S&P Global
Ratings

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University of Toronto

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Table Of Contents

University of Toronto

Rationale

Issuer Credit Rating
AA+/Stable/--

The ratings on University of Toronto (UofT) reflect the university's stand-alone credit profile (SACP), which S&P Global Ratings assesses at 'aa+'. The ratings also reflect our opinion of a moderately high likelihood that the Province of Ontario would provide extraordinary support in the event of financial distress.

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 88,766 students in fall 2016. 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 gained a strong international reputation for its research.

The SACP on UofT reflects our combined assessment of the university's extremely strong enterprise profile with a remarkable enrollment and demand profile and strong management and governance practices; and its very strong financial profile, with a history of solid financial performance, excellent levels of available resources, and a low debt burden. In our opinion, substantial postemployment liabilities, and the fiscal challenges facing the provincial government, which could affect operating grants, offset some of these strengths.

UofT's enterprise profile primarily benefits from excellent economic fundamentals, given Ontario's very strong economy, a strong market position, and continuing demand. Its enrollment has steadily increased by an average of almost 3% per year in the past five years, reaching 78,292 full-time equivalents (FTEs) in fall 2016. Graduate students represent about 20% of total enrollment, a level comparable with that of other national research-intensive universities. We believe UofT's student quality is sound, as reflected by its historically stable retention and average entry grade rates of almost 92% and 85%, respectively, in the past several years. First-year selectivity (offers to applications) and six-year graduation rates are typically strong and have shown a broadly increasing trend over the past five years, to about 75% and 74%, respectively.

UofT's adjusted operating margin was 7.9% in fiscal 2016 (year ended April 30), slightly down from 8.3% a year earlier, primarily due to lower investment returns recognized during the year and a broad increase in expenses, and despite increasing student-derived revenues. We expect UofT's financial profile will remain very strong in the next two years, with abundant financial resources (available resources in excess of 35% of adjusted operating expenses) and positive adjusted net margins. However, significant operating constraints remain--primarily the tuition framework, pressure on provincial operating grants, and increasing salaries and benefits costs. In our view, the university's debt burden is low compared with that of similarly rated peers, especially in light of the healthy level of available resources. Given UofT has no firm plans to issue debt in the next two years, we expect that the university's debt metrics will remain in line with current levels and well within UofT's internally approved debt limits.

In accordance with our criteria for government-related entities, our view of the university'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 UofT's role as Canada's largest university in enrollment and research capacity. The province's oversight, program approval rights, and tuition regulation over the university suggest a strong link to it. Also supporting this view is that the province provides substantial operating grants, which account for about 24% of the university's total revenue, and it appoints 16 of 50 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 difference reflects UofT's ownership structure, in which the government is neither an owner nor shareholder. We consider the risk of extraordinary negative government intervention to be low, given the university's operational independence, important public policy role, and the government's hands-off approach to the sector. Although the Ontario government faces fiscal challenges and projects it will not return to fiscal balance until fiscal 2017-2018, we do not expect provincial operating grants for postsecondary education to diminish significantly, given its vital public policy role.

Liquidity

UofT's liquidity is exceptional, in our opinion. Consolidated cash and investments totaled C$3.9 billion at fiscal year-end 2016, up 2.4% from fiscal 2015. They represented 142.6% of 2016 adjusted operating expenditures, or 5.4x total debt. Available resources (internally restricted net assets and internally restricted endowments) stood at C$1.3 billion, up from C$1.2 billion in fiscal 2015. This equaled almost 1.8x debt and 46.5% of adjusted operating expenses. We believe these ratios will remain more than sufficient to finance all debt service requirements and provide a sufficient buffer to withstand any likely medium-term stress scenario. UofT has the largest endowment among Canadian universities, with a fair value of C$2.1 billion as of the end of April 2016. It has significantly increased in the past 10 years, by about 29% since 2006.

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 a superior level of available resources. 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 ratings if adjusted net margins weakened to near balance or sustained deficits because of enrollment growth falling well short of targets, a significant reduction in government grants, or substantial pressure from rising pension deficits; or if available resources eroded materially. We could also lower the ratings if applications to UofT and total FTEs declined substantially over the next several years, resulting in a weakening of the demand profile. 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 GRE criteria. All else equal, we could also lower the ratings if there were a significant reduction in 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 consider the possibility of a positive rating action during our two-year outlook horizon unlikely given our three-notch cap above the rating on the supporting government.

Government-Related Entities Methodology: 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 large operating grants received from the province, accounting for about 24% of the university's total revenue, and the province's appointment of some board members. We consider the risk of extraordinary negative government intervention to be low, given the university's operational independence, important public policy role, and the government's hands-off approach to the sector.

The Ontario government has made strides in reducing its annual deficit and plans to return to a balanced budget in 2017-2018. Although we believe that the province's overall support for universities will remain solid, we do not expect overall funding for the sector to increase materially in the medium term. In January 2016, the province announced it would extend its current tuition framework for two years, capping annual increases to an average of 3% for undergraduate programs and 5% for professional and graduate programs. It is also reviewing its university funding formula, which is expected to result in a shifting focus toward measurable student outcomes and away from a more enrolment-based formula.

In July 2016, the federal government announced a three-year C$2 billion fund to cover up to 50% of eligible infrastructure projects at postsecondary institutions (Post-Secondary Institutions Strategic Investment Fund). We believe that many universities will try to leverage these federal dollars to not only expand their facilities but also to address deferred maintenance issues in existing eligible facilities. Although we expect that provincial funding and private donations will cover some of the remaining costs, given the tight timeline for project completion (substantial completion by April 30, 2018), we expect that the universities themselves will be required to contribute significant resources.

Enterprise Profile

Low industry risk

Industry risk addresses the higher education sector's overall cyclicality and competitive risk and growth by applying various stress scenarios and evaluating barriers to entry, levels and trends of profitability, substitution risk, and growth trends observed in the industry. We believe the higher education sector represents a low credit risk compared with other industries and sectors.

Extremely strong economic fundamentals

UofT's students predominantly come from Ontario (total intake of 64% in fall 2016). This level has slowly decreased in the past five years, while international student intake and the share of students coming from the rest of Canada continued to grow. In our view, Ontario's real GDP per capita, which in 2015 was about US$48,200, anchors our assessment of the university's economic fundamentals. The province's population was about 13.9 million in 2016 with good income indicators with some moderate employment and population growth projected.

Market position and demand

UofT's enrollment has grown significantly over the past two decades to 88,766 FTEs in fall 2016, across all three campuses. The university's long-range budget guidelines project further undergraduate growth primarily at its Mississauga and Scarborough campuses, with about 6% and 9% FTE growth planned, respectively, by 2021-2022. In addition, the university plans to increase graduate intensification, with overall graduate enrollment increasing from almost 22% of total FTE enrolment in 2016-2017 to over 23% in the next five years. International enrollment, which has been rising steadily, should reach close to 21% by fiscal 2022 (from 19% in 2016-2017). We believe the university has the ability to achieve its growth targets, given the province's commitment to fund additional new university spaces; and UofT's ability to attract new students, as reflected by an increase in its high school applications within the province in the past several years, despite a decline in Ontario's university-age population projected for the next several years.

The university has maintained a very strong student quality, in our view, as reflected by its historically high and stable retention and average entry grade rates (averaging almost 92% and about 85%, respectively, in the last five years). First-year selectivity (offers to applications) has weakened slightly in recent years, to about 75%, but remains high overall. The six-year graduation rate has been strong and fairly stable at about 72% in the last five years. UofT also benefits from exceptional faculty quality with 97% of full-time faculty members having a terminal degree.

In fiscal 2016, it received C$380 million in external research funding, which has been fairly stable in the past several years. In July 2015, the university was awarded a record-breaking research grant of C$114 million by the federal government's Canada First Excellence Research Fund. This grant will be spent over seven years, and will be used by UofT and its partners (the Hospital for Sick Children, the University Health Network, and Mount Sinai Hospital) to establish a leading center in regenerative medicine.

We believe that UofT has superior fundraising capabilities. The university and its affiliated colleges reached their C$2 billion fundraising goal by the end of November 2016, six months ahead of schedule, and have now expanded their goal to C$2.4 billion. In fiscal 2016, UofT raised a total of C$233 million; slightly below the record C$248 million raised in 2015. The majority of the funds raised under this campaign will likely have external restrictions, which tends to be the case for about 85% of UofT's total endowment. However, we believe that even these provide strength, by producing spendable endowment income. Furthermore, endowments restricted for scholarships or faculty chairs enhance a university's profile, attracting quality students and faculty.

Management and governance

A 50-member board governs the university, 16 of which are appointed by the province. The board appoints the president, senior administrators, and senior staff. The board's decisions include approval of strategic plans, academic programs, budgets, capital expansion, fundraising research, and employment policies.

The university's academic and operational priorities are guided by its strategic plan, Towards 2030 (last revised in 2012), which sets the university's goals to enhance its position as a leader in graduate education and in research-intensive undergraduate education, and a globally ranked research center. UofT reviews its performance relative to the plan annually and tracks its progress against specific activity indicators. In addition, the university identifies and monitors risks to the plan. Through its Strategic Mandate Agreement, the university's central premise is based on provincial recognition of UofT as a flagship university.

In March 2013, the university elected a new president for a five-year term. He has been with UofT for the past three decades. The president's three priorities are leveraging the university's urban location, focusing on strengthening international partnerships, and rethinking undergraduate education. There has been some natural turnover of the senior management team in the past year but this has not had any material disruptive effect on the university's operations.

Financial Profile

Financial management policies

Our analysis of financial policies includes a review of UofT's financial reporting and disclosure, investment allocation and liquidity, debt profile, contingent liabilities, and legal structure; and a comparison of these policies with those of similar institutions. Overall, we view UofT's transparency and disclosure to be good, with policies and procedures in place to adequately mitigate risks. The university conducts its activities according to an annual operating budget that includes a five-year long-range plan that is aligned with its strategic plan and contains what we view as reasonable assumptions. UofT prepares externally audited financial statements, which have been unqualified and it has formal policies for endowments, investments, debt (which includes benchmark targets), and reserves.

Financial performance

UofT's financial performance has historically been robust and has demonstrated improvement in the past two years, in our view. Its adjusted operating margin was 7.9% in fiscal 2016, slightly down from 8.3% a year earlier, but still higher than the prior three-year average of about 3%. UofT's fiscal 2016 margin is above the fiscal 2015 median for U.S. public universities in the 'AA' category and superior to that of most rated Canadian peer institutions. Like those of its Canadian peers, UofT's salaries and benefits expenditures are a significant strain, typically accounting for close to 60% of its total reported expenditures.

The university's 2017-2018 budget anticipates a 6.7% increase in its reported operating revenues and expenses in fiscal 2018 from its projected level for fiscal 2017. The budget plans for a balanced operating result throughout the planning period, partially through the inclusion of unallocated funds that can be adjusted to meet unforeseen contingencies. A decrease of C$3 million (0.5%) is projected in the operating grant for 2017-2018 as a result of slower undergraduate growth, and an increase of only C$13 million is projected over the next five years. The budget assumes that domestic undergraduate tuition fee growth will be capped at 3% over the five-year budget period and growth in government operating grants will be minor. Nevertheless, operating revenues and expenses are forecast to rise at an annual average rate of about 5%, with academic expenses accounting for the majority of budgeted operating expense growth.

UofT depends on student-generated revenues for 43.9% of 2016 adjusted operating revenues, which is more than at other Canadian universities and has been steadily growing in the past three years. Similar to peers, it has somewhat limited flexibility to increase these revenues. Ontario monitors and guides tuition rates and student aid (through the tuition framework), and enrollment expansion (through operating grants). However, universities have the final decision on these matters and their long-term strategies. The current tuition framework restricts annual increases to an average of 3% for undergraduate programs and 5% for professional and graduate programs (for a maximum annual average of 8% institutionwide). Universities have some flexibility on how they increase tuition among programs as long as the total increase entitywide is below the cap.

Available resources

At fiscal year-end 2016, consolidated cash and investments totaled C$3.9 billion, up 2.4% from fiscal 2015. Total cash and investments represented 142.6% of adjusted operating expenditures, or about 5.4x total debt. Unrestricted financial resources (internally restricted net assets and internally restricted endowments) stood at C$1.27 billion, which was up from the previous year's total of C$1.19 billion. This equaled about 176.3% of debt and 46.5% of adjusted operating expenses.

UofT has the largest endowment among Canadian universities, with a fair value of C$2.1 billion, at April 30, 2016. It has significantly increased in the past 10 years, by about 28.8% since 2006. It includes a full inflation protection of C$531 million and a preservation of capital above inflation cushion of C$6.6 million to protect against any possible market downturn. The university has a conservative endowment draw, in our view, with an annual spending rate target of 4% of the opening market value of the endowments. In fiscal 2016, the endowment paid out C$78.7 million, which represented about 3.7% of the opening balance market value.

UofT's investment portfolio in fiscal 2016 consisted of 56.8% in fixed-income securities, 40.3% in Canadian and international equities, and 2.9% in cash. The endowment fund's annual return (net of investment fees and expenses) was negative 0.3% in fiscal 2016; much lower than the 15% return achieved the previous year, and well below the 5.7% targeted return. Endowment per FTE also remains strong at about C$27,400.

Debt and contingent liabilities

Total gross debt outstanding stood at C$718.6 million at fiscal year-end 2016, virtually unchanged from the previous year. Most of UofT's debt (98%) consists of fixed-rate, bullet debentures, which it uses mainly to finance capital projects. To repay its debt, the university sets aside principal payments from academic divisions into a self-imposed sinking fund (the long-term borrowing pool). In fiscal 2015, these assets totaled C$199 million; they are invested together with the endowment fund.

UofT's estimated maximum annual debt service is about C$50 million, or 1.8% of adjusted fiscal 2016 expenses. We view this as a very low debt burden for the current rating, especially in light of the healthy level of available resources at the end of fiscal 2016, at 176% of total debt. Considering UofT has no debt issuance planned in the next two years, we expect that the university's debt metrics will remain in line with current levels and well within the university's internally approved debt limits.

UofT has several defined benefit plans that provide pension and other postemployment benefits to its employees. As of July 1, 2016, UofT's deficit for its registered pension plan was about C$573 million on a going-concern basis. This is down from C$1,156 million in 2012 due to a combination of excellent investment returns and employer special payments, which actuarial assumptions changes partially offset. The solvency deficit has also decreased slightly and was C$1,681 million as of July 1, 2016, from C$1,811 million in 2012, but still remains very high largely because of lower interest rates resulting in low discount rates, as well as increasing longevity.

As of April 30, 2016, the pension plan accounting deficit was C$797.4 million, up 29% from C$617.4 million the previous year, reducing its pension funded status to 83.5% from 86.8% a year earlier. As of the same date, UofT also had a C$567.3 million nonpension postemployment deficit (on an accounting basis). Nonpension postemployment benefits include medical and dental coverage and long-term disability. Because there is no legislative requirement to maintain assets against these liabilities (unlike pensions), the university funds these on a pay-as-you-go basis, similar to other universities.

To address its solvency deficit, in addition to two lump sum payments of C$150 million in fiscal years 2012 and 2014 and increased employee contributions, the university also raised the annual pension special payments budget. Under the province's amended solvency funding relief regulation, the university will be required to make minimum special payments sufficient to liquidate 25% of the solvency deficiency over seven years and to cover interest applied on the remaining 75%. Based on the valuations as of July 1, 2016, UofT estimates that its amended solvency funding requirement will be approximately C$15 million per year over seven years beginning July 1, 2018 (in addition to the going-concern special payments, which are C$78.7 million per year). The required minimum solvency payments will be identified in the next required filing of the actuarial valuation as at July 1, 2017. Until then, UofT has added C$5 million to the pension special payments budget for each of fiscal years 2018-2022, increasing the budget line to

C$127.2 million in 2022 from C$97.2 million in fiscal 2016.

The provincial government is studying initiatives regarding a university sectorwide jointly sponsored pension plan. In addition, UofT is considering creating its own internal jointly sponsored plan. Although we see these initiatives as positive, they are forward-looking and would not address the going-concern and solvency deficits.

Based on public disclosures, we do not believe that UofT has any contingent liabilities that could materially affect our view of its credit profile.

University of Toronto -- Financial Statistics

	--Fiscal year ended April 30--					Medians for 'AA' U.S. public colleges & universities, 2015**
	2016	**2015**	**2014**	**2013**	**2012**	
Enrollment and demand						
Headcount	87,639	85,383	83,012	80,899	79,085	MNR
Full-time equivalent	77,130	74,516	72,370	70,311	68,088	32,632
First-year acceptance rate (%)	75.1	71.9	69.2	67.7	68.1	71.7
First-year matriculation rate (%)	33.8	33.2	33.9	35.3	34.5	MNR
Undergraduates as a % of total enrollment (%)	80.5	80.6	80.9	81.1	81.1	77.7
First year retention (%)	91.7	92.1	92.1	92.1	92.1	85.5
Graduation rates (six years) (%)*	73.7	71.7	71.7	71.7	71.7	MNR
Income statement						
Adjusted operating revenue (C$000s)	2,940,200	2,786,200	2,742,900	2,523,400	2,395,300	MNR
Adjusted operating expense (C$000s)	2,725,600	2,572,500	2,644,800	2,395,600	2,412,200	MNR
Net adjusted operating income (C$000s)	214,600	213,700	98,100	127,800	(16,900)	MNR
Net adjusted operating margin (%)	7.9	8.3	3.7	5.3	(0.7)	2.1
Provincial grants to revenue (%)§	24.3	25.6	25.7	27.9	29.3	21.0
Student dependence (%)	43.9	41.6	37.9	37.4	35.4	42.4
Investment income dependence (%)	3.7	6.9	6.5	6.0	4.3	0.8
Debt						
Debt outstanding (C$000s)	718,600	721,100	722,800	726,000	727,700	646,050
Current debt service burden (%)	1.48	1.57	1.53	1.74	1.45	MNR
Current MADS burden (%)	1.84	1.95	1.89	2.09	2.07	3.70
Financial resource ratios						
Endowment market value (C$000s)	2,097,700	2,142,100	1,880,800	1,663,700	1,518,100	642,929
Cash and investments (C$000s)	3,886,600	3,794,700	3,359,500	3,158,700	2,880,500	MNR

University of Toronto -- Financial Statistics (cont.)						
	--Fiscal year ended April 30--					Medians for 'AA' U.S. public colleges & universities, 2015**
	2016	2015	2014	2013	2012	
Adjusted UFR (C$000s)	1,266,600	1,194,500	1,053,900	932,700	836,000	MNR
Cash and investments to operations (%)	142.6	147.5	127.0	131.9	119.4	51.7
Cash and investments to debt (%)	540.9	526.2	464.8	435.1	395.8	162.6
Adjusted UFR to operations (%)	46.5	46.4	39.8	38.9	34.7	30.3
Adjusted UFR to debt (%)	176.3	165.6	145.8	128.5	114.9	86.7
Average age of plant (years)	18.2	17.9	17.6	17.2	16.7	12.4
OPEB liability to total liabilities (%)	13.9	15.1	13.6	17.0	14.5	MNR

*Median figure is five-year graduation rate. §Median figure is state appropriations to revenue. **U.S. median figures are in U.S. dollars. 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 And Research

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

- 2017 Outlook For Not-For-Profit Public Universities In Australia, Canada, Mexico, And The U.K.: A Stable Trend For All, Despite Funding Concerns, Jan. 17, 2017
- Credit Conditions: Policy Uncertainty And Rising Rates Pose Risks In North America, But Faster Growth May Help, Dec. 5, 2016

Ratings Detail (As Of March 9, 2017)	
University of Toronto	
Issuer Credit Rating	AA+/Stable/--
Senior Unsecured	AA+
Issuer Credit Ratings History	
08-Mar-2016	AA+/Stable/--
22-Mar-2013	AA/Stable/--
17-Mar-2011	AA/Negative/--

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.