

## CREDIT OPINION

28 November 2016

Update

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### RATINGS

#### University of Toronto

Domicile	Ontario, Canada
Long Term Rating	Aa2
Type	LT Issuer Rating
Outlook	Stable

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

### Contacts

Adam Hardi CFA 416-214-3636  
 AVP-Analyst  
 adam.hardi@moodys.com

Michael Yake 416-214-3865  
 VP-Senior Analyst  
 michael.yake@moodys.com

Alejandro Olivo 52-55-1253-5742  
 Associate Managing  
 Director  
 alejandro.olivo@moodys.com

David Rubinoff 44-20-7772-1398  
 MD-Sub Sovereigns  
 david.rubinoff@moodys.com

# University of Toronto

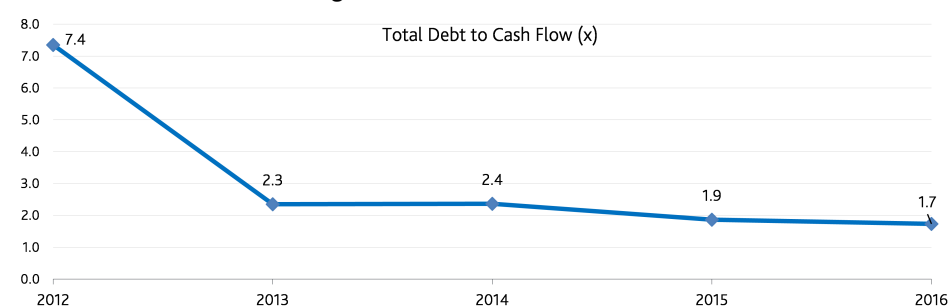
## Update to Discussion of Key Credit Factors

### Summary Rating Rationale

The University of Toronto's (U of T) Aa2 senior unsecured rating reflects (1) the university's solid operating performance and operating cash flow generation, (2) a low debt burden and (3) strong balance sheet liquidity. These positives are balanced against (4) sizeable unfunded pension liabilities and (5) provincially imposed revenue constraints. The university maintains strong fiscal flexibility and is able to make ongoing adjustments to its budgets in order to ensure that it can post satisfactory fiscal outcomes. The ratings also take into account U of T's strong market position as Canada's largest post-secondary institution and as a national and international leader in research.

Exhibit 1

#### U of T maintains solid cash flow generation and low debt burden



Source: Moody's Investors Service, University of Toronto

### National Peer Comparison

U of T is rated in the upper band of Canadian universities, which span a range of Aa1 to A3. The university's rating position reflects its lower debt burden, strong operating performance and excellent reputation and name recognition.

### Credit Strengths

- » Excellent market profile built on brand recognition and strong reputation
- » Financial flexibility and balance sheet strength from low debt burden, solid operating results and sizeable endowment assets
- » Strong governance and management practices that drive positive operating results

## Credit Challenges

- » Provincially imposed revenue constraints limit the university's ability to fully capture its market position
- » Unfunded pension liabilities weigh down on balance sheet

## Rating Outlook

The rating outlook is stable, reflecting our assessment that the university will maintain its strong market profile and will continue to generate positive fiscal outcomes.

## Factors that Could Lead to an Upgrade

- » Increased ability to set tuition fees, leading to higher revenue growth and greater financial flexibility
- » Growth in the university's endowment
- » Material improvement in the funded status of pension liabilities

## Factors that Could Lead to a Downgrade

- » Sustained deterioration in financial performance
- » Sustained losses in the asset value of the university's endowment
- » Inability to address the significant unfunded pension liabilities

## Key Indicators

Exhibit 2

### University of Toronto

(Year Ending April 30)	2012	2013	2014	2015	2016
Operating Revenue (CAD Million) [1]	2,214.1	2,330.0	2,427.0	2,540.8	2,697.7
Annual Change in Operating Revenue (%)	5.1	5.2	4.2	4.7	6.2
Operating Cash Flow Margin (%)	4.4	13.2	12.6	15.2	15.4
Total Cash and Investments (CAD Million)	2,872.8	3,152.8	3,359.5	3,794.7	3,886.6
Spendable Cash and Investments to Operating Expenses (x)	0.69	0.79	0.76	0.84	0.85
Total Debt to Cash Flow (x)	7.4	2.3	2.4	1.9	1.7

[1] Revenue is net of scholarship expenses.

Source: Moody's Investors Service, University of Toronto

## Baseline Credit Assessment

U of T's rating combines (1) a baseline credit assessment (BCA) for the entity of aa2, and (2) a high likelihood of extraordinary support coming from the Province of Ontario (Aa2 stable) in the event that the entity faced acute liquidity stress.

## Profile

The University of Toronto, Canada's largest post-secondary institution, is a comprehensive teaching and research university offering programs in 18 faculties, including Applied Science & Engineering, Arts & Science, Medicine, Law and Management. Enrolment exceeds 77,000 full-time-equivalents (FTE).

Like other universities in the Province of Ontario, U of T was created by a separate act of the provincial legislature. While the province is ultimately responsible, constitutionally, for the delivery of post-secondary education, U of T operates at arm's-length from the province, as do other Ontario universities. The provincial government establishes broad strategies and targets for each university, provides operating grants and has the authority to control tuition fees, but each university retains autonomy to carry out its activities.

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While the Ontario Ministry of Advanced Education and Skills Development monitors developments at individual universities and demands that universities be accountable, the "hands-off" approach to the university sector in Ontario is unlike that in some other Canadian provinces, such as Quebec and British Columbia, where the level of provincial control and oversight is considerably greater. U of T's strong standalone characteristics including strong governance and management mitigate any concerns posed by the relative independence of Ontario universities from the provincial government

### Detailed Rating Considerations

#### EXCELLENT MARKET PROFILE BUILT ON BRAND RECOGNITION AND STRONG REPUTATION

U of T possesses a strong market profile, reflected in its ability to consistently increase enrolment. In the 2015-16 academic year, enrolment exceeded 77,000 students on a full-time equivalent (FTE) basis, up 3.5% from the prior year. The increase in enrolment was largely driven by a 12% increase in international students, who represent approximately 19% of total FTEs. On a year over year basis the university's operating revenue grew by 6.2% in 2015-16 (4.7% growth the prior year) primarily on the strength of an increase in international students as a proportion of total FTEs.

Despite its ongoing fiscal pressures, the government of Ontario continues to support the creation of 60,000 new post-secondary spaces, an initiative that has been extended until 2017. As these spaces are largely expected to be created within the Greater Toronto Area, one of the few regions in the province that exhibits a growing 15-25 year old cohort, it is expected that U of T will benefit from these additional spaces. Due to this support, in combination with U of T's strong academic reputation and consistently strong domestic and international student demand, we expect the university can reach its target of over 80,000 FTEs by the 2018-19 academic year.

U of T, along with its affiliated institutions, including several hospitals, continues to be the leader among Canadian universities in securing federal government research funding from the three granting councils and from other federal programs. Despite a modest 3.6% decline in research revenue to CAD383 million in 2015-16, research funding from all sources remains substantial and the university continues to rank highly in terms of research output and international rankings. In addition to this amount, there are also substantial research grants and contracts awarded to university faculty and administered by the affiliated teaching hospitals.

#### FINANCIAL FLEXIBILITY AND BALANCE SHEET STRENGTH FROM LOW DEBT BURDEN, SOLID OPERATING RESULTS AND SIZEABLE ENDOWMENT ASSETS

U of T's credit profile benefits from strong levels of spendable cash and investments, which covered 2.9x total debt in 2015-16 (2.7x in 2014-15) and low levels of total debt to cash flow at 1.7x in 2015-16 (slightly down from 1.9x in 2014-15). Spendable cash and investments excludes permanently restricted net assets of the university, debt service funds that the university holds as well as any unspent bond proceeds.

U of T's credit profile benefits from the university's low debt burden (26% of revenue in 2015-16) and low interest burden (1.4% of revenue). We currently do not expect any new debt issuance in the next 12 months. Capital projects have been financed in recent years to a significant degree with solid internal operating cash flow generation. Over the last five years, annually generated funds from operations were around 8% of revenue and around 29% of debt on average.

On a Moody's-adjusted basis, which makes adjustments to the university's annual fiscal outcomes to smooth the impact of investment returns and remove scholarships, fellowships and bursaries from both revenues and expenses (reflecting the "flow-through" nature of these expenses), U of T generated over CAD263 million in operating income in 2015-16, supported by CAD109 million in investment income. While these figures lagged the previous year's results (CAD311 million and CAD192 million, respectively), they remain robust and we expect the university to continue to generate positive operating incomes in the medium term.

At April 30, 2016, the university's endowment assets totaled CAD2.1 billion (2015: CAD2.1 billion), which comprised approximately half of the university's net assets. The Long-Term Capital Appreciation Pool, which includes assets of the endowment fund, posted an investment return of -0.3% in 2015-16 (net of interest fees and expenses) due to weaknesses in international markets (compared to a strong 15% return in 2014-15).

The University of Toronto has also been historically successful in its fundraising activities. Its CAD2 billion Boundless campaign, launched in November 2011, is nearing its goal and the university has now secured more than CAD1.9 billion in donations. Supported

by its strong market position, we expect U of T will continue to be successful in its fundraising campaigns despite international and national competition for fundraising dollars.

#### STRONG GOVERNANCE AND MANAGEMENT PRACTICES THAT DRIVE POSITIVE OPERATING RESULTS

The success of U of T in maintaining a strong balance sheet, while meeting academic goals, is underpinned by the development and execution of multi-year frameworks for academic and financial planning. Each faculty is responsible for developing its own budget and adhering to self-imposed revenue and expense targets, which allows the faculties to be more entrepreneurial in areas where they see greater demand and by extension generate positive operating results. The university itself still maintains control over collective bargaining, however, which takes a certain amount of expenditure control out of the hands of individual faculties.

The University of Toronto Asset Management Corporation (UTAM), a non-share capital corporation controlled by the university, is tasked with managing the investment assets of the university's Long-Term Capital Appreciation Pool (which includes assets of the endowment fund), the Expendable Funds Investment Pool (including short- to medium-term funds) and assets of the university's pension plan. The university made changes to the governance arrangements of UTAM following the 2008 financial crisis to improve oversight over investment activities and has also modified its investment strategies, placing greater emphasis on risk management and stress-testing the portfolio from both a liquidity and an asset allocation standpoint.

#### PROVINCIALY IMPOSED REVENUE CONSTRAINTS LIMIT THE UNIVERSITY'S ABILITY TO FULLY CAPTURE ITS MARKET POSITION

U of T, similar to other universities in Ontario, targets a balanced budget every year. Annual surpluses and deficits are largely a result of investment return and savings from divisions, and the university has been successful in most years in balancing its core operations.

Pressures on the revenue side mainly arise from government operating grants, which have been stagnant over the last five years, as well as regulatory limits on tuition fee increases for domestic students imposed by the Ontario government. These tuition limits, which are set at 3% for domestic students in Ontario, prevent the university from raising tuition to a level that is comparable to other global institutions with similar reputations. Despite these constraints, the university's growth in enrolment and focus on international students, to which tuition fee caps do not apply, have supported an average growth of 11.1% over the last five years. Operating transfers from the provincial government represented approximately 24% of revenues in 2015-16, down from 26% average over the last five years.

Due to the need to remain competitive with other top institutions and attract academic talent, the University of Toronto continues to face challenges from rising costs of salaries and benefits, which represents the university's largest expense item at around 60% of operating expenditures. Although in 2015-16 the growth rate in personnel expenditure exceeded revenue growth by 1%, the university's prudent budgetary policies have helped to manage these cost pressures, with the university successfully maintaining the 3-year average rate of growth in personnel expenditures below the average revenue growth.

#### UNFUNDED PENSION LIABILITIES WEIGH DOWN ON BALANCE SHEET

The university continues to face additional pressure from significant pension expenses arising from the university's pension plan deficit. U of T recorded a pension deficit of CAD797 million as of April 30, 2016 (29% of revenue), significantly higher than the CAD617 million (24%) recorded in the prior year. The higher pension deficit was mainly driven by weaker pension plan asset returns, upward revisions in longevity assumptions and a protracted low interest rate environment. The large unfunded liabilities continue to place downward pressure on the rating.

Offsetting some of these pressures, U of T has been granted entrance into the provincial solvency funding relief program, and has recently received additional solvency funding relief under Stage 3. This allows the university to make minimum special payments sufficient to liquidate 25% of the solvency deficiency over 7 years starting in 2018 and to cover interest applied on the remaining 75% of the solvency deficit, barring any further changes to pension solvency rules from the provincial government. The potential impact of these future solvency payments continues to be reflected in the rating.

## Extraordinary Support Considerations

Moody's assigns a high likelihood that the Province of Ontario would act to prevent a default by the university. The high support level reflects a perceived risk to the province's reputation as regulator of the university sector if the University of Toronto or any Ontario university were to default.

Moody's also assigns a very high default dependence between the university and the Province of Ontario reflecting our assessment of the university's and the province's joint exposure to the impact of prolonged economic shocks. It also reflects the university's reliance on provincial government grants for a sizeable portion of its overall revenues.

## Ratings

Exhibit 3

Category	Moody's Rating
<b>UNIVERSITY OF TORONTO</b>	
Outlook	Stable
Issuer Rating	Aa2
Senior Unsecured -Dom Curr	Aa2

Source: Moody's Investors Service

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