



University of Toronto

OFFICE OF THE VICE-PRESIDENT, BUSINESS AFFAIRS - FINANCE

TO: Business Board

SPONSOR: Sheila Brown, Chief Financial Officer

CONTACT INFO: 416-978-2065, sheila.brown@utoronto.ca

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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. Reviews of that Borrowing Strategy were presented to the Business Board on January 15, 2007 and February 4, 2008 which concluded that no change was needed. Regular updates of the borrowing status have been provided to the Board, most recently on December 15, 2008.

HIGHLIGHTS:

The current borrowing strategy is financially prudent and provides sufficient capability to meet key priorities for the next several years. It is projected to enable additional borrowing of \$121 million to \$218 million (after taking into account principal repayments of \$103 million on amortizing loans and EFIP loans) by April 30, 2013 over and above the \$920 million allocated by Business Board to January 31, 2009 under current accounting rules.

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.

The borrowing strategy review asked:

- What is the current status?
- How do we compare to others?
- Where are we going? Will this strategy meet our priority needs?
- Should we add credit rating parameters to our strategy?
- Should we add debt service or debt repayment parameters to our strategy?

Current status

This borrowing strategy currently provides for maximum external plus internal borrowing capacity of \$948.0 million at April 30, 2008, of which \$919.8 million has been allocated by Business Board to projects to January 31, 2009. Actual external borrowing at April 30, 2008 was \$556.3 million (excluding \$2.3 million to be repaid to lenders during 2008-09). Actual internal borrowing to January 31, 2009 was \$148.2 million.

Benchmarking

We compared the University of Toronto to selected Moody's U.S. Public College and University Medians 2008, with respect to our external borrowing:

- + Actual debt per student of \$8,963 was well below medians.
- + Actual debt to total revenue of 28.7% was well below medians.
- + Actual debt service to operations (expense) of 1.9% was below medians.
- + Total resources to long-term debt of 3.71 was similar to medians.
- Unrestricted resources to long-term debt of 0.34 was below medians.
- Expendable resources to long-term debt of 1.09 was well below medians.
- Unrestricted resources to expenses of 0.11 was well below medians.
- Expendable resources to expenses of 0.34 was well below medians.

Conclusion: to date we have borrowed externally less than our rating peers, but we also have fewer resources to support debt issuance, and we have internal debt.

Projecting maximum borrowing capacity

Net assets increase due to 1) net income (revenues minus expenses) for the year mainly from operating and restricted funds, and 2) growth in endowment, including endowed donations and grants and reinvested investment earnings, offset by 3) the changes in the fair value of interest rate swap contracts. The following table summarizes current projections as compared to last year's projections:

| Projected maximum total borrowing capacity ranges (in millions) | | | | |
|--|----------------------|---------|---------------------|---------|
| | December 2007 Review | | January 2009 Review | |
| | LOW | HIGH | LOW | HIGH |
| April 30, 2009 | 1,013.2 | 1,050.8 | 973.7 | 973.7 |
| April 30, 2010 | 1,075.7 | 1,146.8 | 983.6 | 998.0 |
| April 30, 2011 | 1,124.3 | 1,245.4 | 987.1 | 1,014.0 |
| April 30, 2012 | 1,156.6 | 1,343.4 | 962.4 | 1,018.3 |
| April 30, 2013 | | | 938.2 | 1,035.2 |

Current projected maximum borrowing capacity is lower than last year's projection, mainly due to lower investment returns on endowments for the fiscal years 2007-08 (loss of 2% compared to an income of 7%) and 2008-09 (forecasted 20% loss compared to 7% income). Divisional and central carry forwards are now expected to be lower than previously projected resulting in lower net income.

Reduction in maximum borrowing capacity and availability was projected as follows:

- Net assets are projected to be between \$1.9 billion and \$2.4 billion by 2013 under current accounting rules, reflecting the long-term operating budget, ancillary long-term budgets, projections of donations, other receipts, and capital expenditures and under several investment return scenarios.
- Maximum external borrowing capacity is projected to be between \$738 million and \$835 million by 2013 at 40% of those results averaged over 5 years.
- The continuing use of \$200 million of EFIP funds is being confirmed.
- About \$103 million in amortizing loan (bank loans, EFIP) repayments and adjustments is expected to be available for reallocation by 2013.

Assuming these projections are reasonable, we would expect between \$0.9 billion and \$1.0 billion available borrowing by 2013 under current accounting rules. This is about \$121 million to \$218 million more than the \$920 million allocated to January 31, 2009 by the Business Board. Please note that for every 1% decline in the 2009 investment return, the maximum borrowing capacity will be reduced for \$10 million.

In addition, apart from the uncertainties contained in the assumptions used to project net assets, there is a risk that the accounting rules, particularly with respect to unfunded employee future benefits, could change in future, negatively affecting net assets.

Conclusion: although the current strategy will constrain our ability to provide the necessary capacity to satisfy graduate and medical enrolment expansion needs with room for other academic priorities over the next few years, we recommend no change to the current strategy for determining maximum borrowing capacity as it is a financially prudent strategy.

Credit ratings

The purpose of credit ratings is to give investors an assessment of a borrower's ability to repay debt.

U of T credit ratings are Aal (Moody's), AA (S&P) and AA (DBRS). U of T has ratings higher than those of most of our peers.

Credit ratings are refreshed at least annually by the rating agencies, and may be changed at any time for many reasons including student demand, government policy and funding, debt per student, levels of unrestricted resources, investment performance and quality of management.

Conclusion: since credit ratings reflect financial health, levels of borrowing and the other factors noted above, no minimum credit rating parameters are considered necessary, and no change in strategy is recommended.

Debt service and debt repayment

How much do we want to spend ON the classroom and other facilities rather than IN the classroom?
The following constraints guide our ability to service and repay debt:

- Interest rates are FIXED.
- Allocation of borrowing to any particular project continues to be dependent on the ability of that particular project or division to service the debt and repay the borrowing with low risk of default.
- The internal financing program requires regular principal and interest payments at specified interest rates that are linked to market rates.

- The long-term borrowing pool, an internal sinking fund, accumulates funds for repayment of debentures at maturity.

At April 30, 2008, interest expense as a percent of operations, as defined by Moody's, was 1.7%, well below Moody's medians. Interest expense was 1.7% of total revenues, allocated as follows: 1.0% of operating fund revenues and 13.7% of ancillary revenues.

To January 31, 2009 actual and projected interest plus principal repayments on allocated borrowing of \$920 million were \$75.9 million annually and represented 3.6% (\$50.1 million) of the 2008 operating revenues and 19.3% (\$25.8 million) of the 2008 ancillary revenues.

Conclusion: The debt service ratios are well below Moody's medians. Debt service and debt repayment load on a particular division or project is subject to the internal financial parameters outlined above. Therefore, no overall debt service or debt repayment parameters are considered necessary and no change to the current strategy is recommended. Continued careful review of each new project is important to the continued prudence of this approach.

Overall Conclusion

In conclusion, the current borrowing strategy, as approved by the Business Board in June 2004, continues to be financially prudent, but its projected borrowing capacity is expected to constrain our ability to satisfy graduate and medical enrolment expansion needs with room for other academic priorities over the next several years:

- This strategy should continue to provide debt capacity only for key priorities while maintaining a prudent approach to debt.
- Ability to pay is assessed on a project by project basis.
- A comprehensive and disciplined internal financial program requires regular principal and interest payments for each project at fixed interest rates linked to market rates.
- An internal sinking fund to accumulate the principal repayments collected through the internal financing program to repay the debentures.
- Interest rates are fixed. Debt service and repayment allocations are a reasonable proportion of total revenues and expenses.
- The discipline that this strategy represents has been well received by the lending community based on our selected enquiries.

We will continue to update the maximum external borrowing capacity annually in June, once the net assets for the year are finalized, and will report it to the Business Board at that time.

To facilitate planning, we expect to allocate borrowing based on projected borrowing capacity as contained in this report, to be updated annually during the Fall. This will enable planning to continue at an appropriate pace. However, such projects will only be executed (including awarding of contracts and actual construction) after the necessary maximum borrowing capacity to permit the borrowing to occur has been reached through the achievement of the required net assets level.

FINANCIAL AND/OR PLANNING IMPLICATIONS: Enables a continuation of capital investment on key priorities.

RECOMMENDATION:

For information.