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CREDIT OPINION
23 April 2019

Update

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RATINGS

University of Toronto

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

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.

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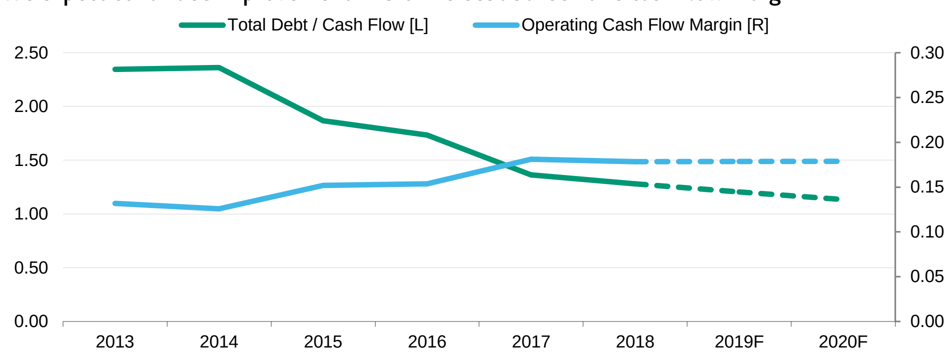
University of Toronto (Canada)

Update to credit analysis

Summary

The credit profile of the University of Toronto (Aa2 positive) (U of T) reflects its flagship status and very strong market position as Canada's largest post-secondary institution and international leader in research, consistently strong operating performance and high enrolment demand. The university also has a strong balance sheet with large endowment holdings and a consistently improving debt burden. These positives are balanced against provincially imposed revenue constraints, international student concentration risk and large unfunded pension liabilities.

Exhibit 1
We expect continued improvement in U of T's debt burden and cash flow margin



Source: Moody's Investors Service, University of Toronto

Credit strengths

» Excellent international reputation as a leading teaching and research institution

» Ability to generate strong operating results despite challenging provincial funding environment

» Financial flexibility from low leverage, high levels of liquidity, and fundraising ability

» Strong governance and management that provide stability

Credit challenges

» Tuition revenues exposed to international student concentration risk and demographic shifts

» Sizeable unfunded pension liabilities

Rating outlook

The outlook is positive, reflecting our assessment that the university's balance sheet, including its liquidity levels, pension liability and debt burden, will continue to improve in the medium term. The outlook also reflects our view that the university could successfully address operating challenges from additional sources driven by market demand, including rising international student enrolment and tuition, a growing investment portfolio, and launching new programs and teaching streams.

Factors that could lead to an upgrade

The rating could be upgraded if U of T were able to generate continued positive fiscal results and continued enrolment growth despite ongoing funding and enrolment pressures. Further improvements in liquidity or the university's continued success in addressing its unfunded pension liabilities would also put upward pressure on the rating.

Factors that could lead to a downgrade

An inability to successfully address operating funding challenges, leading to a sustained decline in financial performance resulting in operating deficits, or a significant decline in the asset value or returns of the university's endowment could lead to a downgrade in the rating.

Key indicators

Exhibit 2

University of Toronto

(Year Ending April 30)	2013	2014	2015	2016	2017	2018
Operating Revenue (CAD Million) [1]	2,330.0	2,427.0	2,540.8	2,697.7	2,905.2	3,135.0
Annual Change in Operating Revenue (%)	5.2	4.2	4.7	6.2	7.7	7.9
Operating Cash Flow Margin (%)	13.2	12.6	15.2	15.4	18.1	21.6
Total Cash and Investments (CAD Million)	3,152.8	3,359.5	3,794.7	3,886.6	4,558.0	4,821.0
Spendable Cash and Investments to Operating Expenses (x)	0.79	0.76	0.84	0.85	0.98	0.99
Total Debt to Cash Flow (x)	2.3	2.4	1.9	1.7	1.4	1.1

[1] Revenue is net of scholarship expenses.
Source: Moody's Investors Service, University of Toronto

Detailed credit considerations

Baseline credit assessment

The credit profile of U of T, as expressed by its Aa2 positive rating, combines a baseline credit assessment (BCA) for the university of aa2, and a high likelihood of extraordinary support coming from the Province of Ontario (Aa3 stable) in the event that the university faced acute liquidity stress.

Excellent international reputation as a leading teaching and research institution

U of T is Canada's largest post-secondary institution across its three campuses in downtown Toronto, Mississauga and Scarborough. U of T is Canada's preeminent research university and consistently places as the top ranked Canadian school and one of the top 25 global schools in international rankings, underpinning its international brand.

U of T's excellent market profile is reflected in its ability to attract consistently high global demand and increase enrolment and revenue numbers in the face of provincial funding and enrolment constraints. In the 2018/19 academic year, enrolment exceeded 80,600 students on a full-time equivalent (FTE) basis, up 1.8% from the prior year. The rise in enrolment and operating revenue was supported by growth in international students, who now represent approximately one fifth of total FTEs. The university projects that FTE enrolment will exceed 82,700 by 2022/23, representing approximately 0.5% average annual growth, with growth driven primarily by graduate student increases.

Ability to generate strong operating results despite challenging provincial funding environment

U of T consistently generates positive fiscal results from diversified revenues comprising mainly of student fees, government operating grants, research grants, donations and investment income. The university was able to maintain operating revenue growth that averaged

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6.1% between 2013 and 2018, above the growth in operating expenditures (average 4.0%) despite a challenging provincial funding environment. Along with its affiliations, including several hospitals, the university also continues to be the leader among Canadian universities in securing federal government research funding from the three granting councils and from other federal programs. U of T operates at arm's-length from the province and retains autonomy to carry out its activities. This, along with its revenue diversification, partly shelters the university from its reliance on the province for ongoing operating funding support.

Operating challenges arise both from mandated tuition fee cuts and expectations of flat growth in provincial operating funding. In January 2019 the Ontario government announced a province-wide 10% reduction in domestic student tuition fees starting in 2019/20, and freezing rates for the 2020/21 academic year. This replaces the expiring tuition framework which allowed for domestic undergraduate tuition to rise a maximum 3% on average across all programs, with no program to exceed 5%. U of T estimates that the change will translate into a tuition revenue reduction of CAD65 million over 2018/19 levels and a CAD88 million reduction over previous budget projections for 2019/20. The province also indicated that core operating grants will be conditional on universities adhering to the new tuition framework. U of T has budgeted for only nominal increases in provincial operating funding for 2019/20 and 2020/21. Nevertheless, provincial funding continues to represent a declining share of operating revenues, falling to 23% in 2017/18, down from 30% in 2012/13, which cushions some of the impact of the challenges in funding environment.

The university also has significant flexibility to mitigate these challenges. These include market demand-driven revenue sources including the launch of new programs and teaching streams, rising income from a growing investment portfolio and the university's capacity to increase international student tuition fees and enrolment numbers which are not subject to provincial controls. For 2019/20 the university projects that enrolment-related revenues will rise by 2.9%, which includes the impact of both the 10% domestic tuition fee cut, flat growth in provincial operating funding and a 5.4% increase in international tuition fees. We anticipate that demand from international students will remain very strong, evidenced by consistently strong demand over the last few years despite annual increases in international tuition fees.

Financial flexibility from low leverage, high levels of liquidity, and fundraising ability

U of T benefits from low levels of leverage. The university issued its latest debenture in 2011 and as a result its debt burden steadily declined to 22.7% of revenue in 2017/18, from 30.9% in 2012/13. We do not expect new debenture issuances for the next 2-3 years, as the university's practice in recent years is to fund and finance capital projects to a significant degree with solid internal operating cash flow generation. We expect that the university will also maintain strong debt affordability, with a continued improving trend in the debt to cash flow ratio, which fell to 1.05x in 2017/18 from 2.35x in 2012/13.

Spendable cash and investments, which exclude sinking fund and permanently restricted net assets, rose to 3.72x in 2017/18 from 2.41x total debt in 2012/13. Moody's-adjusted operating cash flows covered 21.6% of operating revenue and 94.8% of debt in 2017/18. Given U of T's ability to generate positive cash flows, we expect a continued rise in these metrics.

The university's endowments have grown significantly, increasing by 50% over the last five years. Endowment assets stood at CAD2.5 billion fair value at April 30, 2018 which represented 42% of the university's net assets. Endowment asset growth is expected to remain positive in the medium term given the significant endowment assets donated to the university annually and strong investment returns. The Long-Term Capital Appreciation Pool, which includes assets of the endowment fund, continues to post investment performance, returning 6.7% (net of interest fees and expenses) in 2017/18, exceeding its 10-year rolling average return of 4.7% but below its 2016/17 performance of 15.4%. While we expect pool investment returns to remain strong over the next few years, recent experience has shown that annual returns exhibit significant volatility which results in uncertainty in performance.

U of T has also been highly successful in its fundraising activities. Its seven-year Boundless fundraising campaign, with a campaign target of CAD2 billion, concluded at year-end 2018 and raised CAD2.6 billion. In March 2019, the university also received a CAD100 million gift to help construct an innovation complex and fund emerging technologies research, especially in artificial intelligence. The gift and the success of the fundraising campaign highlight U of T's brand name and profile and its ability to generate sizeable philanthropic interest and donations despite competition for fundraising dollars both domestically and internationally.

Strong governance and management that provide stability

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

The success of U of T in maintaining a strong balance sheet, while meeting academic goals, is underpinned by strong governance and management and 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.

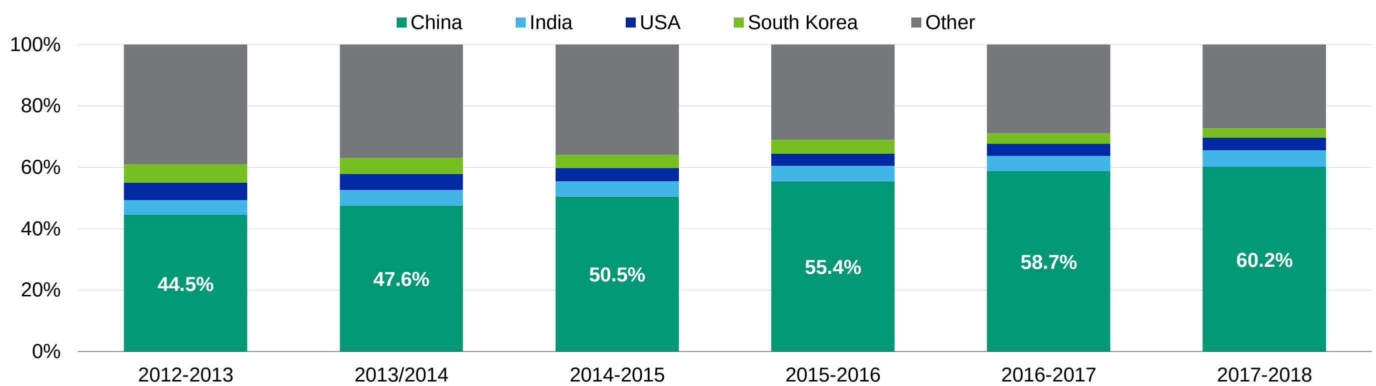
The University of Toronto Asset Management Corporation (UTAM), a non-share capital corporation whose members are appointed by the university, manages the investment assets of the university's Long-Term Capital Appreciation Pool (which includes assets of the endowment fund), the Expendable Funds Investment Pool (including short- to medium-term funds) and assets of the university's pension plan.

Tuition revenues exposed to international student concentration risk and demographic shifts

The share of international students to total enrolment has grown materially in the last decade, growing from 14% of total students in 2012/13 to 21% in 2017/18. Much of the growth has come from Asia, with particularly strong growth from China. The number of Chinese students more than doubled over the last 5 years and now constitute 60% of total students.

Exhibit 3

The concentration of Asian, and in particular Chinese, international students has grown significantly



Source: University of Toronto

The rise reflects China's considerably larger applicant pool than that of many countries, a well-established relationship with China, considerable support networks for Chinese students and significant Chinese investment in research. The dependence on international tuition revenue exposes U of T to revenue concentration from a single region or country, and to political risks due to potential diplomatic tensions, including the current intensification of political tension between Canada and China.

Similar to other Ontario universities, U of T also faces pressure from a shift in student demography as the 18-20 year old population in Ontario is expected to decline over the next 4-5 years. Nevertheless, the university attracts strong demand from the Greater Toronto Area, where the population decline is expected to be the smallest relative to the rest of the province.

Sizeable unfunded pension liabilities

U of T's financial profile remains pressured by significant pension expenses arising from the university's pension plan deficit (both a going concern deficit and a solvency deficit). U of T recorded a pension deficit of CAD319 million at April 30, 2018 (10.2% of Moody's adjusted operating revenue). The pension deficit was larger than the CAD296 million deficit (10.2%) recorded in the prior year mainly due to lower discount rates, partly offset by strong asset returns and special going concern payments made into the plan. Although the plan deficit improved significantly over the past five years from CAD1.1 billion in 2012/13, unfunded liabilities remain sizeable and continue to pressure the university's balance sheet, and future reductions in the deficit will continue to be subject to favourable investment returns.

U of T was previously granted entrance into the provincial solvency funding relief program, and received additional Stage 2 solvency funding relief measures. This allows the university to make minimum special payments sufficient to liquidate 25% of the solvency deficiency over 7 years beginning in 2018 and to cover interest applied on the remaining 75% of the solvency deficit. The potential impact of these future payments continues to be reflected in the university's credit profile.

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.

Rating methodology

Higher Education, December 2017

Government-Related Issuers, June 2018

Ratings

Exhibit 4

Category	Moody's Rating
UNIVERSITY OF TORONTO	
Outlook	Positive
Issuer Rating	Aa2
Senior Unsecured -Dom Curr	Aa2

Source: Moody's Investors Service

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