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Research Update:

University of Western Ontario 'AA' Ratings Affirmed On Continued Strong Enrollment Demand And Good Budgetary Performance

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Table Of Contents

Overview

Rating Action

Rationale

Outlook

Related Criteria And Research

Ratings List

Research Update:

University of Western Ontario 'AA' Ratings Affirmed On Continued Strong Enrollment Demand And Good Budgetary Performance

Overview

- We are affirming our 'AA' long-term issuer credit and senior unsecured debt ratings on the University of Western Ontario.
- The ratings reflect our view of the university's strong enrollment demand profile, good budgetary performance, and significant growth in unrestricted financial resources in the past four fiscal years.
- We believe that the tight operating environment and possibility for further reductions in provincial grants together with a debt load that is slightly higher than that of peers partially mitigate these strengths.
- The stable outlook reflects our expectations that Western will continue to generate modest consolidated surpluses, its debt burden will not increase materially, adjusted debt service coverage will not fall below 4x, and unrestricted financial resources will remain sufficient to cover at least 100% of debt.

Rating Action

On Feb. 20, 2015, Standard & Poor's Ratings Services affirmed its 'AA' long-term issuer credit and senior unsecured debt ratings on the University of Western Ontario, in London, Ont. The outlook is stable.

Rationale

The ratings reflect the university's stand-alone credit profile (SACP), which Standard & Poor's assesses at 'aa'. The ratings also reflect our opinion of a "moderately high" likelihood that the Canadian government would provide extraordinary support in the event of financial distress.

The SACP on Western reflects Standard & Poor's view of the university's strong enrollment demand profile, good budgetary performance, and significant growth in unrestricted financial resources in the past four fiscal years. In our opinion, Western's higher debt burden stresses the ratings somewhat, but we believe that its housing operations should generate sufficient cash to support the debt load without weakening its core operating budget. Furthermore, we do not expect the university's debt burden to increase materially within the two-year rating horizon. The ratings also reflect our assessment of the tight operating environment in which Canadian universities and their supporting provincial governments operate.

In accordance with our criteria for government-related entities, our view of Western'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), as well as the university's role as one of the province's largest universities by enrollment and its strong research capacity. Ontario's oversight, program approval rights, and tuition regulation over Western suggest a "strong" link to it. Also supporting this view is that provincial operating grants account for about 21% of the university's total revenue (excluding provincial grants for capital and student aid), and its appointment of some board members.

Despite the provincial support, in our view, Western operates independently of the Ontario government. It is an autonomous legal entity with ownership of its assets. The province appoints four of the 28 board members; however, the board alone is responsible for overseeing the university's academic, business, and student affairs, including financial matters. Although the province monitors and guides tuition and student aid (through the tuition framework) and enrollment expansion (through operating grants), Western has the final decision in these matters, and its long-term strategy. We rate the university one notch higher than Ontario, reflecting our estimate that, along with the university's independence regarding ownership and operations, its financial assets demonstrate sufficient resiliency to withstand a period of financial stress at the provincial level.

Western continues to enjoy what we view as a good market position and has demonstrated strong student demand. Excluding its affiliates, the university had about 31,800 full-time equivalent (FTE) students in the fall of 2014, up about 1.2% from the previous year. Student quality metrics, such as graduation and retention rates, have improved and compare favorably with the average for the U15 (the 15 leading research-intensive universities in Canada). The average entering grade was 89.3% for fall 2014, the highest among Ontario universities. Western has also invested significantly in attracting both graduate and international students, which helps improve its reputation and research profile.

In our opinion, management has demonstrated prudent budgeting practices and has kept expenditure growth under control where possible, although salary and benefit costs continue to exert the greatest pressure on expenditures, accounting for 61% of total expenses in fiscal 2014 (year ended April 30). The university generates what we view as good budgetary performance, with the fully consolidated balance averaging a surplus of 5.9% of total expenses for the past five years (8.6% in fiscal 2014). However, Western has budgeted for a slight deficit in its operating budget for fiscal 2015 due to one-time allocations largely targeted at increasing the university's research profile and addressing infrastructure requirements. As such, we expect that budgetary performance could decline slightly over the two-year outlook horizon but that it will remain in line with that of peers.

Western's debt decreased slightly to about C\$310 million from the end of fiscal 2014 from about C\$316 million in 2013, equal to 30% of adjusted expenses in fiscal 2014. Based on current projections, which do not include any material borrowing in the next two years, we do not believe that these ratios will weaken materially within the two-year outlook horizon.

We have used the "Principles Of Credit Ratings" in conjunction with "U.S. Public Finance: Higher Education" as our criteria foundation for our analysis of the university's creditworthiness. We feel that there is a sufficient degree of similarity between U.S. and Canadian public university systems such that we believe the U.S. higher education criteria is an appropriate methodology for evaluating Canadian universities' credit quality.

Liquidity

Western's liquidity is what we consider good. At fiscal-year end 2014, its cash and equivalents totaled C\$1.2 billion, or 115% of adjusted expenses and 387% of debt outstanding, in line with that of many similarly rated Canadian peers. The value of the university's endowment was C\$510 million in April 2014, up from C\$432 million in 2013. Despite this, the endowment lags that of some peers in the 'AA' rating category, at about C\$17,300 per FTE.

Western's unrestricted financial resources (UFR), consisting of internally restricted endowments and unrestricted net assets (including undistributed investment returns but net of investments in capital assets), have risen significantly in the past several years, to C\$496 million at fiscal year-end 2014. This was sufficient to cover 160% of debt at year-end compared with only about 50% in fiscal years 2008 and 2009. We expect that the university will maintain strong liquidity to support its debt burden throughout the outlook horizon.

Outlook

The stable outlook reflects our expectation that, during the two-year outlook horizon, Western will continue to generate modest consolidated surpluses, its debt burden will not increase materially, adjusted debt service coverage will not fall below 4x, and UFR will remain sufficient to cover at least 100% of debt. We could revise the outlook to negative or lower the ratings if government support were to decline meaningfully such that operating deficits significantly exceed expectations, or adverse market conditions led to a precipitous decline in UFR. We could revise the outlook to positive if the province were to increase funding steadily or alter the tuition framework to the extent that Western's revenues increased meaningfully and budgetary performance exceeded expectations.

Related Criteria And Research

Related Criteria

- Principles Of Credit Ratings, Feb. 16, 2011
- Rating Government-Related Entities: Methodology And Assumptions, Dec. 9, 2010
- USPF Criteria: Higher Education, June 19, 2007

Ratings List

Ratings Affirmed

University of Western Ontario

Issuer credit rating	AA/Stable/--
Senior unsecured debt	AA

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