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Research Update:

University of Toronto 'AA+' Ratings Affirmed; Outlook Remains Stable

Primary Credit Analyst:
Adam J Gillespie, Toronto (1) 416-507-2565; adam.gillespie@spglobal.com

Secondary Contact:
Nineta Zetea, Toronto + 1 (416) 507 2508; nineta.zetea@spglobal.com

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Overview

- In our view, the University of Toronto's (UofT) exemplary student demand and research capacity will continue to support its flagship status among Canadian universities, while healthy operating margins and very strong liquidity will underpin its financial profile in the next several years.
- We are therefore affirming our 'AA+' long-term issuer credit and senior unsecured debt ratings on UofT.
- The ratings reflect, in part, the university's stand-alone credit profile, which we have assessed at 'aa+' based on UofT's extremely strong enterprise and very strong financial profiles.
- The stable outlook reflects our expectation that, within our two-year outlook horizon, the university will maintain its exceptional market position and student demand profile, its adjusted operating margins will remain positive, and its level of available resources will remain very robust.

Rating Action

On Nov. 20, 2018, S&P Global Ratings affirmed its 'AA+' long-term issuer credit and senior unsecured debt ratings on the University of Toronto (UofT). The outlook is stable.

Outlook

The stable outlook reflects our expectations that, within our two-year outlook horizon, UofT will maintain its exceptional market position and student demand profile, with continuing growth in student-derived revenues driving positive adjusted operating margins, and levels of available resources remaining very high. At the same time, we expect that the university's debt burden will be largely stable and that UofT's relationship with the province will not alter materially.

Downside scenario

We could lower the rating if adjusted net margins weakened to near-balance, on a sustained basis, because of a significant reduction in government grants, enrollment falling well short of targets, or greater-than-expected operating expenses. We could also lower the ratings if UofT issued substantial debt in the next two years, resulting in the level of available resources falling to less than the total debt outstanding and the estimated maximum annual debt service rising to greater than 2% of operating expenses. A negative rating action on Ontario will also result in a similar rating action on UofT, given the maximum three-notch rating differential between the university and the province allowed under our government-related entities criteria. All else equal, we could also lower the ratings if we significantly reduce our estimate of UofT's resilience to an Ontario default scenario. Moreover, although highly unlikely, a strengthening of our assessment of the link between UofT and the province would cause us to equalize the ratings with those on Ontario.

Upside scenario

We could raise our assessment of the university's stand-alone credit profile in the next two years if the provincial government relaxed its restrictions on tuition increases, while maintaining its supporting operating grants, resulting in a material increase in student-derived revenues. However, we consider the possibility of this scenario resulting in a positive action to our issuer credit rating on UofT during our two-year outlook horizon unlikely, given our three-notch cap above the rating on the supporting government.

Rationale

The ratings reflect UofT's stand-alone credit profile, which S&P Global Ratings assesses at 'aa+'. This reflects our combined assessment of the university's extremely strong enterprise profile and very strong financial profile. The ratings also reflect our opinion of a moderately high likelihood that the Ontario government would provide extraordinary support in the event of financial distress.

We expect that UofT will maintain its position as a flagship institution, being the largest and most research-intensive university in Canada, with a solid international reputation and strong student demand characteristics. Growth in full-time equivalents (FTEs) has slowed in the past two years, although this is in line with the university's plan, and it expects overall enrollment to increase only modestly in the next five years, mainly in graduate and international students. We believe that UofT is well placed to compete for these students, but that slower student growth, against a backdrop of constrained provincial funding and inflationary cost pressures, could result in smaller operating margins than it has enjoyed in the past several years. The university has a moderate debt burden that is partially mitigated by very high and increasing levels of available resources. UofT has identified the possible need for additional funding for unapproved capital projects; however, the amount, timing, and nature (internal or external borrowing) of this funding have not been determined and we do not believe that capital funding requirements will weaken the university's financial profile in the next two years.

Founded in 1827, UofT is Canada's largest university based on enrollment and has three campuses (St. George, Scarborough, and Mississauga) that together accounted for 90,077 students in fall 2017. The university offers a variety of undergraduate, graduate, postgraduate, and professional degrees across its 18 faculties and schools. It also has affiliations with seven colleges, 65 centers and institutes, and nine Toronto hospitals. UofT employs more faculty and staff and offers a greater range of courses than any other Canadian university. It is also Canada's most important research institution and has been the highest ranked Canadian university in recent years in several international surveys.

We believe the university has an extremely strong enterprise profile. Supporting our opinion is our assessment of the higher education sector's low industry risk, characterized by countercyclicality and low competitive risk and growth. In addition, the university benefits from excellent economic fundamentals, measured by the province's GDP per capita, estimated to be over US$49,000 in 2017; good income indicators; and moderate employment and population growth projections. In addition, with about a third of students coming from outside Ontario, the university's enterprise profile benefits from a geographically diversified student body.

Furthermore, UofT's leading market position and healthy demand strengthen the university's enterprise profile. FTE growth through fall 2017 slowed to an average of 1.4% per year in the past two years, from an average of more than 3% in the preceding three years, reaching 79,262. About 22% of FTEs were graduate and professional students, a ratio that is in line with that of most Canadian research-intensive universities. As part of its negotiated agreement with the province, UofT plans for a slight decrease in the number of provincially funded domestic undergraduate students in the next five years. However, it expects that planned growth in graduate and international students will result in overall FTEs growing about 2.5% in the next five years. In our opinion, student quality continues to be strong as reflected by the university's historically stable retention and graduation rates of about 91% and 73%, respectively, in the past several years, as well as a robust selectivity rate well below 75%.

We believe UofT's tuition discounting, which we define as total financial aid costs as a percentage of gross tuition and fees, is fairly stable and lower than that of some rated Canadian peers. It suggests greater flexibility to address affordability concerns, which bolsters the university's competitive position. We also believe that UofT has superior fundraising capabilities relative to most Canadian peers. The university and its affiliated colleges expect to meet their C$2.4 billion fundraising goal by the end of 2018 and have set an ambitious annual fundraising target of C$200 million.

In our view, UofT's management expertise and governance practices, as well as financial management policies, are very strong and in line with those of other highly rated Canadian universities. The university's academic and operational priorities are guided by its strategic plan, Towards 2030 (most recently revised in 2012), and its Strategic Mandate Agreement with the province. These in turn inform the detailed annual budget and long-range plan, which incorporate operating and capital plans. UofT reviews its performance relative to the plan annually and tracks its progress against specific activity indicators and financial metrics. In addition, it identifies and monitors risks to the plan. The university has formal policies for endowment, liquidity and investments, debt, and reserves, and meets standard annual disclosure requirements. Overall, we view UofT's transparency and disclosure to be very good, with policies and procedures in place to adequately mitigate risks, and we believe that the university's overall financial policies are not likely to negatively affect its ability to pay debt service.

In our opinion, UofT has a very strong financial profile, bolstered by healthy adjusted operating margins averaging about 8% in the past four fiscal years. It has budgeted for balanced results in its long-range operating budget plan out to fiscal 2023, partially through including unallocated funds that it can adjust to meet unforeseen contingencies. However, we believe that ongoing challenges stemming from moderating provincial operating grants and increasing employee-related expenditures could result in a modest decline in margins for combined funds in the next two years. Similar to that of Canadian peers, the university's limited flexibility to increase its student-generated revenues somewhat offsets its strong financial performance. This is primarily because Ontario monitors and guides domestic tuition rates and student aid (through the tuition framework), and enrollment expansion (through operating grants).

In our view, UofT has a relatively moderate debt burden that is very manageable given its good operating performance and robust liquidity. At fiscal year-end 2018, its total gross debt outstanding stood at C$715 million. The debt consists primarily of five series of fixed rate, 30- and 40-year bullet debentures maturing from 2031-2051, along with about C$4 million of mortgage and other debt. We believe that the high level of bullet debentures makes UofT's debt structure more aggressive than that of peers with amortizing debt; however, the university has established a self-imposed sinking fund to help repay these obligations with assets totaling C$344 million at the end of fiscal 2018. Our estimate of UofT's maximum annual debt service is equal to a modest 1.7% of adjusted fiscal 2018 operating expenses, which is lower than the median for peers in the 'AA' rating category. The university has identified a potential need for up to C$560 million in additional financing for capital projects to the end of fiscal 2024 that have yet to be approved. However, some or all of this financing could come from internal sources and we do not believe that the university's debt will exceed UofT's internally approved debt limits or lead to a material erosion of the university's financial profile in the next two years.

UofT has several funded and unfunded defined benefit programs that provide pension and other postemployment benefits (OPEB) to its employees. At fiscal year-end 2018, the pension plan's deficit increased moderately to C$319 million, from C$296 million the previous year. The university also had a C$488 million deficit in its OPEB plan. Because there is no legislative requirement to maintain assets against these liabilities (unlike pensions), UofT funds them on a pay-as-you-go basis, similar to other universities. We do not believe that funding employee future benefits will have a material impact on the overall credit profile of the university in the next two years as the pension plan is in a healthy funded status and the university continues to make required payments. In addition, the university has no material off-balance-sheet or exposure to contingent liability risks.

Liquidity

In our view, the university has very robust liquidity. It continued to increase its total cash and investments to C$4.82 billion from C$4.56 billion in 2017. At the same time, our measure of UofT's available resources (internally restricted net assets plus internally restricted endowments) had increased slightly to C$1.53 billion from C$1.52 billion the year before; equal to 51% of adjusted operating expenses on a three-year, weighted-average basis. We believe that the level of available resources could decline somewhat in the next several years if the university internally finances a larger portion of its capital plan. However, in our opinion, with total cash and investments being greater than 2x the available resources and close to 7x the debt outstanding, UofT's liquidity will remain more than sufficient to finance all debt service requirements and provide a significant buffer against any likely medium-term stress scenario. In addition, continued fundraising in fiscal 2018 helped to boost the market value of the university's endowment, which is the largest among Canadian universities, to C$2.50 billion from C$2.38 billion at the end of fiscal 2017.

Moderately high likelihood of extraordinary provincial government support

In accordance with our criteria for government-related entities, our view of UofT's moderately high likelihood of extraordinary government support reflects our assessment of its important role in the province, given that postsecondary education is one of Ontario's priorities in both expenditure and mandate (after health care and school boards), and that there are no viable private alternatives. It also reflects our assessment of the university's role as Canada's largest university in enrollment and research capacity. The province's oversight, program approval rights, and tuition regulation over UofT suggest a strong link to it. Also supporting our assessment of the link are the significant operating grants received from the province, accounting for about 22% of the university's total revenue, and the province's appointment of some board members.

We rate UofT three notches above Ontario, the maximum differential allowed in accordance with our methodology for rating government-related entities that depend on ongoing government support. The differential reflects our view that there is a measureable likelihood that UofT's substantial financial resources would meet ongoing operational and debt service requirements should the government default and temporarily suspend payments to the university. In addition, the differential reflects UofT's status as an autonomous legal entity with ownership of its assets and our view that UofT operates independently of the Ontario government. The board is responsible for the management, administration, and control of the university's property and other assets and all business affairs. We consider the risk of extraordinary negative government intervention low, given UofT's operational independence, its important public policy role, and the government's hands-off approach to the sector.

Ontario elected a new provincial government in June 2018. The previous government had begun the process of shifting its grant funding toward measurable student outcomes and away from a more enrollment-based formula. It had committed to maintain the 2016-2017 funding level for all universities until 2019-2020 and extended its tuition framework through fiscal 2019, maintaining the annual increases capped at an average of 3% for most undergraduate programs and 5% for professional and graduate programs. The new government has yet to articulate a clear policy for post-secondary funding but it has cancelled capital funding for several campus expansions and other projects across the province. The government has pledged to reduce the province's large fiscal deficit and although we continue to believe that there is a moderately high likelihood that the province would support UofT in a distress scenario, we are not anticipating any material increase in operating or capital funding from the province in the medium term.

University of Toronto -- Financial Statistics

	--Fiscal year ended April 30--					
	2018	**2017**	**2016**	**2015**	**2014**	**Medians for 'AA' U.S. public colleges & universities, 2017***
Enrollment and demand						
Headcount	90,077	88,766	87,639	85,383	83,012	MNR
Full-time equivalent	79,262	78,292	77,130	74,516	72,370	34,653
First-year acceptance rate (%)	63.7	71.5	67.6	64.8	69.2	66.0
First-year matriculation rate (%)	25.2	25.7	25.2	26	33.9	MNR
Undergraduates as a % of total enrollment (%)	79.4	79.7	80.4	80.5	80.9	79.2
First year retention (%)	N.A.	91.3	91.7	92.1	92	86.0
Graduation rates (six years) (%)	N.A.	75.2	73.7	71.7	72.3	MNR
Income statement						
Adjusted operating revenue (C$000s)	3,230,000	3,022,000	2,940,200	2,786,200	2,742,900	MNR
Adjusted operating expense (C$000s)	2,973,000	2,821,000	2,725,600	2,572,500	2,644,800	MNR
Net adjusted operating income (C$000s)	257,000	201,000	214,600	213,700	98,100	MNR
Net adjusted operating margin (%)	8.6	7.1	7.9	8.3	3.7	1.2
Provincial grants to revenue (%)§	22.4	23.6	24.3	25.6	25.7	19.5
Student dependence (%)	49.0	47.4	43.9	41.6	37.9	42.4

University of Toronto -- Financial Statistics (cont.)						
	--Fiscal year ended April 30--					
	2018	2017	2016	2015	2014	Medians for 'AA' U.S. public colleges & universities, 2017*
Investment income dependence (%)	5.6	7.3	3.7	6.9	6.5	1.4
Debt						
Debt outstanding (C$000s)	715,000	718,000	718,600	721,100	722,800	798,089
Current debt service burden (%)	1.35	1.42	1.48	1.57	1.53	MNR
Current MADS burden (%)	1.66	1.77	1.84	1.95	1.89	3.51
Financial resource ratios						
Endowment market value (C$000s)	2,504,000	2,380,000	2,097,700	2,142,100	1,880,800	858,805
Cash and investments (C$000s)	4,821,000	4,558,000	3,886,600	3,794,700	3,359,500	MNR
Adjusted UFR (C$000s)	1,532,000	1,522,000	1,266,600	1,194,500	1,053,900	MNR
Cash and investments to operations (%)	162.2	161.6	142.6	147.5	127.0	58.2
Cash and investments to debt (%)	674.3	634.8	540.9	526.2	464.8	167.8
Adjusted UFR to operations (%)	51.5	54	46.5	46.4	39.8	34.3
Adjusted UFR to debt (%)	214.3	212	176.3	165.6	145.8	100.5
Average age of plant (years)	18.1	18.5	18.2	17.9	17.6	13.1
OPEB liability to total liabilities (%)	15.0	15.8	13.9	15.1	13.6	MNR

*U.S. median figures are in U.S. dollars. §Median figure is state appropriations to revenue. N.A.--Not available. MNR--Median not reported. MADS--Maximum annual debt service. UFR--Unrestricted financial resources. Average age of plant = accumulated depreciation/depreciation and amortization expense.

Related Criteria

- General Criteria: Methodology: Not-For-Profit Public And Private Colleges And Universities, Jan. 6, 2016
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Australia, Canada, Mexico, And U.K. Universities 2018 Medians Report: Increased International Tuition Revenues Preserve The Sector's Stability Amid Stagnant Government Support, Aug. 20, 2018
- U.S. Public College And University Fiscal 2017 Median Ratios: Lower-Rated Entities Continue To Face Financial Stress, July 16, 2018

Ratings List

Ratings Affirmed

University of Toronto	
Issuer Credit Rating	AA+/Stable/--
Senior Unsecured	AA+

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.