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University of Toronto

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University of Toronto

Rationale

Issuer Credit Rating
AA/Negative/--

The ratings on the University of Toronto (UofT) reflect Standard & Poor's Ratings Services' assessment of the university's exceptional student quality and enrolment demand; strong liquidity; and good government support. Sizable pension deficit payments and high debt constrain the ratings.

Like many of its Canadian peers, UofT saw its pension deficit increase substantially after the recession, triggering big legislated pension deficit payments that eroded its financial flexibility. According to the last actuarial valuation as of July 1, 2011, its pension deficit stood at about C$1 billion on both a going concern and solvency basis. However, Ontario's two-staged pension relief and the university's own efforts to make its pension plans more sustainable have limited the potential scope of UofT's pension difficulties since we revised the outlook to negative March 17, 2011.

Particularly, the university obtained stage one relief under Ontario's two-staged pension relief provisions in early 2012. As a result, it will benefit from a three-year exemption on solvency deficit payments until July 2014, with actual net solvency payments scheduled to begin July 1, 2015, reflecting one year deferral provisions in the regulations. If granted stage two relief, it would subsequently be able to fund any solvency deficit over a 10-year period, up from the current five-year requirement. As a result, UofT's projected pension deficit payments leading up to 2015-2016 have fallen significantly from the C$200 million yearly installments we originally thought possible in the absence of stage one approval.

At the same time, the university has made efforts to increase its pension contributions and negotiate higher employee-funded contributions, which should help put its pension plans on a more stable footing. Of note, it made a C$150 million lump sum contribution in 2011. UofT intends to make another of equal size in 2014. It also took steps to reduce its pension deficit by increasing the member contributions for current service. While this will benefit the pension's assets, it also creates the conditions for the university to receive approval for stage two relief. The university has reached agreements with most of its labor groups, but is still negotiating with the faculty association.

While UofT has stepped up efforts to improve the sustainability of its pension plans, its intention to raise its annual pension contributions in the next several years could reduce its financial flexibility, in our view. However, we think Ontario's stage one relief has given the university near-term relief to address current and future budget pressures. Accordingly, we intend to evaluate UofT's progress in meeting the conditions for stage two. We will also wait for the province to update its current tuition policy, which expires in 2012-2013.

Outlook

The negative outlook reflects our view of the likelihood of a downgrade in the next 12 months if the university's fails to keep its pension deficit payment schedule according to its approved strategy. All else equal, if UofT successfully reaches agreements to increase employee contributions as necessary to receive stage two approval, we could revise the outlook to stable next year. Conversely, if we foresee significant growth in pension deficits affecting its operating results, material setbacks in meeting conditions for stage two acceptance, or sizable new debt issuance, we could lower the ratings next year. Similarly, if Ontario detrimentally changes its funding support or tuition policy, we could downgrade the university.

Rating Methodology: Government Support And Government-Related Entity Criteria

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, and lack of viable private alternatives. It also reflects our assessment of the university's role as Canada's largest university in enrolment and research capacity. The province's oversight, program approval rights, and tuition regulation over UofT suggests a "strong" link with it. So, too, does Ontario's funding support, which accounts for about 30% of the university's total revenue (excluding provincial grants for capital and student aid), and its appointment of 16 of the university's 50 board members.

The stand-alone rating on UofT incorporates our view of the province's ongoing financial support. It also incorporates the university's important public policy role as the largest in Canada, as well as its substantial endowment. Ontario's weakening budgetary performance could constrain its financial support to universities in the medium term. However, we do not expect it to significantly diminish its funding support to universities, given the priority it places on higher education.

Strong Enrolment Demand And Research Profile

UofT had 68,088 full-time equivalent students (FTEs) as of November 2011 (fiscal 2012), up 18% since fiscal 2005. This growth largely reflected the university's efforts to increase its student spaces, which coincides with the province's initiative to raise graduate enrolment systemwide. About 20% of UofT's students are in graduate programs, which is similar to research-intense peers such as McGill University (AA-/Stable/--) and the University of British Columbia (AA+/Stable/--). Research funding was C$381 million in fiscal 2011, up about 66% in the past decade.

We consider UofT's demand composition to be well-diversified. In fiscal 2012, international students represented about 13% of the university's total student population (13% of undergraduates and 12% of graduates). This was up from 11% in fiscal 2010 and exceeded UofT's target to increase its overall international student enrolment to 13% by 2013. In fall 2011, the university drew 61% of its total enrolment from the Greater Toronto Area, down from 66% in fall 2009.

According to its 2012 budget, UofT expects to increase the number of student spaces across its three campuses by 2,500 during the next five years. The province's efforts to add 41,000 new university spaces systemwide by 2015-2016 (6,000 graduate spaces have been extended to 2017-2018), coupled with Toronto's rising university-aged population bodes well for the university's enrolment demand profile for the next decade, in our view.

Balanced Operations Likely To Continue

UofT had a C$7 million full accrual surplus, or 0.3% of revenues, in fiscal 2011, largely due to investment income. Except for fiscal 2009, its operations have generally been in surplus since fiscal 2004. Adjusted for noncash items, the accrual surplus was 4.7% in fiscal 2011. Investment income was C$136 million, or 5.8% of 2011 revenues. Included in that amount is the endowment payout (of 3% to 5% of the opening fair value of the endowment pool), which the university reinstated after suspending it in fiscal 2009 in response to the world financial crisis.

Like its Canadian peers, UofT's salary and benefits expenditures are a significant strain. They account for about 63% of its total expenditures. They rose 11% in fiscal 2011, largely reflecting negotiated salary increases and increased faculty and staff to deal with significant student growth in the past eight years. Benefit expenses alone climbed 21% in fiscal 2011, mainly due to increased pension expenses.

UofT is projecting balanced annual budgets until at least 2016. While it expects strong revenues for fiscal years 2012 and 2013, it acknowledges there are uncertainties related to the province's expiring tuition policy in fiscal 2013. It also expects significant challenges related to rising pension contributions. Although the university is working with its service divisions to contain expenses (by 2% in fiscal 2013) and raise revenues in its academic divisions, it does not intend to severely draw on its operating budget to fund the pension deficit to help preserve its core mission. Instead, UofT borrowed about C$113 million from its expendable resources and used C$37 million from pension reserves to make a C$150 million lump sum payment by June 2011. It plans to use a combination of supplemental retirement arrangement (SRA) fund assets and internal loans to finance a second lump sum payment of C$150 million by 2014. These lump-sum payments have enabled the university to limit the annual budget impact to C$70.0 million, representing an increase for special payments and related costs to C$91.0 million by 2015 from C$27.2 million in 2011.

To offset its fiscal 2009 endowment payout suspension and maintain services, the university ran accumulated deficits that reached C$36 million in fiscal 2011. It expects to shrink its overall accumulated deficit to C$21 million in fiscal 2012, and eliminate it in fiscal 2014.

Provincial support and tuition flexibility will continue to support revenues

UofT also benefits from sound and fairly stable funding support from Ontario, which provides about 30% of the university's total revenues. In its March 2012 budget, the province announced it would maintain the 30% Off Ontario Tuition grant it introduced in January 2012. Under the grant, it will offer a C$1,680 rebate on the tuition fees to university students with household income of less than C$160,000 per year. We think this new grant targets a broader spectrum of students, supporting enrolment demand.

In addition, the province's current tuition policy gives universities an element of fee-setting flexibility. Ontario allows universities to increase tuition a maximum annual average of 5% institutionwide. UofT's annual increases are about 4.3% in total, reflecting its particular program mix. While the tuition policy expires in fiscal 2012-2013, we believe Ontario will continue to give universities some form of limited tuition flexibility. UofT introduced a flat fee structure in September 2009 for its arts and science students at its main (St. George) campus. The structure requires all full-time students to pay full semester fees even if they take fewer than five courses. The university expects this could generate C$8 million-C$15 million annually. In addition, we believe the unregulated tuition from international students should help enhance revenue diversity.

Postemployment Deficits Funding Remains Challenging

Like many of its Canadian peers, UofT has experienced significant deficits in its defined-benefit pension plans since 2008, reflecting a decline in the discount rate on liabilities and deep erosion of plan assets. The last actuarial valuation, as of July 1, 2011, showed going-concern and solvency basis deficits of about C$1 billion each. However, these were slightly lower than the previous year levels, primarily due to improved investment returns and increased employer special contributions, which partly offset actuarial assumptions changes. The one-year return to June 30, 2011, for the pension master trust was 12.7%, net of investment fees and expenses, which exceeded the university's target return of 7.2%. This was also higher that the previous year's return of 8.2%. Employer contributions as of June 30 totaled C$243 million, including UofT's first lump sum payment of C$150 million. The university estimates the employer contributions will be C$144 million for the year ended June 30, 2012, including C$93 million current service funding and C$51 million budgeted special funding.

UofT recently received stage one relief under Ontario's two-staged pension relief provisions. Accordingly, it will receive a three-year exemption on solvency deficit payments until July 2014, with actual net solvency payments scheduled to begin in July 1, 2015, reflecting one year's deferral provisions as permitted under regulation. If granted stage two relief, it would then be able to fund any solvency deficit across 10 years, rather than five.

During stage one, in addition to making annual budget contributions, UofT's board has also approved two lump sum payments of C$150 million each, which will boost pension assets and relieve pressure on the operating budget by minimizing the need for cost containment. The university financed the first lump sum payment by June 2011 using C$113 million of a C$150 million internal loan that the board approved, and C$36 million from pension reserves. It intends to make the second lump sum payment by July 2014 and partially fund it with SRA assets. UofT's budget forecasts annual special pension deficit payments to increase to C$77 million in 2012-2013, reaching C$97 million in 2015-2016. This is a significant increase from the C$27 million in 2010-2011.

Pro Forma Debt Burden Remains Manageable

At the end of fiscal 2011, UofT's debt was C$527 million, slightly lower compared to fiscal 2010. Its debt level represented about C$8,000 per FTE or about 23% of adjusted revenues. We believe these compare favorably with those of other Canadian universities. Net adjusted operating income available for debt service was 3.1x (excluding depreciation and interest expenses). All the university's debt issuances are bullets with 30-to-40-year terms.

In fiscal 2012, UofT issued C$200 million of senior unsecured bullet notes due 2051. It will use the proceeds to finance capital projects. We estimate that the pro forma debt represents C$10,674 per FTE or 32% of adjusted revenues, both of which are somewhat higher than those of its Canadian peers. However, its pro forma debt service remains a manageable 2% of adjusted operating expenditures (up from 1.6% in fiscal 2011).

UofT is now very close to its internally imposed debt limit of C$773 million, or 40% of net assets averaged across five years. However, we believe its move to new accounting standards for not-for-profit organizations by fiscal 2013 (with previous-year restatement for fiscal 2012) could increase the value of its net assets, potentially giving it additional borrowing capacity absent a mitigating debt policy revision.

Liquidity Remains Strong

UofT's total cash and fair value investments totaled C$2.7 billion as of April 30, 2011, up C$188 million from 2010 and in line with the precredit-crisis level. This represented 117% of operating expenditures, or 373% of total pro forma debt, both of which are strong in our view. The university has the largest endowment of any Canadian university, at C$1.54 billion as of April 30, 2011. This is up 7% from 2010 level; however, it's still about 12% below its fiscal 2008 peak, largely due to market volatility. Unrestricted financial resources (internally restricted net assets and internally restricted endowments) stood at C$328 million as of April 30, 2011. This equaled about 62% of debt or 14% of annual consolidated expenses, both of which are in line with the average of its Canadian peers.

Capital Plan Targets Growth At Satellite Campuses

UofT had about C$379 million of projects under construction in fiscal 2011. Some of the most significant projects include new instructional centers for both the Mississauga and Scarborough campuses, and a student center building at the St. George campus. For many of these projects, the province has committed a significant portion of the funds, with the rest coming from advancements and donations.

The university has relied on debt to finance about a third (C$527 million) of its total capital projects as of April 30, 2011. It plans to use the proceeds of its recently issued C$200 million senior bullet for capital projects, primarily graduate programs expansion. It uses government capital grants, donations, and other sources of internal financing to fund most capital project costs.

UofT's deferred maintenance liability is an estimated C$448 million in fiscal 2011, including asbestos containment and removal, with about C$12 million set aside annually from the operating budget to address these obligations. The university also charges departments for the space they use, encouraging more effective use of available space and helping to contain costs.

Endowment Is Recovering

As of April 30, 2011, the market value of UofT's endowment was C$1.54 billion, up about 7% from the previous year. However, it was still below its C$1.82 billion peak in fiscal 2007, reflecting market losses common to many university endowments. Stronger market performance accounted for most of the increase in fiscal 2011. Net a C$66 million payout, investment income added C$75 million to the endowment, and grants and donations added C$25 million. The university's spending rate is typically 3%-5%. It suspended its payout in fiscal 2009 following significant market losses, but reintroduced it in 2010.

As of April 30, 2011, UofT's annual rate of return was 9.9% net of investment fees and expenses, outperforming its investment return objective of 7.3%. Its endowments were invested in: 21.0% fixed income, 46.5% equities, 13.5% hedge funds, 13.5% private equity and debt instruments, and 5.5% real estate. University of Toronto Asset Management Corp. (UTAM), a wholly owned investment management subsidiary that is governed by its own board, manages university and pension assets. In 2010, the university's board assumed greater oversight of UTAM's investment strategy and asset policy mix through approval requirements.

Fundraising

In fiscal 2011, UofT raised C$100 million, in line with its objective. Excluding federated universities and affiliated colleges (which are separate noncontrolled corporate bodies) the university received about C$85 million in fiscal 2011, up from C$77 million the previous year.

UofT has launched a C$2 billion fundraising campaign, which is the largest in Canadian university history. According to the university, as of November 2011, it has already secured about half of this amount. Although we do not expect this to directly affect the pension deficit payment, we think this will give UofT some financial relief for its future operating and capital budget pressures. It will use the proceeds to modernize its programs and infrastructure, and "foster international fluency and leadership skills" among students, in addition to attracting new domestic and international demand. The most recent major campaign ended in 2003 and raised more than C$1 billion.

University of Toronto--Peer Comparison

	--University of Toronto--		--McGill University--		--York University--	
(C$000s)	**2011**	**2010**	**2011***	**2010**	**2011**	**2010**
Issuer credit rating as of Dec. 31	AA/Negative/--	AA/Stable/--	AA-/Stable/--	AA-/Stable/--	AA-/Stable/--	AA-/Stable/--
Applicants	94,651	84,302	N.A.	40,987	58,402	58,210
Offers	47,603	48,946	N.A.	18,515	40,879	41,812
Registrants	16,142	16,365	N.A.	9,310	N.A.	N.A.
Acceptance rate (offers/applicants; %)	50	58	N.A.	45	70	72
Yield (registrants/applicants; %)	17	19	N.A.	23	N.A.	N.A.
FTEs	66,611	65,402	29,039	28,140	47,894	46,644
% growth	1.8	3.9	N.A.	N.A.	N.A.	N.A.
Total revenue	2,321,100	2,210,900	1,072,353	1,043,483	923,016	890,385
Deferred capital	65,100	61,100	67,540	67,877	11,698	12,846
Adjusted revenue	2,256,000	2,149,800	983,383	952,773	911,318	877,539
Total expenditure	2,313,900	2,165,500	987,988	1,037,829	926,551	894,803
Total interest expense	32,600	32,400	10,285	9,921	19,591	21,060
Total reported interest expense			31,715	32,754		
Depreciation	132,100	124,100	87,623	89,961	39,959	41,225
Adjusted expenditure (For DSCR)	2,149,200	2,009,000	868,650	915,114	867,001	832,518
Current portion of long-term debt (for calculating DSCR)	1,400	7,200	107,989	50,796	4,430	4,181
Consolidated surplus (%)	0.3	2.1	7.9	0.5	(0.4)	(0.5)
Consolidated surplus (for calculating DSCR; %)	4.7	6.5	11.7	4.0	4.9	5.1
DSCR (interest and principal; x)	3.1	3.6	0.8	0.5	1.8	1.8
DSCR (interest only; x)	3.3	4.3	11.2	3.8	2.3	2.1
Total debt	526,800	528,200	246,139	226,285	310,941	315,123
Unfunded postemployment liabilities	1,847,300	1,667,200	169,796	173,070	361,997	353,581
Interest expense to adjusted revenue (%)	1.4	1.5	1.0	1.0	2.1	2.4
Debt to FTE	7,909	8,076	8,476	8,041	6,492	6,756
Debt to adjusted revenue (%)	23.4	24.6	25.0	23.8	34.1	35.9
(Debt plus unfunded)/adjusted revenue (%)	105.2	102.1	42.3	41.9	73.8	76.2
Internally restricted net assets	90,600	136,400	22,867	51,500	148,502	160,199
Internally restricted endowments	237,700	225,200	129,117	115,475	40,533	36,324

University of Toronto--Peer Comparison (cont.)						
Externally restricted endowments	1,301,700	1,212,000	824,770	724,764	290,799	257,496
Unrestricted financial resources	328,300	361,600	151,984	166,975	189,035	196,523
As % of total debt	62.3	68.5	61.7	73.8	60.8	62.4
As % of total debt plus unfunded post-employment liabilities	13.8	16.5	36.5	41.8	28.1	29.4
As a % of operating expense	14.2	16.7	15.4	16.1	20.4	22.0
Per FTE	4,929	5,529	5,234	5,934	3,947	4,213
Total endowment value per FTE (at market value)	23,110	21,975	32,848	29,859	7,057	6,303

*Eleven months to April 30, 2011. FTE--Full-time equivalent. DSCR--Debt service coverage ratio. N.A.--Not available.

Related Criteria And Research

General Criteria: Rating Government-Related Entities: Methodology And Assumptions, Dec. 9, 2010

Ratings Detail (As Of June 6, 2012)	
University of Toronto	
Issuer Credit Rating	AA/Negative/--
Senior Unsecured	AA
Issuer Credit Ratings History	
17-Mar-2011	AA/Negative/--
26-Sep-2003	AA/Stable/--
17-May-2001	AA+/Stable/--

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.