EXCERPT FROM REPORT NUMBER 172 OF THE BUSINESS BOARD – February 11, 2009

THE FOLLOWING ITEM CONTAINS A RECOMMENDATION TO THE GOVERNING COUNCIL FOR APPROVAL.

2. Borrowing

(a) Status Report to January 31, 2009

Ms Brown noted that the Status Report on Borrowing was a regular item on the Board's agenda, which was usually a consent item. However it did at this time provide a very useful introduction to the broader consideration of borrowing on the Board's agenda. The Borrowing Strategy had been approved by the Governing Council on the Board's recommendation in 2004. It had been well received by the lending community because of its discipline in limiting external borrowing to a maximum of 40% of the amount of the University's net assets averaged over the previous five years.

- **Borrowing capacity**. The maximum external borrowing capacity for the 2008-09 year was $748-million. To that was added the $200-million of internal borrowing capacity, whereby loans were made from the University's cash, which was held in the Expendable Funds Investment Pool (EFIP). Therefore, the maximum borrowing capacity – from both external and internal sources was $948-million.

- **Borrowing allocated to projects**. The Board had to date approved the allocation of borrowing to projects amounting to $920-million. It was possible to subtract from that number the principal amount of some of the loans that had been repaid, of $36.5-million. That money could be loaned again. Repayment of the principal of loans that had been made with external debenture borrowing could not be loaned again; it had to be held and invested to enable the University to repay its lenders when its "bullet" debentures became due, which would begin in 2031. The result was the total of borrowing that had been allocated, net of repayments that could be reallocated, amounting to $883-million.

- **Spending of borrowing allocations**. The total of borrowing that had been allocated, net of repayments that could be reallocated, did not necessarily represent money that had already been spent. There was a substantial process and time period that followed approval of a project and the allocation of a loan from external borrowing. That process included design and the various phases of construction. The actual process of using borrowing for a project followed a standard pattern. Costs were paid first from monies on hand. When those monies ran out, short-term construction financing was provided through EFIP. When the projects were completed, a long-term loan was provided for the project.

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2. Borrowing (Cont'd)

(a) Status Report to January 31, 2009 (Cont'd)

- **Actual borrowing arranged**. External borrowing of $556-million was currently outstanding. That included the proceeds of the four "bullet" debenture issues. While regular interest payments were made on the debentures, the entire amount of the principal of each debenture would become due upon its maturity. The first would come due in 2031. The total loan amount also included various smaller loans taken out for the construction of individual projects, primarily student residences and parking garages, before 2001. The total of the individual loans amounted to $46.3-million as at April 30, 2008, and that number declined as both principal and interest payments were made on each loan. In addition, $148-million of loans were outstanding from internal sources as at January 31, 2009. Therefore actual outstanding borrowing totaled $704.6-million ($556.3-million + 148.2-million).

(b) Borrowing Strategy Review, January 2009

Ms Brown said that a review had been completed of the Borrowing Strategy, which had been approved by the Governing Council in 2004. The review asked two questions. First, was the strategy still a prudent one? Second, what would it likely be able to deliver to the University going forward?

- **Prudence of the borrowing strategy: Borrowing limit of 40% of net assets averaged over five years**. To consider the question of the prudence of its borrowing strategy, the University compared its position to that of its peers, using a survey of U.S. public universities and colleges prepared by Moody's Investor Services. The comparison was made with other institutions with AAA and AA credit ratings. That comparison showed that the University of Toronto had less external borrowing than most of its peers, but it also had a slightly lower level of resources to repay its borrowing. The University's position in that survey had remained quite stable over the years. While the University enjoyed a strong credit rating, it had decided that it would not be appropriate to use its credit rating as a criterion for its borrowing strategy. The credit-rating agencies could change their criteria at any time, and the University could exercise no control over such changes. Therefore, the University did consider the matter of its credit rating. It was pleased that it was so highly rated since the rating affected external rates that could be obtained on borrowing. However, the borrowing strategy itself did not include credit rating specifications.

- **Prudence of the borrowing strategy: Debt service capacity**. In considering the amount of debt that should be incurred to finance capital projects and property acquisitions, the University had to decide what portion of its income it should spend on acquiring

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2. **Borrowing** (Cont'd)

(b) **Borrowing Strategy Review, January 2009** (Cont'd)

classrooms as compared to activities in the classrooms. To make that decision in practical terms, it looked at the question of repayment capacity on a project-by-project basis. The University would assign borrowing capacity only to good prospects – i.e. to those divisions that would, in all likelihood, have the ability to repay their loans.

- **Prudence of the borrowing strategy: Conclusion**. Ms Brown said that she had concluded that the borrowing strategy continued to be a prudent one and a reasonable one, even in the current difficult economic period. It had received good reviews from the lending community and from the rating agencies, who approved of the disciplined borrowing limit and of the reasoning behind it.

- **Borrowing capacity going forward**. To answer the second question – what would the strategy be able to deliver – the University had to project the amount of its net assets going forward. It did so to the end of its long-term budget period – a five year rolling period, with one year being dropped and one year added each year. It was possible to obtain some sense of the University's likely assets for the next periods. To do so, Ms Brown projected scenarios of different investment returns going forward. If the financial markets were to have a reasonable recovery over the next five years, the University's borrowing capacity would grow, although not by a great deal. If, on the other had, there were to be no significant recovery, the borrowing capacity would decline. For April 2009, if the 20% decline in the Long-Term Capital Appreciation Pool used in the financial forecast were to be the outcome, the maximum borrowing capacity, combining both the external borrowing capacity and the $200-million internal borrowing capacity, was projected to be $974-million, a modest increase from the current $948-million. (While the reduced net assets for 2008-09 would figure into the calculation, the still lower net assets for 2003-04 would be dropped.) If, on the other hand, the L.T.CAP were to lose 30%, then borrowing capacity was projected to grow only to $958-million from the current $948-million. If actual external borrowing came to exceed the 40% limit, the policy rule required that there be no further borrowing until external borrowing declined to a maximum of 33⅓% of net assets. Ms Brown concluded that the rule would protect the University's financial viability, and that the borrowing strategy left the University in a reasonable position, even in the current difficult environment.

- **Internal borrowing** was also reviewed each year. Ms Brown examined the size of the Expendable Funds Investment Pool and the cash forecast for the year to determine whether the Pool would be able to continue to supply internal loans up to $200-million. At the present time, about $148-million of loans were outstanding from the Pool. If it

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2. Borrowing (Cont'd)

(b) Borrowing Strategy Review, January 2009 (Cont'd)

proved necessary, the approved strategy provided for the University to borrow further externally to meet the cash needs of the Pool. Ms Brown was, however, comfortable that there was currently sufficient liquidity left in the Pool with internal loans of up to the $200-million limit.

(c) Borrowing Authorization

Ms Brown proposed approval of a detailed resolution to authorize the University to borrow a further $200-million. She had been reviewing the market and had concluded that the timing was not opportune to use that authority in the immediate future. She would prefer hopefully a tighter spread between the rate at which the University might borrow and the federal government bond rate for loans of the same length. Therefore, she would likely continue to issue loans to projects from the internal source - the Expendable Funds Investment Pool (EFIP) - beyond the maximum of $200-million, with those loans being financed by the proposed external borrowing at a later date, when the proposed borrowing was actually executed. External borrowing currently stood at $556-million, with the current maximum being $748-million. It was projected that the maximum, being 40% of net assets over five years, would increase to $758-million at the end of the current fiscal year. The round number of $200-million could therefore be accommodated within the borrowing strategy limit. Ms Brown stressed that the borrowing of the amount had in fact been authorized by the Governing Council's approval of the borrowing strategy. The complex resolution currently before the Board was required by the lenders to execute the proposed transaction(s). Ms Brown noted that she would implement the proposed new borrowing either in full or in two or more parts, depending on the markets.

Among the matters that arose in discussion were the following.

(i) Timing of new long-term borrowing. Two members noted that interest rates were now as low as they had been in some time. While it was true that spreads between government and other rates were very high, it appeared from recent evidence that the spreads might increase, given the high interest rates banks had to pay in order to obtain money to lend. Ms Brown replied that the University's average rate on its debenture issues was a very advantageous one for 30-year and 40-year loans. For its Series "D" debenture, the rate of 4.49% was less than 60 basis points above the rate for comparable-term Government of Canada bonds (one basis point is 1/100 of 1%). She hoped that it would not be necessary to borrow at rates that reflected the current high spreads in the market. A member observed that if rate spreads followed the usual pattern after a recession, they would with economic recovery decline substantially from their current very high levels. Rate spreads were currently higher than at any time since the Great Depression of the 1930s.

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2. Borrowing (Cont'd)

(c) Borrowing Authorization (Cont'd)

(ii) Risk of a reduction in the maximum permissible long-term borrowing. Two members noted that long-term borrowing capacity was defined as 40% of the University's net assets over the past five years, and they were concerned that the limit was likely to fall in the light of the current developments that were reducing the value of the University's net assets. While a limit based on assets was useful when those assets were increasing in value, it was a cause for concern when the value of assets was declining. One member was concerned that the borrowing also did not take into account the more general decline in the University's financial situation arising from the forecasted deficit on the current year's operations. Ms Brown replied that she had completed modeling work that showed that borrowing capacity would not likely be constrained unless there was no substantial recovery over the next five years. She recalled that if the borrowing should come to exceed the maximum, the borrowing strategy required that there be no further borrowing until the proportion of borrowing declined to one third of net assets. The operating deficit did not require any borrowing. It was financed from the Expendable Funds Investment Pool. The balance in the EFIP generally varied between $350-million and $800-million, depending on the time of year. The Pool contained money that had been allocated but not yet spent during the current fiscal year, the carry-forward of unspent appropriations from the previous fiscal year, departments' unspent but expendable trust funds, unspent research grants, and funds allocated but not yet spent for capital projects. The Chair noted that the greatest risk to the University's net assets would be a continuation of the reduced value of the endowment funds over the next few years. Another member agreed, but he noted that the value of the assets would also increase with the growth of the Long-Term Borrowing Pool – the sinking fund used to accumulate the principal being repaid by the divisions for their capital projects (for loans supplied from external borrowing). In addition, the calculation of assets and net assets did not take into account the market value of the University's real estate, which would be an amount of some billions of dollars.

(iii) Risk with respect to maximum of internal loans. A member referred to Ms Brown's statement that she intended to rely more on internal loans while awaiting the reduction of rate spreads to return to the market for long-term borrowing, using the proposed authority. The member asked when spending on capital projects might force external borrowing. Ms Brown replied that she did not anticipate the need for some time.

On the recommendation of the Vice-President, Business Affairs,

YOUR BOARD RECOMMENDS

(a) THAT the University be authorized to borrow such amount, not exceeding $200 million, as may be determined by the senior officer of the University responsible for financial matters, as so designated by the

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2. **Borrowing** (Cont'd)

(c) **Borrowing Authorization** (Cont'd)

President, in addition to the $160 million approved by the Business Board on January 15, 2001, the $200 million approved by the Governing Council on June 26, 2003 and the $150 million approved by the Governing Council on June 24, 2004;

(b) THAT such senior officer responsible for financial matters be authorized to determine, in consultation with the University financial advisor, the most appropriate financing structure for this borrowing, including without limitation, by way of private debt placement, a public debenture issue, syndicated bank financing, or securitization and to negotiate, approve and execute and deliver for and on behalf of and in the name of the University, all agreements, documents, certificates and instruments, including without limitation any underwriting or agency agreement and any offering document, and to take all such other actions as such officer may determine to be necessary or desirable to give effect to such financing and offering of debt securities, the execution and delivery of any such agreements, documents, certificates or instruments, and the taking of such actions being conclusive evidence of such determination;

(c) THAT such senior officer responsible for financial matters is further authorized to authorize any other officer of the University to execute and deliver, for and on behalf of and in the name of the University, such certificates, documents and instruments as may be contemplated by the principal agreements entered into with respect to such debt offering or as may be required in connection with the closing of the offering of debt securities authorized hereby;

(d) THAT the borrowed funds be added to the Long-Term Borrowing Pool and invested by University of Toronto Asset Management Corporation until the funds are required for each project;

(e) THAT the senior officer of the University responsible for financial matters be authorized to allocate borrowing as internal financing for spending that has been approved by the Business Board or is within the approval authority of the administration;

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2. Borrowing (Cont'd)

(c) Borrowing Authorization (Cont'd)

(f) THAT principal and interest repayments related to debenture borrowing be placed in the Long-Term Borrowing Pool, or other sinking fund mechanism, and, together with investment income, be used to pay periodic interest payments to lenders, to pay issue and ongoing administrative costs, with the expectation that the net sum from these additions and draw downs will be sufficient to repay the bullet debentures at maturity; and

(g) THAT the senior officer of the University responsible for financial matters report periodically to the Business Board on the status of the Long-Term Borrowing Pool.

______________________ Secretary

_________________________ Chair

February 24, 2009