STANDARD & POOR'S RATINGS SERVICES

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University of Toronto

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Table Of Contents

Table Of Contents (cont.)

University of Toronto

Major Rating Factors

Issuer Credit Rating
AA/Stable/--

Strengths:

- Ability to incorporate the required special pension deficit payments in its operating budget without incurring deficits
- Achievement of savings targets required to receive regulatory pension relief
- Strong reputation and excellent student demand

Weaknesses:

- Substantial postemployment liabilities
- Significant-but-manageable debt

Rationale

The ratings on the University of Toronto (UofT) reflect Standard & Poor's Ratings Services' view of UofT's ability to incorporate the required special pension deficit payments into its operating budget without incurring deficits, and achievement of savings targets required to receive regulatory pension relief. The ratings also reflect what we believe to be UofT's strong reputation and excellent student demand. We believe substantial postemployment liabilities and significant-but-manageable debt constrain the ratings.

In our opinion, UofT has undertaken significant measures to incorporate a large increase in special pension deficit payments into its operating budget, which we expect to remain balanced through our two-year outlook horizon. In particular, cost containment within its academic divisions, coupled with two lump-sum pension contributions of C$150 million each (the first one made before July 1, 2011, and the second one expected before July 1, 2014), have limited the impact of rising pension payments on its operating budget. It projects that the annual special pension payments and related costs budget will gradually rise to C$97 million by fiscal 2016 (or 4.5% of the annual budget) from C$27 million per year in fiscal 2011 (year ended April 30). We believe there is some uncertainty regarding provincial tuition and funding regimes that could put pressure on the university's budget. However, we do not expect provincial operating grants to diminish significantly, given postsecondary education's vital public policy role.

UofT has achieved the savings targets required to obtain stage 2 solvency relief, under which it would be able to fund its solvency deficit over a 10-year period, up from the current five-year requirement. Of note, the university's employer-to-employee contribution ratio will improve to 1.5-to-1 from 2-to-1 once fully phased in. UofT will apply for stage 2 of relief after receiving the results of its next actuarial valuation filing, which it expects as of July 1, 2014. It believes that it will receive acceptance.

UofT's credit profile benefits from healthy and stable demand and enrollment, in our view. The university's full-time equivalent students (FTEs) increased 3.3% to 70,311 in fall 2012; this was above the previous five-year average of 2.2% and was supported by growth in both graduate and undergraduate enrollment. UofT is Canada's most important research institution and has gained an international reputation for its research. In our view, its strategy to increase the number of graduate and international students will continue to support its reputation and research profile.

We believe UofT's large postemployment liabilities constrain the ratings. As of its most recently filed actuarial valuation (July 1, 2011), the university's defined benefit pension solvency deficit was C$1 billion. Under the current pension contribution strategy, UofT estimates annual special pension payments to be C$67 million (from C$200 million in the absence of the solvency relief) until fiscal 2015; they will rise to C$110 million from fiscal years 2016-2024, and decrease to C$76 million thereafter. The university has set aside from its operating budget the funds necessary to meet pension payments required under stage 1 and a part of those required under stage 2.

UofT also has what we consider to be a significant debt burden. To finance its significant capital projects, UofT borrowed C$200 million in fiscal 2012, bringing its total debt to C$728 million. We see its debt-to-adjusted revenues (net of amortization of deferred capital contributions) of 31% and debt-to-FTE of C$10,700 as higher than the average for Canadian rated universities. We believe that new debt issuance is highly unlikely in the next two years.

Outlook

The stable outlook reflects Standard & Poor's expectations that, within our two-year outlook horizon, UofT will maintain its strong student demand profile, its operating budgets will remain balanced, and its debt burden will not materially surpass 30% of adjusted revenues. We could revise the outlook to negative or lower the ratings if operating deficits were to emerge as result of a significant reduction in government grants or substantial pressure from rising pension deficits; debt burden were to increase considerably; or the university were to suffer substantial setbacks for receiving stage 2 acceptance. Conversely, reduced unfunded postemployment liabilities, a significant decline in debt, or a material rise in unrestricted financial resources could result in an upward revision to the outlook or the ratings.

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 suggests a "strong" link to it. Also supporting this view is that provincial operating grants account for about 29% of the university's total revenue (excluding provincial grants for capital and student aid), and its appointment of some board members. Although Ontario is facing significant fiscal challenges and projects large provincial deficits in the medium term, we believe that postsecondary education will remain a top priority for the province and that overall support for the university sector will be fairly stable.

Background

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 about 81,000 students in fall 2012. It offers a variety of undergraduate, graduate, postgraduate, and professional degrees across its 17 faculties and schools. It also has affiliations with seven colleges, 65 centers and institutes, and nine Toronto hospitals. UofT employs more faculty 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 an international reputation for its research. Research funding was C$380 million in fiscal 2012, in line with that of the previous year and about 39% higher than a decade ago.

Management

Governing UofT is a 50-member board, 16 of which the province appoints. In March 2013, the university elected a new president for a five-year term. He has been with UofT for the past three decades and had been dean of the Faculty of Arts and Science -- its largest and most diverse academic division -- since 2008. Senior staff has been stable and we expect no significant turnover in the near term, which we believe lends stability to the credit profile. The university provides a five-year operating budget and has financial policies in place, including investment policies and a new debt policy.

Enrollment Demand And Student Quality Remain Strong

We believe UofT's credit profile benefits from healthy and stable demand and enrollment. The university's full-time equivalent students (FTEs) increased 3.3% to 70,311 in fall 2012; this was above the previous five-year average of 2.2% and was supported by growth in both graduate and undergraduate enrollment. UofT projects that its graduate students, which historically represented about 20% of the total student population, will increase to 22.3% by fall 2017. It expects most of the increase to be at its largest campus (St. George) and will be primarily domestic. The university expects to increase undergraduate enrollment at its Scarborough and Mississauga campuses, with 43% of this coming from international students. International enrollment, which rose steadily in the past decade (to 14.0% of total enrollment in fall 2012 from 7.6% in fall 2003), will continue to increase to 15.4% of total enrollment by fall 2017. We estimate that the province's efforts to increase university spaces systemwide and expected stable growth in university-age population in the Greater Toronto Area (58% of UofT's headcount intake comes from the area) in the next five years should help the university achieve its growth targets.

Student quality metrics also remain fairly strong, in our opinion. The acceptance rate (offers-to-applicants) held steady at 52% in fall 2011, in line with the five-year average and better than that of most rated Canadian peers. The matriculation rate, although slightly lower in fall 2011, still remained adequate, in our view, at about 33%. The average entry grade and the retention rate of first-year students were 85% and 91%, respectively; these were fairly stable in the past five years. The graduation rate was 69%, somewhat below that of other Canadian peers.

Balanced Operating Budget Is Likely To Continue

UofT's operating results have historically been strong, in our opinion. However fiscal 2012 results were weaker than usual, leading to a modest deficit of 1.4% of consolidated revenues, on an accrual basis. This was primarily the result of higher salaries and benefits. On a modified cash basis (adjusted for amortization of deferred capital contributions and capital assets), UofT recorded a surplus of 3.1%, which was below that of the previous years and the peers' average. Expenses for salaries and benefits continue to pressure the operating budget, similar to other Canadian universities. They accounted for 63% of UofT's total expenses and rose 5% in fiscal 2012, largely reflecting negotiated salary increases and increased number of faculty and staff to deal with significant student growth in the past 10 years; benefits expenses alone rose 9% in fiscal 2012, due primarily to continuing declines in interest rates.

UofT expects its operations to remain balanced over the next five years. In the absence of a new provincial tuition framework, the university has assumed a continuation of the existing one and prepared its operating budget accordingly. It projects strong revenues and has worked with academic divisions to reduce expenses (by 1% in fiscal 2014, with no further cost containment in the subsequent years). With Ontario's compensation-restraint legislation having ended March 31, 2012, and in the absence of a new legislation regarding executive and nonbargaining employees' compensation, UofT will maintain senior staff wage freezes for another year, providing some cost stability. In addition, the university took measures to limit the impact of the pension deficit funding on the operating budget and preserve its core mission.

UofT has put in place two lump sum pension contributions of C$150 million to relieve pressure on the operating budget (one made before June 30, 2011 and the second one scheduled before July 1, 2014). Under its current pension contribution strategy, the university projects an increase of C$70 million per year to the annual pension special payments, and related costs. These will reach C$97 million per year by fiscal 2016 from C$27 million in fiscal 2011, and should remain in place until at least 2029. In addition, the university might need to add a further C$16 million to its budgeted special pension payment based on its current pension strategy, should the July 1, 2014, actuarial valuation result in a larger-than-expected going concern pension deficit. Although this would lower resources that the university could use for its core mission, we believe that the impact on estimated fiscal 2016 operating budget should stay fairly limited.

In addition to its base operating grants that are allocated per FTE, the province has a history of providing strategic funding programs to address other operating and capital pressures. UofT's government grants for general operations and restricted purposes accounted for about 47% of its revenues in fiscal 2012. Because the government is projecting budget deficits until fiscal 2018 and economic growth forecasts remain modest, we believe that there will be little room for it to increase its support of universities and still meet this target. However, we do not expect provincial operating grants to diminish significantly, given postsecondary education's vital public policy role.

UofT has taken some measures to deal with its operating budget pressures. It has introduced a flat fee structure for its arts and science students; in fiscal 2012, this strategy generated revenues of about C$10 million. Moreover, we believe that its strategy to increase international enrollment, coupled with unregulated tuition for international students should help enhance revenue diversity.

The new accounting guidelines implemented in fiscal 2013 reflect the adoption of the immediate recognition approach for all the university's defined benefit plans and land's revaluation at fair value, at May 1, 2011. As a result, the restated fiscal 2012 financial statements will include an estimated C$243 million increase in employee future benefit expense and a C$1.0 billion increase in net assets (primarily due to a C$2.1 billion increase in capital assets and a C$1.1 billion decrease in internally restricted net assets). The university does not expect an effect on cash flows from changes in accounting guidelines.

Solvency Relief Moderates Current Pension Contributions

UofT has several defined benefits plans that provide pension and other postemployment benefits to its employees. As of its most recently filed actuarial valuation (July 1, 2011), the university's pension deficit was C$1 billion on both going concern and solvency bases. As of July 1, 2012, the going concern pension plans market deficit widened to about C$1.2 billion; and the solvency deficit increased to about C$1.8 billion. This was primarily the result of changes in actuarial assumptions (namely, lower discount rates);investment returns of 0.9%, significantly below the 5.5% target return; and for the solvency deficit, a decline in interest rates of greater of 1%. As of April 30, 2012, the pension plan deficit (on an accounting basis) was close to C$2.0 billion, or 42% higher than that of the previous year. Under the new accounting rules effective April 30, 2013, pension liabilities will be valued using funding assumptions used for the going concern valuation, thus reducing the difference between the accounting and the going concern deficits. The only differences will involve the measurement period (May-April versus June-July) and in how the Supplemental Retirement Arrangement assets are recorded. The university estimates the employer contributions at June 30, 2013, at C$161.4 million, including C$94.8 million current service funding and C$66.6 million special payment funding.

UofT also had a C$558 million nonpension postemployment deficit based on its fiscal 2012 audited statements. 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.

In 2012, UofT received the approval for stage 1 of the province's solvency relief, which substantially reduced its annual special pension-related payments to C$67 million until July 1, 2014 (from C$200 million in absence of the solvency relief). The university included in its operating budget the funds necessary to meet solvency contributions required under stage 1.

UofT will apply for stage 2 of the province's solvency relief (which extends the amortization period of the solvency pension deficit to 10 years from five) after receiving the results of its next required actuarial valuation. The university estimates it will achieve 100% of the savings targets required by the province and believes that it will receive stage 2 relief. The 10-year amortization solvency payment period associated with stage 2 relief would begin July 1, 2015. Under the extended repayment period, UofT's current pension contribution strategy (based on the July 1, 2011 actuarial reports) estimates annual special pension payments to be C$110 million from fiscal years 2016-2024, decreasing to C$76 million thereafter. Of the C$110 million special pension payment it expects to pay starting fiscal 2016, the university plans to fund C$76 million in cash (as part of the C$97 million set aside from the operating budget) and C$34 million through noncash letters of credit.

Capital Plan

According to its fiscal 2014 budget report, UofT plans to undertake C$51 million of new capital projects in fiscal 2013, bringing the total estimated cost of projects approved and initiated since 2001 to C$1.9 billion. It has used debt to fund about 38% (C$728 million) of capital projects to date. The university has largely paid for projects with government capital grants, donations, and other sources of internal financing. UofT plans to fund almost 81% of its fiscal 2013 new capital projects through internal budgets, and the remaining 19% with provincial funding. It will use some of its proceeds of its C$200 million debentures issued in fiscal 2012 to finance primarily graduate programs expansion.

UofT completed a number of capital projects in 2012, the largest one being the expansion of the Rotman School of Management (almost C$94 million). It had about C$159 million of projects under construction in 2012 calendar-year, including the Goldring Centre for High Performance Sport (C$62 million), and two buildings (Kaneff and UTM North, C$91 million in total) at its Mississauga campus. Other planned capital projects include renovations and expansion to create new space for the John H. Daniels Faculty of Architecture, Landscape & Design (C$62 million), construction of a new building for the Faculty of Law (C$54 million); as well as new buildings and lab renovations at the Mississauga and Scarborough campuses. Most of the funding comes from advancements and donations.

The university's deferred maintenance liability, including asbestos containment and removal, was C$532 million in fiscal 2012. Its fiscal 2014 budget includes C$13.0 million annually, rising to C$17.5 million in a few years, to address deferred maintenance at St. George (estimated at C$410 million), with additional funds set aside for Mississauga and Scarborough campuses. The university also charges departments for the space they use, encouraging more effective use of available space and helping contain costs.

Significant-But-Manageable Debt Burden

UofT's outstanding total gross debt stood at C$728 million in fiscal 2012, or about 31% of adjusted revenues. This ratio increased considerably from the previous year's 23%, as did the debt-to-FTE, which rose sharply to C$10,700 in fiscal 2012 from a C$8,500 average in the previous five years. These levels are higher than the average for Canadian rated universities. However, we expect them to fall moderately in the next two years barring any further debt issuance. A lower fiscal 2012 adjusted surplus resulted in the debt service coverage ratio falling to 2.0x from 3.1x in 2011, while interest expense was stable at 1.5% of adjusted revenues. We expect the coverage ratio will stay above 1x in the next two years.

Most of the university's debt consists of bullet debentures, which it uses to mainly finance capital projects. To repay its debt, UofT sets aside principal payments from academic divisions into a self-imposed sinking fund (the long-term borrowing pool). In fiscal 2012, these assets totaled C$100 million; they are invested together with the endowment fund.

In November 2012, UofT's business board approved a new debt strategy that sets what we view as prudent debt limits. This increases the university's external debt limit for fiscal 2013 to C$980 million from C$747 million under the previous strategy. As of Feb. 28, 2013, the debt burden and viability ratios were well within these limits.

Under its new debt strategy, the university could accommodate an additional C$200 million in the next five years and not exceed the new internally approved debt limit ratios. UofT views any new debt issuance in the next two years as highly unlikely. Nevertheless, we expect downward pressure on the ratings if it were to issue additional C$200 million in the next two years.

Financial Resources

UofT has the largest endowments among Canadian universities, with a fair value of C$1.5 billion, at April 30, 2012. The university has a conservative endowment draw, in our view, with an annual spending rate of 3.0%-5.0% of the opening market value of the endowments (it was 4.5% in fiscal 2012). The portfolio is diverse, in our opinion, with 39.8% in fixed-income securities, 59.3% in Canadian and international equities, and 0.9% in cash at fiscal year-end 2012. The endowment fund's annual return (net of investment fees and expenses) was 1.0%, significantly below the previous year's 9.9% and the 6.0% target return. However, for the year ended Dec. 31, 2012, its annual performance improved significantly reaching an annual return of 9.2%.

In fiscal 2012, consolidated cash and investments were C$2.9 billion, up C$160 million from 2011. This represented 117% of consolidated expenditures, or 395% of total debt, in line with previous year's levels. Unrestricted financial resources (internally restricted net assets and internally restricted endowments) stood at C$258 million. This equaled about 35% of debt and 11% of consolidated annual expenses (see table). Although we believe its total unrestricted financial resources (Standard & Poor's-calculated) as a proportion of debt is somewhat low for the rating, and compared with historical levels, we expect it to improve with positive investment returns and no new borrowing over the next two years.

Fundraising

As of November 2012, the university and its affiliated federated universities had raised C$1.2 billion in receipts and pledges as part of a C$2.0 billion fundraising campaign. The majority of the funds raised 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.

University of Toronto--Peer Comparison

	--University of Toronto--		--McGill University--		--York University--	
(C$000s)	**2012**	**2011**	**2012**	**2011**	**2012**	**2011**
FTEs	68,088	66,611	30,482	29,039	48,323	47,894
Total revenue	2,403,400	2,321,100	1,141,308	1,030,719	956,883	923,016
Deferred capital	64,000	65,100	80,376	67,540	12,041	11,698
Adjusted revenue	2,339,400	2,256,000	1,037,165	942,890	944,842	911,318
Total expenditure	2,437,900	2,313,900	1,108,679	987,988	959,371	926,551
Total interest expense	34,300	32,600	34,260	30,613	19,340	19,591
Depreciation	137,000	132,100	104,852	87,623	41,341	39,959
Adjusted expenditure (For DSCR)	2,266,600	2,149,200	969,567	869,752	898,690	867,001
Consolidated surplus (%)	(1.4)	0.3	2.9	4.1	(0.3)	(0.4)

University of Toronto--Peer Comparison (cont.)						
Consolidated surplus (for calculating DSCR; %)	3.1	4.7	6.5	7.8	4.9	4.9
Interest expense to adjusted revenue (%)	1.5	1.4	1.0	1.1	2.0	2.1
DSCR (interest and principal; x)	2.0	3.1	0.4	0.5	2.3	1.8
Total debt	727,700	526,800	219,071	252,312	306,511	310,941
Debt to FTE	10,688	7,909	7,187	8,689	6,343	6,492
Debt to adjusted revenue (%)	31.1	23.4	21.1	26.8	32.4	34.1
Unfunded postemployment liabilities	2,542,700	1,847,300	181,726	169,796	501,149	361,997
(Debt plus unfunded)/adjusted revenue (%)	139.8	105.2	38.6	44.8	85.5	73.8
Unrestricted financial resources	257,600	328,300	126,282	151,240	156,730	189,035
As % of total debt	35.4	62.3	57.6	59.9	51.1	60.8
As % of total debt plus unfunded postemployment liabilities	7.9	13.8	31.5	35.8	19.4	28.1
As a % of operating expense	10.6	14.2	11.4	14.0	16.3	20.4
Per FTE	3,783	4,929	4,143	5,208	3,243	3,947
Total endowment value per FTE (at market value)	22,296	23,110	31,849	32,848	6,891	7,057

FTE--Full-time equivalents. DSCR--Debt service coverage ratio.

Related Criteria And Research

- Rating Government-Related Entities: Methodology And Assumptions, Dec. 9, 2010
- USPF Criteria: Higher Education, June 19, 2007

Ratings Detail (As Of March 22, 2013)	
University of Toronto	
Issuer Credit Rating	AA/Stable/--
Senior Unsecured	AA
Issuer Credit Ratings History	
22-Mar-2013	AA/Stable/--
17-Mar-2011	AA/Negative/--
26-Sep-2003	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.