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INVESTORS SERVICE

CREDIT OPINION
23 February 2021

Update

Rate this Research

RATINGS

University of Toronto

Domicile	Ontario, Canada
Long Term Rating	Aa1
Type	LT Issuer Rating
Outlook	Stable

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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University of Toronto (Canada)

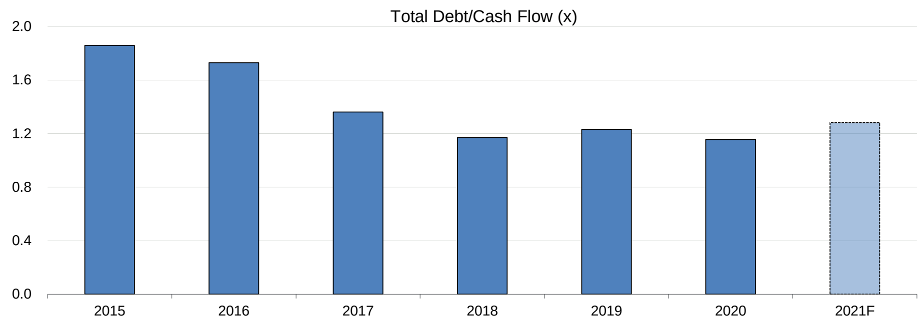
Update following rating affirmation

Summary

The credit profile of the University of Toronto (Aa1 stable) (U of T) reflects its flagship status as Canada's largest and top-ranked post-secondary institution, global brand recognition of its academic and research quality, and balance sheet strength including its endowment funds valued at CAD2.5 billion at April 30, 2020. The credit profile also reflects diversified revenue sources and a lower reliance on provincial funding than most Canadian peers. These strengths provide a buffer against the adverse fiscal impacts of the coronavirus pandemic and pressures from campus closures and ongoing travel restrictions leading to reduced demand, as well as provincial restrictions on tuition fees. Pressure could also arise if the pandemic results in a shift in student demand and/or perception of the value of higher education.

Exhibit 1

Despite our forecast of a modest reversal in 2020/21, leverage (total debt/cash flow) remains low



(fiscal years ending April 30)
Source: Moody's Investors Service, University of Toronto

Credit strengths

» Exceptional wealth and liquidity and low leverage

» Very strong governance and management that provide stability

» Global brand recognition and research strength provides resilience against enrolment pressures

Credit challenges

» Operating pressures from the coronavirus pandemic and provincial restrictions on tuition

» Sizeable unfunded pension liabilities create contingent liability pressure

Rating outlook

The stable outlook reflects our view of continued excellent levels of wealth and liquidity with manageable debt levels, and continued strong fundraising capacity, which provide a significant buffer against enrolment and funding pressures. The stable outlook further reflects our expectation that the university will navigate the pandemic environment with minimal enduring shifts in its credit profile.

Factors that could lead to an upgrade

The rating could be upgraded following a sustained period of strong positive operating performance and increasing enrolment numbers, in conjunction with a material increase in endowment and liquidity levels in line with Aaa global peers. The university successfully addressing its unfunded pension liabilities would also contribute to upward pressure on the rating.

Factors that could lead to a downgrade

A sustained decline in enrolment demand, including from international students, leading to weaker financial performance including operating deficits, would lead to downward rating pressure. A material decline in liquidity and investment returns would also contribute to downward rating pressure.

Key indicators

Exhibit 2
University of Toronto

(Year Ending April 30)	2016	2017	2018	2019	2020
Operating Revenue (CAD Million) [1]	2,697.7	2,905.2	3,068.8	3,184.7	3,300.7
Annual Change in Operating Revenue (%)	6.2	7.7	5.6	3.8	3.6
Operating Cash Flow Margin (%)	15.4	18.1	19.9	18.1	18.6
Total Cash and Investments (CAD Million)	3,886.6	4,558.0	4,821.0	5,259.0	5,418.0
Spendable Cash and Investments to Operating Expenses (x)	0.85	0.98	1.01	1.08	1.12
Total Debt to Cash Flow (x)	1.73	1.36	1.17	1.23	1.16

[1] Revenue is net of scholarship expenses.
Source: Moody's Investors Service, University of Toronto

Detailed credit considerations

Recent developments

On 22 February 2021, we affirmed the university's aa1 baseline credit assessment (BCA) and Aa1 rating and maintained the stable outlook. At the same time, we lowered the assumption of the level of extraordinary support provided by the Province of Ontario to 'moderate' from 'high'. The rating action was prompted by our reassessment of the probability of extraordinary support provided following the recent filing for creditor protection by Laurentian University (unrated) which suggests an increased risk that the province would allow a university to halt payments to creditors ahead of any extraordinary support being provided. It may also suggest weaker regulatory oversight from the province and lower credit support available if the university faced financial distress.

Baseline credit assessment

The credit profile of U of T, as expressed by its Aa1 stable rating, reflects a BCA for the university of aa1. The rating also incorporates a moderate likelihood of extraordinary support coming from the Province of Ontario (Aa3 stable) in the event that the university faced acute liquidity stress.

Exceptional wealth and liquidity and low leverage

The university has seen continued growth in wealth from cash and investments, which exceeded CAD5.4 billion at April 30, 2020, a very strong level relative to peers. This allows the university to maintain excellent coverage ratios, with spendable cash and investments, which exclude permanently restricted net assets, increasing to 4.6x debt in 2019/20 (from 2.4x debt in 2012/13). Although we expect that the university will need to use some of this liquidity to address coronavirus-related fiscal pressures in 2020/21, improving fiscal forecasts starting in 2021/22 should allow the university to replenish its liquidity balances.

The university also maintains the largest endowment portfolio among Canadian universities, totaling CAD2.5 billion at April 30, 2020. Endowment growth was pressured in 2019/20 due to weaker investment returns related to the start of the pandemic and related economic uncertainty at the time of fiscal year end, which will continue to weigh on balances in 2020/21 before an expected rebound later in the year. The Long-Term Capital Appreciation Pool, which had a fair value of CAD3 billion at April 30, 2020 and includes assets of the endowment fund, has posted solid investment performance in recent years with a 10-year rolling average return of 7.6% in 2019/20 (net of investment fees and expenses). Nevertheless, the pool's investment returns exhibit significant annual volatility which results in uncertainty in performance, exacerbated by our expectation of a weaker investment climate in 2020/21.

U of T has also been highly successful in its fundraising activities. Its seven year Boundless fundraising campaign, with an original campaign target of CAD2 billion, concluded at year-end 2018 and raised CAD2.6 billion. The university also receives significant donations and gifts for research and capital projects. These enable the university to capitalize on its brand name and profile and its ability to generate sizeable philanthropic interest and donations despite competition for fundraising dollars both domestically and internationally.

U of T's credit profile benefits from low levels of leverage. The university issued its latest debenture in 2011 and we do not anticipate new debt issues over the next 2-3 years. U of T's practice in recent years has been to finance capital projects from non-debt sources, including funding its capital plan from a combination of departments' operating reserves, provincial and federal funding, and donations. We expect that despite the pandemic, notional debt levels will not increase given that we do not anticipate new long-term debt issuance by the university over the next two years, although debt metrics relative to revenue and cash flow may decline modestly in 2020/21 before rebounding in 2021/22 given our forecast of weaker operating results this year. For 2019/20, long-term debt stood at 22% of revenue and 1.16x cash flow.

Very strong governance and management that provide stability

The success of U of T in maintaining a strong balance sheet, balancing its core operational financial results while meeting academic goals, is underpinned by strong governance and management and the development and execution of multi-year frameworks for academic and financial planning.

U of T's strong governance is also evident in its planning and responses related to the coronavirus pandemic. This included a swift and successful conversion of in-person classes early on during the pandemic to online courses, and scenario analysis of potential operating outcomes. The university also puts strong emphasis on a decentralized style of governance and decision making. Each faculty is responsible for developing its own budget and adhering to self-imposed revenue and expense targets, which allows the faculties to be more entrepreneurial in areas where they see greater demand and by extension generate positive operating results. The university itself still maintains control over collective bargaining, however, which takes a certain amount of expenditure control out of the hands of individual faculties.

The University of Toronto Asset Management Corporation (UTAM), a non-share capital corporation whose members are appointed by the university, manages the investment assets of the university's Long-Term Capital Appreciation Pool (which includes assets of the endowment fund), the Expendable Funds Investment Pool (including short- to medium-term funds) and assets of the university's pension plan.

Global brand recognition and research strength provides resilience against enrolment pressures

U of T is Canada's largest post-secondary institution located in the Province of Ontario across three campuses in downtown Toronto, Mississauga and Scarborough. U of T is Canada's preeminent research university and consistently places as the top ranked Canadian school and one of the top 20-25 global schools in international rankings, underpinning its international brand.

U of T's excellent market profile and global recognition has contributed to the university's ability to attract consistently high historical global demand and increase enrolment and revenue numbers even in the face of provincial funding and enrolment constraints. Along with its affiliations, including several hospitals, the university also continues to be the leader among Canadian universities in securing federal government research funding from the three granting councils and from other federal programs.U of T's research strength is also evident in the number of prestigious research chairs, including 31 new or renewed "Canada Research Chairs" and 3 "Canada 150 Research Chairs" at the university.

The university's outstanding market profile and high student demand resulted in historically robust enrolment growth, with total full-time equivalent (FTE) growth exceeding 25% over the last decade between 2009/10 (65,402) and 2019/20 (82,311). The rise in enrolment and contribution to revenue growth has been supported by a faster growth in international students than domestic students, and international students now represent around a quarter of total FTE students.

The reliance on international students exposes U of T to manageable pressures from the adverse impact of the coronavirus pandemic on international enrolment in 2020/21 given global travel restrictions, and to global trade and political tensions. Much of the historical international growth has come from Asia, and in particular from China. The number of Chinese students more than doubled over the last 5 years and now constitute around 60% of international students. The significant dependence on international tuition revenue exposes it to revenue concentration from a single region or country and to political risk from potential diplomatic tensions, especially in light of the current political tension between Canada and China and previous tensions between Canada and Saudi Arabia.

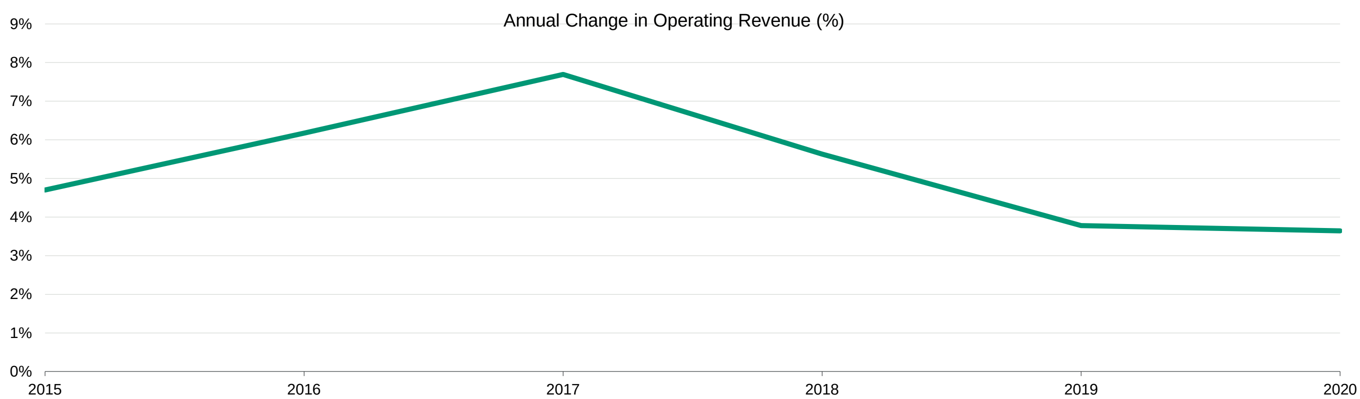
Operating pressures from the coronavirus pandemic and provincial restrictions on tuition

Operating pressures are expected to arise mainly from the fiscal impact of the coronavirus pandemic and from provincial restrictions on tuition fees. U of T, along with higher education institutions globally, faces operating revenue declines mainly from its ancillary operations and higher expenses related to the pandemic resulting in weaker fiscal results in 2020/21. The potential for ongoing travel restrictions, campus closures and other public health concerns could reduce demand, including from international students. Although we currently do not expect that the pandemic will result in long-lasting credit impacts beyond 2021/22, pressure may arise should a permanent shift in student demand and/or perception of the value of higher education occur as a result of the pandemic.

Operating pressures also arise from a provincially mandated freeze in domestic tuition rates for 2020/21 following a mandated 10% reduction in 2019/20. The mandated restrictions weaken U of T's ability to generate revenue from tuition or to offset the international revenue pressure from domestic fees. Additionally, although deferred by 2 years due to the pandemic, the province will transition its operating grants to reflect a greater emphasis on performance metrics, which will introduce the possibility for more volatile government grants in the future.

Exhibit 3

Cumulative pressures have slowed the growth in U of T's operating revenues



(fiscal years ending April 30)

Source: Moody's Investors Service, University of Toronto

Despite these challenges, the university can rely on several mitigants to offset some of these pressures. Mitigants include increasing international student fees, which are not subject to provincial controls, as well as investment income, donations and use of reserves. Furthermore, in the face of changing government funding, U of T has the lowest reliance on provincial funding (around 20-25% of operating revenues) , cushioning some of the impact of the challenges in funding environment relative to provincial peers.

Sizeable unfunded pension liabilities create contingent liability pressure

U of T's financial profile remains pressured by significant pension expenses arising from the university's pension plan deficit (both a going concern deficit and a solvency deficit). U of T recorded a pension deficit of CAD606 million at April 30, 2020 (9.7% of Moody's adjusted operating revenue), nearly double the previous year's deficit mainly as a result of weak investment returns on plan assets. We expect that investment returns in 2020/21, which were initially weakened due to the pandemic, will rebound during the year. Unfunded liabilities remain sizeable and continue to pressure its balance sheet, and future changes in the deficit will continue to be dependent on changes in investment returns.

U of T was previously granted entrance into the provincial solvency funding relief program, and received additional Stage 2 solvency funding relief measures. This allows the university to make minimum special payments sufficient to liquidate 25% of the solvency deficiency over 7 years beginning in 2018 and to cover interest applied on the remaining 75% of the solvency deficit. The potential impact of these future payments continues to be reflected in the university's credit profile.

U of T is currently looking to transition to a jointly sponsored defined benefit pension plan with two other universities, with a targeted conversion date of 1 July 2021.

Extraordinary support considerations

Moody's assigns a moderate likelihood of extraordinary support coming from the Province of Ontario in the event that the university faced acute liquidity stress.

ESG Considerations

How environmental, social and governance risks inform our credit analysis of U of T

Moody's takes into account the impact of environmental (E), social (S) and governance (G) factors when assessing sub-sovereign issuers' economic and financial strength. In the case of U of T, the materiality of ESG to the credit profile is as follows:

Exposure to environmental risks is not material to the U of T's credit profile. The university owns land and owns / operates buildings which may be subject to environmental risks (e.g. asbestos in older buildings or clean-up following construction), but these risks are small and the university proactively manages them through its facilities maintenance.

The university has moderate exposure to social risks. Social considerations principally relate to developments in public policy on education, in particular Ontario's objective of promoting improvements in tuition affordability through mandated provincial tuition fee restrictions. We also consider the coronavirus outbreak as a social risk which adds a high degree of uncertainty on enrolment levels as students may alter their plans on attending universities during a global health pandemic. These pressures are mitigated by an excellent global brand leading to consistently strong enrolment demand and significant liquidity.

Exposure to governance risks is material and governance risk is low. Governance considerations include a robust institutional framework and prudent financial planning which has resulted in multi-year balanced budgets and strong operating results. Each faculty is responsible for developing its own budget and adhering to self-imposed revenue and expense targets. Faculties tend to encourage and explore entrepreneurial ideas for boosting revenue. Oversight is strong from its Governing Council including its boards and committees.

Further details are provided in the "Detailed credit considerations" section above. Our approach to ESG is explained in our cross-sector methodology General Principles for Assessing Environmental, Social and Governance Risks.

Rating methodology and scorecard factors

The assigned baseline credit assessment (BCA) of aa1 is in line with the scorecard indicated outcome of aa1. For details of our rating approach, please refer to the Higher Education (May 2019) and Government-Related Issuers (February 2020) methodologies.

Exhibit 4

University of Toronto

Scorecard Factors and Sub-factors		Value	Score
Factor 1:	**Market Profile (30%)**		
	Scope of Operations (Operating Revenue) ($000)	2,570,471	Aa1
	Reputation and Pricing Power (Annual Change in Operating Revenue) (%)	3.6	Baa1
	Strategic Positioning	Aa	Aa
Factor 2:	**Operating Performance (25%)**		
	Operating Results (Operating Cash Flow Margin) (%)	18.6	Aa1
	Revenue Diversity (Maximum Single Contribution) (%)	58.2	A1
Factor 3:	**Wealth & Liquidity (25%)**		
	Total Wealth (Total Cash & Investments) ($000)	3,895,000	Aaa
	Operating Reserve (Spendable Cash & Investments to Operating Expenses) (x)	1.1	Aaa
	Liquidity (Monthly Days Cash on Hand)	275	Aaa
Factor 4:	**Leverage (20%)**		
	Financial Leverage (Spendable Cash & Investments to Total Debt) (x)	4.6	Aaa
	Debt Affordability (Total Debt to Cash Flow) (x)	1.2	Aaa
	Scorecard-Indicated Outcome		aa1
	Assigned BCA		aa1

Data is based on most recent fiscal year available. Debt may include pro forma data for new debt issued or proposed to be issued after the close of the fiscal year.
For non-US issuers, nominal figures are in US dollars consistent with the Higher Education Methodology.
Source: Moody's Investors Service

Ratings

Exhibit 5

Category	Moody's Rating
UNIVERSITY OF TORONTO	
Outlook	Stable
Issuer Rating	Aa1
Senior Unsecured -Dom Curr	Aa1

Source: Moody's Investors Service

REPORT NUMBER 1266606

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