

## Notes on university announcements of financial crisis

### Endowments

For all that substantial declines in the value of endowment funds provide fodder for dramatic headlines and fantastic claims by university administrations, for the most part these should not be treated as serious threats to university operating budgets. The possible exceptions may be institutions such as the University of Toronto, which has endowments large enough to generate substantial cash flows. If there is a threat to operating activities, it should call into question the strategies and diligence of senior university administrators, not the viability of the university's operations.

For one thing, endowment funds are restricted funds and treated separately from operating funds. If there were an impact on operating funds, it should only occur if a university were using restricted endowment money to fund activities or programs that normally would be included in operating budgets. In this scenario, operating funds would have to be diverted to fill in the gap left by declines in money drawn from endowment funds. This would suggest that a university administration has decided to adopt a strategy of covering permanent or on-going expenses from sources it has itself decided to treat as contingent (on market conditions).

To the extent that there is a conceivable operating impact, the effect of reductions in the value of university endowment funds will vary between universities. For most universities, the size of endowments will not be of sufficient size that revenue from them will represent a significant proportion of overall university funding. If, for example, 5% of the combined revenue for operating fund and trust fund (to which endowment money would flow) budgets came from endowment funds, and if reductions in revenue from endowment funds followed the value in endowment value, say 20%, the actual reduction in the combined funds would be 1%.

Even that 1% is subject to a number of "ifs." There is simply too little publicly accessible information on the flow and use of revenue from endowment funds. It does appear, however, that a substantial proportion of revenue from endowment funds may be going to student aid. In 2006-07, nearly 40% of Ontario universities' expenses paid from restricted trust funds went to student scholarships and bursaries.

Endowment funds are comprised of a number of different endowments, each of which will have unique conditions for the management and use of the funds. That said, endowment funds are unlike pension funds in that there are no legal requirements to ensure minimum funding levels: university administrators may choose to continue the same level of payouts in expectation that the longer term investment cycle and future additions to the endowment funds themselves will be sufficient to offset the near term fund balances. Endowment payouts are based on – and strictly limited even in years of very good investment performance – by fund management models that allow for marked swings over a long investment cycle, precisely to ensure the capital is preserved and the payments continuous.

## **Pensions**

The status of pension funds is a much more serious issue with direct implications for operating budgets. Plan sponsors can be required to make up funding deficiencies through special payments, drawn from operating budgets as a benefit expense.

Declines in the value of pension funds do not have the same implications for operating funds at each university. Effects will depend, first, on the funding status of the respective funds before the recent stock market swings. The ratio of funds to liabilities varies between plans because of differences in plan performance.<sup>1</sup> If a pension fund was in surplus, the potential funding deficiency and the magnitude of possible special payments required will be reduced. For example, a 10% decline in a fund that started with a 110% funding ratio would simply reduce its funding status to virtual parity – 99%.

If a decline in pension value is such that there is a current funding deficiency, the impact on operating budgets also will depend on the timing of the tri-ennial funding valuation. If a funding valuation is not currently due, no immediate special payments will be required to address funding deficiencies. Before the next valuation, the value of the fund may recover sufficiently that any special payments, if required at all, will be much lower than if the valuation were to occur today.

Even if a funding valuation were to be conducted today, and substantial special payments were required, a plan sponsor can seek a new funding valuation before three years have elapsed. Again, equity market recovery can be expected to reduce the size of required special payments. In addition, the provincial government may choose to follow the federal government in extending from five to ten years the period over which funding deficiencies must be made up.

In the case of Wilfrid Laurier University (WLU), the next valuation is not due until the end of 2009. What the value of the pension fund will be at that time is not known. What is known is that the university administration is using its worst case scenario to justify proposed budget reductions.

## **Year-end provincial government grants**

Since the McGuinty Liberal government was elected, the only year-end funding announcements that have been made are:

- Ontario Research Chairs
- Ontario Graduate Fellowships
- Facilities Renewal Program (FRP) funding

Research Chairs and student fellowship funding is one-time-only. Presumably universities do not undertake on-going costs that are not self-funded from these sources.

---

<sup>1</sup> Because of plan differences, there is no rule, but hybrid plans may be less susceptible to funding deficiencies because the level of benefit guarantee is typically lower than those provided in a defined benefit plan.

The FRP is an annual funding program for universities and colleges that allocates \$40 million per year for capital repair and renovation costs. The universities' share is \$26.7 million. With the possible exception of the Budget 2007 announcement of \$390 million one-time only funds for PSE, the "one-time only" reference in the WLU announcement presumably refers to FRP funding above the \$40 million per year. Announcements of additional funding include:

- May 2005 Budget announcement of \$250 million for colleges and universities FRP -- \$133.3 million for universities
- April 2007 budget announcement of \$365 million for colleges and universities -- including \$15 million to universities for new construction and \$210 million to universities for "immediate cost pressures" Funding for universities was not explicitly designated for facilities renewal in the universities (although the budget did indicate that this was the purpose of the bulk of the colleges' share).
- January 2008 of \$200 million in FRP funding to colleges and universities -- \$135 million to universities
- April 2008 announcement of \$200 million to universities for facilities renewal

With respect to whether the provincial government is contemplating the elimination of these one-time only payments, OCUFA is unaware of any such plans. As far as we are aware or have been able to determine, funding for the most recent one-time only announcements has come from federal sources. The money for the 2007 announcement was the federal PSE Infrastructure Trust allocation (the \$390 million corresponds to the amount for Ontario). Since then, the federal government has increased the amount of funding transferred to Ontario through the Canada Social Transfer (CST), which is expected to be a minimum of \$400 million per year (the amount agreed in the Canada-Ontario Agreement<sup>2</sup>).

The federal government has indicated that transfers to the provinces will not be reduced. The provincial government could opt to distribute the additional \$400+ million to universities in additional operating funding and/or for new construction rather than for the FRP. Whatever the case, it is not and cannot represent a reduction in operating funding. The one-time funding arrangements permit universities to address their backlog in deferred maintenance. The most that could be said is that the additional funding provided temporary relief for operating funds. But surely no responsible university administration would undertake additional on-going obligations simply because of temporary funding relief.

---

<sup>2</sup> The amount notionally destined for PSE is estimated to be closer to \$500 as a result of changes in the CST.