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University of Toronto

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University of Toronto

Rationale

Issuer Credit Rating
AA+/Stable/--

The ratings on University of Toronto (UofT), Ont., reflect its stand-alone credit profile(SACP), which Standard & Poor's assesses at 'aa+'. The ratings also reflect our view that UofT's strong financial resilience and independence allow the ratings to exceed those on Ontario under our government-related entities (GRE) criteria.

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 87,639 students in fall 2015. 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, and a healthy market position and demand. Its enrollment has steadily increased by an average of 3% per year in the past five years, reaching 77,130 full-time equivalents (FTEs) in fall 2015. Graduate students represent about 19% of total enrollment, a level comparable with 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 91.7% and 85%, respectively, in fall 2015. First year selectivity (offers to applications) and six-year graduation rates remained strong and increased slightly over the past five years, to 75.1% and 73.7%, respectively.

UofT's adjusted operating margin was 8.3% in fiscal 2015, up from 3.7% a year earlier, primarily due to an increase in tuition revenues as result of higher enrolment, and strong investment revenues. At this level, it was above the fiscal 2014 median for U.S. public universities in the 'AA' category and superior to that of most rated Canadian peer institutions. We expect UofT's financial profile will remain very strong in the next two years by the university maintaining abundant financial resources (with available resources in excess of 35% of adjusted operating expenses) and positive adjusted net margins, despite the operating pressures it faces--primarily the tuition framework, potential for flat or even lower government grants, and increasing salaries and benefits expenditures. In our view, the university's debt burden is low for the current rating especially in light of the healthy level of available resources at the end of fiscal 2015, at 165.6% of total debt. With the university issuing no debt in the next two years, we expect that debt metrics will remain in line with current levels and well within the university's internally approved debt limits.

In accordance with our criteria for GREs, 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 25.6% of the university's total revenue, and it appoints 16 of 50 Governing Council members.

We rate UofT three notches above Ontario, the maximum differential allowed in accordance with our methodology for rating GREs that we believe depend on ongoing government support. The difference reflects our view of the university's substantial financial assets. We believe there is a measureable likelihood that UofT's 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 this sector's vital public policy role.

Liquidity

UofT's liquidity is exceptional, in our opinion. Consolidated cash and investments totaled C$3.8 billion, up 13% from fiscal 2014. They represented 147.5% of 2015 adjusted operating expenditures, or 5.26x total debt. Unrestricted financial resources (internally restricted net assets and internally restricted endowments) stood at C$1.2 billion, up from C$1.1 billion in fiscal 2014. This equaled about 165.6% of debt and 46.4% 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. UfT has the largest endowment among Canadian universities, with a fair value of C$2.1 billion as of the end of April 2015. The endowment has significantly increased in the past 10 years, by about 32% since 2006.

Outlook

The stable outlook reflects Standard & Poor's expectations that, within our two-year outlook horizon, UofT will maintain an exceptional market position and student demand profile, its operating budgets will remain balanced, and its available resources will remain superior. At the same time, Standard & Poor's expects that the university's debt burden will decline modestly or be stable. The outlook also reflects Standard & Poor's expectation that UofT's relationship with the province will be stable.

We could lower the ratings if adjusted net margins weakened to near balance or sustained deficits as a result of significant reduction in government grants or substantial pressure from rising pension deficits; available resources eroded to less than 35% of adjusted expenditures or less than 100% of debt outstanding; or the demand profile weakened such that a declining trend in applications and FTEs emerged. A negative rating action on Ontario will also result in a similar rating action on UofT, given that the university depends on ongoing support from Ontario, thereby preventing us from rating it more than three notches above the province under our GRE criteria. Moreover, negative government intervention from the province, or a significant reduction in UofT's resilience to an Ontario default scenario as our GRE criteria specify could cause us to lower the ratings, potentially to on par with or below that on Ontario, depending on the severity.

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 GREs, 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 the link is the university receiving 25.6% of total revenues from provincial operating grants, 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 GREs that we believe depend on ongoing government support. The difference reflects our view of the university's substantial financial assets. We believe there is a measureable likelihood that UofT's 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 higher education's vital public policy role.

Although we believe that the province's overall support for universities will remain good, Ontario has enacted small funding cuts and imposed some savings targets on the universities over the past several years. UofT estimates that these have resulted in a decline to base operating grants of about C$10.5 million. In March 2013, the province announced changes to the tuition framework, reducing the cap on annual increases to an average of 3% for undergraduate programs and 5% for professional and graduate programs over the next four years (from a maximum annual average of 5% institution-wide). In December 2013, it announced changes to university billing policies designed to protect students, including a continuation of the existing freeze on new program or flat fees, not billing the entire year's tuition upfront, and limiting late fee charges.

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 (70.6% in fall 2015). 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 2014 was US$47,307, anchors our assessment of the university's economic fundamentals. The province's population was about 13.8 million in 2015, with good income indicators and some moderate employment and population growth projected.

Market position and demand

UofT's enrollment has grown significantly over the last two decades to 77,130 FTE students in fall 2015, across all three campuses. The university's strategic plan calls for further undergraduate growth primarily at its Mississauga and Scarborough campuses, with 12% and 11% growth planned, respectively, by 2020-2021. In addition, the university projects to increase its overall graduate enrollment to 22.6% over the next five years from 21.0% of total FTE enrolment in 2015-2016 (most of the increase will be at the St. George campus). International enrollment, which has been rising steadily, should reach 19.5% by fiscal 2021 (from 11.8% in fiscal 2011). We believe the university has the ability to achieve its growth targets, given the province's commitment to fund additional new university spaces; and the university's ability to attract new students, as reflected by an increase in its high school applications in the province in the past several years, despite a slight decline in Ontario's university-age population.

The university has maintained very strong student quality, in our view, as reflected by its historically high and stable retention and average entry grade rates (91.7% and 85%, respectively, in fall 2015). First year selectivity (offers to applications) and six-year graduation rates remained strong and increased slightly over the past five years, to 75.1% and 73.7%, respectively. UofT also benefits from exceptional faculty quality with 97% of full-time faculty members having a terminal degree.

UofT is Canada's most research-intensive university. In fiscal 2015, it received C$390.6 million in external research funding, which has been fairly stable over 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, University Health Network, and Mount Sinai Hospital) to establish a leading center in regenerative medicine.

We believe that UofT has superior fundraising capacity. As of Dec. 31, 2015, the university and its affiliated federated colleges have received C$1.89 billion in receipts and pledges as part of a C$2.0 billion fundraising campaign launched in 2011. Fiscal 2015 was a record-breaking year, when the fundraising totaled C$247.9 million. 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 Governing Council oversees the university, 16 of which are appointed by the province. It appoints the president, senior administrators, and senior staff. The Governing Council'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. Performance to the plan is reviewed annually and progress is tracked against specific activity indicators and identified risks are also monitored. In addition, 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 at UofT for the past three decades. The president's three priorities are leveraging the university's urban location, strengthening international partnerships, and rethinking undergraduate education. There have been no major changes to the senior management team in the past year and we expect it to be stable in the next two years.

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 peers. 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 a five-year operating budget 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 improving, in our view. Its adjusted operating margin was 8.3% in fiscal 2015, up from 3.7% a year earlier, primarily due to an increase in tuition revenues as result of higher enrolment levels, and strong investment revenues. At the same time, adjusted operating expenditures were 2.7% lower, on what we view as effective budgeting and cost controls. UofT's fiscal 2015 margin is above the fiscal 2014 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 more than 60% of its total reported expenditures.

On a consolidated basis, the university estimates that its 2016 net income would total C$138.2 million, down from

C$287.8 million in fiscal 2015, primarily as result of lower investment returns and an 8% increase in total expenditures. According to the university's fiscal 2017 budget, operating results will be balanced for fiscal years 2017-2021. 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 are forecast to rise at an annual average rate of about 5%. With the forecast balanced results, expenditures should rise at the same rate as revenues in the five-year period, with academic expenses accounting for the majority of budgeted operating expense growth.

UofT depended on student-generated revenues for 41.6% of 2015 adjusted operating revenues, which is more than 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 on their long-term strategies. In March 2013, the province implemented a new four-year tuition framework, reducing the cap on annual increases to an average of 3% for undergraduate programs and 5% for professional and graduate programs over the next four years (from a maximum annual average of 8% institution-wide). Universities have some flexibility on how they increase tuition among programs as long as the total increase entitywide is below the cap. The province has also made some changes that have affected the entire university sector, including reduced base operating grants and reduced grants based on enrollment of full-time international students and new requirements to meet efficiency targets.

Available resources

At fiscal year-end 2015, consolidated cash and investments totaled C$3.8 billion, up 13% from fiscal 2014. Total cash and investments represented 147.5% of adjusted operating expenditures, or about 5.3x total debt. Unrestricted financial resources (internally restricted net assets and internally restricted endowments) stood at C$1.2 billion, which was up from the previous year's total of C$1.1 billion. This equaled about 165.6% of debt and 46.4% of adjusted operating expenses.

UofT has the largest endowment among Canadian universities, with a fair value of C$2.1 billion, at April 30, 2015. It has significantly increased in the past 10 years, by about 32% since 2006. For the first time since the 2008 financial crisis, it includes a full inflation protection (C$490.9 million) and preservation of capital above inflation (C$133 million) against any possible market downturn. 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. In fiscal 2015, the endowments paid out C$76.3 million, which represented about 4.1% of total endowments.

UofT's investment portfolios in fiscal 2015 included 52.9% of fixed-income securities, 43.3% of Canadian and international equities, and 3.8% of cash. The endowment fund's annual return (net of investment fees and expenses) was 15.0%, which was slightly above the previous year's return of 14.6% and largely superior to the 4.8% target return. Endowment per FTE has also strengthened significantly; in 2015, it was close to C$29,000.

Debt and contingent liabilities

Total gross debt outstanding stood at C$721 million at fiscal year-end 2015, 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 1.9% of its adjusted fiscal 2015 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 2015, at 165.6% of total debt. The university has no debt issuance plans in the next two years; therefore, 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 benefits plans that provide pension and other postemployment benefits to its employees. As of July 1, 2015, UofT's defined benefit pension deficit for its main registered pension plan was about C$420 million on a going-concern basis, down 40% from C$697 million at the most recent actuarial valuation of July 1, 2014. This was the result of a combination of excellent investment returns and employer special payments, which actuarial assumptions changes partially offset. The solvency deficit was about 4.7% higher, as of July 1, 2015, at slightly about C$1.06 billion, largely because of lower interest rates.

As of April 30, 2015, the pension plan accounting deficit was C$617million, down 10% from C$684 million the previous year, improving its pension funded status to 86.8% from 83.3% a year earlier. UofT also had a C$581 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 to 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 defer the start for its net solvency payments until July 1, 2018, with any solvency deficit at that time amortized over seven years. As a result, it estimates that the annual solvency special payments under the amended stage 2 solvency relief will increase and, until the actual required funding is determined, it added a C$5 million increase to the pension special payments budget for each of fiscal years 2017-2021, increasing the budget line to C$122.2 million in 2021 from C$97.2 million in fiscal 2016. This is used to fund pension special payments and other costs of the pension contribution strategy.

The provincial government is studying initiatives regarding a university sectorwide jointly sponsored pension plan. In addition, UofT is also 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 the university's credit profile.

University of Toronto -- Financial Statistics

	--Fiscal year ended April 30--					Medians for 'AA' U.S. public colleges & universities, 2014***
	2016	**2015**	**2014**	**2013**	**2012**	
Enrollment and demand						
Headcount	87,639	85,383	83,012	80,899	79,085	34,431
Full-time equivalent	77,130	74,516	72,370	70,311	68,088	32,265
First year acceptance rate (%)	75.1	71.9	69.2	67.7	68.1	68.6
First year matriculation rate (%)	33.8	33.2	33.9	35.3	34.5	MNR
Undergraduates as a % of total enrollment (%)	80.4	80.5	80.9	81.1	81.1	77.7
First year retention (%)	91.7	92.1	92.1	92.1	92.1	85.0
Graduation rates (six years) (%)*	73.7	71.7	71.7	71.7	71.7	55.4
Income statement						
Adjusted operating revenue (C$000s)	N.A.	2,786,200	2,742,900	2,523,400	2,395,300	MNR
Adjusted operating expense (C$000s)	N.A.	2,572,500	2,644,800	2,395,600	2,412,200	MNR
Net adjusted operating income (C$000s)	N.A.	213,700	98,100	127,800	(16,900)	MNR
Net adjusted operating margin (%)	N.A.	8.3	3.7	5.3	-0.7	1.8
Provincial grants to revenue (%)§	N.A.	25.6	25.7	27.9	29.3	21.4
Student dependence (%)	N.A.	41.6	37.9	37.4	35.4	32.4
Investment income dependence (%)	N.A.	6.9	6.5	6.0	4.3	2.4
Debt						
Debt outstanding (C$000s)	N.A.	721,100	722,800	726,000	727,700	689,891
Current debt service burden (%)	N.A.	1.57	1.53	1.74	1.45	3.30
Current MADS burden (%)	N.A.	1.95	1.89	2.09	2.07	3.50
Financial resource ratios						
Endowment market value (C$000s)	N.A.	2,142,100	1,880,800	1,663,700	1,518,100	631,508
Cash and investments (C$000s)	N.A.	3,794,700	3,359,500	3,158,700	2,880,500	MNR
Adjusted UFR (C$000s)	N.A.	1,194,500	1,053,900	932,700	836,000	MNR
Cash and investments to operations (%)	N.A.	147.5	127.0	131.9	119.4	63.5
Cash and investments to debt (%)	N.A.	526.2	464.8	435.1	395.8	163.0
Adjusted UFR to operations (%)	N.A.	46.4	39.8	38.9	34.7	36.1
Adjusted UFR to debt (%)	N.A.	165.6	145.8	128.5	114.9	102.1
Average age of plant (years)	N.A.	17.9	17.6	17.2	16.7	12.2

University of Toronto -- Financial Statistics (cont.)						
OPEB liability to total liabilities (%)	N.A.	15.1	13.6	17.0	14.5	5.4

*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: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- General Criteria: Methodology: Not-For-Profit Public And Private Colleges And Universities, Jan. 6, 2016

Ratings Detail (As Of March 10, 2016)	
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. 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. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.