CREDIT OPINION
16 September 2019

Update

Rate this Research

RATINGS

University of Toronto

Domicile	Ontario, Canada
Long Term Rating	Aa1
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.

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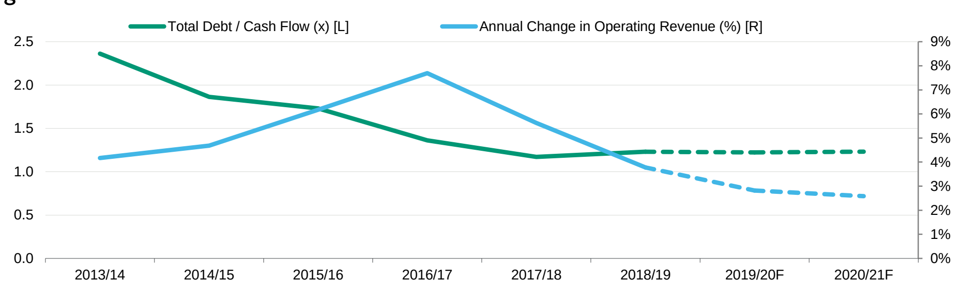
University of Toronto (Canada)

Update following upgrade to Aa1

Summary

The credit profile of the University of Toronto (Aa1 stable) (U of T) reflects its flagship status as Canada's largest and top-ranked post-secondary institution, global brand recognition of its academic and research quality, and continued balance sheet growth including growth in endowments which reached nearly CAD 2.6 billion at April 30, 2019. The credit profile also reflects the university's ability to generate positive net income from diversified revenues, supported by strong enrolment demand, which helps manage revenue pressures from mandated tuition fee cuts. Over the medium term, demographic pressures from a decline in the university entrance-age population in Ontario also imply ongoing revenue pressures, although U of T attracts strong demand from the Greater Toronto Area, where the demographic pressure is expected to be the smallest relative to the rest of the province.

Exhibit 1
U of T will maintain low leverage and positive, although lower than historical, operating revenue growth



Source: Moody's Investors Service, University of Toronto

Credit strengths

» Global brand recognition and robust enrolment demand

» Strong financial profile and manageable revenue pressures

» Exceptional wealth and liquidity and low leverage

» Very strong governance and management that provide stability

Credit challenges

» Geographic concentration in international students and demographic pressures

» Sizeable unfunded pension liabilities

Rating outlook

The stable outlook reflects Moody's view that the university will be able to maintain excellent levels of wealth and liquidity with manageable debt levels, and continued strong fundraising capacity. The outlook also reflects expectations of continued robust domestic and global enrolment levels supporting positive operating performance.

Factors that could lead to an upgrade

A sustained period of significant revenue growth from a combination of higher provincial operating grants or provincially funded enrolment numbers, in conjunction with a material increase in endowment and liquidity levels in line with Aaa global peers would lead to upward pressure on the rating. The university successfully addressing its unfunded pension liabilities would also put upward pressure on the rating.

Factors that could lead to a downgrade

Evidence of an inability to accommodate provincial funding pressures could also lead to downward rating pressure, leading to lower than projected enrolment numbers and 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 downward rating pressure.

Key indicators

Exhibit 2

University of Toronto

(Year Ending April 30)	2014	2015	2016	2017	2018	2019
Operating Revenue (CAD Million) [1]	2,427.0	2,540.8	2,697.7	2,905.2	3,068.8	3,184.7
Annual Change in Operating Revenue (%)	4.2	4.7	6.2	7.7	5.6	3.8
Operating Cash Flow Margin (%)	12.6	15.2	15.4	18.1	19.9	18.2
Total Cash and Investments (CAD Million)	3,359.5	3,794.7	3,886.6	4,558.0	4,821.0	5,259.0
Spendable Cash and Investments to Operating Expenses (x)	0.76	0.84	0.85	0.98	1.01	1.08
Total Debt to Cash Flow (x)	2.36	1.86	1.73	1.36	1.17	1.23

[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 Aa1 stable rating, reflects a baseline credit assessment (BCA) for the university of aa1.

Global brand recognition and robust enrolment demand

U of T is Canada's largest post-secondary institution located in the Province of Ontario (Aa3 stable) across 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 20-25 global schools in international rankings, underpinning its international brand.

U of T's excellent market profile and global recognition 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 2019/20 academic year, enrolment exceeds 81,000 students on a full-time equivalent (FTE) basis, up 12% since 2013/14. The rise in enrolment and operating revenue is supported by growth in international students, who now represent around a quarter of total FTE students. The university projects that FTE enrolment will grow to nearly 82,600 by 2022/23, with growth driven primarily by international, and in particular graduate, student increases.

Strong financial profile manageable revenue pressures

U of T consistently generates positive fiscal results from diversified revenue sources comprising mainly of student tuition fees, government operating grants, research grants, donations and investment income. These strengths allowed the university to report a CAD 505 million surplus in 2018/19, up nearly 9% from the prior year.

Operating challenges arise from a provincially mandated 10% reduction in domestic student tuition fees in 2019/20, followed by a freeze in these tuition levels for the 2020/21 academic year as the province is seeking ways to improve tuition affordability. 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 to a tuition revenue reduction of CAD 65 million over 2018/19 levels (2.4% of operating revenue) and a CAD 88 million reduction over the previous budget projection for 2019/20. Starting 2020/21, provincial operating funding will transition from enrolment alone to a new model that includes base funding for enrolment, funding based on 10 performance metrics, and other grants. The performance metrics will determine 25% of the funding in 2020/21, rising to 60% by 2024/25.

Although provincial funding restrictions will slow the growth in operating revenues, we believe the university has significant flexibility to mitigate these challenges and maintain positive financial results. Mitigants include higher international student fees and enrolment, given the university's capacity to increase international student tuition fees and enrolment numbers which are not subject to provincial controls. 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. We also expect rising revenues from certain new programs for which the university has the capacity to set pricing independent of the province.

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, in our view partly shelters the university from its reliance on the province for ongoing operating funding support. Among rated Canadian peers, U of T has the lowest reliance on provincial funding which continues to decline as a share of operating revenues, cushioning some of the impact of the challenges in funding environment.

Exceptional wealth and liquidity and low leverage

The university has seen continued growth in wealth from cash and investments, which exceeded CAD 5.2 billion at April 30, 2019, a very strong level relative to peers. This allows the university to maintain excellent coverage ratios, with spendable cash and investments, which exclude permanently restricted net assets, to rise to 4.3x debt in 2018/19 (from 2.4x debt in 2012/13), which we expect will further improve to 5.3x by 2020/21.

The university also maintains the largest endowment portfolio among Canadian universities, totaling CAD 2.6 billion at April 30, 2019. Endowment asset growth is expected to remain positive in the medium term given the significant endowment assets donated to the university annually and given our expectations of strong investment returns. The Long-Term Capital Appreciation Pool, which includes assets of the endowment fund, continues to post solid investment performance, returning 5.2% (net of interest fees and expenses) in 2018/19, which was nevertheless below its 10-year rolling average return of 9.2%. 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 CAD 2 billion, concluded at year-end 2018 and raised CAD 2.6 billion. In March 2019, the university also received a CAD 100 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 ability to capitalize on its brand name and profile and its ability to generate sizeable philanthropic interest and donations despite competition for fundraising dollars both domestically and internationally.

U of T's credit profile benefits from low levels of leverage. The university issued its latest debenture in 2011 and we do not anticipate new debt issues over the next 2-3 years. U of T's practice in recent years has been to finance capital projects from non-debt funding sources, including funding its CAD 2.1 billion, 5-year capital plan for 2019-2024 from a combination of departments' operating reserves, provincial and federal funding, and donations. As a result, debt metrics will be relatively stable or slightly improve, with long-term debt around 21-22% of revenue in the medium term (down from 31% in 2012/13), along with continued strong debt to cash flow ratios of around 1.2x over the next to years (down from 2.4 times in 2012/13).

Very strong governance and management that provide stability

U of T, similar to other universities in Ontario, targets a balanced budget every year and has been successful in recent years in balancing its core operations.

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.

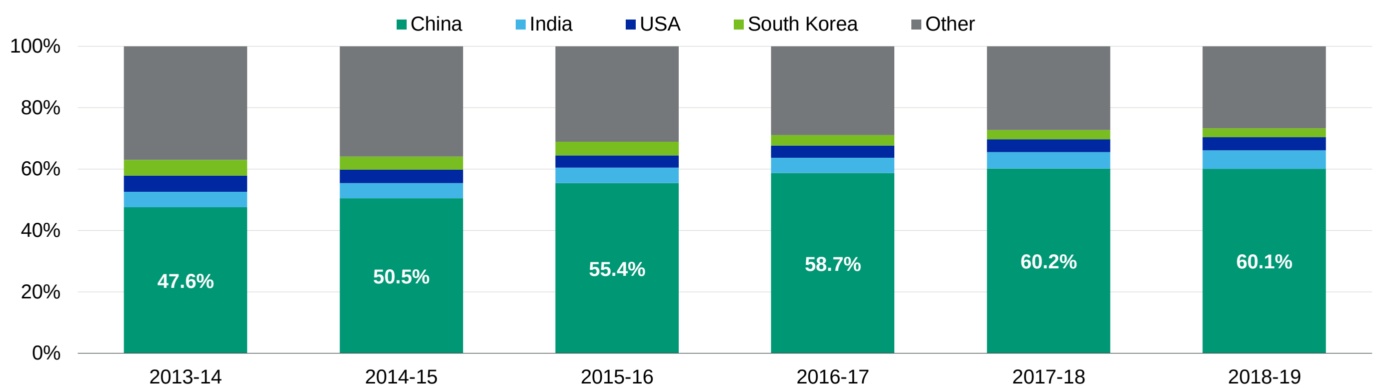
The University of Toronto Asset Management Corporation (UTAM), a non-share capital corporation whose members are appointed by the university, manages the investment assets of the university's Long-Term Capital Appreciation Pool (which includes assets of the endowment fund), the Expendable Funds Investment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

Geographic concentration in international student and demographic pressures

The share of international students of total enrolment has grown materially in the last decade, growing from 14% of total students in 2012/13 to 24% in 2018/19. 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 around 60% of international 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. Although the university is taking proactive measures to diversify its international student composition, the significant dependence on international tuition revenue exposes it to revenue concentration from a single region or country (particularly China) and to political risk from potential diplomatic tensions, especially in light of the current political tension between Canada and China and recent tensions between Canada and Saudi Arabia.

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, which has created manageable revenue pressures for the university. The university attracts strong demand from the Greater Toronto Area, where the demographic pressure 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 CAD 308 million at April 30, 2019 (9.7% of Moody's adjusted operating revenue). Although the plan deficit improved significantly over the past five years from CAD 1.1 billion in 2012/13, unfunded liabilities remain sizeable and continue to pressure its 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.

U of T is currently looking to transition to a jointly sponsored defined benefit pension plan with two other universities, with a targeted conversion date of 1 July 2021.

Extraordinary support considerations

Moody's assigns a high likelihood of extraordinary support coming from the Province of Ontario (Aa3 stable) in the event that the university faced acute liquidity stress. 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.

ESG Considerations

How environmental, social and governance risks inform our credit analysis of Sinai Health System

Moody's takes account of the impact of environmental (E), social (S) and governance (G) factors when assessing subsovereign issuers' economic and financial strength. In the case of U of T, the materiality of ESG to the credit profile is as follows:

Environmental considerations are not material to the U of T's credit profile. The university owns land and owns / operates buildings which may be subject to environmental risks (e.g. asbestos in older buildings or clean-up following construction), but these risks are small and the university proactively manages them through its facilities maintenance.

Social considerations principally relate in the near term to developments in public policy on education, in particular Ontario's objective of promoting improvements in tuition affordability through mandated provincial tuition fee cuts which have created manageable revenue pressures for the university. Over the medium term, demographic pressures from a decline in the university entrance-age population in Ontario also imply ongoing revenue pressures. These pressures are mitigated by continued very strong enrolment demand, significant liquidity and U of T's ability to set international student fees without government restriction.

Governance considerations include a robust institutional framework and prudent financial planning which has resulted in multi-year balanced budgets and strong operating results. Each faculty is responsible for developing its own budget and adhering to self-imposed revenue and expense targets. Faculties tend to encourage and explore entrepreneurial ideas for boosting revenue. Oversight is strong from its Governing Council including its boards and committees.

Further details are provided in the "Detailed credit considerations" section above. Our approach to ESG is explained in our cross-sector methodology General Principles for Assessing Environmental, Social and Governance Risks.

Rating methodology and scorecard factors

The assigned baseline credit assessment (BCA) of aa1 is in line with the scorecard indicated outcome of aa1. For details of our rating approach, please refer to the Higher Education (May 2019) and Government-Related Issuers (June 2018) methodologies.

Exhibit 4

University of Toronto

Rating Factors		Value	Score
Factor 1:	**Market Profile (30%)**		
	Scope of Operations (Operating Revenue) ($000)	2,421,172	Aa1
	Reputation and Pricing Power (Annual Change in Operating Revenue) (%)	3.8	Baa1
	Strategic Positioning	Aa	Aa
Factor 2:	**Operating Performance (25%)**		
	Operating Results (Operating Cash Flow Margin) (%)	18.2	Aa1
	Revenue Diversity (Maximum Single Contribution) (%)	57.6	A1
Factor 3:	**Wealth & Liquidity (25%)**		
	Total Wealth (Total Cash & Investments) ($000)	3,917,955	Aaa
	Operating Reserve (Spendable Cash & Investments to Operating Expenses) (x)	1.1	Aaa
	Liquidity (Monthly Days Cash on Hand)	283	Aaa
Factor 4:	**Leverage (20%)**		
	Financial Leverage (Spendable Cash & Investments to Total Debt) (x)	4.3	Aaa
	Debt Affordability (Total Debt to Cash Flow) (x)	1.2	Aaa
	Scorecard-Indicated Outcome		aa1
	Assigned BCA		aa1

Data is based on most recent fiscal year available. Debt may include pro forma data for new debt issued or proposed to be issued after the close of the fiscal year.
For non-US issuers, nominal figures are in US dollars consistent with the Higher Education Methodology.
Source: Moody's Investors Service

Ratings

Exhibit 5

Category	Moody's Rating
UNIVERSITY OF TORONTO	
Outlook	Stable
Issuer Rating	Aa1
Senior Unsecured -Dom Curr	Aa1

Source: Moody's Investors Service

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CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454