Debt Policy Update 2023

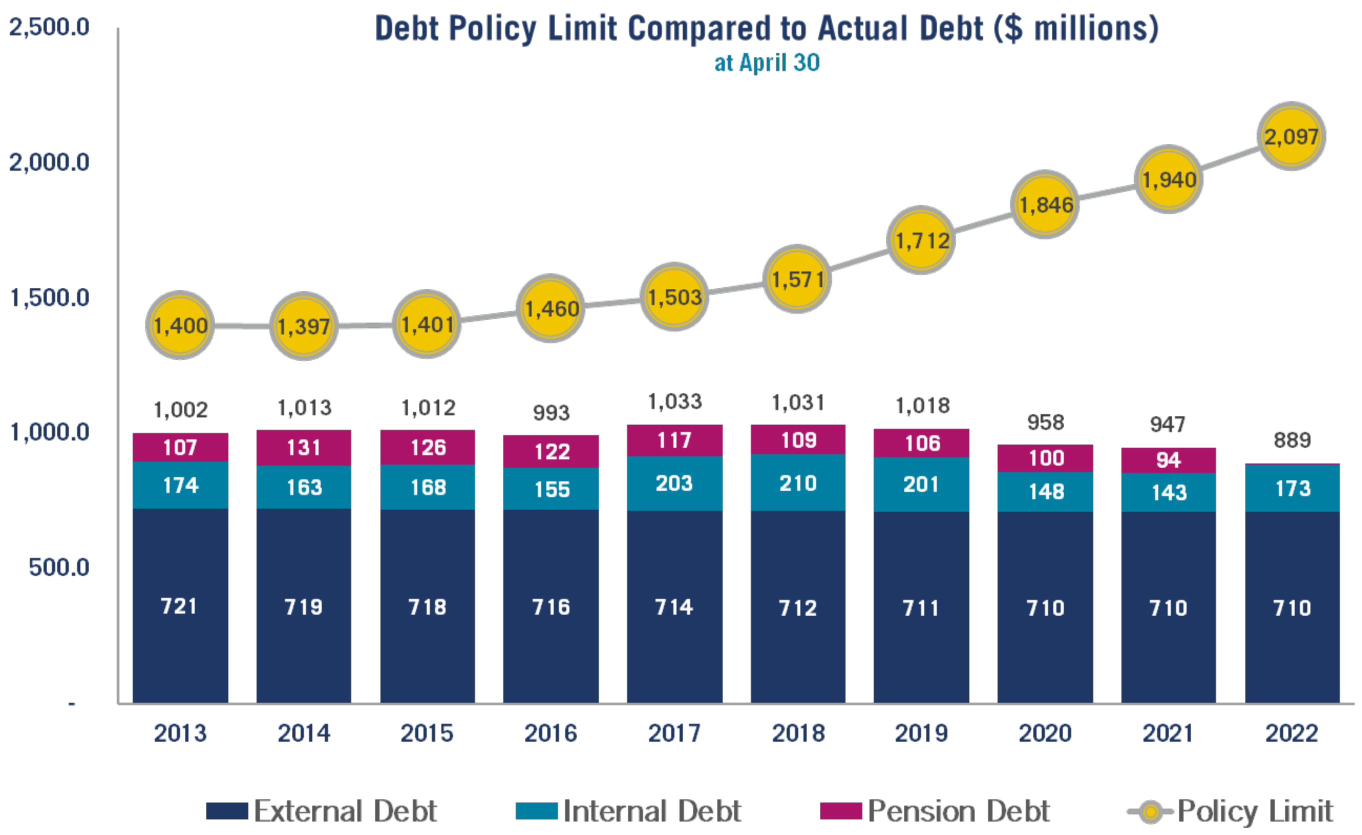
Business Board
April 26, 2023

UNIVERSITY OF TORONTO

DEFY GRAVITY

Debt Policy Limit

- Debt limit is based on affordability, with a maximum debt burden (P&I) of 5% of total expenditures
- The limit includes all long-term debt, regardless of whether borrowed externally (debentures) or internally (from expendable cash in EFIP)
- Current debt limit is $2.1 billion including up to $963 million from EFIP
- Actual debt outstanding as of April 30/22 was $889 million – with a 2.2% debt burden ratio



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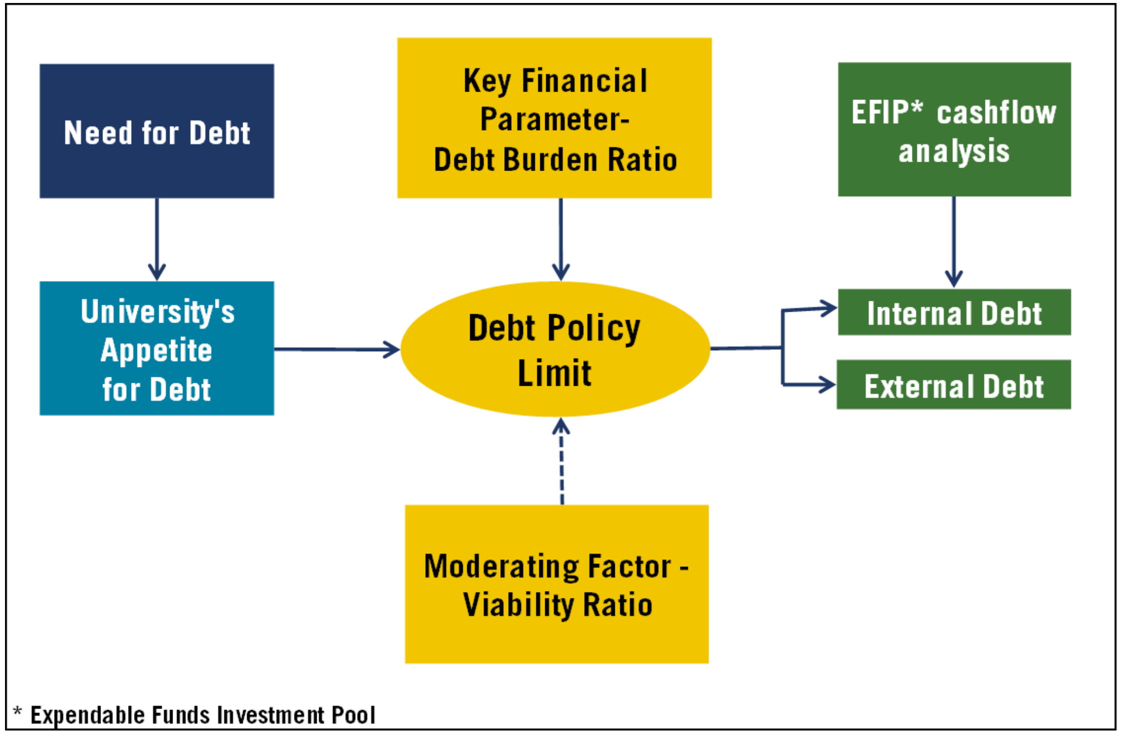
Key Definitions

- **Debt affordability (primary factor)** is defined as the amount that can be made available to pay interest and repay outstanding debt, both external and internal. The debt strategy sets the acceptable **debt burden ratio (principal plus interest / total expenditures)** at 5%.

- **Debt capacity (moderating factor)** is defined as the amount that can be borrowed based on the funds that are available to repay outstanding debt, measured via the **viability ratio (expendable resources / debt)**. The debt strategy identifies a viability ratio of 0.8 as the appropriate lower threshold.



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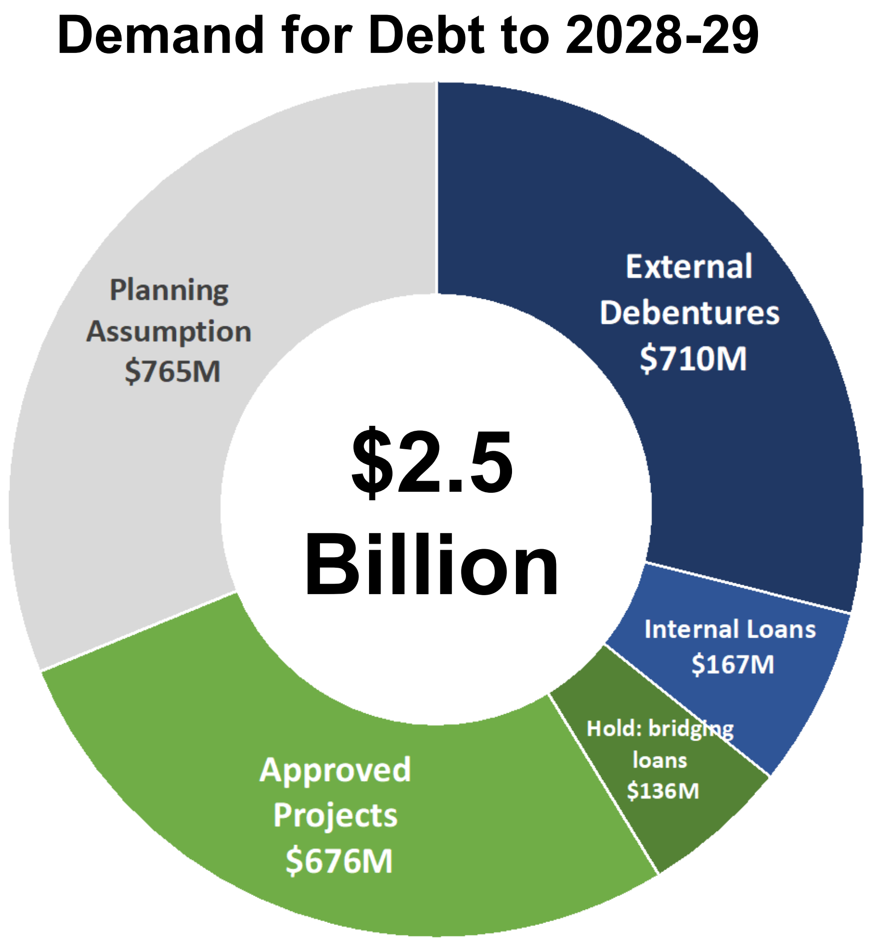
Debt Forecast

- Debt limit grows with overall financial capacity, projected to rise to $2.5 billion by 2028-29
- Rising demand due to:
  - Academic capital expansion
  - Infrastructure renewal (e.g. LEAP, GGRP)
  - 4C projects (profit-generating)
  - Construction cost inflation
- Downward pressure due to:
  - Rising interest rates
  - Affordability crunch



* Per annual debt strategy review to Business Board, Feb 2023

Evaluating Indirect Debt

- University is pursuing innovative financing structures beyond the traditional use of internal and external borrowing.
- Debt limit will be updated to capture a portion of indirect (off balance sheet) debt exposure from debt held by development partners arising out of 4 Corners joint ventures (commercial profit-generating projects).
- Project-specific risk assessment will inform the proportion to be included in the debt limit on a case-by-case basis when projects are brought forward for approval. As a guideline:

Commercial Projects - Proposed Debt Service Coverage Ratios (DSCR)	Financial Health Assessment	Range of Factors to be assigned to Indirect Debt
Higher than 1.2	Very Healthy	0% - 10%
Between 1.15 to 1.2	Healthy	11% - 25%
Between 1.1 to 1.15	Moderate	26% - 40%
Between 1.0 to 1.1	Break-even	41% - 60%
Below 1.0	Unhealthy	60% - 100%

- In future, if the University were to consider joint venture partnerships to support academic projects, these would be assessed based on the division’s capacity to carry their share of the project’s cost and, if appropriate, an allocation for indirect debt of the JV partner. This assessment would be included in the submission of the project for governance approval.

Impact on Debt Limit

- Existing partnership agreements include $116 million of debt held by JV partners, of which we recommend including **$31 million of indirect debt exposure**.

Indirect Debt	Off-Balance Sheet Debt Amount	Factor	Indirect Debt Exposure
Spadina-Sussex University Residence Inc. (Joint Venture)	$20.3M	10%	$2.0M
UTSC Residence Limited Partnership	$95.8M	30%	$28.8M

- Indirect debt exposure associated with other joint ventures that are in the early stages of planning, including the Westbank development partnership for the Site 1: The Gateway project, will be assessed and reviewed as the capital projects proceed through governance approval.

Assessing Debt Burden Using the Expanded Definition of Debt

- **With the expansion of the definition of debt, we propose to increase the combined upper threshold for the debt burden ratio from 5% to 6%.** This increase will provide flexibility to engage in partnerships while restraining the escalation of the risk that these projects may bring to the University.
- **The revised 6% limit will continue to be lower than the 7% industry benchmark**[1]. The revised limit will be applied to direct and indirect debt, without specific ratios for each category, thereby continuing to keep the fungibility principle from the current debt strategy.
- The **viability ratio will remain unchanged at 0.8**, but will apply to external debt only. The approach of including internal debt in this measure is overly conservative. The use of internal resources to fund debt already reduces expendable resources and mirrors the settlement of external debt using university's funds.

$389M

Additional Debt Capacity

6%

Debt Burden Limit

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[1] *see Prager, Sealy & Co LLC, KPMG LLP; and Attain LLC; Strategic Financial Analysis in Higher Education – Seventh edition (2010), p.117*

Financial Health Indicators & Credit Ratings – Projected to 2028-29

- **Base Case Projections:** Likely case - debt allocations based on currently approved borrowing, plus Indirect Debt, plus planning assumptions of $765M of capital expansion. **No credit rating implications.**

- **Maximum External Debt:** Unlikely "worst case" – borrowing entirely from external sources up to maximum allowed under policy at 6% debt burden ratio. Risk of credit rating downgrade if all debt is issued externally. Extremely unlikely given regular monitoring by Business Board.

- **The administration will expand its regular reporting to Business Board** to include information about indirect debt exposure and overall MCU Financial Health Indicators as part of the Monthly Status Report on Debt.

*** DRAFT: pending details from MCU on final metrics, definitions, and data sources**

	Current	PROJECTION RANGE: BASE CASE AND WORST CASE		
		LOW RISK	MEDIUM RISK	HIGH RISK
Viability Ratio	4.90	4.00 1.40	0.6	0.3
Debt Ratio	6%	7% 11%	35%	70%
Debt to Revenue Ratio	23%	28%	35%	48% 50%
Interest Burden Ratio	1%	1%	2%	4% 4%

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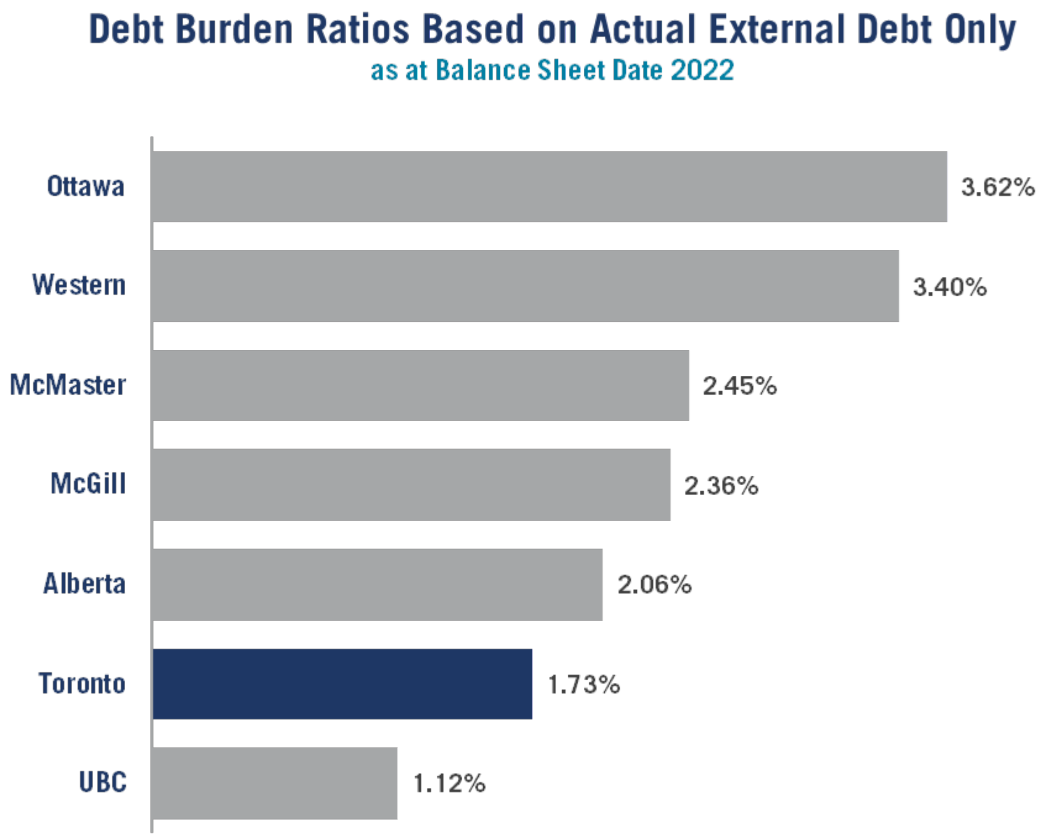
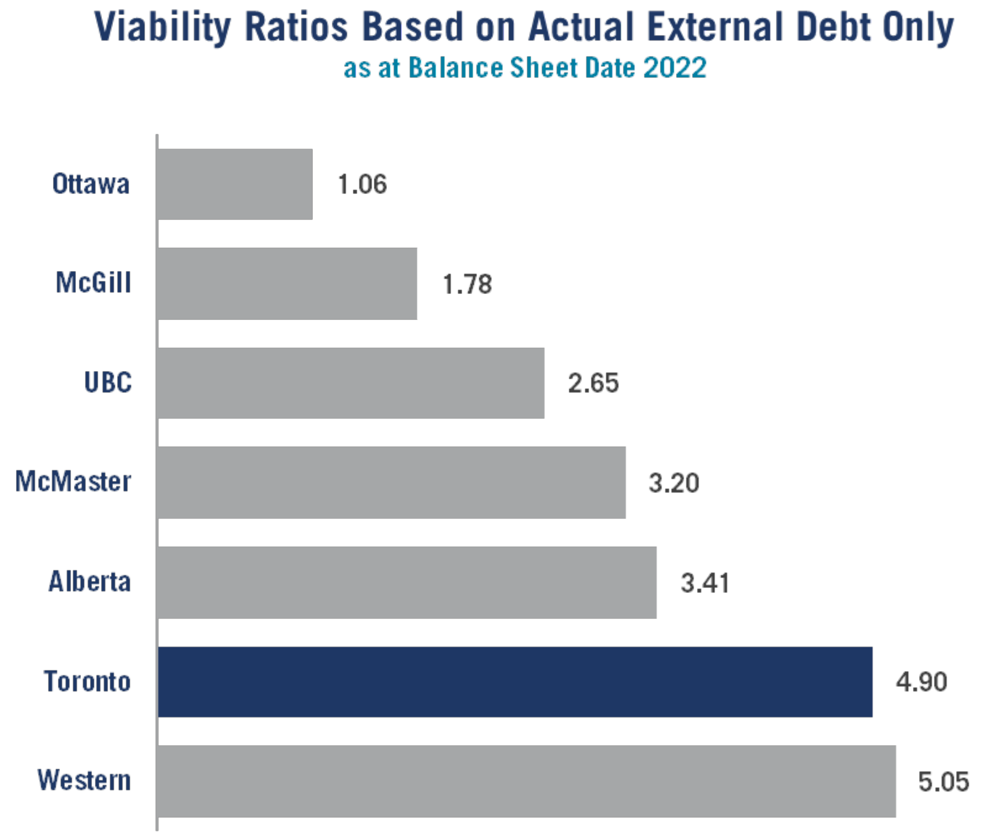
Recommendations to Business Board April 26 (Cycle 5)

The administration recommends to the Business Board:

- Expand the definition of debt for purposes of the University's debt strategy to include indirect debt exposure from joint venture partnerships
- Increase the upper threshold debt burden ratio from 5% to 6% based on the expanded definition of debt noted above
- Revise the definition of the viability ratio used for monitoring purposes to exclude internal debt, while maintaining the threshold at 0.8
- Expand the monitoring ratios included in the debt policy to include any MCU Financial Health Indicators that are applicable to the University

APPENDIX 1 – U of T's external debt ratio is better than Canadian peers





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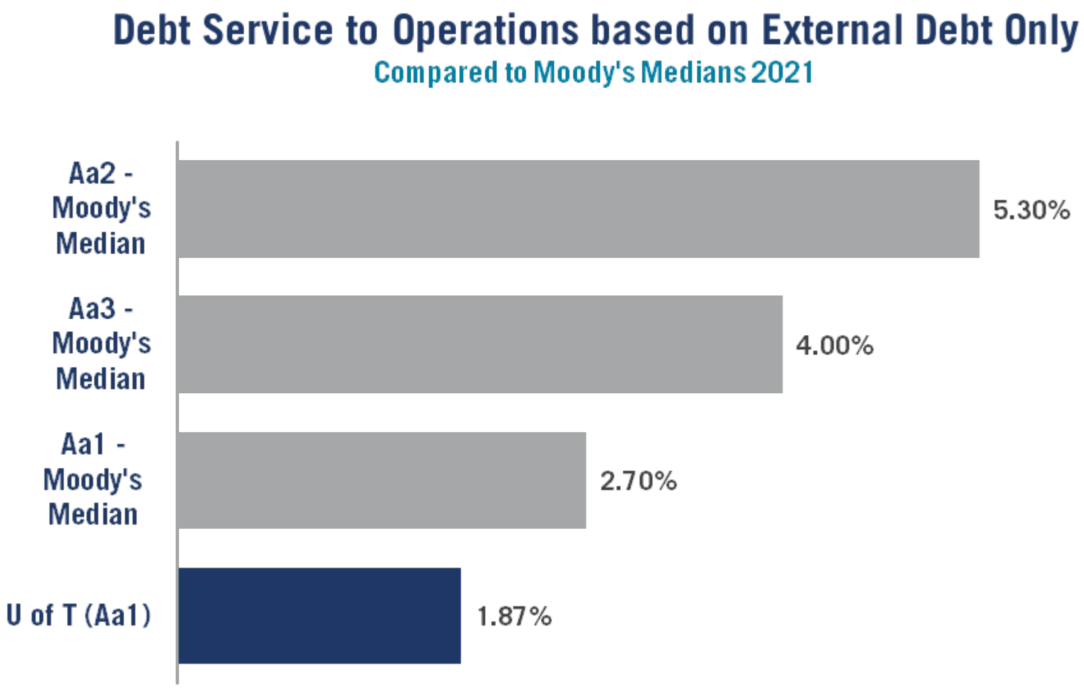
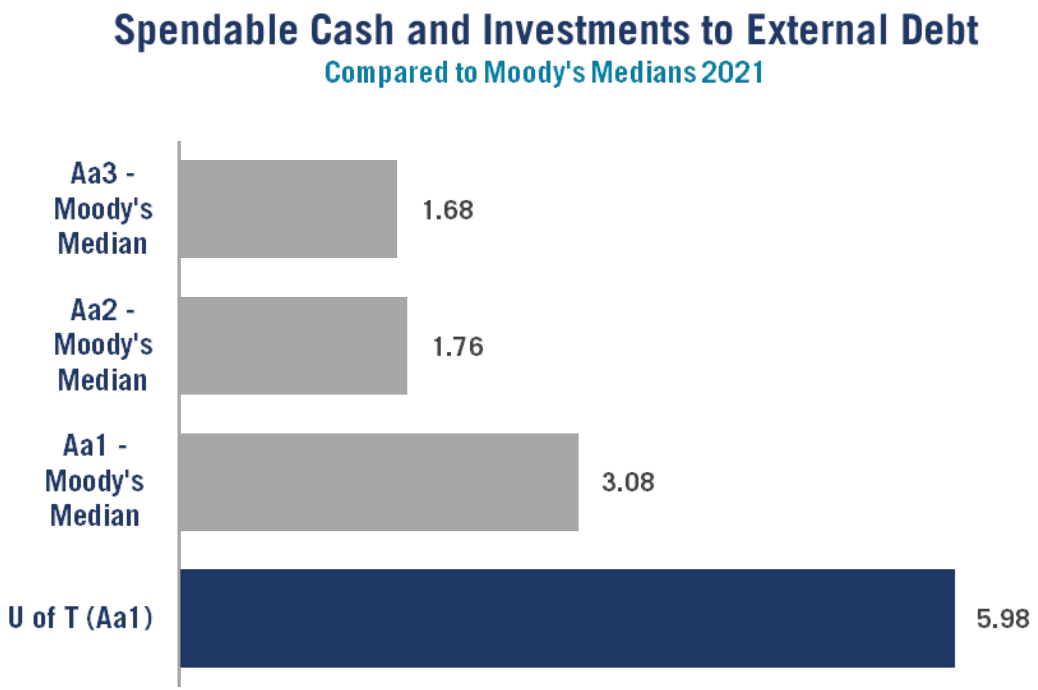
APPENDIX 2 - U of T's debt burden ratio is healthier than U.S. universities with similar credit ratings





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