MEMO

To: Members of the Board of Governors

From: P. Marc Joyal, CPA, CA, Vice-President, Resources

Date: May 26, 2014

Subject: 2014-2015 Budget

INTRODUCTION

The 2014-2015 budget presents revenues and expenses for the following University of Ottawa funds:

1. Operating
2. Ancillary services
3. Trust and research
4. Capital

This budget takes into consideration the regulatory framework governing Ontario universities as well as the financial issues facing the University in the upcoming and subsequent years, based on the information available as at April 30, 2014.

CONTEXT AND PREPARATION OF 2014-2015 BUDGET

Like other Ontario universities, the University of Ottawa has had to take a number of factors into consideration when drawing up its budgets for a number of years now—factors such as legal obligations, demographics, the volatility of financial markets as well as the financial constraints imposed by governments—while at the same time ensuring we move forward on goals outlined in its strategic plan, Destination 2020. For 2014-2015, the most important factors include:

- A levelling off of student numbers
- A 2% decline in government funding for 2014-2015 over 2012-2013, which translates into a $8.3M reduction in funding this year
- The regulatory framework governing tuition and other fees
- Increase of 3.4% in operating grant funding and 1.1% in overall funding in 2014-2015 (6.3% and 6.2%, respectively, in 2013-2014), requiring the University to set increases in spending to levels below institution inflation, which ranges from 5 to 8% annually according to the Ontario government.¹
- The challenge of maintaining the proportion of the University’s revenue that comes from Canadian tuition fees. Over the last 10 years, the proportion of total revenues from Canadian tuition fees has remained stable at about 36%
- Increased use of accumulated surpluses by faculties and services to cover rising costs. In 2014-2015, faculties and services will need to draw more than $13M

¹ Source: Ministry of Training, Colleges and Universities
from their accumulated surpluses to cover current financial and structural requirements.

- The necessity to continue investing the funds required to support Destination 2020 goals and for large-scale projects, including replacement of the student information system (SIS), at a cost of $42M over the next three years.

We will see a new and troubling trend in 2014-2015 and subsequent years—a levelling off and then a decrease in the number of students in Ontario. While student enrollment has grown on average 2.4% over the past three years and 4% since 2000, we predict only 0.6% growth in 2014-2015, with the total number of students hitting 42,590. The challenge will only be greater in 2015-2016 and 2016-2017, when the University expects to see a drop of 1.2% in the number of students over these two years if no steps are taken to mitigate the decrease. Every 1% drop in student numbers represents a reduction of more than $7.3M in funding and revenues from tuition fees. In order to counter this trend, the University has adopted a recruitment strategy to reach students outside the National Capital Region and in specific international markets.

For 2014-2015, demographic changes and changes to admission requirements—particularly changes related to minimum admission averages, and new strategies for recruiting international students make predicting student numbers accurately more difficult; any changes in student numbers have a direct impact on projected revenues in the 2014-2105 budget.

This information served as the background for the 2014-2015 budget exercise. Just as we did when preparing the 2013-2014 budget, the University held consultations with key partners on budgetary priorities. For 2014-2015 These consultations provided an opportunity for discussions with members of the University community on the priorities, issues and challenges the University faces in preparing its budget for 2014-2015, and beyond. Members of the University community provided their feedback and suggestions, which assisted the University in preparing its budget proposal.

The Budget Consultation Report presented by the Budget Advisory Committee to the Administrative Committee last month can be found online.

In addition, in February 2014, President Rock presented Roadmap@Destination2020. This document lays out the issues we must address in order to get “there from here” and to reach “Destination 2020 in the age of differentiation and financial challenges.” Section three of the document, which deals with the University’s financial condition and the challenges we’ll face over the coming years, identifies the structural challenges and, in particular, the diversification of revenues necessary to maintain a balanced budget.

**HIGHLIGHTS**

- The consolidated financial position of the University’s (based on the accounting principles used to prepare the audited financial statements) projects a deficit of more than $41M. Operating expenses will exceed revenue by approximately $27.5M in 2014-2015. The shortfall will be covered by surpluses accumulated in past years for this purpose (use of net assets). Given this financial situation, the University’s goals laid out in Destination 2020 and changing government policies, the University launched Roadmap@Destination2020, which describes in detail the approach we need to change the University’s financial structure.

- As required by the University’s budget policy, the 2014-2015 operating fund budget is balanced. The ability to do so depends on increasing revenue related to indirect research costs, increasing donor contributions and immediately reducing spending, including a reduction of $4.7M for renovations (Facilities Renewal Plan) and postponing $4M of planned spending on Destination 2020 initiatives, earmarking instead $3.5M. These measures take into account the pace of implementing strategic initiatives, particularly the hiring of new professors.

Faculties and services will have to use $13M of their accumulated surpluses in order to balance their budgets. The Faculty of Arts faces some particularly difficult challenges, with an anticipated
deficit of $4.8M for 2014-2105, due in great part to a substantial drop in student numbers. An external evaluation of the Faculty’s programs is currently under way, the results of which will have an impact on the recovery plan the Faculty is to present between now and the fall of 2014. In 2013-2014, the University used $5M of accumulated surpluses to fund the Faculty’s activities.

- This situation reflects the structural financial challenges the University faces. At this pace, all faculty and service accumulated surpluses will be depleted within three years. The University cannot continue balancing our budget through one-time reductions or cuts, which serves to only delay creating a financial structure that is sustainable over the long term. Although policies and regulations governing the budget process allow us to use surpluses accumulated in past years to balance the current budget, using surpluses to cover structural deficits on a regular basis is not a sound practice.

- The University has always been concerned with maintaining the proportion of its revenues from tuition fees. Tuition was the topic of many discussions among members of the Budget Advisory Committee. While recognizing the need to increase tuition fees an average of 3% for Canadian students, as provided for in provincial regulations, the Committee ensured contributions by Canadian students to the University’s revenue would remain at the same level as they have been for the past years. The University is maintaining the proportion of its revenue coming from tuition fees at 35.5%, the same levels as in 2004-2005.

- The proportion of the University’s revenue coming from grants is the lowest it’s been in 10 years, going from 54.4% in 2004-2005 to 49.2% of total operating fund revenues in 2014-2015. This is the first time grant revenue has fallen below the 50% mark, clear evidence of the ongoing cuts in grants over the last decade. This loss in grant revenues (which represents $40.1M) has been countered in part through the University’s efforts to increase the number of international students, which account for 8.8% of operating fund revenues in 2014-2015 compared with 4.7% in 2004-2005. Essentially the proportion of revenue from the international student group has almost doubled in 10 years. The University would like to continue growing this portion of its student base, in keeping with the goals of Destination 2020 (target is 9%). As a clear indication of where we sit, we expect international students to make up 10% of our student base in 2014-2015. Growth will be mainly in the number of international students who wish to study in French, by offering Canadian tuition fee rates to students who meet the program criteria. It’s important to also highlight the increased investment revenues from the operating fund.

- With improved student experience the top priority of Destination 2020, the University has included the resources necessary to hire 60 new professors between now and 2016 in its budget. This important initiative will result in a lower overall ratio of students to professors and improve the overall student experience.

- Replacement of the University’s student information system (SIS) will begin in 2014-2015. This project, an essential element of improving the student experience and at the heart of the University’s information management systems, requires an investment of over $42M over the next three years, including $18M in 2014-2015.

BALANCING THE BUDGET – KEY INITIATIVES

In order to present a balanced budget for 2014-2015, the University is recommending a number of adjustments be made. Some of them are structural in nature, but others are one-time or immediate measures.

A number of the recommendations come from the Budget Advisory Committee.

The most important to mention here are:
a) Revenue

- **Research – General fees and indirect costs**: Proposed $1M increase in revenue from general and indirect costs;

- **Giving**: $1M increase in revenue from donors to support financial aid and awards currently financed by the operating fund.

b) Expenditures

- **Financial aid and awards**: Increase the envelope to 6.8% for a total of $72.3M in 2014-2015, compared with the much lower 3.9% increase for all other expenditures combined. This increase takes into account the increase in financial aid equivalent to 10% of the tuition-fee increase. It also includes an envelope of $2.5M to help recruit French-speaking international students by offering them Canadian tuition fees if they choose to study at French. The University continues to review all its financial aid offerings to ensure they remain relevant and appropriate and to remain competitive among Canadian universities.

- **Wages and benefits**: Budget envelopes for wages and benefits take into account current collective agreements. The University was able to balance the budget without any hiring or salary freezes. We will continue to accept requests to regularize positions and to create new positions on a case-by-case basis so we can assess the need and pertinence for each one.

- **Construction and renovations**: Proposed $4.7M reduction in the 2014-2015 envelope for renovations under the building inventory improvement plan (PAPI). However, this approach is not a long-term solution as it would compromise the University’s ability to maintain its buildings and support new research and academic activities.

- **Library acquisitions**: Proposed reduction in the historical acquisition rate from 5% to 3%. The University recognizes, however, the necessity to continue to fund the envelope for acquisitions.

- **Destination 2020 envelope**: With an initial envelope of $7.5M for Destination 2020 initiatives, particularly the hiring of additional professors, the University has already targeted programs and activities to receive this funding. To take into account the rate at which we expect to implement these initiatives, we recommend this envelope be reduced from $7.5M to $3.5M.

**CHALLENGES AND OPPORTUNITIES BEFORE US**

**Challenges**

The University has always been able to find solutions in order balance its budgets over the years, in spite of the challenges they may present. The University’s prudent and rigorous approach to financial planning often causes members of the University community to ask, “Is the University really facing a structural deficit?” This structural deficit we will face in years to come is very real, due in part to the following factors:

a) **Levelling off and potential drop in student numbers**: Having experienced continued growth in student numbers and revenues over the past 10 years, the University is now facing a new reality that negatively affects its ability to increase revenues.

b) **Issues related to the pension plan**: The pension plan presents a number of major challenges.
• Significant variations in actuarial valuations from one year to the next, which has serious repercussions on the University’s operating budget.

• Regular and significant increases in overall pension costs. While in 1999 total regular employee-employer contributions (for current service) were 13.8% of contributory salaries, in 2014 these contributions are 20.4%, for similar pension benefits. A 48% increase over the years has required annual investments of $20M in the pension plan by the University (excluding special payments).

• The uncertainty surrounding the solvency valuations of the pension plan. Albeit theoretical, this valuation method is mandatory under the law and the results it produces require the University to make significant special payments. If the University had not qualified for the Government of Ontario’s mitigation measures, we would have had to make special payments of $62M per year beginning in 2014 to cover the actuarial deficit, which, as we can imagine, would have had a disastrous effect on our operating fund.

The actuarial assessment filed on January 1, 2013, projected special payments of $12M from 2014 to 2016 and $32M from 2017 to 2026. Following our application for stage 1 funding relief, we are able to extend the period over which we have to make these special payments. The stronger markets in 2013 will have a positive effect on the results of the January 1, 2014, actuarial valuation and will reduce the pension plan deficit. Although this improvement was not anticipated at the outset, it may be advantageous to file the actuarial valuation as at January 1, 2014, nonetheless, based on the revised assumptions including those related to the pension plan. As a result of the support we received from our employees, who agreed to a 0.8% increase in their contributions in 2015 and 2016, we’re confident we’ll be able to satisfy the criteria to qualify for the Government of Ontario’s stage 2 funding relief. However, these savings can only be achieved if we meet the requirements for stage 2 funding relief and receive approval from the Ministry of Finance. Once we receive this approval, which can take several months, the amount of the reduced special payments will be used to fund the University’s priorities.

It’s important to keep in mind that the increasing costs of the pension plan, described above, will continue to be an important financial element we must address in order to minimize the negative impact and consequences on being able to achieve our mission.

c) Cost of bilingualism: The University of Ottawa has the privilege and the requirement to offer its programs and services in both of Canada’s official languages and to promote linguistic duality in Ontario. The University allocates a great deal of its resources to meeting this requirement and in order to offer francophones a quality university education. The additional costs of bilingualism is approximately $62M of which $32M is offset, leaving a shortfall of $30M

d) Roadmap@Destination2020: This document lays out the issues the University must face over the coming years and in particular those of a structural nature.

e) Using one-time solutions to address structural challenges: The University has been able to find solutions in order to maintain a balanced budget. However, as is noted in the Budget Consultation Report, one-time measures are not sustainable over the long term. The Committee stressed "that the University is facing a structural financial challenge and that the university must develop and implement an overall long-term vision. The University’s limited capacity to increase its traditional sources of revenue, such as grants and tuition fees, combined with an expenditure increase over the rate of inflation, will put significant pressure on the University in the future. New initiatives such as diversification of revenues, pension plan cost reduction and review of the internal funding formula need to be seriously considered.”

The University's approach has served it well in maintaining a healthy financial position and has made it possible for our institution to ensure a balanced budget year after year. However, our capacity for innovation and change is greatly reduced in a context where we rely on one-time

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solutions, and would put our institution in a precarious position. The University must therefore address these new requirements through structural reform, which will be a difficult undertaking if we don’t free up the necessary resources to do so.

Opportunities

There are also a number of opportunities in the years to come. The Government of Ontario has shown some comprehension with respect to the problem of deferred maintenance of our buildings, as it will gradually increase provincial funding in this area, from $17M this year to $40M in 2015-2016 and $100M in 2019-2020. The government is also allocating $800M in funding for campus expansion as part of its commitment to ensure Ontario colleges and universities can expand, renovate and upgrade their facilities. This program is of particular interest to the University of Ottawa as it explores the possibility of partnering with other Ontario universities and colleges to create a French campus in Southwestern Ontario.

In its budget of May 1, 2014, the Ontario government announced $250M in funding to support research, including matching funds for the Canadian Foundation for Innovation program. The most recent federal budget also proposed a new funding envelope, the Canada First Research Excellence Fund, with $50M in 2014-2015, reaching $200M in 2018-2019, to help Canadian postsecondary institutions excel in research.

The University continues to develop plans and set directions related to the two projects targeted in the $127M capital plan for 2012-2017—the Faculty of Health Sciences and the new learning centre. These two projects, which will greatly improve the University’s facilities and help create a richer student experience, will be an important addition to recently opened Advanced Research Complex (April 2014), an innovative world-class research facility.

Finally, the University is planning to increase the number of students it can accommodate in residence with the construction of a 170-bed residence in the fall of 2015 (on Henderson Avenue) and by entering into a long-term lease for a building on Friel Street in the fall of 2014. These two large-scale self-financed projects will provide many additional student residence spaces, which has been one of the University’s long-standing goals. We continue to explore other opportunities for additional residence spaces.

CONCLUSION

The University of Ottawa believes the budget for fiscal year 2014-2015 is consistent with the goals set by the Board of Governors, although it recognizes it must soon take significant measures if it is to maintain a secure financial position in the coming years. Consequently, in keeping with Roadmap Destination2020, the University’s administration plans to undertake a consultation process that will allow us to make significant changes to our activities and achieve long-term financial viability.

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