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Research Update:

University of Toronto 'AA+' Ratings Affirmed On Extremely Strong Enterprise Profile And Very Strong Financial Profile

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Table Of Contents

Overview

Rating Action

Rationale

Outlook

Related Criteria

Related Research

Ratings List

Research Update:

University of Toronto 'AA+' Ratings Affirmed On Extremely Strong Enterprise Profile And Very Strong Financial Profile

Overview

- We are affirming our 'AA+' long-term issuer credit and senior unsecured debt ratings on the University of Toronto (UofT).
- The ratings reflect our assessment of the university's stand-alone credit profile, which reflects UofT's extremely strong enterprise profile and very strong financial profile.
- The ratings also incorporate our view of a moderately high likelihood of extraordinary support from the Province of Ontario.
- The stable outlook reflects our expectation that, within our two-year outlook horizon, UofT will maintain its exceptional market position and student demand profile, its adjusted operating margins will remain positive, and its level of available resources will remain superior.

Rating Action

On March 9, 2017, S&P Global Ratings affirmed its 'AA+' long-term issuer credit and senior unsecured debt ratings on the University of Toronto (UofT), in Ontario. The outlook is stable.

Rationale

The ratings 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.

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 List

Ratings Affirmed

University of Toronto

Issuer Credit Rating	AA+/Stable/--
Senior Unsecured	AA+

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at www.spcapitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

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