

President's Advisory Committee to Address the Impact of the Current Economic Condition on McMaster University

In the November 2008 Financial Outlook (http://www.mcmaster.ca/bms/pdf/2008-09_Financial_Outlook-Nov-2008.pdf), we reported that the University is currently evaluating the impact of the changing economy on its financial operations.

The market declines are continuing, and the impact is much more widespread. McMaster University is already experiencing financial challenges from the equity market instability and current economic conditions.

To address this issue, President George has created a President's Advisory Committee. This committee will develop recommendations to guide the University through this economic uncertainty. The membership of the committee will include leadership from the Board, Senior Management, Unions, Faculty and Staff. It will begin its work early in the new year and report to the Board through every meeting of the Finance Committee. The next meeting of the Finance Committee is January 29, 2009.

Declining Investment Markets and the Effect on Endowment Funds

Negative investment returns have a direct impact on the investments of the University. Endowment and trust funds are expected to generate investment income that is used each year to pay for the cost of supporting scholarships, bursaries, endowed chairs, research activity and general operating costs.

As of April 30, 2008, the market value of McMaster's endowment funds were \$490.1 million. Investment returns last year were not sufficient to cover expenditures, resulting in the use of \$17.2 million of previous earnings (referred to as our preservation of capital funds). To date our endowment fund is down approximately 20%. While we do have funds remaining in our preservation of capital, it is clear that payments from endowments will be affected. We are currently reviewing each individual fund and working with University trust fund managers to develop a prudent strategy for each fund.

Declining Investment Markets and the Effect on Pension Funds

Even before this period of declining investment returns the University had a deficit in the hourly and salaried pension plans. Special deficit payments have been made and will continue to be made to comply with pension legislation.

The University is required by legislation to file a valuation of its pension plans every three years. At the last valuation of the salaried plan in 2007 the results were as follows:

- Going concern deficit of \$66 million. requiring deficit payments of \$7.1 million per year over 15 years
- No additional solvency deficit funding was required

The next valuation filing will occur in 2010. Based on the current equity market conditions and even with assumptions regarding positive returns for the next 18 months, it is obvious that the deficit situation will worsen.

Our modeling indicates that the University will have both a sizable going concern deficit and a solvency deficit in 2010. Various scenarios that we have calculated indicate that going concern deficit payments could rise to \$17 million per year, and solvency deficit payments, even after assuming some payment relief, could add an additional \$20 million in deficit payments for a total annual deficit payment nearing \$37 million. In addition, our current service cost will rise to \$31 million. In total, annual pension payments made by the University could reach \$68 million. Under some reasonable short-term investment return scenarios, the deficit payments could be higher than these estimates.

The Council of Ontario Universities (COU) has coordinated an advocacy effort to bring this issue to the attention of the provincial government. All Universities with defined benefit pension plans are seeing the same negative impact of the equity market declines. COU is advocating for action by the government to lessen this impact. Actions that are being recommended include a deferral of the filing requirement in 2010, exemption from solvency deficit payments, and funding relief greater than that just announced by the Province.

The Operating Budget

The 2008/09 operating budget approved by the Board in June of this year indicated that the University would have a \$17.9 million deficit. Approximately \$2.5 million of this deficit relates to continuing operations, and \$15.4 million represents one-time payments in this year that are covered by funds already received and being held in appropriated reserves. The University had appropriated reserves of \$59.4 million at year end April 30, 2008.

The five-month review has recently been completed and presented to the Finance Committee. This report shows that the deficit has risen from \$17.9 million to \$28.8 million. Much of the increase is related to one-time expenditures that are funded with resources received in previous years; however, the continuing or structural deficit has risen to \$6.3 million. The Vice Presidents are in the process of implementing strategies to reduce this continuing deficit; for example; discretionary spending is on hold, and job vacancies are being reviewed. The Finance Committee has asked management to present several financial scenarios to better understand the impact of the economic climate.

While early indications from the Ministry suggest that our funding will not be impacted this year, we have also been told **NOT** to expect any year-end funding “pots” that we have become accustomed to in previous years. The funding situation for 2009/10 is very uncertain. COU is strongly advocating for one-time funding relief.

All departments are being asked to make prudent and conservative decisions relating to expenditures and to hold off on long-term commitments that add new unbudgeted costs to the University.

The following risk assessment table highlights areas of concern. High risk is indicated in red, moderate risk in yellow and low risk in green.

Financial Element	Risk	Comment
Revenue		
Operating Grants	High	Reduced grant as provincial revenues decline Lower BIU Funding – no year end grants
Research Grants and Contracts	Moderate	Lower provincial and federal grants available Private Corporate funding is reduced.
Tuition Fees	Low	Student enrolment is stable Tuition income will increase by maximum 5%
Ancillary Sales and Revenue	High	Consumer spending declines
Other	Moderate	Recoveries from other operations will be reduced
Investment Income	High	Negative returns will result in little income Cash may be required to fund internal loans
Donations and other grants	Moderate	Signs of declining donations
Research Overhead	Moderate	Dependent upon grants and government actions
Expense		
Salaries and Wages	High	Annual increase in excess of new revenues Hiring in strategic areas only
Employee Benefits	High	Pension deficit payments will increase significantly Benefits – active and retired costs exceed funding increases
Supplies and Services	Moderate	Discretionary spending can be delayed Student Aid increases Known increases in non-negotiable expenses
Interest on long-term debt	Low	Stable – no new external debt planned at this time
Share in loss of MIP	Low	Risky revenue streams may result in deficit
Endowment expenditures	High	Negative returns will impact endowments – impact varies across the endowments