the Secretary of a request that the Board receive a presentation of the item in the usual way.

A member observed that the budget for the operation forecast a substantial deficit of $426,000 for 2005-6, before commitments and transfers. He asked that the Board receive a report at an early future meeting on the steps being planned to deal with the operating deficit.

On the recommendation of the Vice-President, Business Affairs,

YOUR BOARD APPROVED

The operating budget for the Real Estate Ancillary for 2005-06, as contained in the fourth column of the Five-Year Operating Plan, attached to Ms Riggall's memorandum of March 17, 2005 as Schedule 1.

10. Date of Next Meeting

The Chair reminded members that the next regular meeting was scheduled for Monday, May 2, 2005 at 5:00 p.m. Among the anticipated items were: the second half of Professor Tuohy's report on government-relations activities, the annual report on deferred maintenance, and a report on benchmarks for capital projects.

THE BOARD MOVED INTO CLOSED SESSION

On motion duly made and seconded, it was RESOLVED

> THAT pursuant to section 33 of By-Law Number 2, the Board continue in closed session to consider the Report on Gifts and Pledges and that it meet *in camera* to consider the remainder of the agenda, with Dr. FitzPatrick, Ms Parnass, Ms Ross, and Mr. Shapira invited to be present for the *in camera* session.

11. Gifts and Pledges over $250,000: Quarterly Report, November 1, 2004 to January 31, 2005

The Board received, for information, the Report on Gifts and Pledges over $250,000 for the period November 1, 2004 to January 31, 2005.

THE BOARD MOVED *IN CAMERA*.

12. University of Toronto Faculty Association: Agreement on Retirement Matters

When the Board was still in open session, the Chair invited Professor Luste, the President of the Faculty Association, to speak to the interim Agreement with the Association on Retirement Matters. Professor Luste said that the Faculty Association was very pleased with the comprehensive, constructive and generally positive interim agreement. It was indebted to the senior administration for making it possible to end mandatory retirement, to introduce provisions for early retirement and phased retirement, and to facilitate post-retirement participation by members of the faculty and librarians. The Faculty Association Council would be voting on the agreement in two days' time. The Association did, however, have one item of concern: the options available to faculty members and librarians whose normal retirement date was June 30, 2005. The new arrangements would come fully into effect only for those whose normal retirement date was June 30, 2006 or later, and the new arrangements would not apply to those who were already retired. Members of the retiring class of 2005, many of whom had devoted their entire lives to the University, would like to be able to take advantage of the new arrangements and, for example, wind down their careers over three years of phased retirement. That option would not, however, be available as of right, but would require special approval.

12. University of Toronto Faculty Association: Agreement on Retirement Matters (Cont'd)

In the absence of such approval, those faculty members would be able to opt only for a one-year 20% contract. Professor Luste urged the University to find a way to make better one-time-only transitional arrangements for a limited number of people, requiring the expenditure of a limited amount of money. In the absence of doing so, the University would leave itself with a black mark against this otherwise commendable agreement.

On the recommendation of the Vice-President, Human Resources and Equity,

Subject to Governing Council approval of the proposal to rescind the Policy on Retirement Age affecting members of the teaching staff and professional librarians,

YOUR BOARD RATIFIED ON BEHALF OF THE GOVERNING COUNCIL

The Agreement between the Governing Council of the University of Toronto and the University of Toronto Faculty Association on Retirement Matters dated March 14, 2005.

13. Canadian Union of Public Employees, Local 3902, Unit 3: First Contract

The Chair reminded members that the Business Board was charged to consider and, if appropriate, ratify first contracts with unions. Thereafter the administration had authority to approve changes to those contracts, apart from any changes that would constitute "new policy directions."

On the recommendation of the Vice-President, Human Resources and Equity,

YOUR BOARD RATIFIED ON BEHALF OF THE GOVERNING COUNCIL

The Collective Agreement between the Governing Council of the University of Toronto and CUPE Local 3902, Unit 3, for the period September 1, 2004 to August 31, 2006.

14. United Steelworkers of America: Extension of Retirement Date under the Early Retirement Window

On the recommendation of the Vice-President, Human Resources and Equity,

YOUR BOARD APPROVED

The proposal to extend the retirement date under the early retirement window for University of Toronto employees represented by the United Steelworkers of America, as described in Professor Hildyard's memorandum to the Business Board dated March 28, 2005.

THE BOARD RETURNED TO OPEN SESSION.

The meeting adjourned at 7:35 p.m.

Secretary	Chair

April 14, 2005

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