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UNIVERSITY OF TORONTO

THE GOVERNING COUNCIL

REPORT NUMBER 172 OF THE BUSINESS BOARD

February 11, 2009

To the Governing Council,
University of Toronto.

Your Board reports that it met on Wednesday, February 11, 2000 at 5:00 p.m. in the Council Chamber, Simcoe Hall, with the following members present:

Mr. Richard Nunn, (In the Chair)
Mr. Geoffrey Matus, Vice-Chair
Ms Catherine J. Riggall, Vice-President, Business Affairs
Professor Angela Hildyard, Vice-President, Human Resources and Equity
Ms Mary Anne Elliott
Ms Paulette L. Kennedy
Dr. Joel A. Kirsh
Ms Anna Okorokov
Mr. David Oxtoby
Ms Jennifer Riel
Mr. Stephen C. Smith
Mr. John Varghese
Ms B. Elizabeth Vosburgh

Professor Cheryl Misak, Vice-President and Provost
Mr. David Palmer, Vice-President, Advancement
Ms Judith Wolfson, Vice-President, University Relations
Ms Sheila Brown, Chief Financial Officer
Mr. Louis R. Charpentier, Secretary of the Governing Council
Ms Christina Sass-Kortsak, Assistant Vice-President, Human Resources
Mr. Nadeem Shabbar, Chief Real Estate Officer
Ms Elizabeth Sisam, Assistant Vice-President, Campus and Facilities Planning
Mr. Ron Swail, Assistant Vice-President, Facilities and Services
Professor Safwat Zaky, Vice-Provost, Planning and Budget

Mr. Neil Dobbs, Secretary

Regrets:

Mr. David Asper
Ms Susan Eng
Mr. David Ford
Mr. Steve (Suresh) Gupta
Dr. Gerald Halbert
Dr. Stefan Mathias Larson
Mr. Jim Linley
Mr. Gary P. Mooney
Mr. George E. Myhal
Professor Arthur S. Ripstein
Mr. Larry Wasser
Mr. W. David Wilson

In Attendance:

Ms Monica Bodurka, Director, Strategic Marketing and Business Development, Executive Programs, Rotman School of Management
Ms Deepa Jacob, Research and Policy Analyst, Office of the Vice-President, Business Affairs
Mr. Henry T. Mulhall, Assistant Secretary, Office of the Governing Council
Ms Alison Webb, Committee Secretary, Office of the Governing Council

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The Chair said that the Board would focus on two major themes for the meeting. First, it would be briefed on the University's current financial position. The Board would receive the financial forecast for 2008-09 compared to its budget. The Board would also be advised on the current status of the University's borrowing and would be asked to authorize another tranche of borrowing for capital projects. The Board would then review the University's construction program and the status of deferred maintenance.

1. Reports of the Previous Meetings

(a) Report Number 170, December 15, 2008

Report Number 170 (December 12, 2008) was amended to add the following footnote to section 12, "Real Estate Transaction."

> It was subsequently made public that the Board approved a recommendation contained in a memorandum from Ms Riggall concerning the lease of land at 245 College Street to Knightstone Capital for its construction and operation of a 30 storey student residence building. The Board approved the following resolution:
>
> THAT, subject to Governing Council approval of the designation of 245 College Street as surplus to University requirements,
>
> (a) the transaction described in Ms Riggall's memorandum to the Business Board dated December 15, 2008 be approved, and
>
> (b) the Vice-President, Business Affairs be authorized to negotiate the final agreements and conditions.

Report Number 170 (December 12, 2008), as amended, was approved.

(b) Report Number 171, January 14, 2009

Report Number 171 (January 14, 2009) was amended to add the following footnote to section 1, "Real Estate Transaction."

> It was subsequently made public that the Board approved a recommendation contained in a memorandum from Ms Riggall concerning the purchase from the Royal Ontario Museum of 90 Queen's Park, currently the site of the McLaughlin Planetarium. The Board approved the following resolution:

1. Reports of the Previous Meetings (Cont'd)

(b) Report Number 171, January 14, 2009 (Cont'd)

THAT the Vice-President, Business Affairs be authorized:

(a) to negotiate the final agreements and conditions for the acquisition of 90 Queen's Park for $22 million; and

(b) to arrange the necessary financing.

Report Number 171 (January 14, 2009), as amended, was approved.

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

2. Borrowing (Cont'd)

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

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.

- **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.

2. Borrowing (Cont'd)

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

- **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 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

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.

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

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;

(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

2. Borrowing (Cont'd)

(c) Borrowing Authorization (Cont'd)

(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.

THE FOLLOWING ITEMS ARE REPORTED TO THE GOVERNING COUNCIL FOR INFORMATION.

3. Government of Canada Budget - University Response

Professor Misak reported that three aspects of the recent federal budget were of particular interest to the University. The first, a very positive aspect, was the reservation of $2-billion to fund certain projects at universities and colleges. Because that amount would support projects at a large number of institutions, there would no doubt be a great deal of competition for funding. The funding would support projects of two kinds, and it was currently unclear how the funding would be divided between the two categories. The first was strategic projects in the area of science and technology. The second was deferred maintenance projects. The University hoped that the largest portion of the funding would support infrastructure improvements in strategic areas of science and technology. The University had submitted an impressive list of proposals for renovations and refurbishments in the area, and it was a leader in the area. In the area of deferred maintenance, it was likely that funding would be divided on a formulaic basis, and the University of Toronto would not receive as great a share. Ms Wolfson noted that the federal government planned to pay only for up to half the cost of projects, with the remaining half coming from the Provinces and perhaps the institutions. The universities were making every effort to urge the Government of Ontario to assume responsibility for the remaining half of funding without the expectation of payment by the Ontario institutions of some share of the cost. The outcome would depend on the Ontario budget, expected at the end of March.

Professor Misak said that the second aspect of the federal budget of importance to the University was the allocation of $750-million over three years for projects to be funded by the Canada Foundation for Innovation (C.F.I.) to develop research infrastructure at universities, colleges and hospitals. Because of its outstanding researchers, the University of Toronto had generally fared very well in competitions for research infrastructure funding by the C.F.I.

The third area at first appeared to be highly beneficial to the University: the allocation of $87.5-million over three years to the federal research granting councils to expand the Canada Graduate Scholarships program. The expansion would likely have been a real benefit to the University; because of the quality of its graduate students, they normally fared very well in scholarship competitions. However, it appeared to be the case that a corresponding amount was being removed from the overall budgets of the three federal research granting councils. That would result in a reduction in faculty research grants, a very significant portion of which was used by faculty researchers to provide support for graduate students.

4. Financial Forecast, 2008-09

Ms Brown said that the financial forecast sought to predict the key elements of the University's financial statements for the fiscal year ending April 30, 2009, in particular (a) the income statement, and (b) the net assets appearing on the balance sheet. In some cases, the information on which the forecast was based was precisely known. In other cases, including investment returns, the information represented only a broad estimate.

Ms Brown referred to the sensitivity analysis presented on page 2 of the forecast document. As she had noted on a number of occasions previously, the University planned its activities to break even financially. The one aspect of its operations least amenable to prediction in the short term was investment returns. Having a good year with a positive net income or a bad year with a net loss depended in very large part on investment returns. The forecast had been based on the assumption that the Long-Term Capital Appreciation Pool (L.T.CAP) - primarily the investment vehicle for the endowment funds - would incur a loss of 20% for the 2008-09 fiscal year. That projection had appeared to be the most likely one at the time the forecast exercise had begun in late December. By end of December, however, the loss on the L.T.CAP had grown to 27.3%. The analysis also showed other outcomes based on losses of 5%, 10% and 30%, and it appeared at this point that the scenario of a 30% loss would be most likely, although there were still some months to go before the end of the fiscal year. In the case of projections of a 5% loss and a 10% loss, it was assumed that the usual payout from the endowment would be made. In the case of losses of 20% and 30%, it was assumed that the endowment payout would not be made although it was assumed that the obligations of the endowments would be funded from other sources.

On the assumption of a 20% loss in the endowment fund, overall University revenue would be $1,906.6-million. Expenses would be $2,064.6-million. The net loss for the year would be $ 157.9-million. The only variation in the four projections was the investment return.
Ms Brown stressed that the revenue line followed accounting standards and showed only the projected investment loss on the internally restricted endowments. The investment loss on the externally restricted endowments was reflected only in the net assets, and the amount of that loss was shown separately on the line of the sensitivity analysis placed just below the net loss.

Ms Brown said that the University's net assets reflected its net worth. Only two factors changed the amount of net assets from year to year: the overall net income or net loss for the year and changes in the value of the externally restricted endowments. On the assumption of a 20% loss in the value of the Long-Term Capital Appreciation Pool and therefore of the endowments, the net assets would decline from $2.174-billion to $1.808-billion. Historically, the amount of net assets had varied a great deal over the years, positively and negatively, generally depending on investment returns, but 2008-09 was proving to be a year of exceptional negativity in the securities markets. The net assets included four components. The endowment funds were projected to be about $1.5-billion. It was projected that there would be $385-million accounted for as the University's investment in capital assets. That represented money already spent by the University for buildings, with the amount amortized over time to reflect depreciation. Internally restricted assets of a projected amount of $172-million represented money on hand that had been

4. Financial Forecast, 2008-09 (Cont'd)

allocated for spending in the future but had not yet been spent. From those amounts was subtracted the unrestricted deficit – the amount of cumulative gains or losses in the University's four fund groups (operating fund, ancillary operations fund, restricted funds and capital funds). That deficit amount included the amount of internal borrowing.

Ms Brown recalled that the forecasted value of the endowment funds, assuming a 20% loss for the year, would be approximately $1.5-billion. If that loss were to be only 5%, the endowments would be valued at about $1.7-billion. With a loss of 10% they would be valued at about $1.6-billion. In both cases, it was assumed that the endowment payout would be made. On the other hand, if the loss were to be 30%, the endowment would be valued at about $1.3-billion, assuming that there would be no payout.

Ms Brown commented on the unrestricted deficit. That deficit in the operating fund was projected to be $62.3-million. The budgeted deficit in the operating fund was $44-million, which included an amount devoted to the plan to pay down the deficit to zero within five years. Under the budget process, the deficit in excess of the previous year's budget was to be reflected back to the divisions as part of their budgets for the next year. For example, in 2007-08, the budgeted deficit had been $55-million. Because the year's results were favourable, the actual deficit had been $46-million. The $9-million positive variance had been distributed back to the divisions for their budgets for 2008-09. The same process would take place in the budget for 2009-10, although with the opposite outcome. The main variance in the operating fund was in the investment income earned by the Expendable Funds Investment Pool (EFIP) – the investment vehicle for the University's cash float. The EFIP, which was invested in money-market securities, short-term bonds and a small amount of absolute-return hedge funds, had earned money. However, in significant part because of the decline in interest rates, it was projected to earn
$12.4-million less than projected in the operating budget. In the ancillary operations fund, the projected deficit was $111.4-million. That deficit reflected the extraordinary expansion of the ancillary operations over the past eight or nine years. The main component of that deficit was the cost of internal borrowing for new facilities. The forecast deficit of $63.9-million in the capital fund similarly reflected the cost of borrowing for other facilities.

Among the matters that arose in questions and discussion were the following.

(a) Endowment payout. A member asked about the prospects for the endowment payout for 2009-10. Ms Brown replied that it was not possible at this time to answer the question. For the current year, the University would be able to make an endowment payout if the market were to reverse previous declines and if losses were limited to 10%. At a 10% loss, the cash cushion that had been left in the endowment funds overall as at the beginning of the 2008-09 fiscal year would be sufficient to enable a payout without impinging on the capital of the endowments and with sufficient funds to insulate the capital from the effect of inflation. That would, however, require a very substantial turnaround in the markets over the next two and one-half months. If the markets did recover sufficiently this year to enable a payout for 2008-09, then a payout for 2009-10 would require a return of about 7% again to maintain the value of the capital against the effects of

4. Financial Forecast, 2008-09 (Cont'd)

inflation, assuming that the current policies remained in place. Professor Misak said that it was highly unlikely that an endowment payout, or some other form of payment in lieu of an endowment payout, could be absent for a second year. For the current year, the divisions had been asked to use other resources to meet their commitments, such as the salaries of endowed chairs, and their other very important payments, such as need-based student aid. The divisions were in fact doing that, using such funds as carry-forwards of unspent appropriations from the previous year and departmental trust funds. However, the divisions were incurring substantial pain in so doing, and those resources would by and large no longer be available for 2009-10. Therefore, there would be need either for a payout from the endowment or a comparable payout funded by some other means.

(b) University response to the funding shortfall. The Chair invited Professor Misak to comment on the University's response to the financial situation projected in the forecast. Professor Misak said that the University would seek to cope with the shortfall largely by making severe reductions in its spending, which might reduce the number of courses offered and increase the faculty/student ratio. No part of the University would be spared the effect of the problem, with budget reductions being required in administrative as well as academic divisions. There would be cases in 2009-10 where divisions would be unable to manage without incurring a temporary deficit.

A member noted that the University had moved to a budgeting arrangement in which divisions themselves balanced revenues and expenses and decided how best to use their revenues. Would the Business Board be able to see the impact of the budget reductions on the various divisions? Professor Misak replied that the Budget Report itself, which was presented to the Business Board, did not contain detail of the effects of the budget on the individual divisions. She would, however, be able to provide the Board with some "snapshots" of those effects. The Chair suggested that when the budget was presented to the next regular meeting of the Board, Professor Misak provide such information, briefly describing the types of spending control measures that were required in the individual divisions and giving the Board some flavour of the effects of the budget.

5. Investments: Benchmarking - A Reference Portfolio for Evaluating Investment Management

The Chair said that the proposal to establish a reference portfolio as a further basis of judging investment returns was being presented for preliminary discussion at this time. The proposal would be revised, if appropriate, on the basis of the Board's discussion and that of the Board of the University of Toronto Asset Management Corporation (UTAM), and the revised reference portfolio would be brought back to the Business Board for its information.

Ms Riggall said that a benchmark portfolio would add another useful tool for the evaluation of UTAM's performance. It represented a passive portfolio that could be put into place as an alternative to the active management of UTAM. The Board would then be able to

5. Investments: Benchmarking - A Reference Portfolio for Evaluating Investment Management (Cont'd)

determine whether the reference portfolio was able to provide the same or better performance as UTAM at a lower cost and within the University's stated risk parameters. The UTAM Board could use the portfolio to answer the same question. The only other organization known to Ms Riggall to use a reference portfolio was the Canada Pension Plan (C.P.P.) Investment Board. Its reference portfolio was different from that proposed for the University because the C.P.P.'s asset mix included its legacy assets. The C.P.P had a different definition of risk tolerance, but both the C.P.P. and the University used a long-term time horizon for measurement.

Ms Brown said that the administration had for some years been considering various means to measure the value added by active management of the University and pension plan investment portfolios. The current benchmark used to evaluate UTAM's performance was, like the proposed reference portfolio, one based on market indices, and it similarly asked whether active management added value. However, the asset mix for the benchmark used was that actually chosen by UTAM for its investments for the year. In the case of the reference portfolio, the asset mix used was a standard one, set in advance, that could actually be implemented by the University without the expertise, infrastructure and complexity added by UTAM. To determine the asset mix of the reference portfolio, the University had looked at the mixes used by other universities, although they did not, in general, employ the exceptionally high level of expertise found in UTAM. The administration also looked at what the University of Toronto had done in the years before the establishment of UTAM. The basic asset mix chosen was 60% equities and 40% fixed income investments – a standard asset mix frequently used by comparable funds including those at other universities. Within that asset mix, the University had chosen indexes in which it could invest passively and with which investors were comfortable. For the fixed income component, the mix included 35% DEX Canadian Universe Bond Index and 5% iShares Canadian Real Return Bond Index Fund, which was invested to match the DEX Real Return Bond Index. The equity component included 30% Standard and Poor's (S&P) Toronto Stock Exchange Composite Index, 15% S&P 500 Index of U.S. large-company equities (one half hedged to the Canadian dollar) and 15% Morgan Stanley Capital Inc Europe, Australasia, Far East (EAFE) Index of non-North-American, developed-country equities (half hedged). For comparability, the performance of that asset mix was measured net of an estimate of fees. That performance would be compared to UTAM's performance for various periods. That group of indices had been selected on the basis of their past performance to provide the best possible returns within the University's risk-tolerance parameters.

Among the matters that arose in discussion were the following.

(a) Value of active management. A member said that in his experience, investment managers could add value by shifting their asset mix in anticipation of major market developments. Many plans used fixed asset allocations, which did not serve them well. Ms Brown replied that the point was one that the reference portfolio would test.

5. Investments: Benchmarking - A Reference Portfolio for Evaluating Investment Management (Cont'd)

(b) Expense levels. A member noted that the expense of UTAM management amounted to approximately 100 basis points or 1%. He did not think that so high an expense level could be justified for a portfolio with a conservative investment objective of only 4% after inflation, which could be achieved with a passively managed portfolio. Fees and expenses at UTAM's level would be understandable only with a much higher investment objective. Ms Brown replied that, again, the relative performance of the UTAM portfolio and the reference portfolio would provide the answer to the member's point. The reference portfolio included a 15 basis-point component for fees and expenses (i.e. 15/100 of 1%), which included fees for the consulting that would be required in the absence of UTAM; that inclusion would enable a fair comparison of performance net of fees. A member, who also served on the UTAM Board, noted that the expenses of UTAM itself did not account for the 100 basis-point cost of management. The cost of UTAM itself was only 8 basis points. The remainder represented fees charged by the external fund managers. Those fees were particularly high for the complex, but potentially lucrative, areas of investment included in UTAM portfolios. Another member anticipated one result of the current crisis in the financial markets would be a substantial reduction in the fees charged by many managers of hedge funds and private-equity funds.

A member asked about the expenses of other large funds that used complex investments, in particular the Canada Pension Plan. Another member said that it would be unfair to compare the expense levels of the University's portfolio with the C.P.P. A very large fund enjoyed substantial economies of scale. Another member remarked that large funds often did not enjoy advantages, particularly in a relatively small market such as Canada, where there was insufficient liquidity to allow large funds to make meaningful purchases or sales without moving the market to make purchases more costly and sales less so. Another member noted that UTAM invested a relatively small proportion of its long-term funds in Canada.

(c) Value of the reference portfolio as an evaluation method. A member noted that only one other major Canadian investor, the Canada Pension Plan Investment Board, used a reference portfolio to evaluate fund performance. Given that the University already compared UTAM's performance to the University's real-return objective, to a market benchmark and to the performance of peer funds, would one more layer of judgement in fact be useful? Ms Brown replied that the specific aim of adding the reference portfolio was to address the continuing question: was management by UTAM the best approach? Comparison to the performance of a reasonable reference portfolio would help to answer that question. It was simply one additional test for doing so. Ms Brown did acknowledge the concern that having too many criteria could cause confusion.

(d) Alternative assets. A member noted that there were no alternative-asset categories in the reference portfolio although they were prominent among UTAM investments. Ms Brown replied that the observation was a correct one. The objective of the reference portfolio, in contrast to the market benchmark that matched UTAM's asset mix, was to compare UTAM's results to those that could be achieved by a relatively simple portfolio that could be managed passively.

5. Investments: Benchmarking - A Reference Portfolio for Evaluating Investment Management (Cont'd)

(e) Retrospective comparison of UTAM performance to date with that of the reference portfolio. In response to a question, Ms Brown noted that it was reasonable to compare UTAM's return to the return that would have been obtained by the reference portfolio for the seven years from January 1, 2001 (seven months after the establishment of UTAM) to December 31, 2007 (the most recent calendar year for which firm full year returns were available). The return on the reference portfolio would have been an average of 3.63% per year compared to the actual return of the pension fund of 4.49% and that of the Long-Term Capital Appreciation Pool of 3.60%. The member noted that the performance data to date did validate the conclusion that UTAM had added value over the seven years. Ms Brown agreed and noted that UTAM provided a number of other services that would not be available with the passive alternative, including verification of the completeness and valuation of the assets, monitoring of returns relative to University needs and risk tolerance, and so on.

(f) Option of contracting out active management. A member asked whether the University had considered a middle option – having active management but contracting out its oversight to another third-party provider. Ms Riggall said that the Ontario universities as a group had considered such an option. They had discussed contracting out their combined pension funds for management by a major external management group such as the Ontario Municipal Employees Retirement System (OMERS) or the Ontario Teacher's Pension Plan (although the Teachers' charter did not currently provide for its management of other funds). While the group had not decided to proceed with investigation of such a step at this time, the possibility had also not been ruled out.

The Chair thanked Ms Riggall and Ms Brown for the proposal and for bringing it to the Board for discussion before its finalization. He suggested that members with further suggestions forward them to Ms Brown.

6. Capital Projects Review, September 2006 – January 2009

Mr. Shabbar recalled that he had, one year ago, presented a report on capital projects completed in the previous eighteen months. The current report would deal with major projects (those costing over $2-million) from September 2006 to January 2009. In that period, 26 projects had been active, eighteen of them had been completed, six were currently underway and two were "on hold." The East Arrival Court project at the University of Toronto at Scarborough (UTSC) was awaiting the resolution of site planning issues. The Medical Academy building at the University of Toronto at Mississauga (UTM) was being held up pending the resolution of certain government funding issues. The value of the completed projects was $199-million. The value of those underway was $144.7-million. The value of the two projects "on hold" was $39.3-million. Mr. Shabbar displayed photographs and architectural renderings of a sample of the projects that had been completed or were underway.

6. Capital Projects Review, September 2006 – January 2009 (Cont'd)

Mr. Shabbar reported that of the $383-million of projects during the period, it had been necessary to request increased appropriations amounting to $26.9-million. Three quarters of that amount had arisen from three projects. The project for the Department of Economics had incurred $9.3-million of additional costs arising from a strike, scope changes, problems discovered in the soil conditions, delays caused by bad weather, and the insolvency of the contractor. It had been necessary to make a claim under the contractor's bond insurance. While it was still necessary to clear up a few minor deficiencies, the Department had now moved into its rebuilt buildings. For the Varsity stadium site, it had been necessary to increase the cost of Phase I of the project by $5.3-million. The increased cost had been the outcome of problems arising from the footings for the original stadium, which had affected the overall site conditions. In the case of the new UTSC Science Building, the cost had increased by $5.6-million owing to major changes in scope requested by UTSC: the addition of a basement and the addition of a lobby adjacent to the major lecture theatre. Costs had increased by a total of $6.7-million on seven other projects, with relatively minor increases caused either by unanticipated site conditions or by scope changes.

Mr. Shabbar said that all except three projects had been completed and occupied either on time or ahead of time. Delays had been encountered in the cases of the Economics Building and the Varsity Centre for the reasons noted in connection with their cost. There had also been some delay in the occupancy of the Centre for Biological Timing and Cognition for two reasons. First, it had been necessary to complete construction in an area where there was substantial infrastructure located, requiring time to work around that infrastructure. Second, there had been some delay in the delivery of steel for the project.

Mr. Shabbar stressed that the University had achieved savings of on a number of its projects. For the period of the report, $3.6-million had been saved on twelve projects. The Real Estate Operations Department did not simply spend to the limit of the approved project cost in each case. On the contrary, it engaged in strenuous negotiations with suppliers including consultants, contractors, furniture suppliers, and so on in a focused effort to return money to the University.

7. Capital Projects Report as at January 31, 2009

The Board received for information the Capital Projects Report as at January 31, 2009. That report showed projects under construction (forecast cost of $192.21-million) and projects that were occupied but not formally closed (forecast cost of $445.69-million).

8. Deferred Maintenance: Annual Report to December 2008

Mr. Swail was pleased to report, as he had in the previous two years, that progress had been made on the matter of deferred maintenance. The cost of dealing with deferred maintenance on all three campuses had been reduced, and the Facilities Condition Indices of all three campuses had improved. The total amount of maintenance work that had been deferred, however, remained

8. Deferred Maintenance: Annual Report to December 2008 (Cont'd)

significant at $257-million, although that sum was $19-million less than that reported one year ago. The University had been able to reduce its backlog of deferred maintenance for three reasons: significant internal funds provided to deal with deferred maintenance problems; the indirect benefit of capital projects that resulted in new buildings or renovations to replace or renovate facilities with deferred maintenance problems; and a very significant infusion of capital-renewal funding from the Province of Ontario at the end of its 2007-08 fiscal year. The deferred maintenance problems continued to be concentrated on the St. George Campus, with 98% of the Priority 1 projects located on that campus. The total deferred maintenance liability for the Campus was estimated to be $241-million. The Facilities Condition Index for the Campus was 10, which was at the threshold for buildings in poor condition. On the Mississauga and Scarborough Campuses, the Facilities Condition Indices were under 5, indicating buildings in excellent condition. The deferred maintenance backlog for each of those Campuses was under $10-million. The good condition of those Campuses was not surprising given that their buildings were comparatively new.

Mr. Swail commented on the deferred maintenance program going forward. The University hoped that, with consistent and significant funding, it would be able to continue to manage the issue and to reduce the overall liability arising from deferred maintenance. For 2009, Mr. Swail planned to survey the condition of campus infrastructure and add it to the annual report. While it had originally been intended to complete a survey of infrastructure in 2008, it had been necessary to delay the step by one year. When completed, next year's annual report would provide a complete picture including the condition of not only the University's buildings but also its infrastructure.

A member noted that the conditions of the Mississauga and Scarborough Campuses were relatively good, but she asked if they were declining. Mr. Swail replied that on the contrary the condition of buildings on those campuses had been improving.

9. Sustainability Office Annual Report, 2007-08

The Chair noted that the Environmental Protection Policy required the preparation of an annual report concerning the University's impact on the environment, summarizing initiatives undertaken and identifying matters that required particular attention.

Ms Sisam said that the Sustainability Office led to a combination of research, student activity, and good work by the Facilities and Service Department in the cause of conserving energy and reducing spending on energy on all three campuses. An important element of the work of the Office for the past year had been on the establishment of initiatives across the three campuses.

A member noted that the Director of the Sustainability Office, Professor Beth Savan, had attended the most recent meeting of the University Affairs Board to present the report in some detail. One of the most pleasing features of the report was its stress on student involvement.

9. Sustainability Office Annual Report, 2007-08 (Cont'd)

Ms Sisam noted that about 4,000 students participated in this work, a number greater than any other University activity apart from certain sports activities.

The Chair noted that Professor Savan had similarly made an extensive report to the Business Board one year ago. He asked Ms Sisam to convey the Board's thanks to members of the Sustainability Office and their network of volunteers for their outstanding work.

10. Report Number 89 of the Audit Committee – December 3, 2008

The Chair noted that the Audit Committee had met a few days before the previous meeting of the Business Board. The Board had received from the Audit Committee an oral report on its review of the Pension Plans, and the Board had approved the financial statements of the two registered plans. The Board received the written report of the Audit Committee meeting for information.

11. Date of Next Meeting

The Chair reminded members that the next regular meeting of the Board was scheduled for Monday, March 23, 2009 at 5:00 p.m.

THE BOARD MOVE INTO CLOSED SESSION.

12. Human Resources: Recently Ratified Collective Agreements

The Board received for information a report from Professor Hildyard on nine recently ratified collective agreements.

13. Closed Session Reports

Professor Hildyard reported on the recent collective agreement with the Canadian Union of Public Employees, local 3902, unit 1, the union local representing the University's teaching assistants, invigilators and course instructors. A copy of Professor Hildyard's written report had been placed on the table for members' information. Members congratulated Professor Hildyard, her colleagues and the union for their arriving at the agreement, a particularly noteworthy achievement in view of the prolonged strike by teaching assistants and others represented by the same union at York University.

THE BOARD MOVED IN CAMERA.

14. Striking Committee: Appointment

The Chair said that the Striking Committee was responsible for nominating non-Governing Council members to the Business Board and to its Audit Committee. The Chair of the Board recommended the membership of the Striking Committee, which included the Chair and one Governing Council member of the Business Board from each estate represented on Council.

On the recommendation of the Chair

YOUR BOARD APPROVED

THAT the following be appointed to the Business Board Striking Committee to recommend appointments for 2009-10:

Mr. Richard Nunn (Chair)
Mr. Geoffrey Matus (Lieutenant-Governor-in-Council appointee; Vice-Chair)
Ms Jennifer Riel (administrative staff)
Mr. David Ford (student)
Professor Arthur Ripstein (teaching staff)
Ms B. Elizabeth Vosburgh (alumna)

THE BOARD RETURNED TO OPEN SESSION.

The meeting adjourned at 6:50 p.m.

Secretary   Chair

March 2, 2009

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