

Research Update:

University of Toronto 'AA+' Ratings Affirmed; Outlook Remains Stable

November 11, 2020

Overview

- We expect that the COVID-19 pandemic will pressure the University of Toronto's (UofT's) operating margins in the near term, particularly if associated travel and social distancing restrictions persist into the next fiscal year, affecting enrollment levels.
- However, despite these near-term difficulties, we believe that UofT will maintain a strong student draw, given its flagship status, high levels of liquidity, and manageable debt burden.
- We are affirming our 'AA+' long-term issuer credit and senior unsecured debt ratings on UofT and maintaining our stable outlook.

Rating Action

On Nov. 11, 2020, S&P Global Ratings affirmed its 'AA+' long-term issuer credit and senior unsecured debt ratings on the University of Toronto (UofT). The outlook is stable.

Outlook

The stable outlook reflects our expectations that, within our two-year outlook horizon, UofT will continue to generate positive operating margins, despite the budgetary pressures exacerbated by the pandemic. We also expect UofT will maintain its exceptional market position, very high levels of available resources, and stable debt burden, and that its relationship with the province will not alter materially.

Downside scenario

We could lower the ratings in the next two years if the COVID-19 pandemic and associated social distancing measures persist well into the next fiscal year, extending the disruptions to the university's operations and diminishing enrollment levels and revenue, resulting in significantly weaker operating margins, debt service coverage, and liquidity. A negative rating action on the Province of Ontario would also result in a similar rating action on UofT, given the maximum

PRIMARY CREDIT ANALYST

Adam J Gillespie
Toronto
+ 1 (416) 507 2565
adam.gillespie
@spglobal.com

SECONDARY CONTACT

Hector Cedano, CFA
Toronto
+ 1 (416) 507 2536
hector.cedano
@spglobal.com

RESEARCH CONTRIBUTOR

Deepanshu Goyal
CRISIL Global Analytical Center, an
S&P Global Ratings affiliate, Mumbai

Research Update: University of Toronto 'AA+' Ratings Affirmed; Outlook Remains Stable

three-notch rating differential between the university and the province allowed under our government-related entities criteria. All else equal, we could also lower the ratings if we significantly reduce our estimate of 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 could raise our assessment of UofT's stand-alone credit profile in the next two years if the provincial government relaxed its restrictions on tuition increases, while maintaining its supporting operating grants, resulting in a material increase in student-derived revenues and increased financial flexibility. However, we consider the possibility of this scenario resulting in an upgrade on UofT during our two-year outlook horizon unlikely, given our three-notch cap above the rating on the supporting government.

Rationale

The ratings reflect UofT's stand-alone credit profile, which S&P Global Ratings assesses at 'aa+'. This reflects our combined assessment of the university's extremely strong enterprise profile and very strong financial profile. The ratings also reflect our opinion of a moderately high likelihood that the Ontario government would provide extraordinary support in the event of financial distress.

We believe the pandemic and resulting prevention measures represent a short-term risk to UofT and other universities we rate. It did not materially weaken the university's overall financial results in fiscal 2020 (year ended April 30), and preliminary indicators suggest that fall 2020 enrollment has not been significantly affected, despite ongoing restrictions to on-campus learning and other activities. However, we believe that the threat of a more prolonged pandemic, and associated restrictions on campus activities and student mobility, poses a material risk to longer-term student demand and enrollment growth, particularly international students, which could affect the university's enterprise and financial profiles.

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 93,081 students in fall 2019. 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 been the highest-ranked Canadian university in recent years in several international surveys.

We believe the university has an extremely strong enterprise profile, given its position as a flagship institution with strong student demand characteristics. Supporting our opinion is our assessment of the higher education sector's low industry risk, characterized by countercyclicality and low competitive risk and growth. In addition, the university benefits from excellent economic fundamentals, measured by the province's GDP per capita, estimated to be about US\$42,600 in 2020; good income indicators; and moderate employment and population growth projections. In addition, with about a third of students coming from outside Ontario, the university's enterprise profile benefits from a geographically diversified student body.

Furthermore, UofT's leading market position and healthy demand strengthen the university's enterprise profile. Enrollment growth picked up in fall 2018 and 2019, reaching 82,311 full-time equivalent students (FTE), largely in line with the university's growth plan, which calls for most

Research Update: University of Toronto 'AA+' Ratings Affirmed; Outlook Remains Stable

enrollment growth to be in graduate and international students. About 23% of FTE students were graduate students, which is in line with that of most Canadian research-intensive universities. In our opinion, student quality remains strong, as reflected by the university's historically stable retention and graduation rates of about 92% and 75%, respectively, in the past several years, as well as a robust selectivity rate well below 75%.

In our view, UofT's management expertise and governance practices, as well as financial management policies, are very strong and in line with those of other highly rated Canadian universities. The pandemic has tested the entire university organization as it pivoted to online instruction in the spring and implemented significant health and safety controls ahead of the start of the 2020-2021 academic year. The university's academic and operational priorities are guided by its strategic plan and its Strategic Mandate Agreement with the province. These in turn inform the detailed annual budget and long-range plan, which incorporate operating and capital plans. UofT reviews its performance relative to the plan annually and tracks its progress against specific activity indicators and financial metrics. In addition, it identifies and monitors risks to the plan. The university has formal policies for endowment, liquidity and investments, debt, and reserves, and meets standard annual disclosure requirements. Overall, we view UofT's transparency and disclosure as very good, with policies and procedures in place to adequately mitigate risks, and we believe that the university's overall financial policies are not likely to negatively affect its ability to pay debt service.

In our opinion, UofT has a very strong financial profile, bolstered by healthy adjusted operating margins averaging 8% in the past five fiscal years. The financial impact of the pandemic on fiscal 2020 results was fairly muted, coming as it did near the end of the fiscal year after all tuition and grant revenue had been received. UofT has budgeted for balanced results in its long-range operating budget plan out to fiscal 2025, although this was prepared before the pandemic was declared. We expect that weaker results in the university's ancillary operations (housing, parking, food services, etc.), together with elevated health and safety expenditures, will pressure margins in the next year or so, although we expect that they will remain positive. Similar to that of Canadian peers, the university's limited flexibility to increase its student-generated revenue somewhat offsets its strong financial performance. This is primarily because Ontario monitors and guides domestic tuition rates and student aid (through the tuition framework), and enrollment expansion (through operating grants, which are not expected to increase in real terms).

We believe UofT's tuition discounting, which we define as total financial aid costs as a percentage of gross tuition and fees, is fairly stable and in line with similarly rated Canadian universities. This suggests greater flexibility to address affordability issues, which bolsters the university's competitive position. We also believe that UofT has superior fundraising capabilities relative to most Canadian peers. The university and its affiliated colleges raised more than C\$2.6 billion in the most recent fundraising campaign, and in September 2020, UofT announced that it had received a C\$250 million donation, the largest in its history, that will be used for health-care research and medical innovation.

In our view, UofT has a relatively moderate debt burden that is very manageable, given its good operating performance and robust liquidity. At fiscal year-end 2020, total gross debt outstanding was C\$709 million, consisting of five series of fixed-rate, 30- and 40-year bullet debentures maturing from 2031-2051. We believe that the high number of bullet debentures makes UofT's debt structure more aggressive than that of peers with amortizing debt; however, the university has established a self-imposed sinking fund to help repay these obligations, with assets totaling C\$411 million at fiscal year-end 2020. Our estimate of UofT's maximum annual debt service is equal to a modest 1.9% of adjusted fiscal 2020 operating expenses, which is lower than the median for peers in the 'AA' rating category. The university has identified a potential need for up to C\$620 million in additional funding to the end of fiscal 2026 for capital projects that are under

Research Update: University of Toronto 'AA+' Ratings Affirmed; Outlook Remains Stable

consideration but have yet to be approved. However, some or all of this funding could come from grants, fundraising, or internal sources and we do not believe that any likely external debt issuance will exceed UofT's internally approved debt limits or lead to a material erosion of the university's financial profile in the next two years.

UofT provides several defined-benefit pension plans to its employees. We do not believe that these liabilities will have a material impact on the university's overall credit profile in the next two years, as the pension plan had a funded status of about 80% on a solvency basis as of July 1, 2019 and the university continues to make required payments. At fiscal year-end 2020, the pension plan's deficit had increased substantially to C\$606 million, from C\$308 million the previous year, as actual investment returns fell short of expectations. UofT, along with two other Ontario universities, is working toward the establishment of the risk-shared jointly sponsored University Pension Plan Ontario (UPP) that would cover employees and retired employees in the existing plans at all three universities. UofT anticipates that the assets and liabilities of its current plan will be transferred to the UPP, and contributions and accrual of benefits under the UPP will come into effect, on July 1, 2021.

In our view, the university has very robust liquidity, providing a substantial buffer against likely volatility in financial performance in the next year or so. It continued to increase its total cash and investments to C\$5.42 billion at the end of fiscal 2020 from C\$5.26 billion in 2019. At the same time, our measure of UofT's available resources (internally restricted net assets plus internally restricted endowments) had increased to C\$1.76 billion from C\$1.63 billion the year before; equal to 51.8% of adjusted operating expenses on a three-year, weighted-average basis. We believe that the level of available resources could decline somewhat in the next several years due to potential volatility in enrollment, escalating cost pressures, and internal financing of its capital plan. However, in our opinion, with total cash and investments being greater than 2x the available resources and more than 7x the debt outstanding, UofT's liquidity will remain more than sufficient to fund all debt service requirements and provide a significant buffer against medium-term stress. In addition, UofT holds the largest endowment of any Canadian university, with a market value of C\$2.51 billion at fiscal year-end 2020.

Moderately high likelihood of extraordinary provincial government support.

In accordance with our criteria for government-related entities, 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 our assessment of the link are the significant operating grants received from the province, accounting for about 20% of the university's total reported revenue, 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 government-related entities that depend on ongoing government support. The differential reflects our view that there is a measurable 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 differential reflects UofT's status as an autonomous legal entity with ownership of its assets and our view that the university operates independently of the Ontario government. The board is responsible for the management, administration, and control of the university's property and other assets and all business affairs. We consider the risk of extraordinary negative government

Research Update: University of Toronto 'AA+' Ratings Affirmed; Outlook Remains Stable

intervention low, given UofT's operational independence, its important public policy role, and the government's hands-off approach to the sector.

In January 2019, the government of Ontario imposed a 10% reduction to domestic tuition for the 2019-2020 academic year and a freeze in 2020-2021. Furthermore, the province did not provide additional grant revenue to offset the tuition cut and has yet to release an updated tuition framework beyond fiscal 2021. Neither the federal nor provincial government has announced any material direct financial support for universities to offset impacts stemming from the COVID-19 pandemic, although the federal government introduced an income support program for students, which should help mitigate affordability concerns. Although we do not expect any material increase in ongoing operating or capital funding from the province in the medium term, we believe that there is a moderately high likelihood that the province would provide support to UofT in a distress scenario.

Environmental, Social, And Governance Factors

In our view higher-education entities face elevated social risk due to uncertainty over the duration of the COVID-19 pandemic, and its uncertain effect on enrollment levels, campus activities, and mode of instruction in 2020 and beyond. We view the risks posed by COVID-19 to public health and safety as a social risk under our ESG factors. Despite the elevated social risk, we believe UofT's environment and governance risk are in line with our view of the sector as a whole.

S&P Global Ratings believes there remains a high degree of uncertainty about the evolution of the coronavirus pandemic. Reports that at least one experimental vaccine is highly effective and might gain initial approval by the end of the year are promising, but this is merely the first step toward a return to social and economic normality; equally critical is the widespread availability of effective immunization, which could come by the middle of next year. We use this assumption in assessing the economic and credit implications associated with the pandemic (see our research here: www.spglobal.com/ratings). As the situation evolves, we will update our assumptions and estimates accordingly.

Table 1

University of Toronto -- Selected Indicators

(Mil. C\$)	--Fiscal year-end April 30--					Medians for 'AA' U.S. public colleges & universities*
	2020	2019	2018	2017	2016	2018
Enterprise profile						
Full-time equivalent enrollment (no.)	82,311	80,652	79,262	78,292	77,130	35,846
Selectivity rate (%)	59.6	62.9	63.7	71.5	67.6	67.8
Undergraduates as a % of total enrollment	78.2	78.8	79.4	79.7	80.4	78.6
Retention rate (%)	N.A.	92	91.7	91.3	91.7	86
Graduation rates (six years) (%)	N.A.	76.1	75.6	75.2	73.7	MNR
Financial profile						
Adjusted operating revenue	3,480.0	3,423.0	3,230.0	3,022.0	2,940.0	MNR
Adjusted operating expense	3,242.0	3,138.0	2,973.0	2,821.0	2,725.0	MNR
Net adjusted operating margin (%)†	7.34	9.08	8.64	7.13	7.87	1.5
Student dependence (%)	52.1	50.5	49	47.4	43.9	39.7

Research Update: University of Toronto 'AA+' Ratings Affirmed; Outlook Remains Stable

Table 1

University of Toronto -- Selected Indicators (cont.)

(Mil. C\$)	--Fiscal year-end April 30--					Medians for 'AA' U.S. public colleges & universities*
	2020	2019	2018	2017	2016	2018
Government operating grant dependence (%)	20.7	21.2	22.4	23.6	24.2	19.2
Investment income dependence (%)	5.1	6	5.6	7.3	3.7	1.4
Outstanding debt	709.0	713.0	715.0	718.0	718.6	828.7
Maximum annual debt service/total operating expense (%)	1.9	1.6	1.7	1.8	1.8	3.5
Available resources to adjusted operating expenses (%)	54.3	51.9	46.0	54.0	46.5	35.3
Available resources to total debt (%)†	248.1	228.3	191.5	212.0	176.3	97.8

*U.S. median figures are in U.S. dollars. †As % of adjusted operating expense. N.A.--Not available. MNR--Median not reported.

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: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Australia, Canada, Mexico, And U.K. University Medians Report: Pandemic-Related Pressures Could Upset Recent Credit Metric Stability, Oct. 20, 2020
- Not-For-Profit Higher Education Mid-Year Sector View: Fall 2020 Enrollments Will Drive Credit, Aug. 18, 2020
- The Higher Education Sector Outlook Is Now Negative For Australia, Canada, Mexico, And The U.K., May 14, 2020

Ratings List

Ratings Affirmed

University of Toronto

Issuer Credit Rating AA+/Stable/--

Analytical Factors

Local Currency aa+

Research Update: University of Toronto 'AA+' Ratings Affirmed; Outlook Remains Stable

Ratings Affirmed

University of Toronto

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.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

Copyright © 2020 by Standard & Poor's Financial Services LLC. All rights reserved.

No content (including ratings, credit-related analyses and data, valuations, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of Standard & Poor's Financial Services LLC or its affiliates (collectively, S&P). The Content shall not be used for any unlawful or unauthorized purposes. S&P and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&P's opinions, analyses and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives. Rating-related publications may be published for a variety of reasons that are not necessarily dependent on action by rating committees, including, but not limited to, the publication of a periodic update on a credit rating and related analyses.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw or suspend such acknowledgment at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal or suspension of an acknowledgment as well as any liability for any damage alleged to have been suffered on account thereof.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain non-public information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, www.standardandpoors.com (free of charge), and www.ratingsdirect.com (subscription), and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.

STANDARD & POOR'S, S&P and RATINGSDIRECT are registered trademarks of Standard & Poor's Financial Services LLC.