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MEMORANDUM

To: Board of Governors

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

Date: May 30, 2016

Subject: **2016-2017 Budget**

INTRODUCTION

The University has prepared its 2016-2017 budget to support the goals of *Destination 2020* and to maintain the momentum gained over recent years in teaching and research as well as the student experience. However, the University must take into account budgetary constraints our institution, just like all Ontario universities, is facing. Compared with previous years, 2016-2017 represents a year of significant change, particularly with respect to the student population.

The 2016-2017 budget presents the details of revenues and expenses for the operating fund, the ancillary enterprises fund, the research and trust fund and the capital fund. This budget takes into account the regulatory framework governing Ontario universities and is based on information available as at April 15, 2016.

The University uses fund accounting to track sources of financing, allocation of resources and restrictions, including transfers allowed between the different funds. A modified cash accounting method is used to prepare the budgets and ensure the funds are appropriately managed.

THE NEW CONTEXT FOR 2016-2017 AND ITS IMPACT ON BUDGET PLANNING

The University is considering a number of opportunities and must take into consideration a variety of external and internal factors influencing its operations and that have an impact on the allocation of resources. Taking into account these factors, the University remains on track with its goals outlined in *Destination 2020*.

Opportunities

The University has laid a solid and sound foundation to deal with the wave of changes in its path. We have developed internationally recognized levels of expertise in our programs and research. Our international reach continues to grow.

The current and future context opens the door to a number of opportunities, including:

- **New support for students:** Although measures announced in the provincial and federal budgets will take effect in 2017-2018, the University, in cooperation with the province, can develop innovative and structural measures that will provide immediate and ongoing financial support to students from more disadvantaged families, in addition to creating greater transparency when it comes to tuition fees. When we take into account the various tax credits and the financial support available from the University, many students pay a net amount that is less than 20% of the posted tuition fees. The current fragmented approach involving a variety of steps and different sources makes this fact difficult to see. The Government of Ontario's new approach will be significantly easier to see and understand, allowing both universities and students to gauge their effect.

- **Research development:** The development and growth in our research activities has been remarkable. We are starting to see the positive impact of the new Advanced Research Complex. The University's high level of success with the Canada Foundation for Innovation's Innovation Fund (close to $60M in funding secured) will allow the University to take its place as a leader in its areas of expertise. The 2017 Innovation Fund call for proposals represents a potential of $120M in funding for our institution.

- **Internationalization and promotion of the francophonie and bilingualism:** Internationalization and bilingualism are two of the University's four main institutional priorities. Recall that our initial target of 9% of the student body to be made up of international students was increased to 15%. With the number currently sitting at 12%, we believe we can reach this goal, which will help us partly offset the demographic decline we are seeing in Eastern Ontario.

  The University of Ottawa's differential tuition fee exemption, which has allowed international students registered in a French-language program to pay the same tuition fees as Canadian students since 2014-2015, has significantly increased the number of French international students at the University and is a major contribution to gaining a reputation as a leading bilingual institution on the world stage. The number of international francophone students has increased by more than 500 students in two years, going from 524 in 2014-2015 to an estimated 1,028 in 2016-2017.

  We have also created a joint school of medicine in Shanghai, an innovative initiative that positions the University of Ottawa well in China and will facilitate exchanges in terms of both teaching and research. In addition, we opened the Max Planck–uOttawa Centre for Extreme and Quantum Photonics last spring. It is one of only three such laboratories in North America. The University also now houses the International Longevity Centre, part of an international network that focuses on helping people live longer, healthier lives.

- **Recognition of our efforts in energy efficiency and real property management:** According to *UI GreenMetric World University Ranking 2015*, the University ranks second among Canadian universities and 27th worldwide in sustainable development. In addition, the firm Sightlines determined that efficiency and productivity measures resulted in $25M in cost avoidance. This remarkable result made it possible for the University to allocate substantial additional resources to our teaching and research activities. They also contribute directly to sustainable development, proof that sustainable investment is possible without compromising economic development. We must continue to invest in maintaining and developing our very diverse but aging real property—over 550,000 square metres of space—with deferred maintenance costs in the area of $360M. The Government of Ontario is continuing with its goal of increasing provincial funding in this area to $100M in 2019-2020. Each dollar not spent today to maintain our buildings translates into expenses that will be two to three times higher in the future. The University will also send out a request for tender in 2016-2017 that will involve a thorough review of the cleaning and housekeeping services in order to increase the productivity and efficiency of how these services are delivered.

- **Campus development:** In 2015, the Board of Governors approved the campus master plan, which will guide development of the campus over the coming decades and serve as the basis for infrastructure development. The response of the University community has been enthusiastic and will allow us to plan our investments in order to meet our capital project needs for the coming years. The Learning Centre ($80M) is well under way and will be completed by the beginning of 2018. The new labs in Marion Hall ($11M) will increase our teaching and research lab space considerably. Conversion of parking lot X into a green space as of May 2016 ($5.5M) and the opening of the 24/7 dining hall in the University Centre last September ($5.5M) bring greater vitality to the campus and give new life to the student experience. In addition, market conditions for financing in the form of long-term debt are quite favourable. As a result, we must anticipate the University moving forward with a long-term loan for infrastructure development.

- **A large-scale fundraising campaign:** The most ambitious fundraising campaign in the history of the University, launched in 2015, is now in full swing. The $400M campaign aims to draw $35M to $40M each year until 2020 for the University's activities in support of its mission. The campaign has already raised a total of $183M. Philanthropy will play an increasingly important role in recruiting and retaining professors, enhancing the student experience and developing campus infrastructure.

- **Development of housing and other ancillary enterprises:** Since 2013-2014, the University has increased total beds available by 43%, to bring the total to 4,300 beds by September 2016. To guide this expansion, Housing Service created a strategic development plan. This plan, approved by the Administration Committee and the Executive Committee of the Board of Governors, demonstrates the need for 1,600 additional beds and work to be done on residences built in the 1960s and 1970s. In addition, there are substantial deferred maintenance requirements. Major investments for this work, fully financed by Housing Service, are included in the plan. In order to ensure the long-term viability of the residences, the University reviewed its financial structure and is making the necessary adjustments to meet this goal, including fee adjustments, to ensure it is competitive.

All other ancillary enterprises, which must be self-funded, have reviewed their revenue and expense structure in order to meet their long-term financial obligations.

External factors

A number of internal and external factors must be considered when preparing the 2016-2017 budget. Some of the most significant include:

- A drop in the number of 18- to 20-year-olds in Ontario and in the rest of Canada.

- Permanent reduction of 2% (over 2012-2013 levels) in government grants, resulting in decreased funding of $6.2M per year, with an accumulated loss in revenue of almost $20M since 2013-2014.

- The regulatory framework governing tuition and other fees, which expires in 2016-2017.

- Very volatile and unstable financial markets directly affecting the University's investment income and the financial status of the pension plan. Market volatility also has an impact on the decision-making process of our major donors and the timing of their gifts.

- The desire of donors to target their donations to specific projects and activities. The proportion of unrestricted gifts that can be directed to the operating fund remains low. The University must therefore find innovative ways for allowing these donations to support ongoing activities, and in particular our scholarships and financial aid programs.

Internal factors

The budget takes into account the University's decisions and direction as well as those of its Board of Governors. These factors help the University grow and improve and allow it to set itself apart:

- *Destination 2020*: Our strategic plan has influenced all our activities and the University's direction since 2011. Since then, the University has invested substantially each year in the four pillars of *Destination 2020,* and in fact an additional $15.7M in the 2016-2017 budget is directly linked to the University's commitment to reaching the goals of its strategic plan.

- Maintaining the proportion of the University's revenue that comes from Canadian tuition fees. For the past 12 years, about 36% of the University's operating fund revenue comes from Canadian tuition fees.

- Revenue diversification: For the past 10 years, more than 94% of operating fund revenue comes from tuition fees and provincial grants. Despite our diversification efforts, we have not seen the desired results in this area. The University's situation is no different from that of other Ontario universities.

- The intention to continue investing heavily in financial aid and awards: Scholarships and financial aid are the expenditure items that have grown at the highest rate since 2005-2006.

Spending under these programs has increased at a rate higher than the rate at which tuition fees have increased.

Changes in student numbers

All the above factors as well as a number of others affect the University's revenues and resource allocations. However, the most significant factor is the change in the student population. On November 1, 2014, we had a total of 42,575 students. We expect a total of 42,094 students as at November 1, 2016, and 41,708 as at November 1, 2018. This expected decrease in the number of students represents a significant change in the University's growth. Whereas it experienced a decade of continual growth between 2005 and 2014 (from 33,475 students to 42,575 students, respectively, representing a 27% growth), the University will see a 2% decrease in student numbers between 2014 and 2018.

Every drop of 100 in students represents a reduction of about $1M in provincial funding and tuition fee revenues. This means that the decrease of 481 students between 2014 and 2016, which will reach 867 in 2018, will result in a drop in revenues of about $5M for 2016-2017, with a cumulative loss of $21M by 2018-2019.

<u>HIGHLIGHTS</u>

- **Deficit:** The University is proposing a budget deficit of $4.9M in the operating fund for 2016-2017, compared with a deficit of $1.9M in 2015-2016. This deficit takes into account different structural and one-time measures, including a permanent 2% decrease in the base budgets of faculties and services beginning in 2016-2017.

- **Tuition fees:** The University is proposing an average increase in tuition fees of 3% for Canadian students. The increase is in keeping with the Ontario government's regulatory framework, which expires in 2016-2017. The contribution to revenues from Canadian students represents about 36% of the operating fund, a level that has remained unchanged since 2004-2005. The University is recommending an increase in international student tuition fees and in tuition fees for unregulated programs based on market conditions.

- **Government funding:** Since 2014-2015, the proportion of the University's revenue coming from government grants has been under 50% of total operating fund revenues. This trend will continue in 2016-2017, while revenue from grants represents 46.9% of operating fund revenue, compared with 56.1% 10 years ago. This loss in grant revenues (which represents $74.7M) has been countered in part through the University's strategy to increase the number of international students, who account for 10.8% of operating fund revenues, compared with 4.8% in 2006-2007. The proportion of revenue from international students has therefore doubled in 10 years. We expect 12% of our student population to be international students in 2016-2017, while our Destination 2020 target is 15%. The University continues to work on increasing the number of international students studying in French by offering them tuition rates equivalent to those for Canadian students.

- **Investment income:** Investment income represents 3.6% of operating fund revenues in the 2016-2017 budget (based on expected long-term return of 7.65%), whereas it represented 1.9% of revenues in 2006-2007. This means that investment income is increasingly important in the University's funding structure. Note that investment income is the most unstable and volatile source of income, which is why we created a policy on investment income stabilization a few years ago, which created a stabilization reserve. In 2015-2016, the University used 60% of the $32M reserve to compensate for poor market performance. We must be attentive to market fluctuations to ensure the stabilization reserve remains healthy enough to cover potential shortfalls in investment income in 2016-2017 and in the years to come.

- **Salaries and benefits:** Salaries and benefits represent 71% of the 2016-2017 operating budget, compared with 67.3% in 2006-2007, due mainly to increased benefit and pension plan costs. A number of collective agreements are currently being renegotiated, which may eventually have an effect on the financial situation in 2016-2017.

- **Accumulated surplus:** In accordance with its budget policies, the University uses accumulated surpluses to fund non-recurrent expenses and one-time projects. For 2016-2017, the University recommends using $19.7M to implement individual projects and activities, including $10.6M for replacing the student information system (SIS).

- **Consolidated results:** For 2016-2017, the consolidated results for all funds show total revenue of $1,066.7M, expenditures of $1,071.6M and a projected deficit of $4.9M on a modified cash basis. On an accrual basis, in accordance with Canadian accounting standards for non-profit organizations, revenue will exceed expenditures by about $16M. The difference between the deficit on a modified cash basis and the surplus on an accrual basis can be explained mainly by the amortization and capitalization of investments in capital assets (books, equipment, information systems and major renovations and construction), by reimbursement of the debt and by the use of net assets (accumulated surplus of faculties and services) to support certain initiatives and projects. Based on accounting standards, we expect an excess in expenses over revenues in the area of $14M for 2015-2016.

MAIN INITIATIVES

In preparing the 2016-2017 budget, the University recommends a number of structural and one-time adjustments:

a) **Hiring of additional professors:** In support of the goals of *Destination 2020*, through implementing **structural measures**, the University has committed to continue with initiatives aimed at providing a rich and inspiring student experience and further developing our research capacity. We achieved our goal of hiring 60 new professors and providing them with support and training for their teaching and research activities. This $15.7M recurrent investment was achieved over three years by reallocating resources. The University would like to continue in this direction as this initiative is aimed at producing concrete and inspiring results for the University community. The entire community contributed to this ambitious goal and supports the University's decision to put students at the heart of our strategic orientation. Our institution is determined to continue investing in supporting its strategic plan but would like to consolidate current investments in order to continue with them in the years to come.

b) **Increased revenue:** The implementation of **structural** measures aimed at increasing revenue—and specifically through an improved contract for bookstore services, a review of the rates charged by ancillary enterprises and an increase in volume by ancillary enterprises, totalling about $5M—will better ensure the services remain self-funding over the long term. In addition, the working group struck by the University to make recommendations on ways to increase and diversify revenue submitted its report to the Administration Committee (AC) in March 2016. The AC is currently reviewing the working group's recommendations, and the University plans to begin implementing them in 2016-2017.

c) **Structural changes to reduce expenditures:** In order to maintain a balanced budget—or with a slight deficit—and to support additional strategic initiatives, some **structural** measures have been implemented in order to reduce expenditures. The most significant measure involves a 2% reduction in the base budgets of faculties and services, representing $9.1M. The faculties and services are reviewing their activities and implementing the measures required in order to cover this 2% adjustment.

d) **Pension plan special payment**: As in the past two years, faculties and services will contribute $1.1M towards the $2.8M special payment for the pension plan.

e) **New student information system (SIS):** The University's new SIS will go live in the fall of 2016. This project, which involves an investment of $43M, marks a major milestone in the University's efforts to provide a more enriching student experience and will result in greater efficiency and greater productivity. The project is currently on track and on budget.

FUTURE CHALLENGES AND OPPORTUNITIES

The university sector, both in Ontario and nationally, is entering a period of rapid and profound change, and the University of Ottawa is affected by this wave of structural change.

Future challenges

Despite the opportunities that lie before us, the University of Ottawa must also deal with some major challenges, which also represent a risk to the University and its growth. Although sound fiscal management has always been one of the University's strengths and allowed us to find solutions to our financial challenges, the University of Ottawa, like all Ontario universities, will face difficult years ahead as a result of the current economic and financial climate. Some elements that will exacerbate these structural challenges include:

- **A drop in the number of Canadian students in the coming years:** This is a recent reality for the University, which has seen continued growth in its student numbers and associated funding for more than 15 years. This decrease in the number of students in the 18-20 age bracket in Ontario and in Canada creates increased competition among institutions. In addition, the creation of a French-language university in Southwestern Ontario currently under consideration by the government could have a direct impact on recruiting our Franco-Ontarian students.

- **Rate of growth in revenues and expenses:** Over the past five years, operating fund expenditures have grown at a rate higher than that of our revenues. Of course, this trend cannot continue. For this reason, the University recently announced the creation of several working groups tasked with finding viable structural solutions. The working group struck to evaluate and make recommendations on alternate revenue streams has already submitted its report to the Administration Committee, with implementation of some of the recommendations beginning in 2016-2017. This structural issue remains one of the greatest challenges the University must face, one that we will continue to tackle with tenacity and in innovative ways. Despite this, the University was able to table balanced budgets or budgets with slight deficits in recent years.

- **Central administration expenses:** Representing 15.6% of total operating fund expenditures, Central Administration continues to maintain spending at about 2.5% below the Ontario average, representing annual savings of about $20M.

- **Underfunding in some areas:** Government funding for some of the activities tied to our mission remains inadequate. Four key areas suffer from chronic underfunding: indirect costs of research, bilingualism, support for students with disabilities or special needs and maintenance and replacement of infrastructure, buildings and IT. These are four essential areas, requiring the University to contribute tens of millions of dollars from its operating fund to cover them.

- **The pension plan:** Issues related to the pension plan have created chronic and significant challenges for a number of years now. A number of elements are responsible for these challenges:

  - Very volatile financial markets affecting the contributions the University must make to the pension plan, particularly in terms of special payments related to pension plan shortfall. These special payments have a direct impact on the University's operating budget.

  - Regular and significant increases in overall pension costs. In 1999, the total regular employee-employer contributions were 13.8% of contributory salaries. Today, this number is 19.4%. This increase is for the most part the result of changes in actuarial assumptions, and in particular those related to life expectancy and expected rates of return. A 41% increase over the years has made it necessary for us to invest an additional $20M annually in the pension plan (excluding special payments).

  - The uncertainty and volatility surrounding the solvency valuations of the pension plan. Albeit theoretical, this valuation method is mandatory under the law and produces numbers that could lead to significant special payments. These payments ($31M per year based on January 1, 2106, estimates) must be made at the time of the January 1, 2017, valuation. With the objective of reducing this significant financial risk, the University is looking at different options, including a possible January 1, 2016, actuarial valuation filing.

- Discussions on creating a multi-employer jointly sponsored pension plan for Ontario's university sector. These talks, involving representatives from the universities and unions, are aimed at exploring the possibility of bringing together individual employer pension plans in the university sector to form a multi-employer pension plan, similar to the current sector-wide pension plans for hospital, school boards, municipalities and colleges. This would enhance the long-term financial stability of the pension plans and lead to an exemption from the Ontario government's solvency funding requirements. We will continue to follow the discussions closely.

Opportunities

While this document focuses on the 2016-2017 budget, we must nonetheless begin the process of planning the budget for 2017-2018 and subsequent years because it takes time to put into place long-term structural measures. The University plans to publish the opportunities for 2017-2018 shortly in order to work together with the University community to find sustainable solutions with the ultimate goal of supporting *Destination 2020.*

The current incremental budget model no longer suits the difficult reality facing universities today in a constantly changing environment, so we must find a new model that will make it possible to change the behaviour of the members of the University community and provide them with the tools and resources they need to move forward. The University is evaluating, in particular, the responsibility centre management (RCM) model, where revenue is attributed to the unit that generates it and where units are responsible for their direct costs, finance service expenses and contribute to an institutional envelope to support strategic initiatives.

CONCLUSION

The University administration, supported by the Finance and Treasury Committee, believes the budget for the 2016-2017 fiscal year is consistent with the goals set by the Board of Governors, while taking into account the challenges and risks that influence the University's activities. This proposed budget introduces significant measures aimed at ensuring the University remains in a stable financial position in the coming years. Further efforts will be needed throughout the year, however, to control costs, maximize revenues and try to achieve a balanced budget by the end of the fiscal year.

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Vice-President, Resources