UNIVERSITY OF TORONTO

50 YEARS | GOVERNING COUNCIL

FOR INFORMATION **PUBLIC** **OPEN SESSION**

TO:	Business Board
SPONSOR: **CONTACT INFO:**	Trevor Rodgers, Chief Financial Officer 416-978-2065, trevor.rodgers@utoronto.ca
PRESENTER: **CONTACT INFO:**	See above.
DATE:	January 25, 2023 for February 1, 2023
AGENDA ITEM:	5

ITEM IDENTIFICATION:

Forecast of University Financial Results at April 30, 2023, prepared as of January 6, 2023.

JURISDICTIONAL INFORMATION:

Review of regular reports on matters affecting the finances of the University.

GOVERNANCE PATH:

1. **Business Board [for information] (February 1, 2023)**

PREVIOUS ACTION TAKEN:

On February 2, 2022 the Business Board was provided the University's financial forecast for the year ended April 30, 2022. On June 21, 2022 the Business Board reviewed the University's audited financial statements for the year ended April 30, 2022 and recommended them to Governing Council for approval. On March 15, 2022, the Business Board concurred with the Academic Board that the Operating Budget Report for 2022-23 be approved.

HIGHLIGHTS:

This financial forecast projects the revenues, expenses, net income and net assets for the University of Toronto fiscal year ending April 30, 2023 across all funds – operating, ancillary, capital, and restricted - including accounting estimates for pension and benefits expense and liability, and for depreciation.

This forecast should be viewed as a reasonable ballpark estimate of the year-end results, given the resources and information available. It contains forward-looking information which is subject to risks and uncertainties that could cause the actual results to differ materially from those contained in this forecast.

At this time, we have good information on most revenues and expenses for 2023 but also have some significant uncertainties:

- Investment returns are, as always, uncertain and can vary significantly from year to year, especially this year due to the war in the Ukraine, the residual effects of the COVID-19 pandemic, persistently high inflation and rising interest rates.
- While units have provided interim information on these items, final year-end results may differ based on actual revenues and expenditures recorded in the final four months of the fiscal year.

This forecast has been produced using a combination of forecasting methods, including projection to April 30, 2023 using current year-to-date actual figures and estimation based on trend analysis of prior years. The key assumptions are:

- Forecasted investment return for the long term capital appreciation pool (LTCAP) of 0.8%.
- Endowment payout of $113 million for 2022/23.
- $140 million in divisional savings that increase reserves for planned capital expansion, faculty start-up funding and research infrastructure, and funds to match future donations, and $192 million in savings for approved capital projects.
- $573 million in capital asset additions during 2023 of which $216 million is funded from current year revenues with the remainder from reserves.

<u>Sensitivity Analysis:</u>

A sensitivity analysis on page 3 of the report shows the impact of varying investment returns for LTCAP on net income and net assets at -3.0%, 0.0%, 0.8%(forecast) and 2.0% for the year. It also shows forecasted net income under all four scenarios.

Variability in the investment return for LTCAP has an impact on the value of externally restricted endowments (reported directly on the balance sheet), and on the investment income in internally restricted endowments (reported on the statement of operations), both of which have an impact on the value of the University's net assets.

<u>Conclusion:</u>

Incorporating all of the above, net income for the year is projected to be $361 million, at a 0.8% LTCAP investment return rate. Net income is projected to range from $318 million (at -3.0% investment return) to $374 million (at 2.0% investment return). Net assets are projected to be $8.81 billion, at the 0.8% investment return rate. The projected range is from $8.66 billion (at -3.0% investment return) to $8.85 billion (at 2.0% investment return).

The operating fund unrestricted deficit is projected to be $68 million, as compared to the budgeted cumulative surplus of nil. This change is primarily due to shortfalls in tuition and investment income on short and medium-term expendable funds. The sensitivity analysis on LTCAP return rates does not impact this figure.

FINANCIAL IMPLICATIONS:

Refer to highlights.

RECOMMENDATION:

For information.

DOCUMENTATION PROVIDED:

- *Financial Forecast to April 30, 2023, as at January 6, 2023*

Financial Forecast to April 30, 2023

as at January 6, 2023

University of Toronto Financial Services

UNIVERSITY OF TORONTO

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INTRODUCTION

This financial forecast projects the revenues, expenses, net income and net assets for the University of Toronto fiscal year ending April 30, 2023 across all funds – operating, ancillary, capital, and restricted - including accounting estimates for pension and benefits expense and liability, and for depreciation. It should be viewed as a reasonable ballpark estimate of the year-end results, given the resources and information available.

The forecast contains forward-looking information which is subject to risks and uncertainties that could cause the actual results to differ materially from those contained in this forecast. At this time, we have good information on most revenues and expenses for 2023 but also have some significant uncertainties:

- Investment returns are, as always, uncertain and can vary significantly from year to year, especially this year due to the war in the Ukraine, the residual effects of the COVID-19 pandemic, persistently high inflation and rising interest rates.
- The distributed nature of the University's operations allocates responsibility for some revenues and a significant portion of expenses at the division and department level. While units have provided interim information on these items, final year-end results may differ based on actual revenues and expenditures recorded in the final four months of the fiscal year.

This forecast to April 30, 2023 has been produced using a combination of methods based on current year-to-date actual figures and trend analysis of prior years. The key assumptions that underlie the forecast are:

- An annual investment return in the long-term capital appreciation pool (LTCAP) of 0.8% based on actual results through the end of November, and an annual return in the expendable funds investment pool (EFIP) of 0.2% based on actual results through the end of October;
- Endowment spending allocation of $113 million for 2022-23 (representing 4.5% of the 10-year average market value of the endowment pool), leaving an accumulated reserve of $243 million in the endowment to protect against future market downturns;
- Allocation of $140 million to operating reserves for planned future capital expansion, faculty start-up funding and research infrastructure, and funds to match future donations, and an additional $192 million in savings for approved capital projects. These planned allocations are not expensed in the current year and are reflected as savings compared to the cash-based operating budget; and
- Capital asset additions of $573 million during 2022-23, of which $216 million is funded from the current year revenues with the remainder from reserves. These costs are capitalized and not expensed in the current year.

Throughout this report, a sensitivity analysis is provided to show the impact of varying investment returns for LTCAP on the University's forecast of net income and net assets. Scenarios include investment returns at -3.0%, 0.0%, 0.8% (forecast), and 2.0% for the year.

Variability in the investment return for LTCAP has an impact on the value of externally restricted endowments (reported directly on the balance sheet), and on the investment income in internally restricted endowments (reported on the statement of operations), both of which have an impact on the value of the University's net assets. A summary of the forecasted results under these scenarios is provided below.

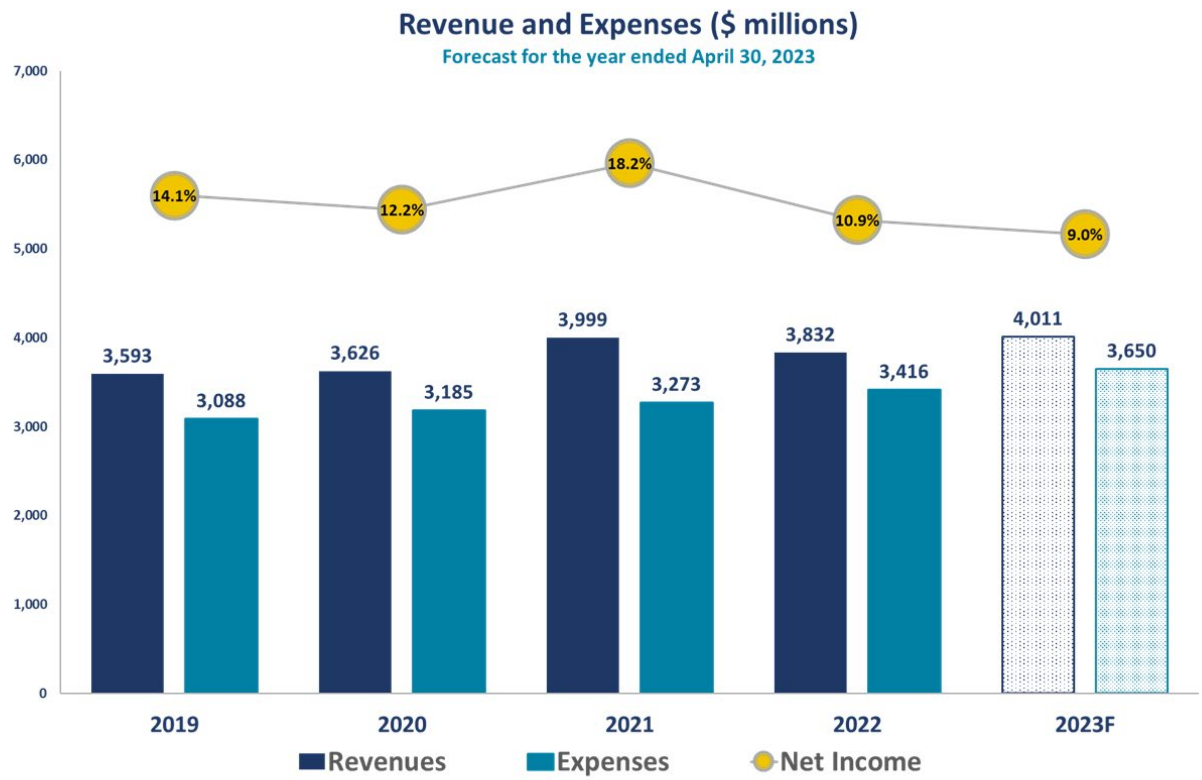
Table 1: University of Toronto Financial Forecast Sensitivity Analysis
For the Year Ended April 30, 2023
($ millions)

	Sensitivty on LTCAP Investment Returns			
Change in Net Assets	-3.0%	0.0%	0.8%	2.0%
Revenues	3,968	4,002	4,011	4,024
Expenses	3,650	3,650	3,650	3,650
Net Income	**318**	**352**	**361**	**374**
Preservation (drawdown) of capital for externally restricted endowments	(178)	(96)	(74)	(42)
Externally endowed contributions	66	66	66	66
Remeasurement of employee future benefits	(49)	(49)	(49)	(49)
Net assets, beginning of year	8,503	8,503	8,503	8,503
Net assets, end of year	**8,660**	**8,776**	**8,807**	**8,852**
Total Net Assets Comprised of:				
Operating fund deficit	(68)	(68)	(68)	(68)
Ancillary fund deficit	(39)	(39)	(39)	(39)
Capital fund deficit	(344)	(344)	(344)	(344)
Restricted fund deficit	-	-	-	-
Total Unrestricted Deficit	**(451)**	**(451)**	**(451)**	**(451)**
Internally restricted funds	1,613	1,633	1,638	1,646
Investment in land and other capital assets	4,461	4,461	4,461	4,461
Endowments	3,037	3,133	3,159	3,196
Total net assets	**8,660**	**8,776**	**8,807**	**8,852**

PROJECTED NET INCOME

Total revenues are expected to increase by $179 million from 2022. Total expenses are forecasted to increase by $234 million, from $3.4 billion in 2022 to $3.7 billion. Net income is projected to be $361 million (9.0%) for the year ended April 30, 2023. This represents a decrease of $55 million from last year's net income of $416 million and primarily reflects the impact of inflation on the cost of supplies and services and increased travel costs coming out of the COVID-19 pandemic.

Figure 1: Forecast of Net Income for the Year Ending April 30, 2023



The net income of $361 million is targeted for in-year capital allocations, as well as contributions to reserves for future capital expansion, faculty start-up funding and research infrastructure, and funds to match future donations.

Sensitivity Analysis – Net Income

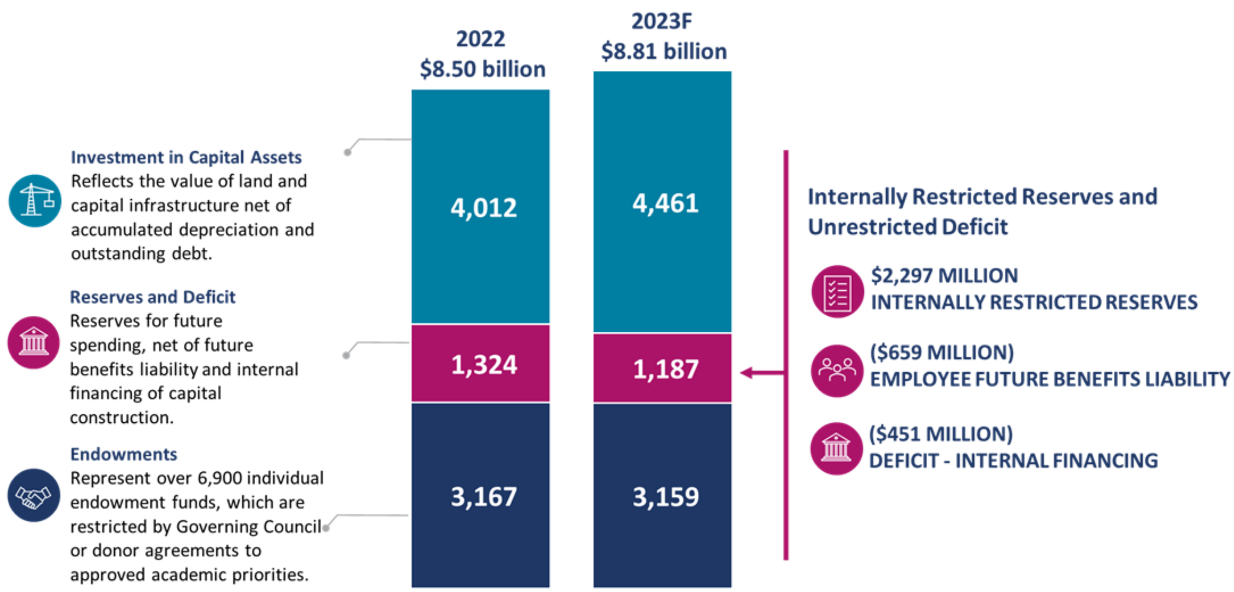
A change in the investment return in LTCAP would impact this result (assuming everything else remains the same) as follows, reflecting the change in investment income on internally restricted endowments:

- At -3.0% return — $318 million net income
- At 0.0% return — $352 million net income
- At 0.8% return — $361 million net income (current forecast)
- At 2.0% return — $374 million net income

PROJECTED CHANGES IN NET ASSETS

This forecast projects an increase in net assets from $8.50 billion at April 30, 2022 to $8.81 billion at April 30, 2023. The increase of $304 million results from the projected net income of $361 million, $66 million in projected endowed contributions, less a $74 million drawdown for spending from externally restricted endowments, and a direct decrease in net assets of $49 million from remeasurement of employee future benefits primarily due to actuarial losses on our post-retirement medical plans. Each of the categories of net assets is described in further detail below.

Figure 2: Forecast of Net Assets at April 30, 2023



Projected Unrestricted Deficit

This forecast projects a cumulative deficit of ($451 million) at April 30, 2023, as compared to last year's cumulative deficit ($314 million). The $451 million deficit is comprised of:

- ($68 million) operating fund unrestricted deficit as compared to the budgeted cumulative surplus of nil. The projected unfavorable variance of $68 million is primarily due to $40 million shortfall in tuition fee revenue from lower international undergraduate enrolment and lower domestic graduate enrollment. A shortfall in EFIP investment income of $34 million compared to budget is partially offset by a favorable variance of $5 million in other expenses.
- ($344 million) unrestricted deficit in the capital fund is due primarily to the internal debt component of the University debt programme. These internal loans will be paid down over time via blended principal and interest payments.
- ($39 million) unrestricted deficit in ancillary operations primarily due to losses sustained during the COVID-19 pandemic, which will be paid down over the next few years as ancillary operations recover. These operations depend on faculty, staff, students, and visitors attending, working, and visiting all three campuses.

Projected Internally Restricted Net Assets

Internally restricted net assets (reserves) are projected to remain unchanged at $1.6 billion. Savings from divisional spending are equally offset by an increase in unfunded employee future benefit expense obligations as a result changes in the actuarial discount rate assumptions. Internally restricted net assets balance of $1.6 billion reflects the positive reserves of $2.3 billion (assets), offset by the unfunded portion of pension and employee benefits of $659 million (liabilities).

Projected Investment in Land and other Capital Assets

The $4.5 billion investment in capital assets represents the value of land and internal monies previously spent by the University on capital projects which will be reduced over time as the depreciable assets are amortized. This amount is projected to increase from $4.0 billion in 2022 to $4.5 billion in 2023 primarily due to $573 million in capital asset additions, partially offset by amortization on internally funded capital assets of $125 million.

Projected Endowments

This forecast projects endowments of $3.2 billion at April 30, 2023, a decrease of $8 million from 2022, comprised as follows:

Table 2: Projected Endowment Balance at April 30, 2023
(millions of dollars)

	Forecasted Fiscal Year 2023	Fiscal Year 2022
Opening Balance, May 1	3,167	3,150
Investment income	26	47
Less: endowment payout	(113)	(110)
Endowed contributions and transfers	79	81
Balance	3,159	3,167

Sensitivity Analysis – Endowments and Net Assets

Varying assumptions for the investment return in LTCAP would affect this result (assuming everything else remains the same) as follows, reflecting both changes in the balance sheet value of externally restricted endowments and the investment income for internally restricted endowments:

- At -3.0% return $3.04 billion endowments $8.66 billion net assets
- At 0.0% return $3.13 billion endowments $8.77 billion net assets
- At 0.8% return $3.16 billion endowments $8.81 billion net assets (current forecast)
- At 2.0% return $3.20 billion endowments $8.85 billion net assets

COMPARISON TO OPERATING BUDGET

It is important to compare the forecasted year-end results to the original operating budget to assess how well the budget has estimated the actual outcome. However, there are differences between the operating budget and the financial statements that must be understood to ensure a meaningful comparison:

- The operating budget includes revenues and expenditures for the operating fund only, which includes the core teaching and administrative activities of the University that are supported mainly by government operating grants, student fees, and sales of goods and services. The financial forecast includes all funds – operating, restricted, capital, and ancillary.

- The operating budget includes allocations to internally restricted funds for future spending that are not assumed to be expensed within the fiscal year, such as planned savings for future capital projects, faculty start-up funding and research infrastructure, and funds to match future donations.

- The financial statements are prepared on an accrual basis following Canadian generally accepted accounting principles for not-for-profit organizations in Canada ("GAAP"), while the operating budget is based on a projection of cash receipts and expenditures. As a result, the forecast reflects the amortization of capital assets while the operating budget includes estimated cash outlays for these assets. Similarly, the forecast includes the costs of pensions and other benefits in accordance with GAAP, while the operating budget includes only the projected cash premiums and funding to be paid in the year.

After accounting for transfers to capital and allocations to internally restricted funds, the operating fund shortfall for the year ended April 30, 2023 is projected to be ($78 million), primarily due to shortfalls in tuition and investment income as noted above.

Table 3: Operating Budget and Forecast for the Year Ended April 30, 2023

	Budget	Forecast	Variance
Operating Revenue	3,233	3,141	(92)
Operating Expense	(3,233)	(2,677)	556
Annual Surplus	**-**	**464**	**464**
Net Transfers from Operating Fund	-	(337)	(337)
Allocations to Internally Restricted Funds	-	(205)	(205)
Net change in deficit		(78)	(78)
Unrestricted surplus, beginning of year	-	10	10
Unrestricted deficit, end of year	-	**(68)**	**(68)**

Note that varying the rate of return on LTCAP does not impact the operating fund deficit amount, as the investment return variations included in this forecast only impact the endowment and internally restricted net asset balances.