Management Discussion and Analysis

2017-2018

Management Discussion and Analysis Overview

The following Management Discussion and Analysis report is intended to give context to the results of operations and the financial conditions of Algonquin College. The report is provided as a supplement to the College's financial statements and accompanying notes.

The report is an overview of the financial results achieved in the fiscal year ending March 31, 2018, and offers a detailed discussion and analysis of the following:

1. Operating Environment
2. Financial Results
3. Net Assets
4. Capital Planning
5. Areas of Financial Risk

Operating Environment

Algonquin College marked its 50th anniversary in 2017, as well as the implementation of a new strategic plan, 50+5. Over the past decade, Algonquin has continued to carefully manage operations and to build restricted net assets to invest in the continued success of students.

In 2017, the Ministry of Advanced Education and Skills Development announced a new funding formula for the college sector. The new corridor funding formula provides stability in terms of budgeting and forecasting, and is not driven by enrolment growth. The results of this change have yet to be fully realized. However, government grant revenue is expected to remain relatively flat while expenditures will continue to increase with inflation. Therefore, the college sector will continue to experience financial pressures.

On January 1, 2018, the first amendments to the Employment Standards Act in Ontario came into effect. The impacts of the increase to the provincial minimum wage and some initial changes to part-time compensation for statutory holidays affected the 2017-2018 financial results. The major impact of the legislation amendments will be realized in the 2018-2019 fiscal year as the equal pay for equal work component is implemented.

As at March 31, 2018, Algonquin has restricted net assets of $73.2 million. College management is able to achieve the goals set out in the strategic plan and annual business plans by careful budgeting and through the prudent use of these funds.

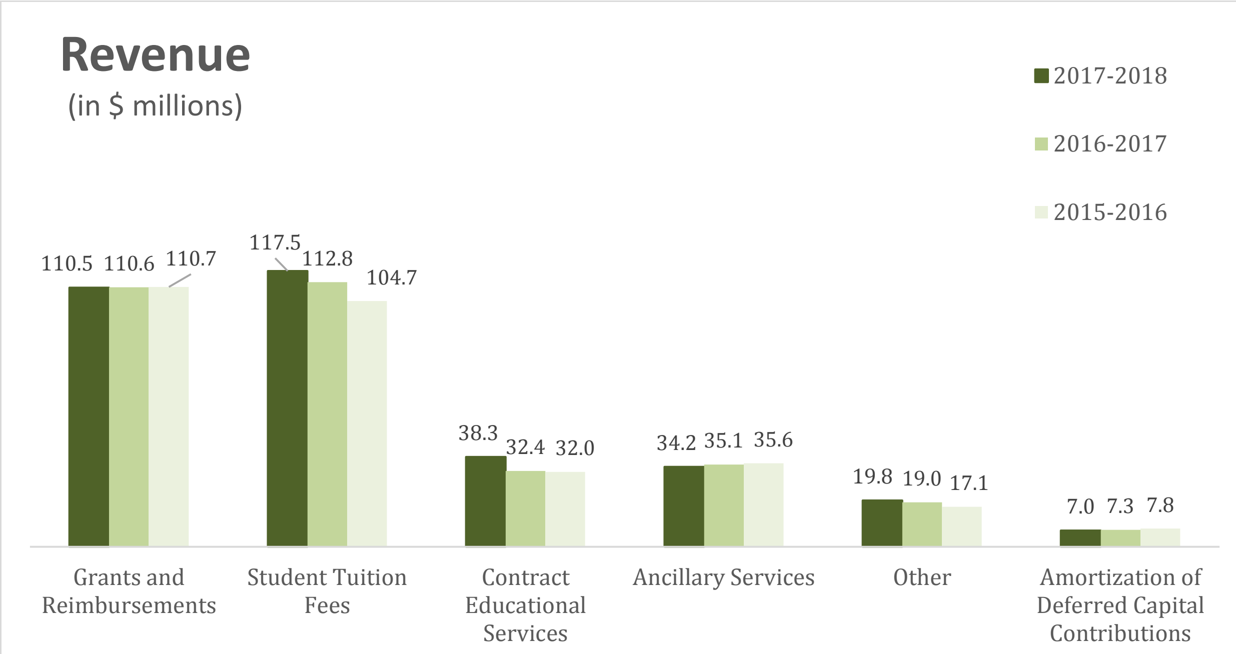
Financial Results

In the fiscal year ended March 31, 2018, the College realized an operating surplus of $13.5 million compared to a budgeted $5.5 million surplus. The $8 million positive variance is primarily due to operating cost savings and International student enrolment exceeding projected enrolment, as well as increased activity from both onshore and offshore contracts through the International Education Centre. A portion of this surplus will be used to fund some of the College's Strategic Investment Priorities. The balance has been added to the College's restricted net assets to fund future investments. These reserves will be instrumental in addressing the risks and challenges facing the College. More information on these challenges can be found on page 12 under the section Areas of Financial Risk.

Included in the financial results, are the impacts of the five week work stoppage. Overall, the work stoppage resulted in a $2.7 million loss to the College's operations. Though the College realized full-time salary savings during the 5 week work stoppage equal to $8.2 million, lost tuition and student ancillary fees through student attrition totaled $6.6 million. Additional losses were seen in College Ancillary Services, with a $1.4 million net loss. Every effort was made to ensure that students would not lose the fall semester, as a result the fall semester was extended by three weeks, resulting in $2.3 million of additional teaching and support costs.

Revenues

For the year ended March 31, 2018, the College recorded $327.3 million in revenues representing an increase of $10.2 million (3.2%) over the prior year. Detailed explanations of this increase follow in this report.



Grants and Reimbursements

Revenues from the Ontario Ministry of Advanced Education and Skills Development have remained relatively stable for the past three years. This trend is expected to continue as the college sector has moved to a corridor funding model. The slight decrease in funding for 2017-2018 is the result of the five week work stoppage, which negatively affected Apprenticeship funding revenues by $787,000 because of the cancellation of eleven classes. This decrease was offset by small increases in Special Apprenticeship Enhancement Funding of $272,000 caused by the timing of the construction of the Welding Lab Project at the College's Transportation Centre, and $379,000 in bursaries.

Student Tuition Fees

Student tuition fees increased by $4.8 million in 2017-2018 over 2016-2017. This increase was driven primarily by a $5.1 million increase in international student premiums over the prior year. This increase was offset by a deliberate decrease in the technology fee charged to students as part of overall student ancillary fees, resulting in a $1.3 million decrease from 2016-2017. Other smaller variances included increases in English as a Second Language revenues of $452,000 and English for Academic Purposes of $381,000.

Contract Educational Services

Contract educational services experienced a significant increase in revenues in 2017-2018. The largest contributors to this increase included a $1.7 million increase in the School College Work Initiative contract, a longstanding initiative to integrate secondary school students into the College and provide exposure to career opportunities. In addition, there was a $1.5 million increase in Corporate Training programs, and a $734,000 increase in international offshore contract revenue. Other small increases included $690,000 increase in collaborative University – College programs, and a $417,000 increase in Literacy and Basic Skill training contracts.

Ancillary Services

The five week Academic work stoppage had a considerable impact on Ancillary Services revenues. Overall revenues declined by $926,000 over 2016-2017. Food services and the bookstore experienced the greatest impact with revenue reductions of $958,000 and $802,000 respectively. The Algonquin College Residence increased their revenue by $857,000 due to increased summer rental sales bolstered by the Canada 150 celebrations in the Ottawa region.

Other

Other revenues consists of a variety of revenue sources such as student application fees, international student insurance premiums, distance education hosting fees, HST and other tax adjustments and rebates from the College's corporate credit card program. These revenues increased by $807,000 in 2017-2018.

The number of International students at Algonquin surpassed fiscal year targets. International student activity accounted for $1.7 million of the revenue increase because of a $1.2 million increase in international insurance premiums (a new process in 2017-2018), and an additional $559,000 of revenue due to forfeited student fees and other revenues. This was offset by a year over year decrease in investment income of $1.6 million. Other minor increases were realized because of an increase in distance education hosting fees of $186,000, $157,000 in increased Alumni Affinity Sponsorship revenues, and a $200,000 contribution from the Students' Association for indigenous initiatives. This contribution is the first installment of a $1.0 million investment by the Algonquin Student's Association.

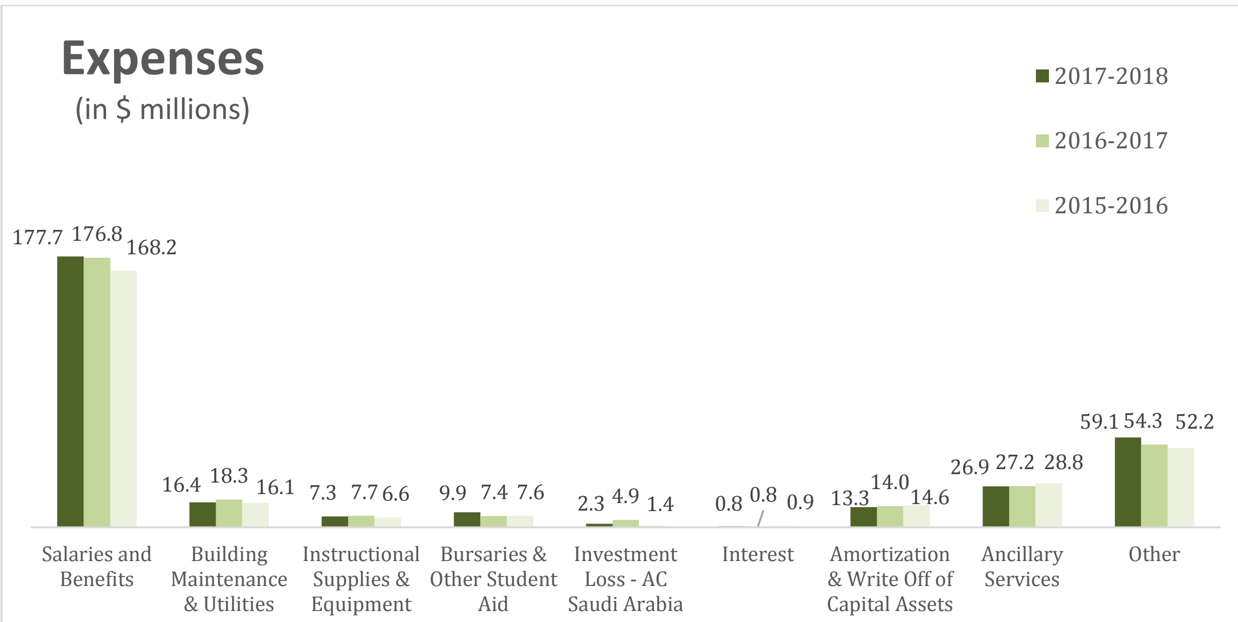
Amortization of Deferred Capital Contributions

There was minor change in the amortization of deferred capital contributions from 2016-2017, decreasing by $322,000. This decrease was the result of some deferred capital contributions for equipment and historical site improvements reaching full amortization levels.

No new material deferred capital contributions were amortized in 2017-2018. However, amortization of deferred capital contributions are expected to increase in 2018-2019 with the completion of the DARE District.

Expenses

For the fiscal year ending March 31, 2018, the College recorded $313.8 million in expenses, representing an increase of $2.4 million (0.7%) over the prior year.



Salaries and Benefits

Salaries and benefits represent the largest expense category for the College. In 2017-2018 the College spent $177.7 million on salaries and benefits.

College management had budgeted an $8.4 million increase in salary expenditures for 2017-2018 over the 2016-2017 actual expenditures. This increase was to account for required collective agreement adjustments, and other benefit increases. The five week academic work stoppage resulted in a net reduction of full-time academic and regular partial load academic salaries of $7.5 million. This resulted in an increase of $945,000 from 2016-2017 expenditures.

Building Maintenance and Utilities

Building maintenance and utilities expenditures decreased by $2.0 million in 2017-2018. The most significant impact was due to the Energy Service Company Project (ESCO 2). Construction delays in phase four of the project resulted in a $1.1 million reduction in energy savings expenditures, as the first co-generator was offline for most of the year. The timing of the phase four construction was also a factor. Construction costs borne by the College for phase four decreased by $1.3 million from 2016-2017. Construction costs to complete the ESCO 2 project are expected to increase in 2018-2019 with the completion of the thermal network.

Instructional Supplies and Equipment

Instructional supplies and equipment expenditures decreased by $349,000 from the prior year. Though regular operations saw an increase in instructional supplies of $355,000, the Perth and Pembroke campuses experienced reductions in training support expenditures in Employment Services and Job Connect contracts of $233,000. An additional $456,000 of reductions were realized in small equipment purchases.

Bursaries and Other Student Aid

Bursaries and other student aid disbursements increased by $2.5 million in 2017-2018, because of the five week Academic work stoppage in fall 2017, College management issued an additional $154,000 as part of the provincially mandated Student Strike Relief Fund. To further aid students who experienced hardship because of the work stoppage, the College increased the disbursement of other bursaries by $1.0 million.

As part of regular operations, the College increased disbursements of student aid by $800,000 over 2016-2017 to align with tuition and enrolment increases.

Investment Loss – AC Saudi Arabia

As of August 31, 2016, Algonquin College-Saudi Arabia terminated its agreement with Colleges of Excellence Saudi Arabia. In February 2018, a final settlement agreement was reached. The total loss realized by Algonquin College in 2017-2018 is $2.3 million.

Interest

Interest expenses continues to remain constant. College management continues to make regular payments on long term debt and did not assume any additional debt in 2017-2018.

Ancillary Services

Ancillary Services expenses decreased by $247,000 over the prior year. Two areas within Ancillary Services experienced notable changes from 2016-2017. The Director's Office realized an increase in expenditures of $941,000 because of a one-time electricity rebate that was realized in 2016-2017. The Bookstore experienced the largest impact with a $927,000 reduction in expenditures due to impacts of the work stoppage. Cost of goods sold related to computer hardware decreased by $496,000 and combined textbook/e-text cost of goods sold decreased by $492,000. Most departments experienced minor decreases in expenses due to decreased cost of goods sold, because of lower sales due to the five week work stoppage.

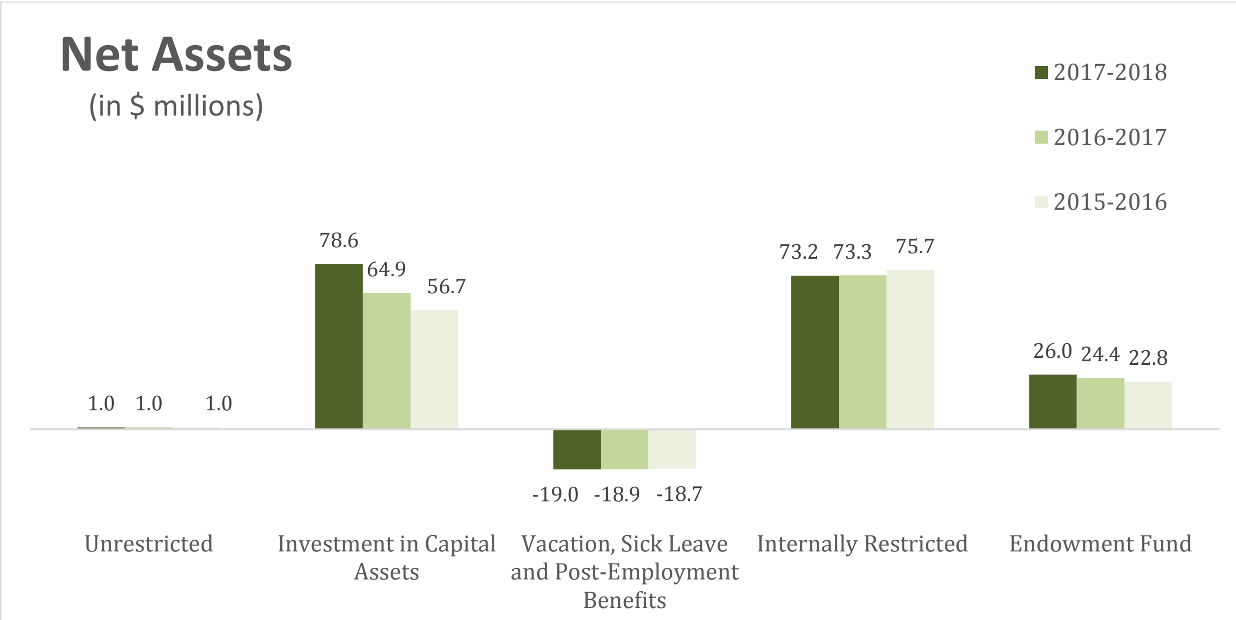
Other Expenses

Other expenses increased by $4.7 million in 2017-2018. These expenses are all because of major contracts and activities that brought significant revenue to the College.

Significant changes include a $963,000 increase in referral fee payments for the recruitment of international students and a $554,000 increase in International Student insurance expenses. Software licenses increased by $969,000 due to new Workday™ licensing fees and increases in other licenses such as Adobe. Increases in College contract activity resulted in $540,000 in increased contract teaching costs for the Corporate Training Centre, and a $508,000 increase in contract services related to the delivery of the AZ Truck Driving Training contract.

Net Assets

The College's net asset balance is an important indicator of financial health. The College's net assets increased by $15.1 million in 2017-2018.



Major changes to net assets in 2017-2018 were the result of the College's investment in capital assets:

- Ongoing construction of the DARE District,
- The development of Workday™, and
- The Student One Stop Space.

All of these contributed to the College's increase in investment in capital assets in fiscal year 2017-2018.

Capital Planning

The College continues to invest significantly in major capital projects to increase the capacity of the College, enhance the learning experience for students, and to continually improve internal processes. College management spent $36.4 million on major capital projects in 2017-2018. The following outlines the progress made on major capital projects during the fiscal year:

Energy Service Company Project (ESCO2)

During 2017-2018, work on phase four of this project continued with a focus on the College Energy Centre and the installation of the second co-generator. $9.7 million of construction was completed during the fiscal year of which $251,000 was contributed from College reserves. The project is expected to be completed in 2018-2019 with the completion of the thermal pipeline network. Once completed, the project is expected to save the College approximately $3.8 million annually in energy savings.

Enterprise Resource Planning – Project Workday

Development and implementation of the Workday™ Enterprise Resource Planning system continued in 2017-2018 with expenditures of $3.2 million. In the late fall, due to implementation challenges, the project timeline was recalibrated. A new implementation partner was announced in winter 2018. Due to the delay in implementation, College management requested approval from the Board of Governors for additional funding. The additional funding was approved, bringing the total value of the project to $18.8 million. This platform will result in operational efficiencies once fully implemented.

DARE District

Construction began on the DARE District initiative in the fall of 2016 to transform existing space in the College and add an additional floor for a state of the art library. A new centre for indigenous entrepreneurship is included in the renovation. The transformed space will allow students, researchers and entrepreneurs to come together to collaborate and spark economic growth. The $44.9 million project was declared substantially complete on April 30, 2018.

Welding Lab Project at the College's Transportation Centre

In June 2016, a $2.8 million investment, funded through an application to the Ministry's Apprenticeship Enhancement Fund, began on the update to the Welding shop facilities. The shop is designed to enhance the student experience through the acquisition of state-of-the-art equipment and updated facilities. In addition, this project will create an additional 20 student welding training spaces and will open the door to opportunities for development of new welding apprenticeship training programming. The project was completed in April 2018.

Transformer Replacement Project

In early 2016, after assessing the risk for failure posed by the existing high voltage transformers at the Ottawa campus, the Board of Governors approved the replacement of the transformers at a total cost of $2.9 million. Expenditures in fiscal year 2017-2018 totaled $480,000, and a total of $2 million has been spent on the project to date. The project is expected to be completed in 2018-2019.

Student One Stop Space

This $7.2 million renovation project began in November 2017. The project will improve the accessibility and usability of student enrolment and retention services by creating a one-stop hub of services. The design of the space, on the lower level of the DARE District, was completed in February 2018 with substantial completion of the renovation planned for summer 2018. Expenditures in 2017-2018 totaled $221,000.

Indigenous Gathering Circle

Located in the inner courtyard of the Ottawa campus, the Indigenous Gathering Circle will serve as a modern and respectful interpretation of a significant Indigenous cultural icon. It will create a welcoming venue that is culturally rich, and a student experience that can benefit from Indigenous teachings, heritage and history. It will provide a culturally appropriate and inclusive space for the entire Algonquin College community.

Hard landscaping was completed in 2017-2018 and the Gathering Circle structure construction begins in June 2018. This $1.6 million investment will be completed in the fall of 2018.

Net Tuition Project

In spring 2016, the Government of Ontario announced a major redesign of the Ontario Student Assistance Program (OSAP) to be implemented in 2017-2018. The major changes to OSAP will provide students with access to financial assistance through bursaries and grants at the start of the semester to reduce the upfront costs to students. As a result, the Ministry of Advanced Education and Skills Development introduced the OSAP Transformation and Net Tuition Project, and required College staff to produce a view for students so that they can see the total cost of tuition and the potential funding options. This $0.9 million project will be completed in 2018-2019.

Future Projects

A number of additional major capital projects have been approved by the Board of Governors and are scheduled to begin in 2018-2019. These include:

- Algonquin Students' Association Athletics and Recreation Complex (ARC). This is a collaboration with the Algonquin Students' Association. A new athletics complex will be built that will increase the physical capacity of student fitness, increase athletic opportunities, and offer students unlimited access to state-of-the-art recreation facilities. The anticipated start date of this $49.9 million project is 2018-2019.
- Pedestrian Bridge to Bus Rapid Transit Station. In partnership with the City of Ottawa, this project will construct an above-grade pedestrian bridge linking the Algonquin

Centre for Construction Excellence with a new bus rapid transit station. The $3.1 million projected investment by the College will help ensure students, employees and visitors to the Ottawa campus have an efficient and safe method for crossing College Avenue. This project will begin in 2018-2019 with substantial completion expected in 2023.

- Learning Management System. The Learning Management System is a crucial online learning environment used by students and faculty as a portal for all digital materials associated with courses and programs of study. It fosters a community of learners through its communication and activity/engagement tools, provides a platform to perform assessments, and it allows faculty and management to assess the progress of learners to better serve their learning needs. BrightSpace™ has been selected as the single learning management system for all campuses, and will be implemented, and piloted during the summer 2018 term. This platform will be operational in September 2018. Implementation costs are documented at $800,000.

The College continues to look forward and plan for the future. College management maintains a five year major capital investments plan to help ensure a strong financial position, and important investments in the future. These projects are submitted to the Board of Governors for approval only when appropriate funding has been found to support the initiative. Some of the future projects currently being reviewed include the implementation of a new Student Information System, a new Healthy Living Education Initiative and enhancements to the Customer Relationship Management system.

Areas of Financial Risk

Employment Standards Act Amendments

In November 2017, the Ontario government passed Bill 148 (Fair Workplaces, Better Jobs Act) amending the Employment Standards Act effective January 2018. The amendments to the Employment Standards Act resulted in a number of required changes to the College's operating budget. Some of the amendments took effect on January 1, 2018, such as changes to part-time employee pay for statutory holidays and minimum wage increases. Other changes with greater impacts to the College took effect on April 1, 2018. One of these amendments, equal pay for equal work, mandates all employers in Ontario to ensure that part time staff are paid on an equal basis to full time employees performing substantially the same work. College management have included all College staff in sessions to determine solutions to meet the mandate and mitigate the effects on the College budget. To date, the estimated annual impact to the College is an additional $25 million in expenses. The College has made a number of assumptions and decisions on how to mitigate the additional expenses and bring the College back to a balanced budget by the fiscal year 2020-2021. As College staff works through these mitigation strategies, there is a risk that the additional revenues or expense reductions will not materialize. Tracking and reporting mechanisms are in place to help monitor the results of the College's mitigation strategies.

Deferred Maintenance

Each year the College invests millions of dollars in the maintenance of the College's physical and digital infrastructure. However, due to the age of many of the College buildings, the speed at which technology develops and inadequate funding for maintenance, the College has incurred a significant deferred maintenance liability. In 2014, the College's deferred physical maintenance liability was independently estimated at $87.3 million. Using modest inflation rates, within two years, the estimated deferred liability maintenance value increased to $93.2 million as of December 2016. Algonquin College is not alone. A report on the Fiscal Sustainability of Ontario Colleges provided to Colleges Ontario by Price Waterhouse Coopers LLP, states, "…we note that on a system wide basis, deferred maintenance is projected to increase from $1.217 billion in 2015-16 to $3.544 billion in 2024-25."[1]This situation poses significant risk to the College's annual budget as the College addresses immediate maintenance issues while balancing demand for limited funding with strategic initiatives.

Budgetary Pressures

The corridor funding model was introduced by the Ministry of Advanced Education and Skills Development for the college sector effective fiscal year 2017-2018. This model was developed to address the issue of the changing demographics in Ontario, which will see a decline across the province of the traditional pool of college-age students (typically between 18 and 24 years of age). The new funding formula aims to provide a steady level of funding to colleges. Previous funding formulas were based on domestic enrolment growth and provided additional funding for realized growth. Current domestic enrolment for Algonquin remains stable with modest projected increases over the next few years. As a result, through the current corridor funding model, the College will receive no additional operating grant funding. Additionally, the government maintains an annual tuition increase cap of 3%. Current revenues are not keeping pace with the rate of inflation. As the College struggles to rebalance the budget by 2021 in the wake of the changes to the Employment Standards Act, it will become increasingly challenging to maintain the current high level of student satisfaction, a key priority for all College employees at all campuses.

[1] Price Waterhouse Coopers, LLP, (2017). "Fiscal Sustainability of Ontario Colleges" [Online]. Available: http://collegesontario.org/policy-positions/position-papers/Fiscal%20Sustainability%20of%20Ontario%20Colleges%20Final%2004.01.16.pdf