UNIVERSITY OF TORONTO

# Borrowing Strategy

# Review
# March 2012

Courtesy of Ken Jones, UTSC Communications

# University of Toronto
# Borrowing at a Glance to March 31, 2012
## (in Millions of dollars)

| | |
|---|---|
| **Maximum borrowing capacity**: | |
| External | 773.1 |
| Internal | 200.0 |
| **Total** | 973.1 |
| **Borrowing allocated**: | |
| Total allocated | 1,053.3 |
| Minus repayment | (83.3) |
| | (970.0) |
| **Unallocated to March 31, 2012** | 3.1 |
| **Actual outstanding external borrowing**: | |
| Series A debenture due July 18, 2031 | 160.0 |
| Series B debenture due December 15, 2043 | 200.0 |
| Series C debenture due November 16, 2045 | 75.0 |
| Series D debenture due December 13, 2046 | 75.0 |
| Series E debenture due December 7, 2051 | 200.0 |
| Borrowing prior to 2001 net of repayments | 13.0 |
| Loan from City of Toronto | 1.1 |
| Actual outstanding external borrowing to March 31, 2012 | 724.1 |
| **Actual outstanding internal borrowing to March 31, 2012** | 168.7 |
| **Total actual outstanding borrowing to March 31, 2012** | 892.8 |
| **Internal Borrowing Capacity Specific for Pension Funding** | 150.0 |
| Loan issued for Pension Funding | (112.6) |
| Remaining borrowing for Pension Funding to March 31, 2012 | 37.4 |

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# INTRODUCTION AND PURPOSE OF REPORT

The University of Toronto's borrowing programme acts as an integral component of the University's overall strategy to accomplish its academic mission by leveraging resources available to enable needed capacity growth and to provide quality enhancements of physical facilities.

Borrowing has been strategically managed as a scarce resource that must be carefully utilized to support revenue generating assets to the greatest extent possible.

The current borrowing strategy contains elements that date from 2001 when the University moved away from project-specific borrowing to a larger programme of borrowing featuring debenture issuance based on the general credit of the University. In 2003, an initial debt limit was established to introduce discipline to the borrowing and the current external debt limit was put in place in 2004. In 2011, additional borrowing capacity was put in place that was reserved for pensions.

**What has been accomplished so far?**

- Borrowed funds have helped fuel the almost 50% increase in student FTE's from 44,681 FTE in 2000 to 66,611 FTE in 2011. The associated capital asset requirements, partly funded with borrowed funds, have resulted in the addition of 178,982 NASM's to the University's physical inventory. Key projects have included the expansion of the Scarborough and Mississauga campuses to accommodate a doubling of their enrolments, as well as key expansion projects on the St. George campus that have added capacity and have enabled upgrading to provide state of the art facilities to students and researchers.

- Borrowed funds have matched donations and government grants to lever those external funds to magnify the impact for the university. Examples include matching student aid to help increase the student aid endowment; contributions to support government sponsored projects where governments and donors required university contributions (e.g. UTM North Building Reconstruction and Davis Lab Renovation Project, Goldring Centre for High Performance Sport and Rotman Building Expansion).

- Borrowed funds have enabled the dramatic increase in residence beds in the early 2000’s from 2,986 beds in 1998 to 6,624 beds by 2007.
- Borrowed funds have also helped to address the pension deficit.

At this time, we are right at the limit of our borrowing capacity under the existing strategy, particularly since pension funding pressures have added to the borrowing load. This is a problem because the University has embarked on an ambitious fundraising campaign with large capital priorities. Borrowing will be needed to support this effort, both on a long-term basis, and on a short-term basis to bridge-finance pledge fulfillment.

As of April 30, 2013, we will be changing our accounting practices, which could change our balance sheet in a favourable way, yielding more borrowing capacity. However, we don’t believe that it is appropriate to borrow more simply because changing accounting practices make our balance sheet look better. We want to continue to manage borrowing in a strategic way, as a scarce resource, in absolute terms and in comparison to our peers.

This report examines how we compare to our peers in relative indebtedness, and, as you will see in the following sections, the results are positive. Thus it may be reasonable to add very modestly to our borrowing capacity.

We are working on a detailed review of the current strategy. Business Board can expect to can expect to hear more on this in the coming months.

# CURRENT BORROWING STRATEGY

The current borrowing strategy determines the limits for borrowing both internally from the expendable funds investment pool (EFIP), and externally from third parties. The key elements of the current strategy are:

- Maximum external borrowing capacity (debt limit) 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 borrowing is permitted until such time as the actual outstanding external borrowing is not greater than 33% of net assets averaged over 5 years.
- Maximum internal borrowing capacity is $200 million loaned from EFIP and excludes internal financing of fund deficits and short-term construction financing of capital projects.
- An additional $150 million of internal borrowing from EFIP has been made available for pension purposes.
- In the event that the funds invested by EFIP would be needed for short-term expenditures, the internal borrowing would have to be re-financed externally.
- 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 parameters.

# CURRENT STATUS

## Maximum borrowing capacity:

The maximum external borrowing capacity is updated annually every April 30. At April 30, 2011, the maximum external borrowing capacity was $773.1 million.

The utilization of up to $200 million of internal borrowing from EFIP is also reassessed annually. At April 30, 2011, it was confirmed that $200 million can continue to be allocated to internal borrowing for capital related purposes.

Therefore, maximum external plus internal borrowing capacity for capital related projects was set at $973.1 million, effective April 30, 2011.

The Business Board also approved on January 31, 2011, the additional borrowing of $150 million from EFIP, specifically for pension purposes.

## Borrowing allocated to capital projects and other requirements:

At March 31, 2012, the Business Board has allocated $1,053.3 million to capital projects and other requirements. With $83.3 million repayments that can be reallocated, this leaves $3.1 million to be allocated to future capital projects, at this time.

## Actual external borrowing:

At April 30, 2011 there was $524.1 million in outstanding external long-term debt. In January 2009, the Business Board had approved an additional $200 million of external borrowing, which was issued by March 31, 2012. Therefore, the outstanding external long-term debt at March 31, 2012 was $724.1 million, as follows:

$ 13.0 million borrowing prior to 2001(excluding $1.3 million to be repaid during 11-12)
$   1.1 million loan from City of Toronto (excluding $0.2 million to be repaid during 11-12)
$160.0 million Series A debenture
$200.0 million Series B debenture
$ 75.0 million Series C debenture
$ 75.0 million Series D debenture
$200.0 million Series E debenture
$724.1 million

The $724.1 million of external borrowing represents 37.5% of net assets averaged over 5 years or 38.2% of net assets as at April 30, 2011.

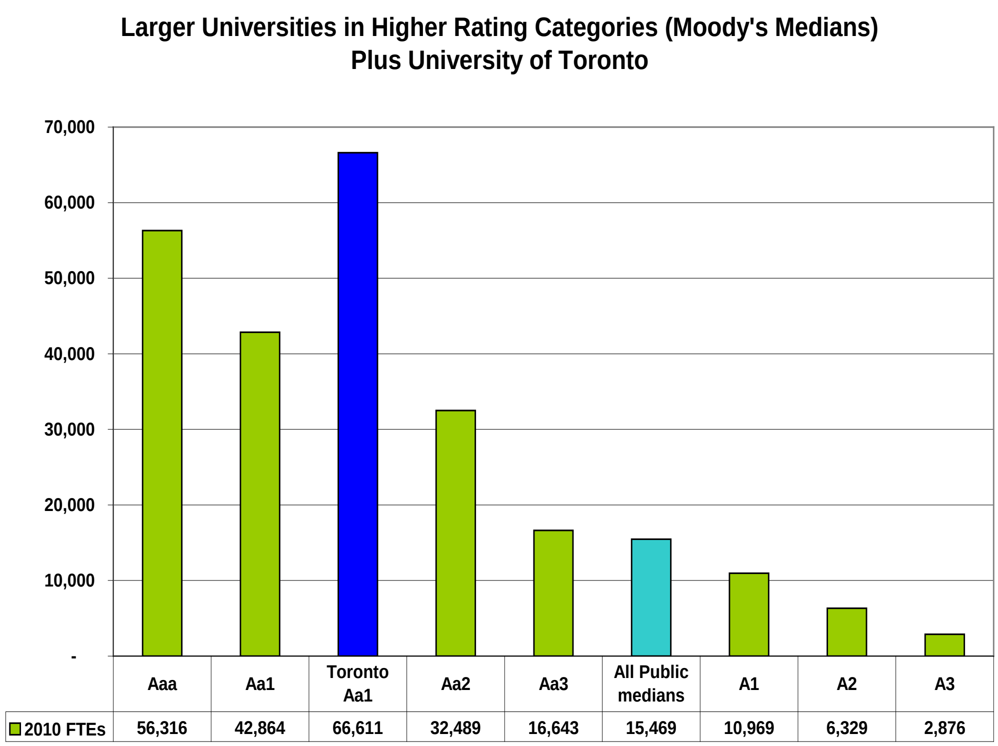
# BENCHMARKING

To assess the financial prudence of the current borrowing strategy, we have compared a number of balance sheet and income statement ratios for the University of Toronto to other universities.

The benchmarks that have been used as comparators are from Moody's Fiscal Year 2010 U.S. Public College and University Medians issued in July 2011. Moody's currently rates "220 public universities on an underlying basis, with over $100.9 billion debt outstanding"[1]. It should be noted that in order to effectively compare the University of Toronto to U.S. peers, we ensured that we utilized definitions for unrestricted resources, expendable resources and total resources that are consistent with U.S. financial reporting.

Moody's credit ratings applied to U.S. public colleges and universities in descending order are Aaa, Aa1, Aa2, Aa3, A1, A2, and A3.

The University of Toronto was ranked Aa1 with a negative outlook by Moody's in its December 2011 review, following the change in the Province of Ontario's rating from stable to negative outlook.




Moody's publishes many ratios for public colleges and universities. We have selected several ratios and have compared University of Toronto to other universities with similar ratings. The chart shows that universities with larger numbers of students tend to be in the higher rating categories.

[1] Moody's Fiscal Year 2010 Public College and University Medians (p. 2).

Here are the comparators in the Aaa, Aa1 and Aa2 categories:

**Aaa**

| | |
|---|---|
| Indiana University | University of North Carolina at Chapel Hill |
| Purdue University | University of Texas System |
| Texas A&M University System | University of Virginia |
| University of Michigan | University of Washington |

**Aa1**

| | |
|---|---|
| Michigan State University | University of Kansas |
| North Carolina State University | University of Minnesota |
| Ohio State University | University of Missouri System |
| Pennsylvania State University | University of Nebraska |
| State University of Iowa | University of Pittsburgh |
| Tennessee State School Bond Authority | University System of Maryland |
| University of California | Virginia Polytechnic Inst. & State University |
| University of Delaware | **University of Toronto** |

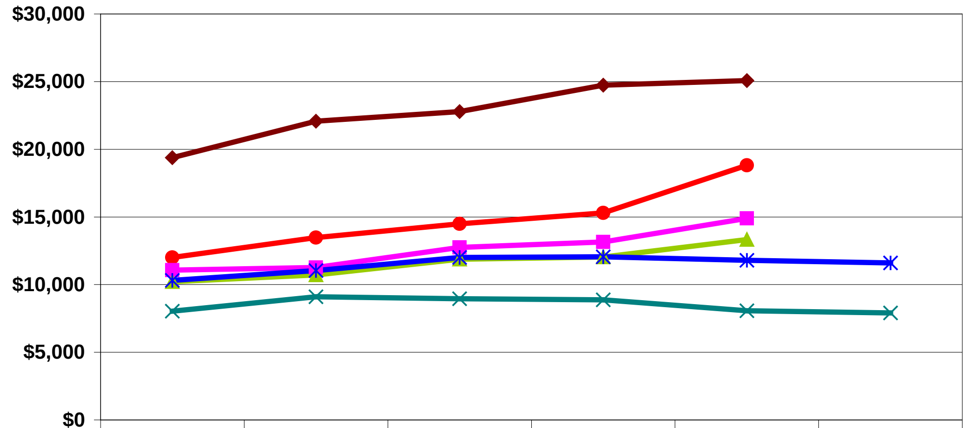
**Aa2**

| | |
|---|---|
| Auburn University | University of Alaska |
| Board of Regents of the University System of Georgia | University of Arizona |
| California State University | University of Arkansas |
| Clemson University | University of Colorado |
| East Carolina University | University of Connecticut |
| Florida State University | University of Florida |
| Iowa State University of Science and Technology | University of Georgia |
| Kansas State University | University of Hawaii |
| Massachusetts State College Building Authority | University of Houston System |
| Minnesota State Colleges $ Universities | University of Illinois |
| Mississippi Inst. of Higher Learning | University of Kentucky |
| Nevada System of Higher Education | University of Louisville |
| New Mexico Military Institute | University of Massachusetts |
| New Mexico State University | University of New Mexico |
| Rutgers, The State of New Jersey | University of North Texas System |
| State System of Higher Education | University of South Carolina |
| State University of New York | University of South Florida |
| State University System of Florida | University of Utah |
| Texas State University System | University of Wyoming |
| Texas Tech University | Virginia Commonwealth University |
| University of Alabama at Birmingham | Washington State University |
| University of Alabama | Wayne State University |

## Direct Debt per Student:

Moody's compares the direct debt to the size of the student body. Direct debt is defined as the legal obligations of the institution, e.g. bonds, notes, commercial paper, capital leases, bank loans and draws upon lines of credit. The size of the student body is the FTE (full-time equivalent enrolment).

**Direct Debt per Student**
**Comparing University of Toronto to Moody's Medians for**
**Aaa, Aa1, Aa2 and Aa3**



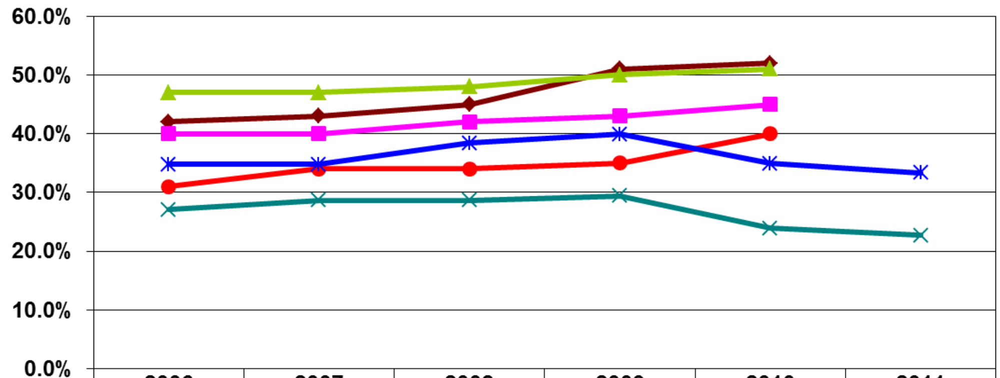

| | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 |
|---|---|---|---|---|---|---|
| Aaa direct debt per student | 19,383 | 22,079 | 22,787 | 24,733 | 25,072 | |
| Aa1 direct debt per student | 12,002 | 13,470 | 14,487 | 15,295 | 18,824 | |
| Aa2 direct debt per student | 11,071 | 11,264 | 12,744 | 13,146 | 14,902 | |
| Aa3 direct debt per student | 10,221 | 10,714 | 11,884 | 12,044 | 13,330 | |
| U of T direct debt per student | 8,034 | 9,095 | 8,963 | 8,881 | 8,076 | 7,909 |
| U of T max debt capapcity per student | 10,318 | 11,031 | 12,006 | 12,051 | 11,796 | 11,606 |

The chart above illustrates that U of T's direct debt per student is well below the medians. The maximum external borrowing capacity is very much in line with the medians for the Aa2 and Aa3 comparators and well below the median for the Aaa/Aa1 group. This means that U of T has borrowed less to date and has set a maximum external borrowing capacity (debt limit) to date per student that is less than the actual outstanding external borrowing of its rating peers. Please note that the University issued additional debenture for $200 million to March 2012. If this debt had been in place in fiscal 2011, the UofT direct debt per student would have been $10,911.

## Direct Debt to Total Revenues:

This Moody's ratio compares direct debt to the annual revenues of the institution. Direct debt is as defined above. Total revenues are the total revenues of the institutions.

**Direct Debt to Total Revenues**
**Comparing University of Toronto to Moody's Medians for Aaa, Aa1, Aa2 and Aa3**




| | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 |
|---|---|---|---|---|---|---|
| Aaa direct debt/rev | 42.0% | 43.0% | 45.0% | 51.0% | 52.0% | |
| Aa1 direct debt/rev | 31.0% | 34.0% | 34.0% | 35.0% | 40.0% | |
| Aa2 direct debt/rev | 40.0% | 40.0% | 42.0% | 43.0% | 45.0% | |
| Aa3 direct debt/rev | 47.0% | 47.0% | 48.0% | 50.0% | 51.0% | |
| U of T direct debt/rev | 27.1% | 28.7% | 28.7% | 29.4% | 23.9% | 22.7% |
| U of T max external debt capacity/rev | 34.8% | 34.8% | 38.4% | 39.9% | 34.9% | 33.3% |

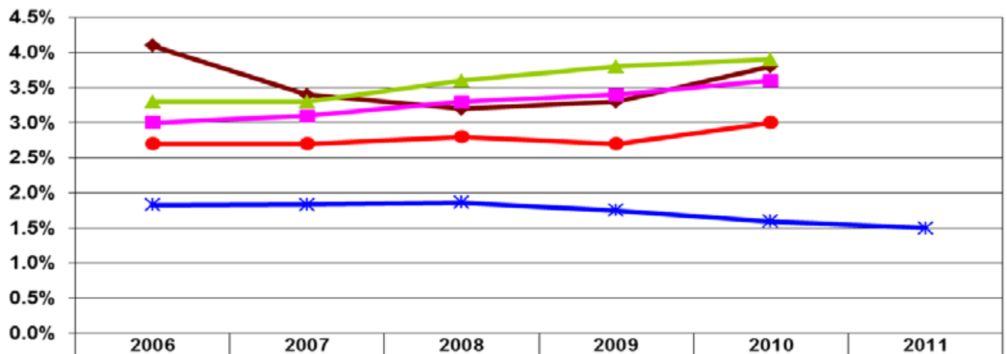
The chart illustrates that U of T's actual direct debt to revenues is well below the median while the maximum debt capacity is comparable to the current medians for its rating peers. This means that U of T has a better ratio of direct debt to revenues than its peers and that its external borrowing capacity to total revenues would be within the range of that of its rating peers. Adding the debenture of $200 million issued to March 2012, would have changed the ratio for fiscal 2011 to 31.3%.

## Debt Service to Operations:

This Moody's ratio measures the debt service burden on expenses. Debt service is defined as the actual direct interest expense. Total expense is the total expenses as stated in the audited financial statements excluding student aid.

The chart below illustrates that U of T's ratio of direct debt service to operations was 1.5% at April 30, 2011, well below the medians for its rating comparators. This means that the U of T interest expense as a percentage of total operations was much less than its rating peers.

**Actual Debt Service to Operations (Total Expense)**
**Comparing University of Toronto to Moody's Medians for**
**Aaa, Aa1, Aa2, and Aa3**

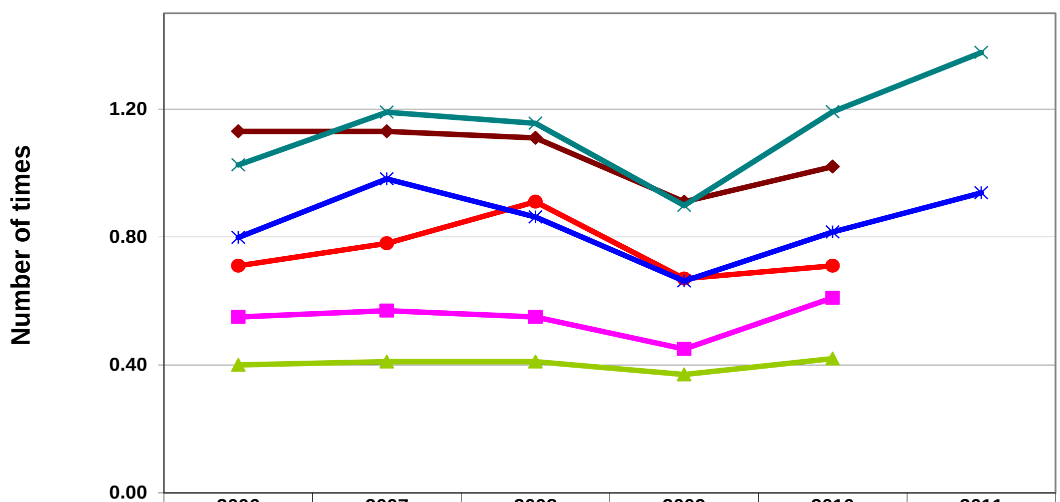



| | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 |
|---|---|---|---|---|---|---|
| Aaa actual debt service to operations | 4.1% | 3.4% | 3.2% | 3.3% | 3.8% | |
| Aa1 actual debt service to operations | 2.7% | 2.7% | 2.8% | 2.7% | 3.0% | |
| Aa2 actual debt service to operations | 3.0% | 3.1% | 3.3% | 3.4% | 3.6% | |
| Aa3 actual debt service to operations | 3.3% | 3.3% | 3.6% | 3.8% | 3.9% | |
| U of T actual debt service to operations | 1.8% | 1.8% | 1.9% | 1.8% | 1.6% | 1.5% |

## Unrestricted Resources to Long-Term Debt:

This Moody's ratio measures the coverage of direct debt by the most liquid resources, which it defines as unrestricted net assets.

**Unrestricted resources to long-term debt**
**Comparing University of Toronto to Moody's medians**




| | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 |
|---|---|---|---|---|---|---|
| Aaa unrest. resources to debt | 1.13 | 1.13 | 1.11 | 0.91 | 1.02 | |
| Aa1 unrest. resources to debt | 0.71 | 0.78 | 0.91 | 0.67 | 0.71 | |
| Aa2 unrest. resources to debt | 0.55 | 0.57 | 0.55 | 0.45 | 0.61 | |
| Aa3 unrest. resources to debt | 0.40 | 0.41 | 0.41 | 0.37 | 0.42 | |
| U of T's unrestricted resources to debt | 1.03 | 1.19 | 1.16 | 0.90 | 1.19 | 1.38 |
| U of T's unrestricted resources to debt capacity | 0.80 | 0.98 | 0.86 | 0.66 | 0.82 | 0.94 |

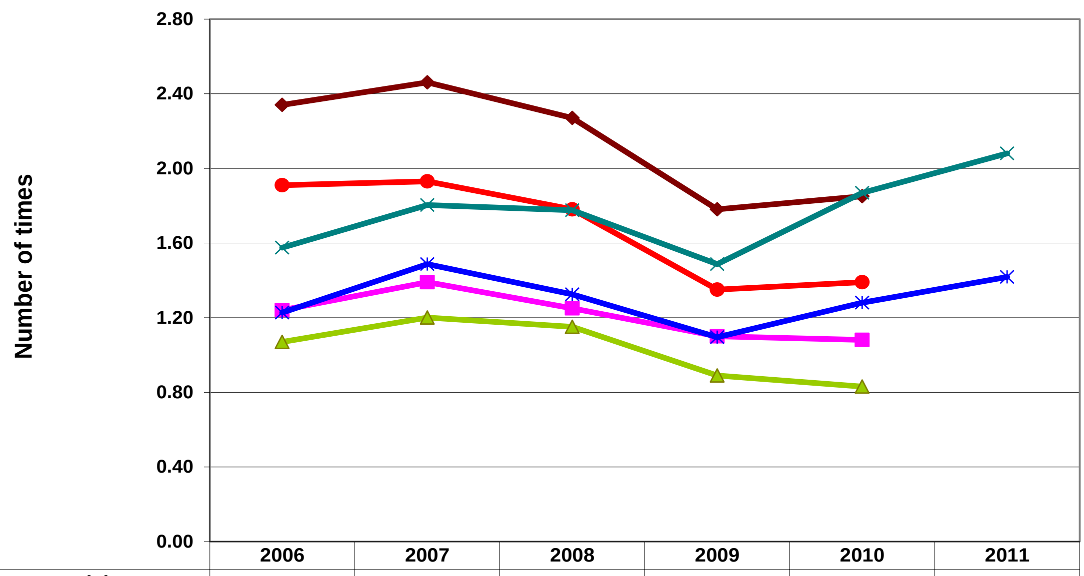
Using Moody's definition, the University's unrestricted net assets include: internally restricted endowments, unrestricted deficit and internally restricted net assets, excluding investment in capital assets and adjusted for the fact that our U.S. peers have not recorded pension and employee future benefit expenses based on actuarial valuations, but have been based on pay-as-you-go basis.

The chart above illustrates that U of T's unrestricted resources to long-term debt ratio[2] of 1.38 is above the medians for its rating comparators. This means that U of T has more unrestricted resources to support long-term debt than its rating peers. Adding the debenture of $200 million issued to March 2012, would have changed the ratio for fiscal 2011 to 1.0.

## Expendable Resources to Long-Term Debt:

This Moody's ratio measures the coverage of direct debt by financial resources that are ultimately expendable, which it defines as the sum of unrestricted net assets plus restricted expendable net assets. Using Moody's definition, the University's restricted expendable net assets consist of unspent restricted grants or deferred contributions.

**Expendable Resources to Long-Term Debt**
**Comparing University of Toronto to Moody's medians**



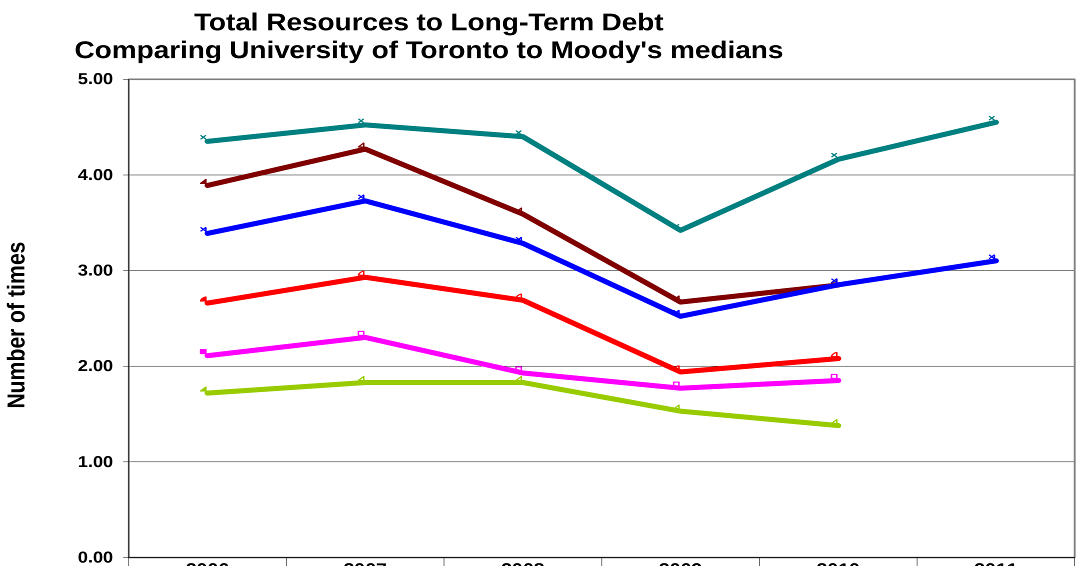

| | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 |
|---|---|---|---|---|---|---|
| Aaa expen. resources to debt | 2.34 | 2.46 | 2.27 | 1.78 | 1.85 | |
| Aa1 expen. resources to debt | 1.91 | 1.93 | 1.78 | 1.35 | 1.39 | |
| Aa2 expen. resources to debt | 1.24 | 1.39 | 1.25 | 1.10 | 1.08 | |
| Aa3 expen. resources to debt | 1.07 | 1.20 | 1.15 | 0.89 | 0.83 | |
| U of T's expendable resources to debt | 1.57 | 1.80 | 1.78 | 1.49 | 1.87 | 2.08 |
| U of T's expendable resources to debt capacity | 1.23 | 1.49 | 1.33 | 1.10 | 1.28 | 1.42 |

[2] The ratios for prior years have been recalculated to make them more comparable to our U.S. peers.

The chart above illustrates that U of T's expendable resources to long-term debt ratio[3] of 2.08 is within the range of the medians for its rating peers.  This means that U of T has similar expendable resources to support long-term debt than its rating peers. Adding the debenture of $200 million issued to March 2012, would have changed the ratio for fiscal 2011 to 1.51.

## Total Resources to Long-Term Debt:

This Moody's ratio measures the coverage of direct debt by total financial resources including permanent endowments. Using Moody's definition, the University's total financial resources include net assets adjusted for pension liability and employee future benefits obligations, less investment in capital assets plus deferred contributions.




| | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 |
|---|---|---|---|---|---|---|
| Aaa total resources to debt | 3.89 | 4.27 | 3.59 | 2.67 | 2.85 | |
| Aa1 total resources to debt | 2.66 | 2.93 | 2.69 | 1.94 | 2.08 | |
| Aa2 total resources to debt | 2.11 | 2.30 | 1.93 | 1.77 | 1.85 | |
| Aa3 total resources to debt | 1.72 | 1.83 | 1.83 | 1.53 | 1.38 | |
| U of T's total resources to debt | 4.35 | 4.52 | 4.40 | 3.42 | 4.16 | 4.55 |
| U of T's total resources to debt capacity | 3.39 | 3.73 | 3.28 | 2.52 | 2.85 | 3.10 |

U of T's total resources to long-term debt ratio[3] of 4.55 is well above medians for its rating peers. This means that U of T has higher levels of total resources to support long-term debt than its rating peers.  Adding the debenture of $200 million issued to March 2012, would have changed the ratio for fiscal 2011 to 3.3.

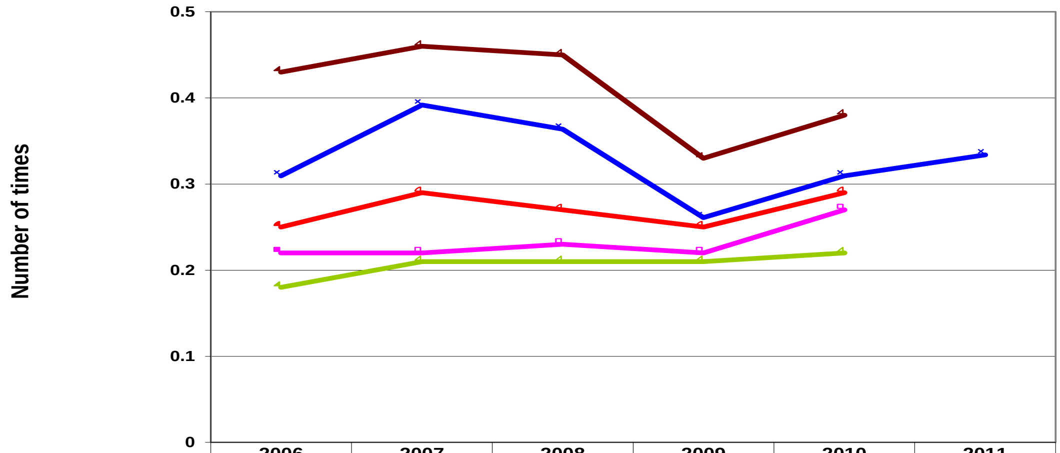
## Unrestricted Resources to Expenses:

This Moody's ratio measures the coverage of annual expenses by the most liquid resources, the unrestricted net assets. The chart below illustrates that U of T's ratio[3] of 0.33

[3] The ratios for prior years have been recalculated to make them more comparable to U.S. peers.

is slightly above its rating peers. This means that U of T has similar unrestricted resources in comparison to its annual expenses than its rating peers.

**Unrestricted Resources to Expenses**
**Comparing University of Toronto to Moody's medians**

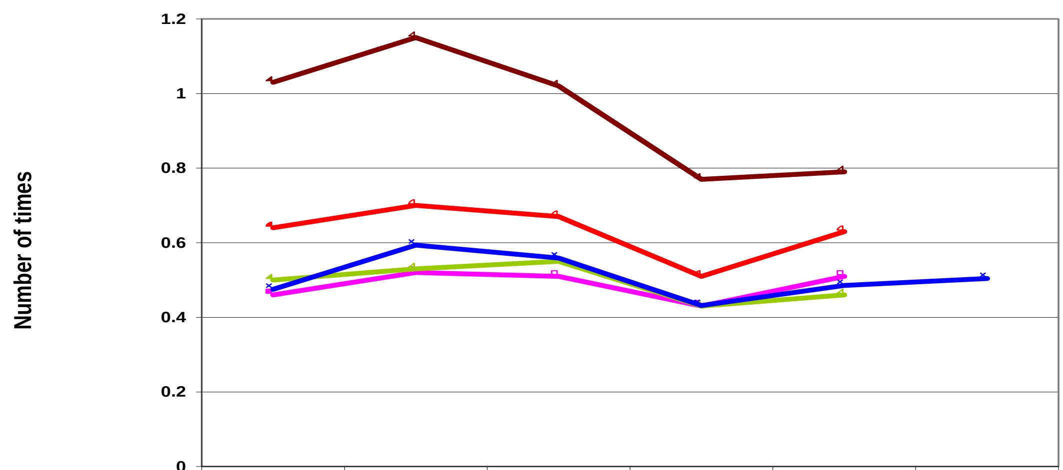



| | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 |
|---|---|---|---|---|---|---|
| Aaa unrest. resources to expenses | 0.43 | 0.46 | 0.45 | 0.33 | 0.38 | |
| Aa1 unrest. resources to expenses | 0.25 | 0.29 | 0.27 | 0.25 | 0.29 | |
| Aa2 unrest. resources to expenses | 0.22 | 0.22 | 0.23 | 0.22 | 0.27 | |
| Aa3 unrest. resources to expenses | 0.18 | 0.21 | 0.21 | 0.21 | 0.22 | |
| U of T's unrestricted resources to expenses | 0.31 | 0.39 | 0.36 | 0.26 | 0.31 | 0.33 |

## Expendable Resources to Expenses:

This Moody's ratio measures coverage of annual expenses by financial resources that are ultimately expendable, defined as unrestricted net assets plus restricted expendable net assets.

**Expendable resources to expenses**
**Comparing University of Toronto to Moody's medians**




| | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 |
|---|---|---|---|---|---|---|
| Aaa expen. resources to expenses | 1.03 | 1.15 | 1.02 | 0.77 | 0.79 | |
| Aa1 expen. resources to expenses | 0.64 | 0.70 | 0.67 | 0.51 | 0.63 | |
| Aa2 expen. resources to expenses | 0.46 | 0.52 | 0.51 | 0.43 | 0.51 | |
| Aa3 expen. resources to expenses | 0.50 | 0.53 | 0.55 | 0.43 | 0.46 | |
| U of T's expendable resources to expenses | 0.48 | 0.59 | 0.56 | 0.43 | 0.49 | 0.50 |

This chart illustrates that the U of T ratio[4] of 0.50 is below that of its rating peers. This means that U of T has fewer expendable resources in comparison to its annual expenses than its rating peers.

## What do these comparisons tell us?

+ Debt per student is below medians
+ Debt to total revenue is below medians
+ Actual debt service to expenses is below medians
+ Total resources to long-term debt is well above of medians
+ Unrestricted resources to long-term debt is above medians
+ Expendable resources to long-term debt is comparable to medians
+ Unrestricted resources to expenses is comparable to medians
- Expendable resources to expenses are below medians

In summary, we have borrowed externally less than our rating peers to date and we have more or comparable resources to support debt issuance.

Those ratios, where it was possible to test maximum borrowing capacity (debt limit) also indicate that the maximum external borrowing capacity (debt limit) to date is within the appropriate range as compared to our rating peers.

[4] The ratios for prior years have been recalculated to make them more comparable to U.S. peers.

# PROJECTING MAXIMUM BORROWING CAPACITY (THE DEBT LIMIT)

This report includes an estimate of the net assets for the next 5 years as a basis for projecting maximum borrowing capacity under the current borrowing strategy. However, the new accounting rules will likely impact both the calculation and amount of net assets, and so the forward projections presented here should be viewed with caution as they assume no change in accounting policies in the future. We have:

- Projected net assets to 2016.
- Calculated projected maximum external borrowing capacity at 40% of net assets averaged over 5 years.
- Assessed continued ability to provide $200 million internal borrowing from EFIP plus the internal borrowing of $150 million allocated from EFIP for pension funding. Note that this component of the borrowing strategy is not expected to be affected by the changes in accounting rules.

## Projecting Net Assets

Net assets increase due to:

1) net income mainly in operating and restricted funds, defined as revenues minus expenses for the year, and
2) growth in endowments from endowed donations and grants and from net reinvested investment earnings.

At April 30, 2011, actual net assets were $1.8 billion. By 2016, net assets are projected to be between $1.8 billion and $2.1 billion, using the following assumptions:

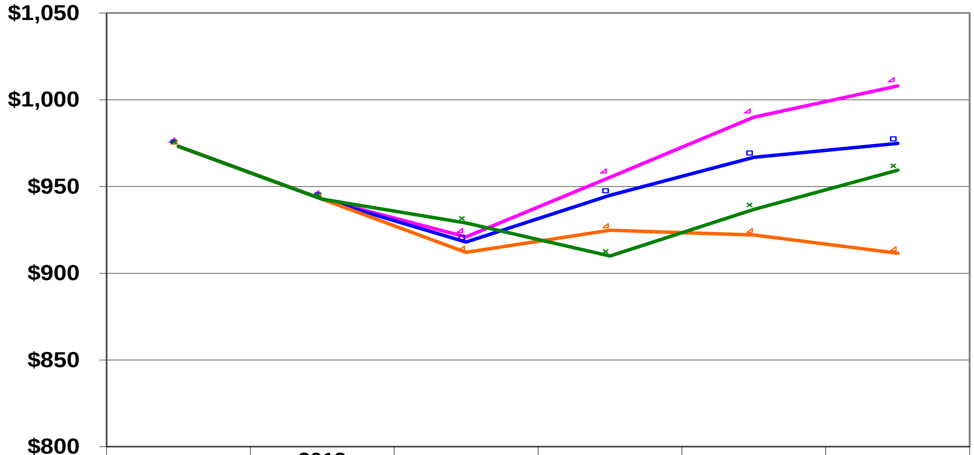
- Long range operating budget to 2016, assuming a balance budget which means that increases in budgeted expenses need to be offset with either increases in revenues or reduction of other expenses.
- Projected increases in pension and other employee future benefits incorporating UofT funding strategy for Pension *(Ensuring a Sustainable Pension Plan for the University of Toronto)* presented to Business board on January 31, 2011. Pension expense which is determined based on accounting rules, is calculated on an actuarial basis and reflects the cost of providing one year of pension service.

- Divisional carry forwards are projected to increase by $40 million in 2012, $20 million in 2013 and $10 million from 2014 to 2016.
- Preliminary ancillary budgets submitted to SARG to 2016.
- Investment return on endowments and other long-term funds is forecasted to be 2% for 2012.
- No additional net losses for the capital fund, assuming that transfers from operating fund will offset.
- Endowed donations of $35 million in 2012, increasing to $52.2 million by 2016.
- Endowed grants of $3.1 million per year.
- Endowment payout increases by 2% inflation annually from $7.41 per unit in 2010-11.
- A variety of investment return assumptions on endowments and other long-term funds from years 2013 to 2016: 6%, 10%, and 12%. These returns represent ten-year average returns of 4.3%, 5.7% and 6.5% respectively from fiscal years 2006 to 2016. A model using returns of 12% for 2013, 6% for 2014, 15% for 2015 and 7% for 2016 has been made to show some variability. These variable returns represent a ten-year average return of 5.7% from 2006 to 2016.

### Projecting borrowing capacity:

At April 30, 2011 the maximum external and internal borrowing capacity was $973.1 million. Assuming the current accounting rules, the projected net assets of between $1.8 billion and $2.1 billion by 2016 would result in a projected maximum external and internal borrowing capacity of between $911.6 million and $1,008 million by 2016.

**Projected Maximum External Borrowing at 40% Net Assets Averaged over 5 Years Plus $200 Million internal Borrowing from EFIP, at various Return Assumptions (millions of dollars)**




| | 2011 Actual | 2012 Forecast (2%) | 2013 Projection | 2014 Projection | 2015 Projection | 2016 Projection |
|---|---|---|---|---|---|---|
| 12% (average 6.5% 2006 to 2016) | 973.1 | 942.7 | 921.0 | 955.3 | 989.9 | 1,008.0 |
| 10% (average 5.7% 2006 to 2016) | 973.1 | 942.7 | 918.0 | 945.0 | 966.8 | 974.9 |
| 6% (average 4.3% 2006 to 2016) | 973.1 | 942.7 | 912.0 | 924.8 | 922.1 | 911.6 |
| 2013:12%, 2014:6%, 2015:15%, 2016:7% (average 5.7% 2006 to 2016) | 973.1 | 942.7 | 929.0 | 910.0 | 936.8 | 959.4 |

The table below summarizes the maximum borrowing capacity projected in January 2011 as compared to the projections in the current review, excluding the $150 million reserved for pension purposes, all assuming the current accounting rules:

**Projected maximum total borrowing capacity ranges (in millions)**

| | January 2011 Review | | March 2012 Review | |
|---|---|---|---|---|
| | LOW | HIGH | LOW | HIGH |
| April 30, 2011 | 961.0 | 961.0 | 973.1 | 973.1 |
| April 30, 2012 | 925.3 | 932.8 | 942.7 | 942.7 |
| April 30, 2013 | 890.1 | 914.0 | 912.0 | 929.0 |
| April 30, 2014 | 899.6 | 950.0 | 910.0 | 955.3 |
| April 30, 2015 | 894.3 | 983.1 | 922.1 | 989.9 |
| April 30, 2016 | | | 911.6 | 1,008.0 |

The actual maximum borrowing capacity for 2011 is higher than the amount previously projected due to the higher than expected return of the LTCAP at April 30, 2011 (9.9% actual compared to expected 5%). The current projected maximum borrowing capacity for the outer years based on the current accounting rules are also slightly higher than previously projected since we are using similar investment return projections to those used in last year's projection, but we start with higher than projected net assets at April 30, 2011.

Additionally, bank loans issued prior to 2001 are almost all amortizing loans, with principal being repaid to lenders each year. Similarly the individual internal loans from EFIP will decline over time as principal is repaid. External debenture borrowing is all repaid at maturity with no intervening principal repayments to external lenders. The principal repayments from bank loans and EFIP loans provide another $178.0 million in loan potential by 2016.

**Therefore, assuming that the projections of net assets are reasonable and assuming the current accounting rules, we would expect to have available between $911.6 million and $1,008.0 million in borrowing capacity by 2016, excluding the additional $150 million reserved for pension purposes. The current borrowing allocated to projects and other requirements by Business Board to March 31, 2012 is $1,053.3 million. With the additional $178.0 million in principal repayments on amortizing loans, the additional borrowing available to be allocated by 2016 is projected to be between $36.3 million and $132.7 million, excluding the additional $150 million reserved for pension purposes.**

The following chart shows the projected range of remaining borrowing available in each future year after taking into account principal repayments that can be reallocated, excluding the additional $150 million reserved for pension purposes and assuming the current accounting rules.

**University of Toronto Debt Strategy**

Borrowing Available Under Current Policy compared to Allocations (millions of dollars)

| | **Proj. 2012-13** | | **Proj. 2013-14** | | **Proj. 2014-15** | | **Proj. 2015-16** | | **Proj. 2016-17** | |
|---|---|---|---|---|---|---|---|---|---|---|
| | **LOW** | **HIGH** | **LOW** | **HIGH** | **LOW** | **HIGH** | **LOW** | **HIGH** | **LOW** | **HIGH** |
| **Maximum Borrowing Capacity** | | | | | | | | | | |
| Maximum external borrowing | 742.7 | 742.7 | 712.0 | 729.0 | 710.0 | 755.3 | 722.1 | 789.9 | 711.6 | 808.0 |
| Maximum internal borrowing | 200.0 | 200.0 | 200.0 | 200.0 | 200.0 | 200.0 | 200.0 | 200.0 | 200.0 | 200.0 |
| Total | **942.7** | **942.7** | **912.0** | **929.0** | **910.0** | **955.3** | **922.1** | **989.9** | **911.6** | **1,008.0** |
| **Allocations:** | | | | | | | | | | |
| Approved up to March 31, 2012 | 1,053.3 | 1,053.3 | 1,053.3 | 1,053.3 | 1,053.3 | 1,053.3 | 1,053.3 | 1,053.3 | 1,053.3 | 1,053.3 |
| **Less:** | | | | | | | | | | |
| Repayments that can be reallocated | (101.4) | (101.4) | (118.4) | (118.4) | (135.2) | (135.2) | (155.1) | (155.1) | (178.0) | (178.0) |
| | **951.9** | **951.9** | **934.9** | **934.9** | **918.1** | **918.1** | **898.2** | **898.2** | **875.3** | **875.3** |
| **Remaining to be allocated** | **(9.2)** | **(9.2)** | **(22.9)** | **(5.9)** | **(8.1)** | **37.2** | **23.9** | **91.7** | **36.3** | **132.7** |

From this chart, we observe that although borrowing available is projected to be between $36.3 million and $132.7 by 2016, there is not projected to be any more borrowing room in fiscal years 2012-13 and 2013-14 under the current accounting rules.

In addition, at April 30, 2011, the outstanding external debt was $524.1 million. With the issue of Series E debenture for $200 million to March 31, 2012, the outstanding external debt at March 31, 2012 was $724.1 million.

From the chart above, we can observe that the maximum external borrowing capacity at 40% of net assets averaged over 5 years is expected to fall below the actual external borrowing of $724.1 million in a number of the future years under the current accounting rules. If this occurs, it will trigger the constraint that no further external borrowing can occur until such time when external borrowing is 33% of net assets averaged over 5 years. This means that net assets averaged over 5 years would need to reach $2.2 billion, before UofT would be able to issue additional external borrowing. This is ultimately unworkable since borrowing allocations have already been made that must be financed externally.

**However, as noted earlier, limited reliance should be placed on the above analysis since the accounting rules are changing.** We will incorporate the impact of the new rules in the upcoming review of the borrowing strategy.

Finally, we have continued to monitor the University's EFIP balances and cash flow requirements and confirm that the currently-assigned $200 million internal borrowing capacity and the $150 million allocated for pension funding can be maintained over the longer term, based on the current cash flow patterns.

# Other Considerations - Credit Ratings

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

The credit rating also influences the interest rate paid by the borrower, reflecting how much the lender wants to be compensated for assuming the risk related to repayment of the debt. Note that other determinants of the interest rate are the underlying interest rates for Government of Canada bonds and spreads between Canada and Ontario bonds at the moment of debt issue.

The following chart compares U of T credit ratings with our Canadian peers and with our U.S. AAU (Association of American Universities) peers and with the Province of Ontario, all at June 2011.

**Credit Rating Comparison**
**University of Toronto with US and Canadian Peers at June 2011**

| **Rating Definitions** | **Moody's Investors Service** | **Standard & Poor's** | **Dominion Bond Rating Service** |
|---|---|---|---|
| Best quality | Aaa | AAA | AAA |
| Next highest quality | Aa1 | AA+ | AA(high) |
| and so on, declining | Aa2 | AA | AA |
| | Aa3 | AA- | AA(low) |
| | A1 | A+ | A(high) |
| | A2 | A | A |
| | and so on | and so on | and so on |

| **University** | **Moody's Investors Service** | **Standard & Poor's** | **Dominion Bond Rating Service** |
|---|---|---|---|
| **PROVINCE OF ONTARIO** | **Aa1** | **AA-** | **AA(low)** |
| University of Texas system | Aaa | AAA | |
| University of Michigan | Aaa | AAA | |
| Queen's University | | AA+ | AA |
| University of Washington | Aaa | AA+ | |
| University of British Columbia | Aa1 | AA+ | |
| **University of Toronto** | **Aa1** | **AA** | **AA** |
| University of California | Aa1 | AA | |
| University of Ottawa | Aa1 | | AA |
| McMaster University | | AA | AA(low) |
| University of Western Ontario | | AA | |
| Ohio State University | Aa1 | AA | |
| University of Pittsburgh | Aa1 | AA | |
| University of Minnesota | Aa1 | AA | |
| McGill University | | AA- | |
| University of Illinois | Aa2 | AA- | |
| University of Arizona | Aa2 | | |

Source: Credit rating agencies' websites and reports.

The table above indicates the credit rating definitions and the ratings assigned to those of our US and Canadian peers that have been rated by the University of Toronto's rating agencies.

As the above chart illustrates, the University of Toronto continues to maintain excellent credit ratings, absolutely and in comparison to our peers and is rated above the Province of Ontario by two rating agencies.

The current borrowing strategy does not specify a minimum credit rating. Many factors affect credit ratings at any point in time, such as:

- Student demand.
- Government policy and funding.
- Debt per student ratios.
- Levels of unrestricted resources.
- Investment performance.
- Quality of senior management

We continue to believe that while the University of Toronto should continue to maintain good credit ratings, both as comfort to our lenders regarding our ability to repay debt, and as a general indicator of financial health, it is not necessary to set credit rating floors. There are too many variables involved, some of which can be quite short-term, to enable credit ratings in themselves to act as a constraint to ensure the continued financial prudence of the borrowing strategy. However, we will examine that position again as part of the review of the current borrowing strategy, in light of any other changes that might be made to the strategy going forward.

# OTHER CONSIDERATIONS - DEBT SERVICE AND DEBT REPAYMENT

The question facing the University of Toronto is how much more do we want to spend ON the classrooms and other facilities rather than IN the classroom?

It is important to note that current outstanding debt is at fixed rates of interest, so that debt service and debt repayment on those obligations are declining as a percent of revenues and expenses over time.

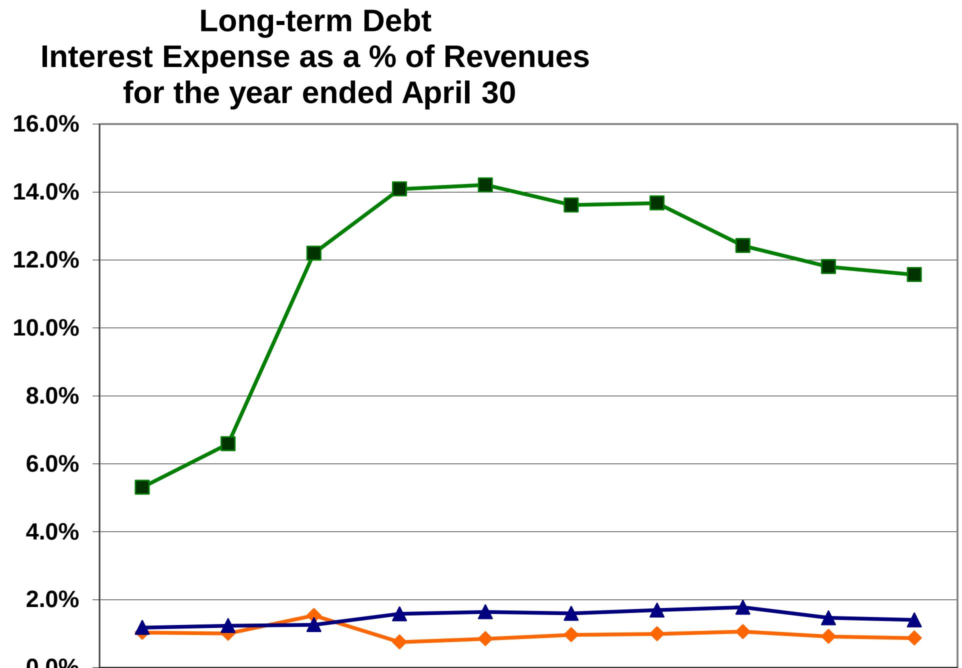
Evaluation of ability to service and repay debt is done on a project by project basis, and it is assumed that the sum of these individual evaluations will aggregate to an overall ability to service and repay the debt with low risk of default.

Internal borrowers, such as academic divisions or residence operations, are required to sign loan agreements under the University's internal financing program, which require regular principal and interest payments at specified fixed interest rates that are linked to market rates.

Those principal and interest payments are deposited into an internal sinking fund (the long-term borrowing pool, or LTBP) along with investment earnings on the LTBP balance. That sinking fund is drawn down by periodic interest payments to lenders and by payment of issue and ongoing administrative costs such as commission, legal and accounting fees and by ongoing trustee and rating fees. The expectation is that the net sum of additions and drawdowns will be sufficient to repay each debenture upon maturity.

## Debt Service – Interest Expense on External Debt:

At April 30, 2011, the interest expense on outstanding external debt was $32.6 million for the year. This was 1.4% of total revenues, and 1.4% of total expenses. Operating fund interest expense was 0.9% of operating fund revenues while ancillary interest expense was 11.6% of ancillary revenues.




| | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 |
|---|---|---|---|---|---|---|---|---|---|---|
| Op Fund interest expense as a % of Operating revenue | 1.0% | 1.0% | 1.5% | 0.8% | 0.8% | 1.0% | 1.0% | 1.1% | 0.9% | 0.9% |
| Ancillary interest expense as a % of Ancillary revenues | 5.3% | 6.6% | 12.2% | 14.1% | 14.2% | 13.6% | 13.7% | 12.4% | 11.8% | 11.6% |
| Interest as a % of total revenues | 1.2% | 1.2% | 1.3% | 1.6% | 1.6% | 1.6% | 1.7% | 1.8% | 1.5% | 1.4% |

## Principal and Interest on External and Internal Debt:

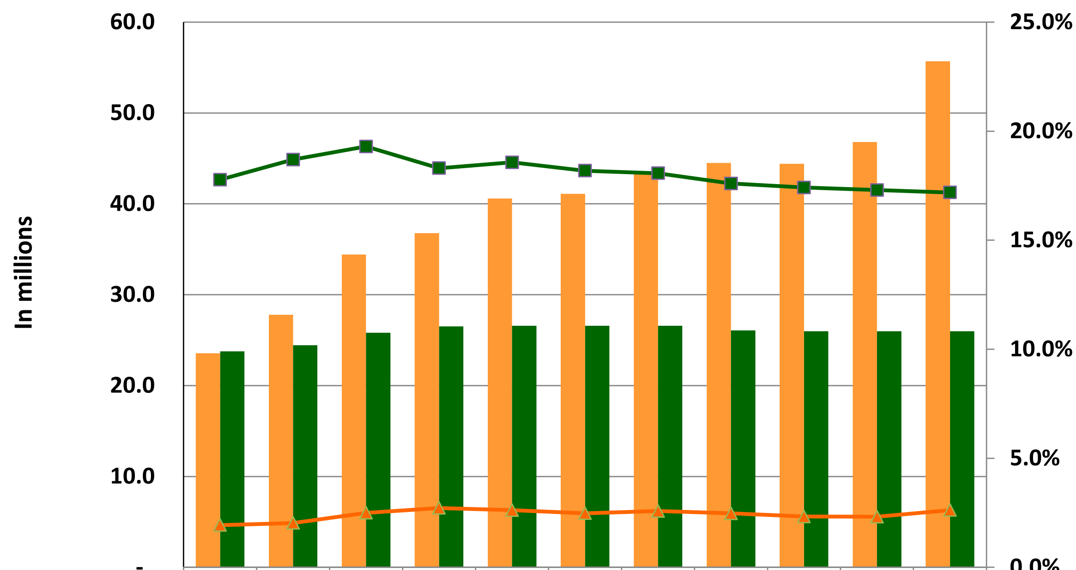
Borrowing, whether internally or externally financed, is covered by the internal financing program, which requires formal loan agreements with regular principal and interest payments for set periods, with interest charged at fixed rates linked to market rates at the issue date of the loan agreement. Therefore, evaluating the principal and interest payment load on the University must take this into account.

The $1,053.3 million in borrowing allocated by the Business Board to March 31, 2012 has been distributed as follows: $753.6 million to academic buildings and other requirements and $299.7 million to ancillary operations. The actual and estimated principal and interest repayment on this allocated borrowing is projected to be $81.7 million per annum by 2016 distributed as follows: $55.7 million per annum to be paid by the operating fund and $26.0 million per annum to be paid by ancillary operations.

The graph below shows the projected principal and interest repayment required in each of the next 5 years for borrowing that has been allocated to March 31, 2012.

Repayments will increase from 2012 as projects are completed and repayments for those projects commence. However, these repayments as a percentage of revenues will remain flat or will decrease since operating and ancillary revenues will increase over time.

**Actual and Projected Debt Service Cost (Principal and Interest) for Projects Allocated to March 31, 2012 - for the years ended April 30**




| | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Paid by operating fund | 23.6 | 27.8 | 34.4 | 36.8 | 40.6 | 41.1 | 43.6 | 44.5 | 44.4 | 46.8 | 55.7 |
| Paid by ancillary fund | 23.8 | 24.4 | 25.8 | 26.5 | 26.6 | 26.6 | 26.6 | 26.1 | 26.0 | 26.0 | 26.0 |
| As a % of operating revenue | 1.9% | 2.0% | 2.5% | 2.7% | 2.6% | 2.5% | 2.6% | 2.5% | 2.3% | 2.3% | 2.6% |
| As a % of ancillary revenue | 17.8% | 18.7% | 19.3% | 18.3% | 18.6% | 18.2% | 18.1% | 17.6% | 17.4% | 17.3% | 17.2% |

The current borrowing does not place any limits on debt service or debt repayment percentages.

External debt service is partly dependent on total debt and partly dependent on interest rates. Since interest rates are fixed, debt service on currently outstanding debt will fall over time as a percent of revenues and expenses.

Allocation of debt to individual projects or divisions is based on their ability to repay that specific loan, while the aggregation of individual assessments provides the overall assessment of ability to repay debt.

Under the current strategy, the various measures that have been put in place are deemed to be sufficient control over debt service and debt repayment and no specific limits are considered necessary. However, ability to repay is a central element in any borrowing strategy and we believe that it would make sense to include this in some form into the revised borrowing strategy.

## Conclusion

This review has considered the current borrowing strategy and has found the following:

- Under the current accounting rules, we are right at the limit of our borrowing capacity and projected borrowing capacity is expected to decline for the next couple of years.

- Although the new accounting rules could change our balance sheet in a favourable way, we do not believe that it is appropriate to borrow more simply because changing accounting practices make our balance sheet look better. We want to continue to manage borrowing in a strategic way, as a scarce resource, in absolute terms and in comparison to our peers.

- Comparison to our peers indicates that the University has borrowed less than our external peers and that we have or comparable resources to support debt issuance.

- Credit ratings continue to be high (Moody's Aa1, negative outlook, DBRS AA stable outlook and S&P AA negative outlook) although the size of the pension deficit is cited as a challenge.

- Debt service and debt repayment continue to be reasonable.

- Internal borrowing levels continue to be reasonable, without impairing immediate cash flow requirements.

Thus, it may be reasonable to add very modestly to our borrowing capacity.

We are working on a detailed review of the current strategy. The Business Board can expect to hear more on this in the coming months.