UNIVERSITY OF TORONTO

FINANCIAL SERVICES

TO: Business Board

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DATE: January 24, 2011 for January 31, 2011

AGENDA ITEM: **6**

ITEM IDENTIFICATION:

Borrowing Strategy review and recommendations

JURISDICTIONAL INFORMATION:

The Business Board approves the financing of capital projects.

PREVIOUS ACTION TAKEN:

The Business Board approved the Borrowing Strategy on June 17, 2004. Since then, this strategy has been reviewed annually by reports to the Business Board, which have concluded that no change was needed. Regular updates of the borrowing status have been provided to the Board, most recently on December 13, 2010.

HIGHLIGHTS:

The borrowing strategy approved by Business Board in June 2004 included the following key elements:

- Maximum external borrowing capacity equals 40% of net assets averaged over 5 years.
- In the event that outstanding external borrowing exceeds 40% of net assets averaged over 5 years, no further external borrowing will be permitted until such time as the actual outstanding borrowing is not greater than 33% of net assets smoothed over 5 years.
- Maximum internal borrowing capacity equals $200 million of internal funds.
- An internal financing program.
- An internal sinking fund to accumulate funds for repayment of debentures.
- No credit rating parameters.
- No external borrowing debt service or debt repayment requirements.

This borrowing strategy currently provides for a maximum external plus internal borrowing capacity of $971.5 million at April 30, 2010, of which $962.6 million has been allocated to projects by the Business Board to January 31, 2011. Actual external borrowing at January 31, 2011 was $525.9 million. Actual internal borrowing at January 31, 2011 was $214.4 million, slightly higher than the $200 million target because internal funds are providing short to medium-term bridge-financing until the University issues the next debenture of up to $200 million.

We compared the University of Toronto to selected Moody's U.S. Public College and University Medians 2010, with respect to our external borrowing. Those comparisons indicated that, to date the University has borrowed externally less than our rating peers, but also has fewer resources to support debt issuance, and has internal debt, which our peers are likely to have as well. Credit ratings are excellent and debt service and debt repayments continue to be reasonable.

Net assets, and therefore borrowing capacity, change over time. The following table summarizes current projections as compared to last year's projections:

Projected maximum total borrowing capacity ranges (in millions)

	January 2010 Review		January 2011 Review	
	LOW	HIGH	LOW	HIGH
April 30, 2010	958.5	958.5	971.5	971.5
April 30, 2011	943.6	956.8	961.0	961.0
April 30, 2012	907.8	942.1	925.3	932.8
April 30, 2013	874.5	944.9	890.1	914.0
April 30, 2014	886.8	1,009.2	899.6	950.0
April 30, 2015			894.3	983.1

Current projected maximum borrowing capacity is lower than last year's projection, mainly due to projected increases in pension and other employee future benefit expense. Pension expense which is determined based on accounting rules, is calculated on an actuarial basis and reflects the cost of providing one year of pension service. The increase in pension expense is mainly caused by the amortization of some of the 2009 investment losses incurred on the pension assets and the reduction in the discount rate required to be used to calculate the value of pension liabilities. For more information on pensions, please see the paper *Ensuring a Sustainable Pension Plan for the University of Toronto* (January 31, 2011 Business Board).

Assuming that the projections of net assets are reasonable, we would expect to have available between $894.3 million and $983.1 million in borrowing capacity by 2015. The current borrowing allocated to projects and other requirements by Business Board to January 31, 2011 is $962.6 million. With the additional $140.1 million in principal repayments on amortizing loans, the additional borrowing available to be allocated is projected to be between $71.8 million and $160.6 million. However, projected reductions in maximum borrowing capacity, if they materialize, would constrain the University's ability to build and renovate using borrowed funds for the next several years (under current accounting rules) because the University could be in a situation where the actual external borrowing is above 40% of net assets averaged over 5 years. In this event, no further external borrowing would be permitted under the current policy until such time as the actual external borrowing is not greater than 33% of net assets averaged over 5 years. **In the event that this occurred, we would likely need to consider changing the constraints around the maximum borrowing capacity to sustain the University's momentum in what will otherwise be a period of some belt tightening.**

It is also important to note that, apart from the uncertainties contained in the assumptions used to project net assets, the accounting rules could change in future, affecting net assets.

Our annual review of the University's cash flow requirements confirmed that the $200 million from EFIP can be continued and should not need to be replaced with comparable external borrowing during the period, and that increasing the limit temporarily beyond the $200 million target in the short-to-medium term is not expected to result in any risk of cash flow shortages. It also indicated that there is significant additional cash available in EFIP that would support up to an additional $150 million of longer term investments by EFIP at a higher rate of return, with impairing cash flows.

While one option would be to increase the general internal maximum borrowing capacity from $200 million to $350 million, we believe that it makes more sense to:

- maintain the current $200 million long term internal borrowing capacity under the current borrowing strategy, with the temporary overage as indicated above; and
- designate this additional $150 million as a pension borrowing capacity, separate and apart from the $200 million internal borrowing capacity, to support the borrowing identified for pensions as discussed in the paper *Ensuring a Sustainable Pension Plan for the University of Toronto* (January 31, 2011 Business Board).

This approach would ensure that the additional amount identified would be reserved for pension purposes. It is also important to keep this pension borrowing capacity, and the actual associated borrowing, separate from the borrowing for predominantly capital purposes, because of the different impact on the University's balance sheet. While internal borrowing of funds for deposit into the pension plan reduces investments in the same way as borrowing for other purposes, it also reduces accrued pension liabilities by the same amount.

All amounts designated as borrowing capacity under both the current borrowing strategy and under this new pension borrowing capacity have been and, will continue to be, assessed in determining the overall prudence of the University's overall borrowing. The utilization of the $150 million pension borrowing capacity will be reported separately from the maximum internal and external borrowing capacity under the current borrowing strategy to ensure that a clear line is maintained between borrowing for pension purposes and for other, predominantly capital, purposes. As with the existing $200 million internal borrowing capacity, if this additional $150 million invested by EFIP were needed for short-term expenditures, the borrowing would have to be re-financed externally.

Overall Conclusion

In conclusion, this review indicated that the current borrowing strategy, as approved by the Business Board on June 17, 2004, continues to be prudent and that an additional $150 million may prudently be designated as a pension borrowing capacity, separate and apart from the borrowing capacity defined under the current borrowing strategy. It also noted that in light of a potential decline in net assets, it would likely be necessary to consider changing the constraints around the maximum borrowing capacity to sustain the University's momentum in what will otherwise be a period of some belt tightening, and that apart from the uncertainties continued in the assumptions used to project net assets, the accounting rules could change in future, affecting net assets.

FINANCIAL AND/OR PLANNING IMPLICATIONS:

Enables a continuation of capital investment on key priorities and provision of borrowing reserved for pension purposes.

RECOMMENDATION:

For information.