UNIVERSITY OF CALGARY

Management Discussion & Analysis

For the Year Ended
March 31, 2018

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Management Discussion and Analysis Overview

This Management Discussion and Analysis ("MD&A") should be read in conjunction with the University of Calgary's ("the University") consolidated financial statements and accompanying notes for the year ended March 31, 2018. The MD&A and consolidated financial statements are reviewed and approved by the University's Board of Governors on the recommendation of the University's Audit Committee. The University's consolidated financial statements have been prepared in accordance with Canadian Public Sector Accounting Standards ("PSAS").

The MD&A is an overview of the University's financial results for the year ending March 31, 2018 and offers analysis of the University's:

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Operating Environment

The University of Calgary is one of Canada's top comprehensive research universities, combining the best of university tradition with the city of Calgary's vibrant energy and diversity. The University's main campus occupies a beautiful setting with a view of the Rocky Mountains, covering more than 200 hectares — an area larger than Calgary's entire downtown.

The University's Eyes High strategic vision continues to be an integral component to the University's vision of being recognized as one of Canada's top five research universities by 2022. We are dedicated to the three foundational commitments established in 2011: 1) sharpen focus on research and scholarship; 2) enrich the quality and breadth of learning; 3) integrate the University with the community.

Our Academic Plan and Research Plan, developed in 2017-18, resulted in three academic and three research priorities that have provided a roadmap for the achievement of our Eyes High vision. The vision and priorities established at the University are designed to show our community the benefits and rewards of integrating teaching, learning and research in an environment where discovery, creativity, and innovation are central to the mission. Our priorities have guided human, financial, and capital resource allocations for the foreseeable future. This trio of documents (Eyes High Strategy, Academic Plan, Research Plan), produced through broad consultation processes on our campus, has resulted in strong strategic decision-making that has moved the institution forward, while at the same time placed focus on prudent fiscal management.

Restated Prior Year Financial Statements

During the fiscal year, the University completed a review of its deferred revenue liability. The review identified $113.2 million included in deferred revenue and $7.1 million included in spent deferred capital contributions that did not meet PSAS requirements for liability recognition. These amounts should have been recorded as revenue in prior fiscal years when the amounts were received or when the obligations of the liability were met. The University retroactively corrected the error and the comparative numbers have been restated.

The impact of the correction to prior year numbers was a decrease of $113.2 million in deferred revenue, a decrease of $7.1 million in spent deferred capital contributions, and an increase of $120.3 million in accumulated surplus ($113.2 million in unrestricted net assets and $7.1 million in investment in tangible capital assets). The correction also included an increase of $14.9 million to prior year revenues and annual operating surplus.

Prior year financial information was also restated as a result of adopting new PSAS that came into effect during the fiscal year. The new accounting standards have added additional disclosure in the consolidated financial statements for related party transactions, contingent assets, and contractual rights. In addition to these new disclosures, new standards for accounting for inter-entity transactions have resulted in adjusting prior year revenue and expense amounts. In prior years, certain salary costs related to individuals who have joint appointments with the University and Alberta Health Services ("AHS") were netted against the funding provided by AHS to cover the costs of the positions. While appropriately recorded in the prior year, the new inter-entity accounting standards now require these transactions to be recorded separately as costs and revenues in the University's financial statements. As a result, prior year Government of Alberta grant revenues have increased by $27.8 million and prior year salary expenses have increased by $27.8 million without impact to net revenues over expenses or annual surplus. The impact of adopting the new PSAS had not been fully quantified at the time of preparing the 2017-18 budget. As a result, certain budget variances are impacted by adopting the new PSAS.

For more detailed information on the restatement to prior year financial information, refer to note 3 in the consolidated financial statements.

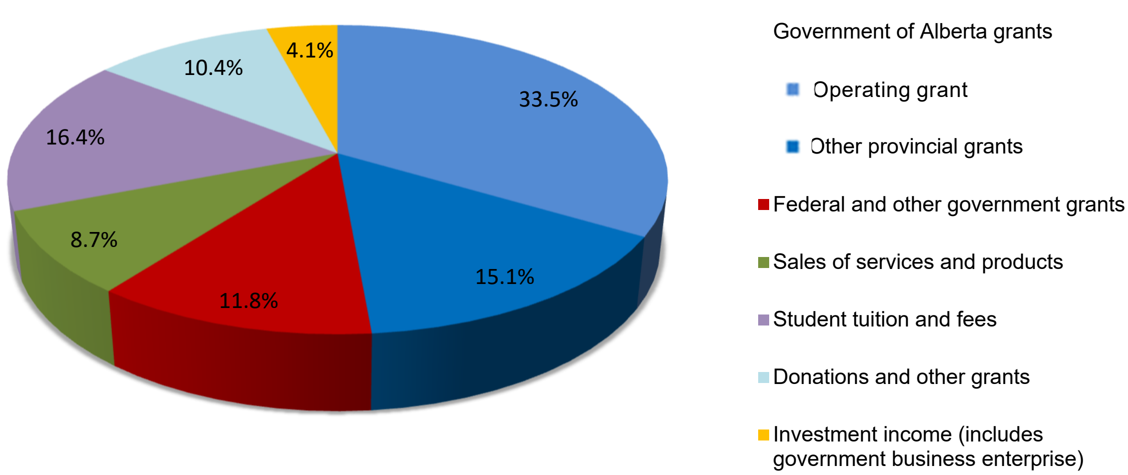
Financial Results

For the year ended March 31, 2018, the University's revenues exceeded expenses by $5.0 million. This annual operating surplus decreased from the $19.3 million surplus in 2017 mainly due to increased spending on strategic research, academic, and facilities operations and maintenance initiatives.

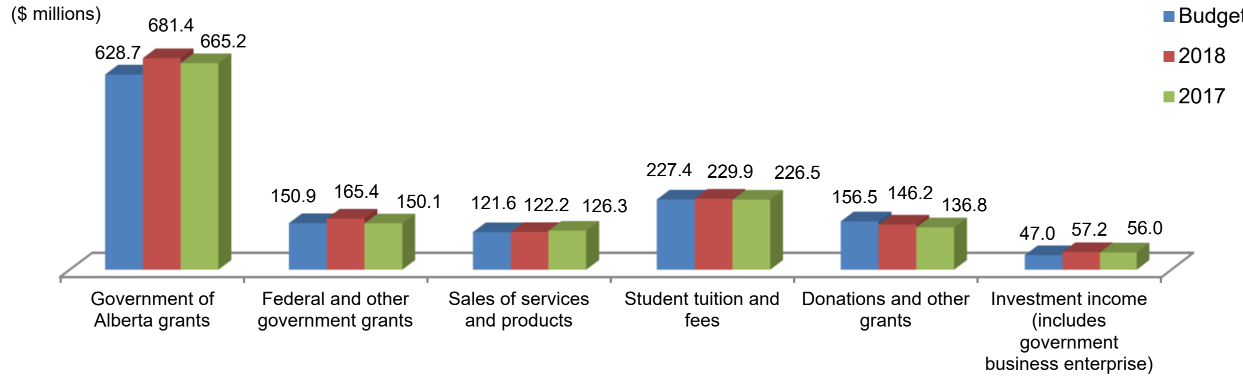
Total net assets have increased by $60.1 million from March 31, 2017 as the result of $5.0 million of annual operating surplus, $18.6 million of endowment donations, and $45.9 million of net realized and unrealized endowment investment gains, which are partially offset by $9.4 million of unrealized losses on non-endowment investments.

Revenue

Total revenues for the year ended March 31, 2018, were $1,402.3 million, an increase of $41.4 million (3.0%) over the prior year and $70.2 million (5.3%) over budget. Revenue from the Government of Alberta represented the University's single largest source of income, at 48.6% of total University revenue, and played a key role in the ability to fund University activities. Major components of revenue are as follows:



Revenue



Government of Alberta grants

Government of Alberta grant revenue of $681.4 million was $16.2 million higher than prior year and $52.7 million higher than budget. The increase over budget is primarily the result of $27.8 million in additional revenues from adopting new accounting standards that were not incorporated at the time of preparing the budget. The remaining increase over budget and prior year are mainly due to $9.5 million of additional funding received from the Government of Alberta related to cost of living adjustments of 2.0% applied to the operating grant funding, $3.0 million in additional funding to cover the tuition freeze, $1.5 million Economic Development Trade grant, $1.0 million Lights on Funding, and $1.0 million in carbon tax refunds received in the current year.

Federal and other government grants

Grant revenue from federal and other government sources of $165.4 million was $15.3 million higher than prior year and $14.5 million higher than budget. The increase from the prior year and budget resulted from higher than anticipated revenue from research and special purpose and trust activities that occurred during the year.

Sales of services and products

Sales of services and products revenue of $122.2 million was $4.1 million lower than the prior year and in line with budgeted expectations. The decrease from prior year is mainly the result of prior year one-time cost recoveries received from the province related to housing Fort McMurray evacuees.

Student tuition and fees

Student tuition and fees of $229.9 million were $3.4 million higher than prior year and $2.5 million higher than budget. While tuition rates were held constant, the increase from prior year was as a result of increased enrolment of approximately 500 full-time equivalent domestic and international students.

Donations and other grants

Donations and other grant revenue of $146.2 million was $9.4 million higher than prior year and $10.3 million lower than budgeted. The increase from the prior year amounts is as a result of increased donations and other grant revenue from research and special purpose activities which did not surpass budgeted expectations.

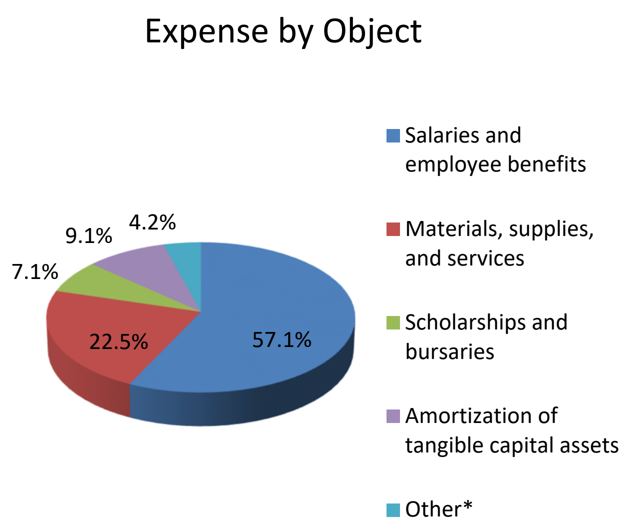
Investment income – Including investment income in government business enterprise

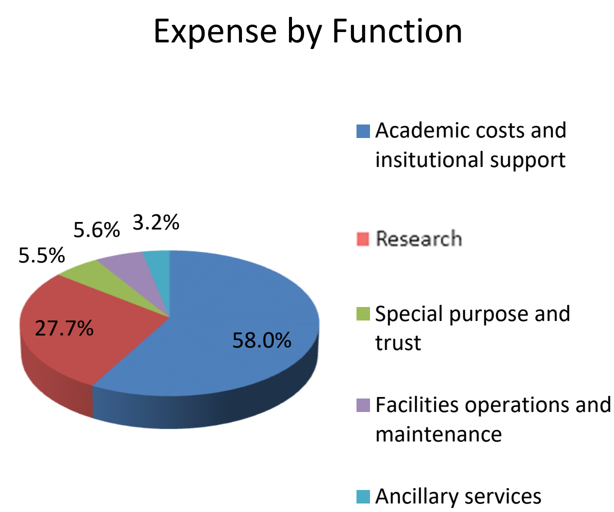
Investment income (including investment income in government business enterprise ("GBE")), of $57.2 million was $1.2 million higher than prior year and $10.2 million higher than budget. The variance is due to $7.4 million increase income from University's investment in its GBE, West Campus Development Corporation, $3.5 million higher than expected endowment income, $0.6 million increase in foreign exchange gains offset by one time realization of gains on floating rate note of $10.0 million that occurred in the prior year.

Expense

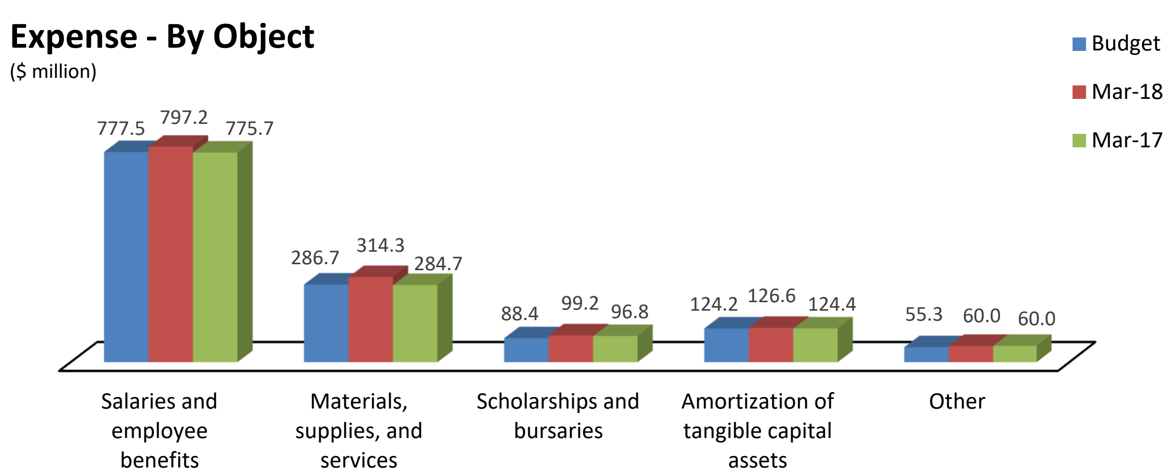
For the year ended March 31, 2018, the University recorded $1,397.3 million in expenses representing an increase of $55.7 million (4.1%) over the prior year and $65.2 million (4.9%) higher than budget. Salaries and benefits are the largest expenditure component at the University, representing 57.1% of the University's expenses. Compensation expenses continue to be a challenge when making budgeting decisions, especially during times where increases in operating grants do not adequately fund increase in salaries that are often governed by union and faculty agreements.

Academic costs and institutional support represents the single largest function at the University, with this function representing 58.0% of the University's expenses. This includes instruction, non-research academic and administrative support activities, effectively representing the operating activities of the University.





*Other expenses include: Utilities, Maintenance and repairs, and Cost of goods sold.



Salaries and employee benefits

Salaries and employee benefits of $797.2 million have increased by $21.5 million over the prior year and $19.7 million from budgeted amounts. The increase from prior year is primarily due to $18.7 million in increased academic and institutional support salaries and benefits resulting from negotiated union agreement increases, new positions, and partially filled vacancies being partially offset by reduced UAPP pension costs. The increase over budget is mainly due to $27.8 million in additional salary costs from adopting new accounting standards that were not incorporated at the time of preparing the budget being partially offset by reduced UAPP pension costs.

Materials, supplies and services

Materials, supplies and services of $314.3 million represents the second largest expense component of the University with current year costs being $29.6 million higher than the prior year and $27.6 million higher than budget. Materials, supplies and services were higher than prior year and budgeted due to $27.0 million of increased spending on externally restricted projects primarily in the faculties of Medicine, Arts, Science, and research activities in the Vice-President Research portfolio.

Scholarships and bursaries

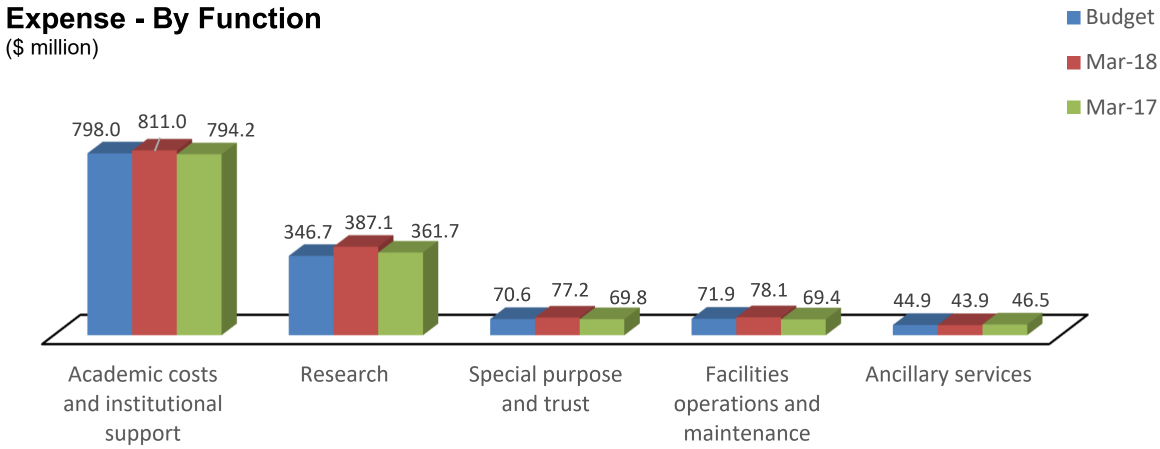
Scholarships and bursaries of $99.2 million were $2.4 million higher than the prior year and $10.8 million above budget. These higher expenses are in line with University goals for attracting and supporting students across various faculties.

Amortization of tangible capital assets

Amortization of tangible capital assets expense of $126.6 million increased by $2.2 million from the prior year and $2.4 million over budget. The increase from prior year is a result of various new assets being put into service, primarily related to the Schulich School of Engineering expansion and amortization of purchased CCTV Cameras and security systems.

Other

Other expenses totaling $60.0 million were consistent with the prior year and $4.7 million higher than budgeted amounts. Increase from budget primarily due to repairs and maintenance spending of $2.7 million on infrastructure maintenance programs across campus, $1.2 million spending in preparation for the new tenants at the University Research Centre, and $1.0 million spending in Facilities due to unforeseen items such as electrical, mechanical, operational, roofing, and structural repairs.



Academic costs and institutional support

Academic costs and institutional support expense of $811.0 million has increased $16.8 million over the prior year and $13.0 million over budget. The increase from prior year is primarily due to $18.7 million in increased salaries and benefits resulting from negotiated union agreement increases, new positions, and partially filled vacancies being offset by reduced UAPP pension costs. While increased academic and support salary and benefit costs from negotiated union agreement increases were budgeted for, the increased costs over budget are primarily from $27.8 million in additional salary costs from implementing new accounting standards that were not incorporated at the time of preparing the budget, offset by reduced UAPP pension costs and vacant positions that were budgeted to be filled during the fiscal year.

Research and Special purpose and trust

Research costs of $387.1 million were $25.4 million higher than prior year and $40.4 million higher than budget. This increase is due to the University's strategic focus on directing resources and activities towards research initiatives in support of *Eyes High* goals for increased research across many faculties of the University. Special purpose and trust costs of $77.2 million were $7.4 million higher than prior year and $6.6 million higher than budgeted amounts primarily due to increase of $5.0 million in materials and supplies related to Postgraduate Medical Education projects as well as Maternal, Newborn and Child Health Strengthening in Tanzania project. Further increases were a result of increases in salaries and benefits in the faculty of Medicine.

Facilities operations and maintenance

Facilities operations and maintenance costs of $78.1 million were $8.7 million higher than prior year and $6.2 million higher than budget. The increase is a result of operating and maintaining a growing and aging campus infrastructure as well as increases in natural gas and electricity expenses in the current year.

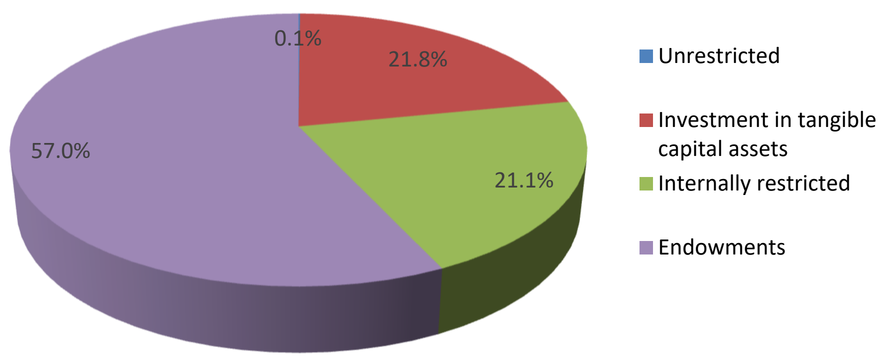
Ancillary services

Ancillary expenditures of $43.9 million were $2.6 million lower than prior year and $1.0 million lower than budget primarily due to the one-time evacuation costs associated with housing Fort McMurray evacuees in the prior year which was not incurred in the current year. Further decreases are due to savings as a result of temporary vacancies as well as reduced maintenance expenses in Residence Services. This was partially offset by additional parking expenses in the current year specifically related to the Foothills campus, Arts Parkade, and SMART Technologies building parking.

Net Assets and Net Financial Assets

Net Assets

The University's net asset balance is an important indicator of financial health for the University. Prudent financial planning and decision making combined with increased endowment contributions from donors have contributed to the University's $1,669.9 million in net assets. Endowments of $952.7 million continue to represent the largest component of Net Assets. Endowments must be maintained in perpetuity with investment income earned used to fund specific research, scholarship, and donor supported initiatives on campus. Of the remaining $717.2 million in net assets, $363.6 million represents funds previously spent as a net investment in capital assets and $352.6 million is formally restricted by the University's Board of Governors for spending on strategic initiatives in support of student learning, research, capital projects, and community service. During the year, a $91.3 million transfer to internally restricted net assets was approved by the Board of Governors to further research and strategic initiatives to drive *Eyes High* goals forward. In addition, the University used unrestricted net assets to fund $19.4 million of capital construction and capital purchases and $57.4 million to repay University debt. After amounts spent on capital assets, Board of Governors restrictions, and debt repayment, $1.0 million remains in unrestricted net assets. Net assets at March 31, 2018 are comprised of the following balances and related summarized transactions:



Net Assets ($ thousands)	Unrestricted	Investment in Capital Assets	Internally Restricted	Endowments	Total
Balance at March 31, 2017	**$ 129,041**	**$ 305,624**	**$ 287,003**	**$ 888,099**	**$ 1,609,767**
Annual operating surplus	4,999	-	-	-	4,999
Transfer to internally restricted net of expenditures	(91,289)	-	91,289	-	-
Endowment					
New contributions	-	-	-	18,557	18,557
Capitalized investment income	-	-	-	70,319	70,319
Tangible capital assets					
Acquisition of capital assets	(19,421)	29,701	(10,280)	-	-
Amortization of capital assets	41,357	(41,357)	-	-	-
Debt repayment	(57,403)	72,765	(15,362)	-	-
Debt – new financing	3,168	(3,168)	-	-	-
Change in accumulated remeasurement gains	(9,428)	-	-	(24,310)	(33,738)
Balance at March 31, 2018	**$ 1,024**	**$ 363,565**	**$ 352,650**	**$ 952,665**	**$ 1,669,904**

Net Financial Assets

The University's liquidity needs are met primarily through operating cash flows, working capital balances and capital expansion funding received through grants or long-term debt. The Net Financial Asset indicator is intended to identify the availability of net financial resources of an organization to fund future operations after considering liabilities owed to third parties. The University presents the Net Financial Asset indicator in a manner as directed by the Controller of the Province of Alberta. The presentation includes $952.7 million of investments that are restricted for endowments. Portfolio investments – restricted for endowments must be maintained in perpetuity and are therefore not available to pay for University liabilities, nor can the University use the endowment portfolio investments to pay for future operating or capital purchases. As a result, net financial assets excluding portfolio investments restricted for endowments is also presented on the Consolidated Statement of Financial Position.

At March 31, 2018 Net Financial Assets excluding portfolio investments restricted for endowments is $182.3 million, representing an $18.9 million increase from the prior year figures. This increase is primarily the result of $5.0 in net revenues over expenses combined with receiving capital grant funding that covered prior year capital expansion costs that were incurred using debt financing.

Capital Expansion and Renewal

On September 9, 2016, the federal government announced that the University would receive funding for key campus infrastructure projects totaling $160.0 million from the Post-secondary Institution Strategic Investment Fund ("SIF"). $78.2 million of the total funding is from the federal government with the remaining $81.8 million coming from a mix of provincial funding, philanthropy and the University's own infrastructure dollars. As at March 31, 2018, the University had received $64.5 million in SIF funding. Given the provincial government facilitates the payment of the SIF program on behalf of the federal government, the SIF funding is included within the Government of Alberta transactions and balances note within the financial statements.

Continuation of capital expansion and renewal projects remains a critical priority for the University, contributing not only to the student learning experience and the quality of research activity, but also positively to the Calgary economy. In 2018, the University expended $196.7 million (2017 - $140.3 million) on construction and other capital asset acquisitions. This increase in capital activity represents the continuation of the University's multi-year capital building program through construction of new buildings as well as redevelopment, renovation, and numerous instructional facility upgrade projects.

The following represents progress on the top six major construction projects on campus:

Major Capital Project Costs ($ thousands)	2018	Project to Date	Total Budget
High Density Library Expansion (SIF)	23,214	26,089	30,000
Science A Redevelopment, Phase 2 Early Works (SIF)	15,802	17,198	20,000
MacKimmie Complex and Professional Building	13,143	14,366	290,000
Research Field Station (SIF)	11,171	12,445	13,000
Veterinary Medicine Clinical Skills Building Expansion (SIF)	10,248	11,776	13,000
Schulich School of Engineering Expansion (SIF)	10,035	172,427	173,875

High Density Library Expansion (SIF Funded) - The High Density Library (HDL) is a dedicated environmentally controlled storage facility that holds books, journals, archival files, photographs, audio-visual media and museum art and artifacts. The university is expanding the HDL to include additional storage, cold storage, collection evaluation, and processing. This expansion and move will consolidate the university's collection of less-used library material into one location, designed with the goal of long-term material preservation.

Science A Redevelopment, Phase 2 Early Works (SIF Funded) - As a first step in a comprehensive redevelopment and expansion of one of the University of Calgary's original buildings, Science A, this early work consists of two discrete early works components: 1) expansion and upgrading the university-scale science research workshop facility within the existing building, and 2) permanent relocation of chemistry undergraduate and support laboratories to alternative buildings such as Energy, Environment, Experimental Learning (EEEL), which are better suited to house these functions.

MacKimmie Complex and Professional Building - The program vision calls for a completely renewed and repurposed MacKimmie Complex and targeted renovations to the Professional Faculties Building associated with the relocation of the Faculty of Social Work to the MacKimmie Tower and backfill of the space to accommodate Faculty of Nursing expansion. The redevelopment represents an opportunity to address many challenges as part of one integrated project including making best use of these two existing buildings, reducing operating costs, co-locating and centralizing student and staff services in the heart of our campus, alleviating space pressures within the Social Work and Nursing Faculties and bringing the Facility Condition Index (FCI) of the MacKimmie Tower and Block to near zero. The project necessitated the decanting of 600 existing MacKimmie Tower occupants (500 to offsite premises and 100 to main campus locations).

Research Field Stations (SIF Funded) - This project will upgrade two University of Calgary research field stations and a meteorological research station. The Barrier Lake Station provides an operating base, labs and work areas supporting wildlife, ecological and environmental research. The R.B. Miller Station supports research in a unique sub-alpine setting. The main campus Weather Research Station has collected atmospheric and climate data for over 50 years. Upgrades will bring research infrastructure up to modern standards.

Veterinary Medicine Clinical Skills Building Expansion (SIF Funded) – The Veterinary Medicine Clinical Skills Building Expansion is the first phase of a comprehensive master plan to expand and improve the highly successful and innovative veterinary research and teaching activities at the University of Calgary. The expansion will allow the creation of expanded research, innovation and learning areas, to support the critical clinical and professional skills programs, and enhance diagnostic research and development.

Schulich School of Engineering Expansion and Renovation (SSE) – During 2013-14, construction began on this $173.9 million dollar initiative to construct an 18,300 square meter expansion to the Canadian Natural Resources Limited Engineering Complex, along with major renovations to 11,100 square meters of the existing building footprint. The building expansion includes high intensity research labs and support spaces, undergraduate engineering teaching labs, group workrooms, low intensity research facilities, and classroom and theatre spaces.

Areas of Significant Financial Risk

Deferred Maintenance

The University directs significant resources to ensure that University buildings are updated with relevant technology, operate efficiently, and meet university and external regulatory standards. The University has an outstanding deferred maintenance balance of $512.2 million (2017 - $518.6 million). Infrastructure Maintenance Program funding from the province increased to $22.0 million (2017 - $14.4 million) as compared to the prior year.

Unfunded Pension Liability

The University participates with other Alberta post-secondary institutions in the UAPP to provide pensions for participating faculty and staff. The extrapolated actuarial deficiency for the pension plan at March 31, 2018 is $446.7 million (2017 - $763.9 million) of which the University's portion is $37.1 million (2017 - $85.0 million). This unfunded deficiency in the UAPP is currently being funded by the Government of Alberta, employee and employer contributions. The deficiency will be eliminated by 2043.

Budgetary Pressure

Although the University has a balanced budget for 2018-19, it is presenting deficit forecasts for 2019-20 and 2020-21. The University is facing a number of risk factors, most notably funding uncertainty related to provincial operating funding. Without increases in provincial funding to offset inflationary costs, and combined with legislatively mandated ceilings on tuition increases, the University will continue to explore and implement process efficiencies and revenue generating opportunities. The University will continue to work in partnership with the government, to help bridge the gap between increasing costs and stagnant revenues. While prudent financial management has resulted in balanced results, budgetary pressures remain a significant strategic risk for the University of Calgary.