FOR INFORMATION	PUBLIC	OPEN SESSION

TO: Business Board

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PRESENTER: Trevor Rodgers, Chief Financial Officer
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DATE: January 22, 2025 for January 29, 2025

AGENDA ITEM: 5

ITEM IDENTIFICATION:

Debt Strategy - Annual Review.

JURISDICTIONAL INFORMATION:

Pursuant to Section 5 (1.) (b.) of the Business Board Terms of Reference, the Business Board has responsibility for reviewing regular reports on matters affecting the finances of the University and on financial programs and transactions.

GOVERNANCE PATH:

1. **Business Board [For information] (January 29, 2025)**

PREVIOUS ACTION TAKEN:

The borrowing strategy was initially approved by Governing Council in June 2004. A revision of this debt strategy was approved in November 2012 followed by an amendment in April 2023. The latest annual review was presented on January 31, 2024.

HIGHLIGHTS:

The debt strategy approved by Business Board in November 2012 established a single debt policy limit including both internal and external debt, with fungibility between them. The debt policy limit amendment in April 2023 revised the maximum debt burden ratio (debt service cost divided by total expenditures) to 6% and introduced the recognition of indirect debt exposure into the debt limit. The 0.8 viability ratio (total expendable resources divided by total debt) taken into consideration in setting that debt policy limit remains unchanged. The purpose of this report is to assess the continued prudence and effectiveness of this debt strategy.

At April 30, 2024, the maximum 6% debt burden ratio resulted in a total debt policy limit of $2,949.9 million. The associated viability ratio with this debt policy limit was 2.1, which is higher (better) than the desired lower threshold of 0.8. Of the $2,949.9 million, $1,806.9 million is set to be issued from internal sources with the remaining $1,143.0 million to be obtained from external debt which includes indirect debt exposure of $32.2 million. We have assessed the financial health of the allocated projects funded via external partnerships and are not recommending any changes to the indirect debt provision at this time.

Actual outstanding debt at December 31, 2024 was $1,163.8 million, of which $443.7 million was internal and $720.1 million was external. At December 31, 2024, $1,875.5 million of borrowing room has been allocated to capital projects and other requirements that have been reviewed by the Business Board, leaving $1,074.4 million ($2,949.9 million less $1,875.5 million) for future debt to finance projects under active consideration but not yet brought forward to the Business Board for approval.

Future capital projects under consideration are projected to require approximately $1,442 million of borrowing room, inclusive of indirect debt exposure related to the Site 1 Gateway and Schwartz-Reisman Phase 2 projects. The future borrowing requirement of $1,442 million is $367.6 million above what is currently available for allocation in 2024-25. Timing, cost, and funding of outer year projects are reviewed and updated annually. If every project comes forward for approval as planned, total allocations will reach approximately $3.2 billion, with actual outstanding debt of $2.7 billion by 2029-30. Based on planned growth in the University's financial resources, the maximum debt policy limit, determined using a 6% debt burden ratio, is projected to grow by an additional $498 million to $3,448 million over the next five years to April 30, 2030, sufficient to meet the projected borrowing needs.

Our analys based on the current estimated timing of capital projects shows that the debt policy limit would deliver enough debt to support the University's capital needs. The mix of internal and external debt will be determined based on timing and availability of internal funds. Sensitivity analysis shows that further increases in interest rates or slower growth in University expenditures would negatively affect this projection and would lower the debt limit. There also remains significant uncertainty given construction cost inflation in the GTA.

Consistent with prior practise, we have continued to assume 6.0% cost of borrowing for future debt. The 6.0% assumption is 100 bps higher than recent comparable debt issuances by peer universities, building in a margin for future rate increases. If future borrowing costs are in the range of 5% to 7%, the debt limit will reach $3,258M to $3,688M by 2030. This assumes modest budget growth per the long-range plan to increase capacity for debt service. For each $10 million reduction in total expenditures, the debt policy limit would decline by $7 million on average annually over the next 5-year period.

To assess the prudence of the debt policy, the University benchmarks actual and planned external debt and key financial ratios to those of selected Canadian universities and to Moody's U.S. Public College and University Medians. Compared to selected Canadian universities at April 2024, U of T had lower debt service costs and higher expendable resource ratios than most of its peers. Compared to U.S. universities at April 2023, U of T had lower debt service cost and higher spendable cash and investments to debt than the median of universities with our same credit rating.

The current debt strategy has been in place for over ten years. This report on the functioning of the strategy demonstrates that, provided interest rates remain relatively stable and provided the University grows as expected, it will deliver sufficient debt capacity to meet the borrowing needs for the highest priority capital projects that are currently under active consideration. Inflation in the construction market and continuing high interest rates would put pressure on available borrowing capacity in the outer years of the plan.

In view of the above, and due to the potential pressure on available debt capacity for allocation from internal sources in future years, outer year capital plans are regularly updated and reviewed by the President and Provost in the context of the University's long range financial plan. A flexible multi-year capital plan allows the University to respond to changing circumstances by reviewing priorities and timing of planned projects.

FINANCIAL IMPLICATIONS:

None

RECOMMENDATION:

For information.

DOCUMENTATION PROVIDED:

- Debt Strategy Review at December 31, 2024 (Powerpoint presentation).

Annual Debt Strategy Review 2024-25

December 31, 2024

University of Toronto Financial Services

UNIVERSITY OF TORONTO

DEFY GRAVITY

Agenda

1. Baseline: Current Debt and Approved Allocations
2. Capital Plans and Future Borrowing Needs
3. Forecast: Financial Impact Assessment

1 | Baseline: Current Debt and Approved Allocations

Debt Policy Summary

Policy Limits

- Debt limit based on affordability, determined by a debt burden ratio of 6% of the University's consolidated expenses
- Limit can be moderated when necessary to reflect overall debt exposure based on a viability ratio of 0.8
- No more than 40% of expendable funds can be used for internal borrowing; current plan assumes no more than 25% of EFIP used for this purpose

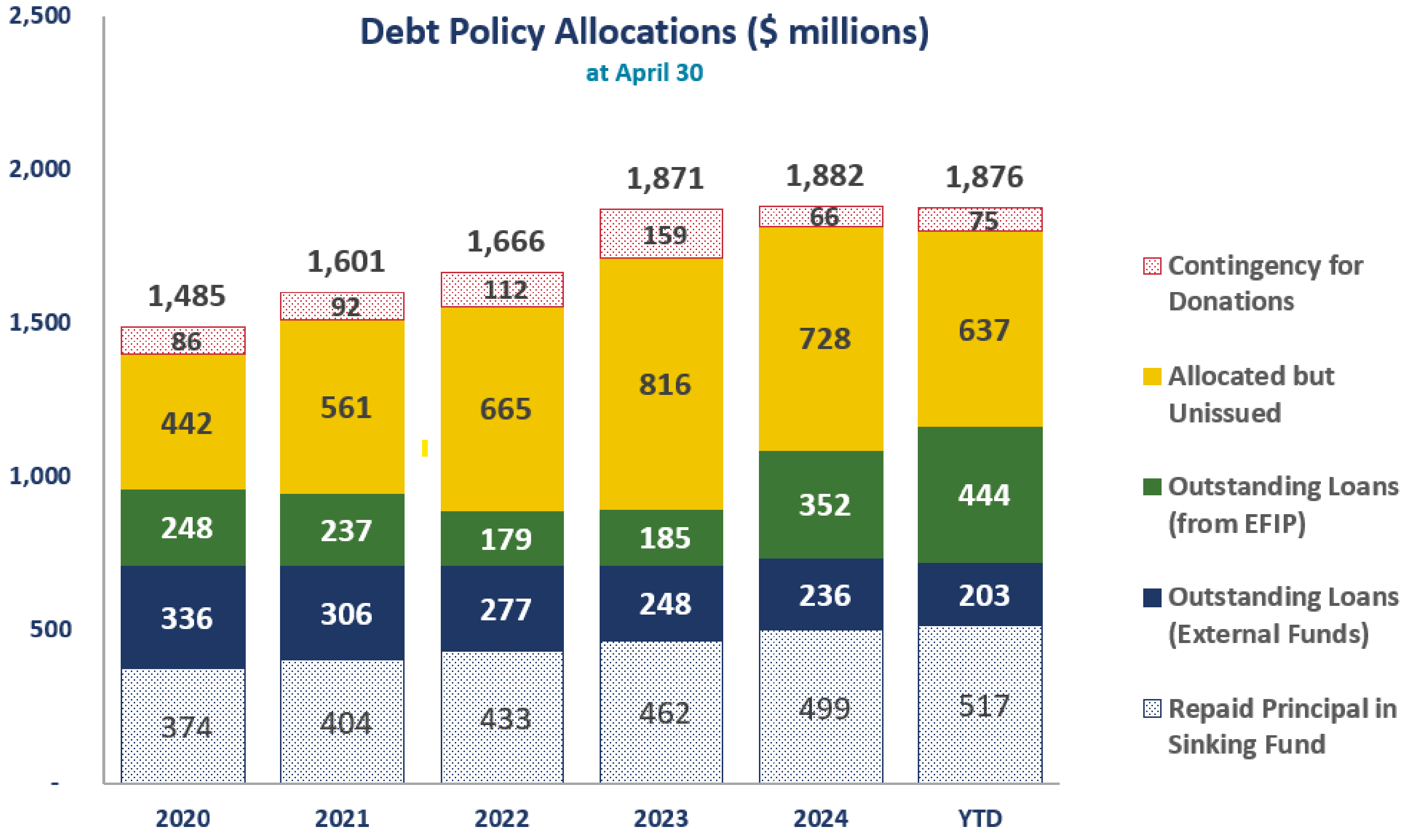
What is included?

- Direct external debt (funds borrowed from third party lenders, on balance sheet as long-term liabilities)
- Direct internal debt (funds borrowed from the Expendable Funds Investment Pool, on balance sheet as deficit in net assets)
- Indirect debt exposure through partnerships or joint venture arrangements (not on balance sheet, but potential for financial or reputational liability)
- Provision for donation targets, pledges, and capital grants not yet in hand
- Capital leases (currently nil)

What is excluded?

- Short-term construction financing arrangements using internal funds
- Short-term and medium-term fund deficits where there are approved plans to address shortfalls (e.g. in multi-year operating or ancillary budget plans)
- Balance in the voluntary sinking fund is not netted against outstanding debt and does not increase amount available for borrowing
- Long-term operating leases

Debt Allocations - History



- The Debt Policy limit includes current debt plus a provision for future borrowing. At April 30/24, the debt limit was set at $2,950 million based on a maximum 6% debt burden ratio.
- As of December 31, 2024, actual debt outstanding is $1,164 million, equivalent to a debt burden ratio of 2.4%. The associated viability ratio is 5.3x, which is above the minimum requirement of 0.8x. Both ratios indicate that the University's debt burden is prudently managed with a financially healthy position.
- The Business Board has approved $712 million of future borrowing for ongoing projects, bringing the total approved debt exposure to $1,876 million (gross of sinking fund and fundraising contingencies).

UNIVERSITY OF TORONTO

Current Debt Allocations (at Dec 31, 2024)

Outstanding Debt
$1,164M

Annual P&I
$92M

Outstanding External Loans $203M

Repaid Principal in Sinking Fund $517M

Outstanding Internal Loans from EFIP $444M

Future Allocations
$712M

Max P&I @6%
$55M

Approved Capital Projects $605M

Contingency for fundraising $75M

Indirect Debt Provision $32M

EXTERNAL DEBT ($720m)

- $710m in debentures issued 2001 to 2011 to finance 76 capital projects
- Fixed interest rates: 4.25% - 6.78%, maturity: 2031 to 2051
- Principal balance outstanding includes $193M in loans from debenture proceeds plus $10M construction financing drawdown for project LEAP
- Voluntary paid-up sinking fund: $691M, including $517M of repaid principal, plus a surplus net asset balance of approximately $174M

INTERNAL DEBT ($444m)

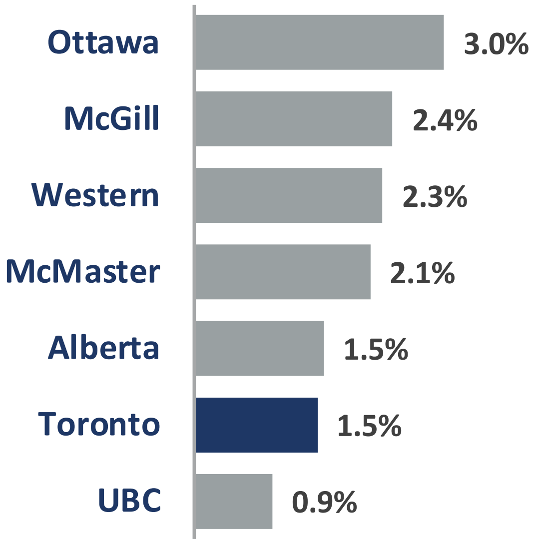
- 31 internal loans with $444M outstanding balances
- Average interest rate: 5.4% (all fixed); average term to maturity 15 years

FUTURE ALLOCATIONS ($712m)

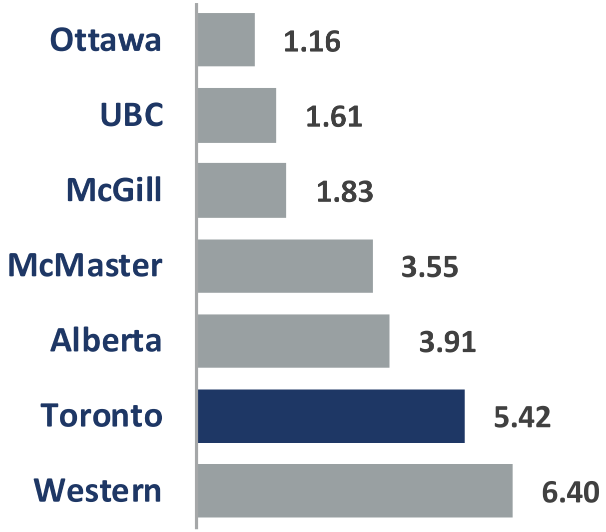
- 20 projects with previous Business Board approval for borrowing of $712M
- Includes $32M of indirect debt exposure from 2 joint venture partners
- Contingency of $75M for projects with donation targets and pledges
- Construction financing excluded until term loan issued & repayment begins

Benchmarking – Canadian Peers

Debt Burden Ratios Based on Actual External Debt Only
as at Balance Sheet Date 2024



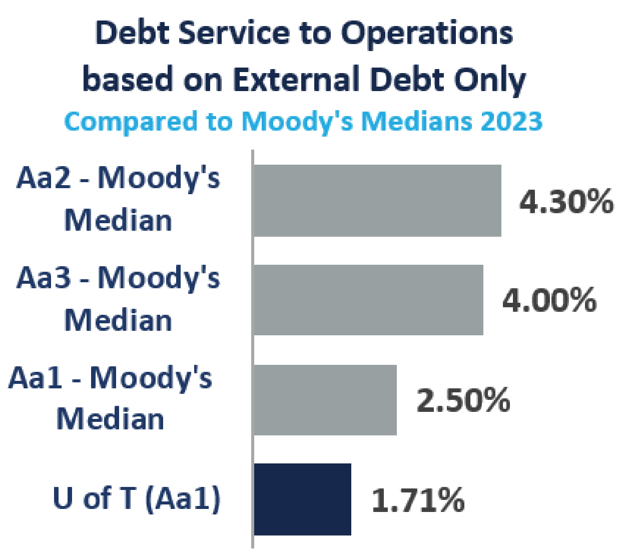
Viability Ratios Based on Actual External Debt Only
as at Balance Sheet Date 2024

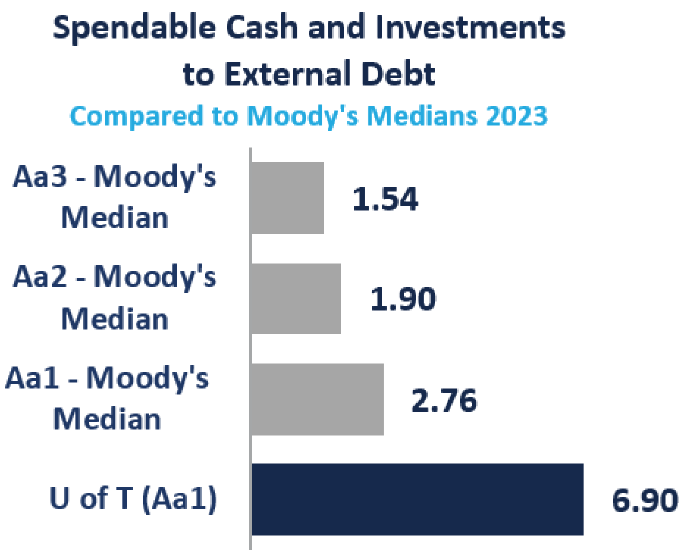


*Based on published financial statements, adjusted for comparability. Includes external debt only, as Information on internal debt is not publicly disclosed by all peers.
Portion of McGill's debt which is secured by the Government of Quebec is excluded.

- At April 2024, U of T's external debt burden ratio was below all selected peer universities, except for UBC.
- Canadian universities have increased their reliance on debt financing, while U of T has not issued significant external debt since 2011, which is reflected in these ratios.
- U of T also has a consistently higher ratio of expendable resources to external debt than most Canadian peers, except for Western University in 2024.

Benchmarking – Select US Peers





* Based on Moody's "U.S. Public College and University Medians (fiscal 2023)".
The University of Toronto is not included in this report.

- When comparing U of T to U.S. universities, we see that U of T's debt burden ratio is lower than universities with similar investment grade rating categories.
- Among US Peers, there are 15 universities at the Aa1 rating level, 32 universities at the Aa2 level, and 40 universities at the Aa3 level. At each rating level, the median university ratio is displayed. Only external debt is considered.

Credit Ratings comparison (as of January 2025)

- The University of Toronto continues to maintain excellent credit ratings in comparison to our peers. We are currently rated Aa1 by Moody's and AA+ by S&P, with stable outlook.
- The University of Toronto is rated 2 notches higher than the Province of Ontario.
- Credit rating agencies have noted recently that declining enrolment, including from international students, along with continued provincial tuition fee caps on domestic students, can have a negative impact to the credit rating outlook of Canadian universities.

University	Country	Moody's	S&P
Province of Ontario	Canada	Aa3	A+
University of Toronto	Canada	Aa1	AA+
Queen's University	Canada	-	AA+
University of Western Ontario	Canada	-	AA
McMaster University	Canada	-	AA
University of British Columbia	Canada	Aa1	AA-
University of Ottawa	Canada	Aa2	-
McGill University	Canada	Aa2	AA-
University of Washington	USA	Aaa	AA+
University of Pittsburgh	USA	Aa1	AA+
University of California	USA	Aa2	AA
Ohio State University	USA	Aa1	AA
University of Illinois	USA	Aa2	AA-
University of Minnesota	USA	Aa1	AA

2 | Capital Plans and Future Borrowing Needs

Capital investments over the next 5 years

$4.6B

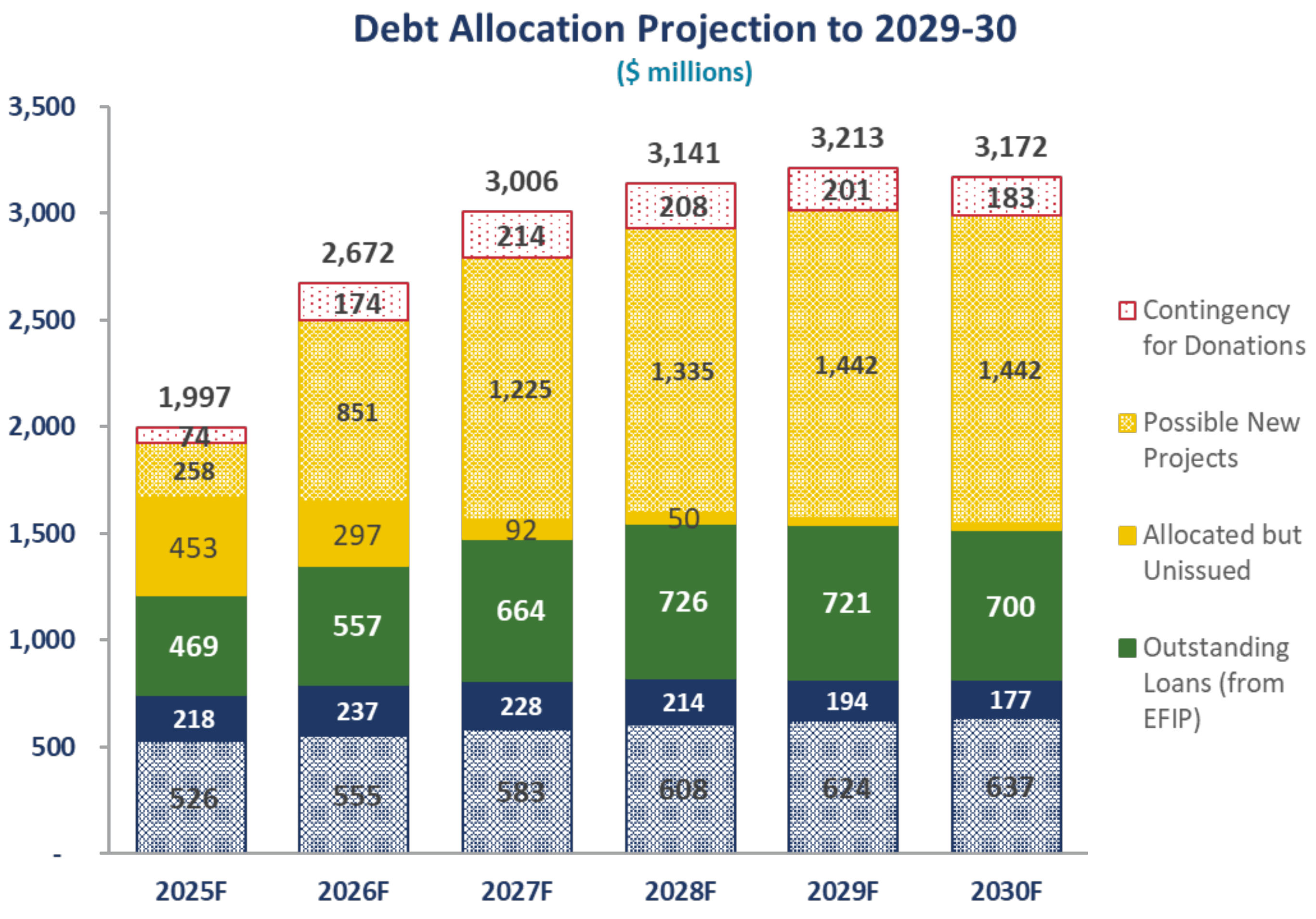
TOTAL SPEND

10% | Cash Reserves
30% | Future Cash Contributions
35% | Donations, Gov't, Partnerships
25% | Debt (internal & external)

Source: Planning and Budget (estimates as of January 2025)

- The University's debt strategy primarily supports its capital expansion program. In assessing the appropriateness of a debt strategy, we consider the need for debt together with the need to remain affordable, and for debt servicing to continue to be financially responsible and prudent.
- Rapid inflation on construction costs in recent years has increased the cost of many projects and requires an on-going careful review of priorities and timing of planned projects.

Future Borrowing Needs



- Possible new projects under consideration include assumptions of up to $1,442M of additional borrowing, including indirect debt.
- During the current fiscal year 2025, debt allocation is forecasted to increase from $1,876M currently to $1,997M primarily driven by an additional $250M debt for the Deferred Maintenance Program.
- Other significant new allocations over the 5-year period include $761M for projects under Four Corners and $430M for Academic projects. Timing, cost, and funding of outer year projects are reviewed and updated annually.
- If <u>every project comes forward</u> for approval as planned, total allocations will reach $3,172M, with expected outstanding issued debt of $2,698M by 2029-30. The mix of internal and external debt will be determined based on timing and availability of internal funds.

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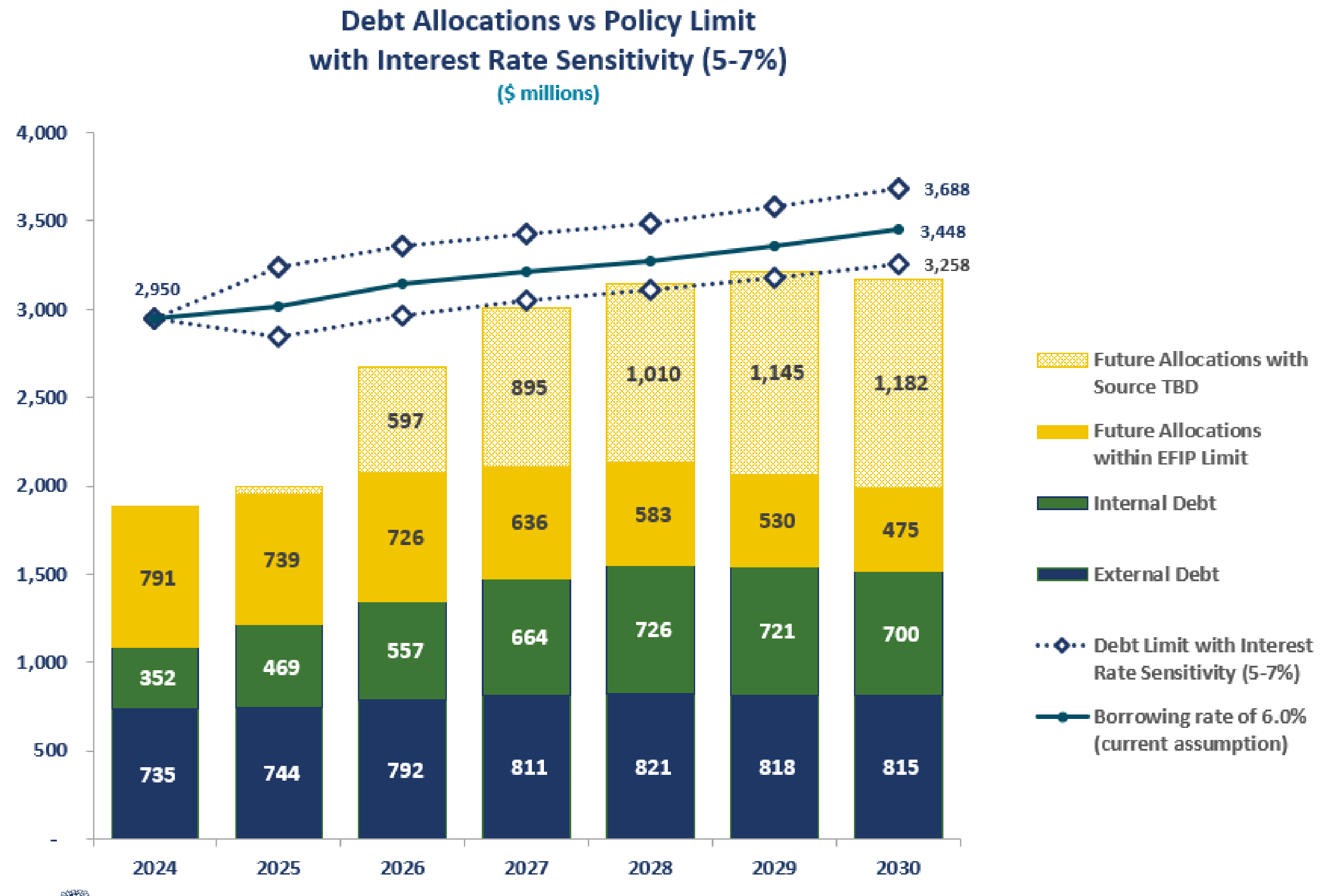
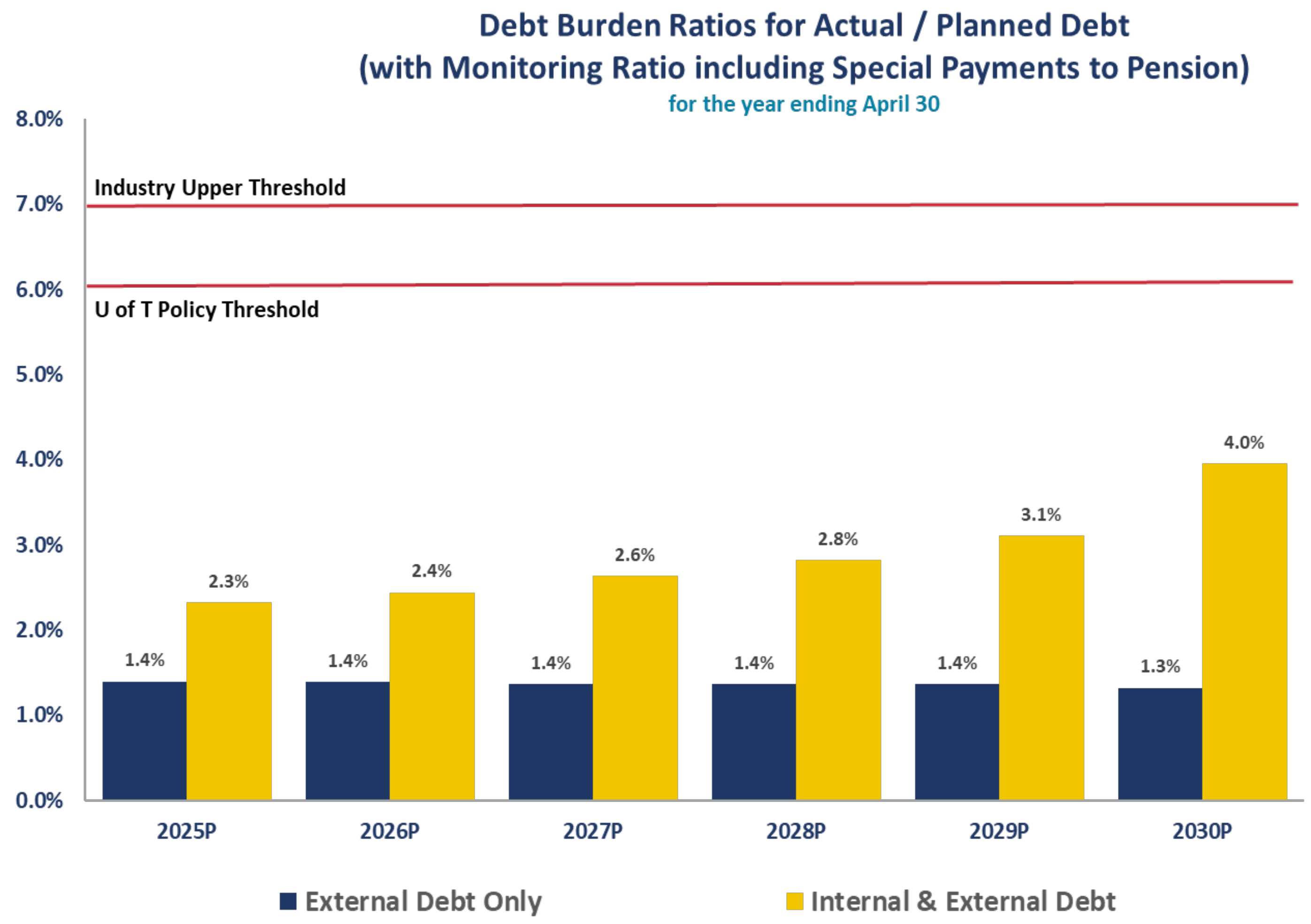
Policy Limit vs Borrowing Needs



- The University's maximum affordable debt burden is assumed to grow from $2,950M to $3,448M by 2030, based on budget growth per the long-range plan.
- A sensitivity analysis shows the 2030 debt limit would be in the range of $3,258M to $3,688M based on borrowing costs between 5% and 7%. For each $10M reduction in total expenditures, the debt policy limit would decline by approximately $7M.
- The rate of growth in EFIP is expected to moderate with inflationary pressures and capital expenditures, flattening the amount of internal financing available.
- Although the debt policy delivers enough capacity to support the University's capital needs over the next five years, there may be a need to increase the proportion of EFIP allocated to internal borrowing.
- Given the large surplus in the Sinking Fund net asset balance, the University is considering the option to draw down a small portion of this liquidity for other priorities.

3 | Assessing Financial Impact

Debt Affordability – Income Statement Approach



- The debt strategy sets the acceptable debt burden ratio (P&I / total expenditures) at 6%, including a provision for debt service on borrowing that has been approved but not issued.
- Based on projected expenditures and debt service costs, including actual debt issued, planned debt on approved projects, and future capital project assumptions, the projected debt burden ratios may increase to 4.0% but will remain below the 6% policy limit.

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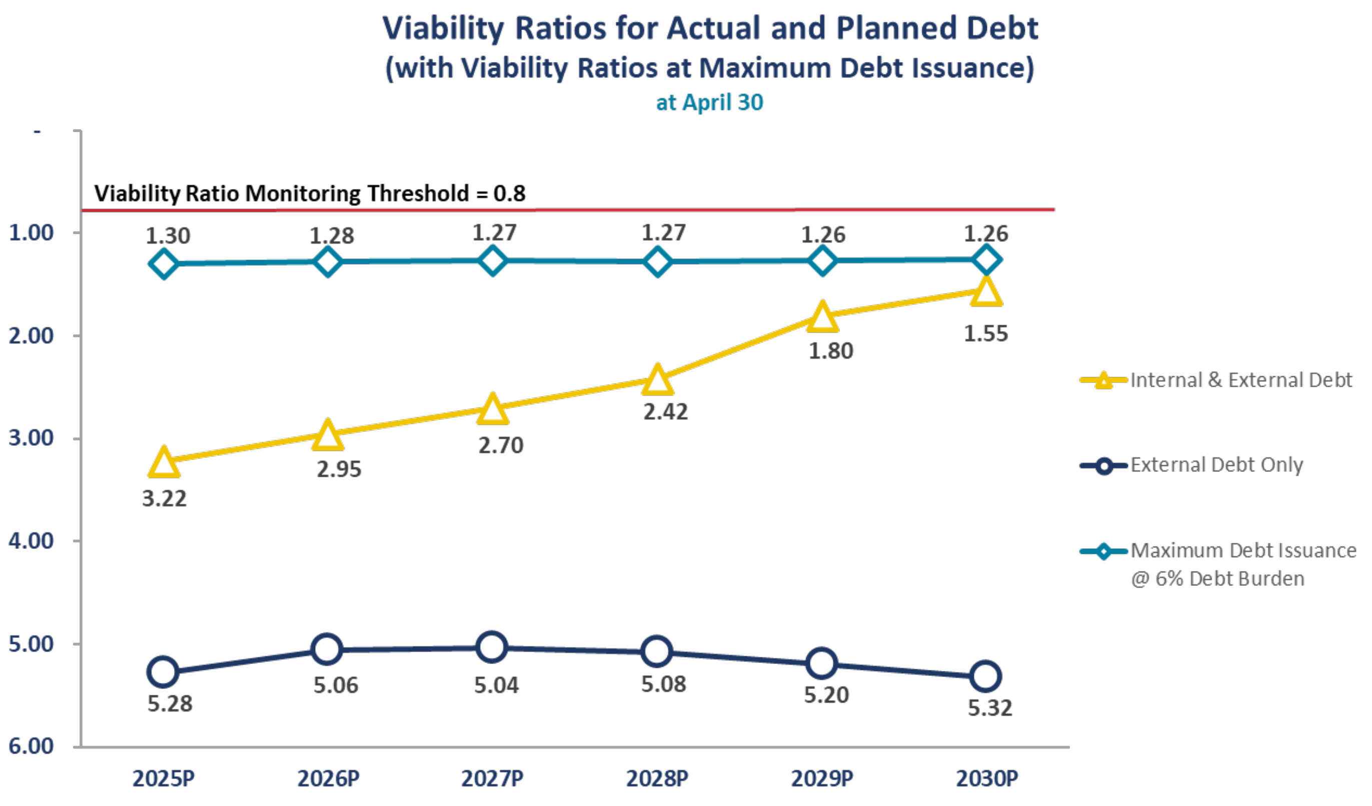
Debt Capacity – Balance Sheet Approach



- Debt capacity is the amount that can be borrowed based on the expendable funds available to repay. It is measured via the viability ratio (expendable resources / debt). The debt strategy identifies a viability ratio of 0.8 as a lower threshold that balances our financial, operating, and capital expansion objectives.

- The viability ratio for actual and planned debt is expected to be better than the threshold of 0.8 for all the years being forecasted. Therefore, we do not anticipate a need to adjust the debt limit based on overall capacity.

MCU Financial Accountability Framework (Actuals and Projections)

MCU Financial Accountability Framework

Sustainability	2023A	2024A	2025F	2026F	2027F	2028F	2029F	2030F
Viability Ratio	4.6	5.0	4.8	4.6	4.6	4.7	4.8	4.9
Debt Ratio	25%	24%	24%	24%	25%	25%	25%	26%
Debt to Revenue Ratio	17%	15%	15%	16%	17%	16%	16%	15%
Interest Burden Ratio	1.1%	1.0%	0.9%	0.9%	0.9%	0.9%	0.9%	0.9%

* Refer to Appendix for details of MCU risk metric definitions and thresholds

- The MCU Framework considers only external debt, and therefore excludes the portion of debt funded internally from our expendable funds.
- The MCU sustainability ratios for the next 5 years are projected to remain in the low-risk "green" category.

Conclusion

- The current debt policy provides sufficient borrowing room for the highest priority capital projects under active consideration. However, inflation in the construction market and continuing high interest rates would put pressure on available borrowing capacity in the outer years of the plan.
- An increase in the debt limit is predicated on planned growth in the operating budget, providing greater capacity for debt service.
- Outer year capital plans are regularly updated and reviewed by the President and Provost in the context of the University's long range financial plan. A flexible multi-year capital plan allows the University to respond to changing circumstances by reviewing priorities and timing of planned projects.

A | Appendices

UNIVERSITY OF TORONTO

DEFY GRAVITY

Appendix: Definitions used for Debt Policy Limit

- **Debt** includes all long-term external and internal borrowed funds obtained by any means (e.g. debentures, bank loans) and excludes letters and lines of credit and all short-term and medium-term internal financing for purposes such as construction financing and fund deficits.
- **Indirect Debt** includes off-balance sheet debt such as long-term debt obtained through a limited partnership arrangement that is not recorded in the University's balance sheet but exposes the University to a potential financial liability.
- **Debt burden ratio**, key determinant of debt policy limit, equals interest plus principal divided by total expenditures.
- **Debt policy limit** is the maximum debt that can be taken on based on a debt burden ratio of 6%.
- **Viability ratio**, be taken into consideration in setting debt policy limit, equals expendable resources divided by external debt as per policy. The debt strategy has set a preference of a viability ratio of 0.8 or greater.
- **Allocations** are all borrowings approved by Business Board, including indirect debt plus contingency for donations pledges.
- **Actual debt outstanding** is the sum of actual internal loans issued, actual external debt issuance and indirect debt.

Appendix: Provincial MCU Risk Metric Thresholds

University Financial Accountability Framework: Technical Manual		
Date: 2023-09-20	Version: 1.1	

Category	Metric	Metric Definition	Metric Scale From Left To Right	Medium Threshold More ← Favorable	High Threshold Less Favorable →
LIQUIDITY	Primary reserve days	(Expendable net assets / Total expenses) x 365 days	Descending	90 days	30 days
	Working capital ratio	Current assets / Current liabilities	Descending	1.25	1
SUSTAINABILITY	Viability ratio	Expendable net assets / Long-term debt	Descending	60%	30%
	Debt ratio	Total liabilities less deferred capital contribution / Total assets	Ascending	35%	55%
	Debt to revenue ratio	Long-term debt / Total revenue	Ascending	35%	50%
	Interest burden ratio	Interest expense / Total expenses less amortization	Ascending	2.0%	4.0%
PERFORMANCE	Surplus (deficit) ratio	Surplus (deficit) / Total revenue	Descending	1.5%	0%
	Net operating revenues ratio	Cash flow from operations / Total revenues	Descending	7%	2%